State Senate

West Virginia Legislature

Senator Joseph Minard
Senate President Pro Temp

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Braxton, Gilmer,
Harrison, Lewis

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West Virginia Insurance Federation

(Unabridged presentation)

Thank you for your invitation to speak before you today.

My first thoughts go to a vintage Yogi Berra mis-speak, "It's deja vu, all over again."

During the past decade ....We were told that rises in homeowners insurance rates in WV were caused by significant catastrophic losses in 1998 and 2002 and problems at that time resulted from a decade of higher-than-normal losses from bad weather, a sour stock market and rising construction costs...

Doctors were leaving the state to escape frivolous lawsuits and rising malpractice rates

Workers compensation unfunded liabilities were nearly $3 billion, and...

West Virginia was a "judicial hell hole".

Like Yogi Berra, I am going to tell you what you already know.

2001 - We addressed the medical malpractice crisis and exodus of doctors.

Multiple factors were at the root of the crisis. Malpractice premiums were sky-rocketing with rising loss trends, increasing number of claims; larger and more erratic jury awards; reduced carrier capacity; rising costs of re-insurance; a lack of consistent tort reform measures; and, declining investment returns.

During the 6th Special Session in 2001, we adopted HB 601 which offered aggressive remedies.

This measure initiated our first steps at tort reform by reducing the number of frivolous lawsuits by requiring a "certificate of merit", i.e. that a physician sign off on any malpractice lawsuit before that suit could be filed.

Other tort reform provisions in the bill included a general $250,000 cap on non-economic damages.

In cases involving three sets of circumstance - wrongful death; permanent physical deformity, loss or use of a limb or loss of bodily organ system; or permanent physical or mental impairment that prevents patients from independent care – the cap was set at $500,000.

Trauma care damages were capped at $500,000 and a "patient compensation fund" was established to cover economic damages suffered beyond that cap.

We also eliminated a practice relative to medical malpractice known as "joint and several liability" which previously allowed a plaintiff to seek the bulk of a monetary award from a party that was minimally liable, but had the most resources.

In civil cases generally, "joint and several liability" remained in tact unless less than 30%

was at fault, then it remained a several liability.

The bill also authorized the creation of a Physicians' Mutual Insurance Company.

With an infusion of a $24 million loan from the Tobacco Settlement Medical Trust Fund, $1,000 from each participating doctor and $2,500 from each insurance company licensed in West Virginia, the money created a surplus for the new Mutual and provided some coverage for participants.

This measure also initiated changes to third-party, bad faith lawsuits but did not remove them from the court system. It did open the door for further changes which we made in 2005.

2003 - While the Board of Risk in 2001 and 2002 temporarily offered medical malpractice insurance to help compensate for the state's loss of our major insurance carriers, we, in 2003, passed legislation which laid the groundwork for the creation of the successful physicians' mutual. (The Mutual's success in the last years has enabled it to repay the $24 million loan from the state.)

2004 - The Insurance Commission in 2004 told lawmakers during a Joint Committee our previous actions taken during 2001 and 2003 not only allowed for medical malpractice rates to stabilize but also companies were beginning to make a profit and at least three companies sought to reduce the premiums they charged physicians.

But insurance problems were not solely related to medical malpractice.

In 2004, a Fraud Investigation Unit within the office of the WV Insurance Commission was signed into law on Mar. 31st and took effect on July 1 of that year.

Also a measure was passed, HB 4004, which changed state law to let insurance companies

drop the worst drivers. **Out of 3,500 drivers who could have been dropped, the top three insurers dropped only 100.**

As a result of that policy, the next year West Virginians saw insurance costs decrease as much as 10 %, depending on their insurer. Overall, premium decreases totaled over $61 million, according to the Insurance Commission.

2005 - House Bill 2878 was passed which strengthened the authority of the fraud unit.

This law clarified the unit was a criminal justice agency and as such it was granted participation in law-enforcement information exchanges, permission to conduct complete criminal background checks on potential employees and to assist other criminal justice agencies.

It also allowed the unit to investigate forgery of insurance documents.

In February 2005, the Insurance Commissioner provided a report entitled, "Third Party Causes of Action: Effects on West Virginia Insurance Markets."

The report indicated that a study by the Rand Institute indicated premiums in West Virginia were about 11 to 19% higher because of third party causes of action. The Legislature was provided with a variety of other studies which supported the Rand Institute's findings.

Gov. Manchin also pushed reforms to third-party lawsuits, deliberate intent and joint and several liability.

He promised that insurance companies would cut their premiums by at least $50 million, including up to $100 off every auto insurance policy.

With those findings, SB 418 was passed. It removed third-party bad-faith lawsuits from the courtroom and replaced them with administrative proceedings.

At the time, major insurance companies told us the bill could knock $50 million off automobile and homeowner premiums paid in West Virginia.

According to further studies at the close of 2005, these legal reforms allowed for a turnaround of the state's judicial reputation.

Other reports during that year indicated that doctors returned to the Mountain State, insurance rates came down, insurance carriers resumed writing homeowners policies and commercial insurance policies that helped to expand insurance options and kept rates more competitive.

Keeping the promises they made, insurance companies enacted premium cuts following the 2005 Session in April and later in June.

According to the WV Insurance Commission, in that year, several of the state's largest carriers – State Farm, Nationwide, Erie Insurance, Allstate and Westfield Insurance - filed for over $59 million in premium reductions.

Erie filed for an additional $2.89 million later in the year, and other companies joined in, filing for over $3 million more in premium reductions.

In 2005, West Virginian's Physicians' Mutual President announced in a mid-day Rotary Club at the University of Charleston that "West Virginia is shedding its nefarious reputation as a "judicial hellhole" in terms of malpractice suits and is beginning to attract doctors.

Other news reports in 2005 indicated that insurers were not dropping a lot of their insureds despite the changes regarding non-renewals. Stories regaled the fact that the marketplace determines consumer prices and that insurance is no different.

The Insurance Commissioner in 2005 told an Interim Legislative Committee on Insurance Availability and Medical Malpractice that insurance companies had met their promises to reduce consumers' premium rates.

In addition, numbers provided from the state Board of Medicine showed the number of claims fell from 375 in 2001 to 224 in 2004 with about 39% dismissed and half were settled out of court in 2005.

Still, in 2005, insurance providers, including the state mutual, are seeing defense costs come down, lower numbers of claims filed, and a more expedited claims process for victims of malpractice, according to the Insurance Commissioner.

At that time, there were less than 3% of claims with a non-zero judgement and most were settled out of court

April 2006 - According to the West Virginia Insurance Commission's most recent annual medical malpractice report, West Virginia Physicians' Mutual Insurance is the biggest malpractice insurer in the state with a 54.5% market share in 2004.

The report also showed that Woodbrook Casualty Insurance, Inc. (Formerly Medical Assurance of WV) reduced its rates 1.1% in October, and Health Care Indemnity Inc. cut its rates by 11.6% in January.

August 8, 06 - State Farm, which insures a quarter of all homes in WV, announced it was

lowering its homeowners insurance rate by 5%. It insured 103,544 homeowner policies.

It indicated the reductions were brought about by the stabilization of the WV insurance market.

But again...in March of 2006, a National Chamber Of Commerce poll ranked WV last in judicial fairness, claiming the legal climate drove business away. Trail lawyers attempted to have national ads pulled.

In the past decade we also struggled with a $3 billion unfunded liability within our Workers Compensation system.

A week after taking the oath of office, Governor Manchin convened a special legislative session to push for the privatization of the state workers' compensation system.

The resulting legislation was passed in 2005 - and BrickStreet Insurance was started up with a $200 million state loan and remained the state's sole provider of workers' compensation until July 1, 2008 when the market opened to all.

No sale of bonds were required to erase the unfunded liability since there was a $230 million revenue stream from the severance tax on coal, timber, oil and gas.

Special Session 05 - State employees who cashed out their sick leave cost the state $4.5 million which was expected during the passage of the original proposal in January.

Proposals to alter the workers compensation transition to a mutual company were passed in another Special Session of 05. The biggest proposal allowed Gov. Manchin to appoint the new company's board of directors.

This permitted the company to take advantage of a little-known federal tax exemption

designed to assist states who moved workers compensation from a state-run to a private company.

The tax savings exceeded $120 million over the next three years.

The transition went fairly smoothly with unpaid debts put into a so-called Old Fund (Owners and officers of unpaid workers comp debts were held personally responsible for any claims workers had against them. If owners did not meet their obligations, then business licenses were revoked.)

In 2006, BrickStreet began to analyze and modify premium rates charged to the state's 42,000 employers.

On Jan. 1, 06, rates dropped by 15% overall. With 94 rate categories, some dropped more dramatically, while a few increased.

In addition to basic premiums, all employers pay a surcharge to pay off existing unfunded liabilities to compensate for awards granted to injured workers when the state still operated the system. The surcharge percentages changed from year to year and are currently set at 9% for non-self insured employers for the next five years.

Employers also pay a second surcharge to cover the Insurance Commission's administrative costs. Employer premium rates were modified - up or down - based on their history of workplace injuries. Overall rates for county school boards in the southern part of the state are higher.

Classifying employees into 94 positions was done according to NCCI rating systems, which

is used in 37 states. In May of 06, the number of risk classifications for the state's 36,000 employers increased from 94 to 470.

The result of the re-classifications was a total decrease in workers compensation rates amounting to $55 million.

Also, BrickStreet worked on rehabilitation efforts to re-educate and retrain injured workers to place them in jobs which pay close to their previous salaries.

If required to take lower-paying job, then they adjusted workers' PTD awards to pay the difference.

By collecting past debts from employers and rehabilitating injured workers, the Insurance Commissioner helped reduce the $3 billion in unfunded liabilities.

In March of 08, BrickStreet posted a $185 million profit, up from $70.7 million in 2006.

Two weeks before BrickStreet opened to a competitive market, privatization had been successful in that rates have decreased more than 30% on average, saving businesses about $150 million per year.

The market opened to competition July 1, and the Insurance Commissioner has since reported that more than 145 insurers are participating in our workers compensation market covering more than 6,500 employers.

In addition, the federal tax exemption provided in a bill passed in 06 saved BrickStreet and the state's employers $194 million. That exemption ended on Jan. 1, 2009.

2008 - Overall, workers comp rates have declined 27.5% more than $30 on average since January 2006.

And in other good news, the West Virginia Physicians' Mutual Insurance Co.(established in 2004 to offer physicians malpractice insurance) is profitable with premiums of approximately $50 million.

In May of 08, The Taxpayers Network, a non-profit social welfare organization, released its yearly edition of "50 State Comparisons".

In this edition, WV ranked 19th in the percentage of people without health insurance for an entire year. Along with other data, it ranked WV at the bottom of the list in liability and litigation systems.

We fixed some problems along the way by working together...but what are we to do now?

A look at some recent headlines/ Top Stories for 2009:

*** Forget the "sour market" of 1998 and 2002, We're in a RECESSION in 2009.**

*** The national unemployment rate for February 2009 is 8.1 %, a .5 % increase from January 2009.**

***Since February 2008, the number of unemployed persons increased by 5 million and the unemployment rate has risen by 3.3%. Since initial talk of a pending recession began in December 2007, about 4.4 million jobs have been lost, with more than half of the decrease occurring in the last 4 months.**

*A close look at Workforce West Virginia's most recent labor market report shows that in the one month period of December 2008 to January 2009 when the state lost a breathtaking 22,400 jobs, 17,700 of the losses were in the service-providing sector and 4,700 were in the goods-producing sector.

Of the 17,700 jobs lost within the service-providing sector there were seasonal declines of 5,400 in government; 4,800 in trade, transportation and utilities; 2,300 in leisure and hospitality; 2,000 in professional and business services; and 1,600 in educational and health services.

In the goods-producing sector, construction employment declined by 3,400 jobs; manufacturing lost 800; and mining and logging lost 500.

Although most of us have been really good at pointing fingers as to the cause of this recession, (blaming subprime lending, outsourcing jobs, market to market accounting, etc.) I would like to take a look at Wall Street's practice of initiating credit default swaps or CDS's.

It is my understanding that American International Group (AIG), a financial services company operating in 130 countries and owning 176 companies, 71 of which are insurance carriers, suddenly collapsed in September 2008 under the weight of bad bets it made in insuring mortgage-backed securities.

According to a variety of insurance articles I have read, AIG's problems rested in its London-based financial products unit. The unit's securities were tied to the value of home loans. The financial products group sold credit-default swaps, which you know, are complex financial contracts allowing buyers to insure securities backed by mortgages.

Many of the buyers were European banks. As home values fell, the value of the underlying mortgages declined and AIG had to reduce the value of the securities on its books.

For US taxpayers, that means a total bailout of over $182 billion including the purchase pf assets. The Federal government owns nearly 80% of AIG's holding company as a result of earlier investments, which included a $60 billion loan, a $40 billion purchase of preferred shares and $50 billion to soak up the company's impaired assets.

According to the *New York Times*, although its name is American, the company is rooted in Asia, and federal officials believed a bailout was preferable to the havoc in international markets that would likely follow bankruptcy.

All over credit default swaps (CDS).

According to Economy's website in an article taken from *Newsweek*, CDSs were initiated 14 years ago by executives at the world's/nation's largest banks, who hired young math and science grads from schools like MIT and Cambridge to create a market for the complex instruments.

CDSs are sort of insurance policies that were deregulated by federal law: a third party would assume the risk of the debt going sour, and in exchange would receive regular payments from the bank, similar to insurance premiums...the banker would then get to remove the risk from his books and free up the reserves.

I found it interesting that Matthew Phillips, the author of the article aptly entitled "The

Monster That Ate Wall Street", included a quote from a 40-year old managing director at JPMorgan who shared in the creation of CDSs said, "And for those of us that were there, there was a feeling of being present at the creation of something incredibly important."

Kind of like inventing the bomb or putting together Frankenstein, the author wrote.

I want to clearly note, CDSs were not only in the hands of AIG but also of bankers throughout the nation and the world. This company simply took the biggest hit.

If nothing else, the secretive practice has been "outed", so to speak. and the US Congress now is looking at passing an insurance federal regulation bill.

There are long-time supporters of a federal system of insurance regulation.

Some note the recent CDS problems are a symptom of a fractured state-based regulatory system. I take exception to that idea and need only to point to the continued financial success of the state regulated AIG insurance subsidies in contrast to the failure of the non state regulated AIG financial products companies.

To address this alleged fractured regulatory system, a bill called the <u>National Insurance Consumer Protection and Regulatory Modernization Act</u> has surfaced in Washington. It would create an optional federal system overseen by the Office of National Insurance acting as a systemic risk regulator.

The office would also have the authority to gather financial data, recommend regulations and have enforcement authority over some insurance holding companies.

Opponents in Congress were antsy about the concept of a systemic regulator. One query was made wondering if the regulator's attention could mean a company could be "too big to fail", attracting more business from consumers looking for safety and growing even bigger.

Other opponents said federal regulators failed to spot Bernard Madoff's $50 billion Ponzi scheme.

Congressional proponents say states' patchwork of regulations may serve as a hindrance to the competitiveness of the industry.

Plus, regulations also serve as a hindrance just from the ability of companies to get products to the market place quickly and deal with policies.

Then again, unregulated markets that overshadow, in terms of size, the regulated ones is a real question.

What will West Virginia do in the coming months? I believe that will be answered following the actions of Congress. Will states lose their rights in overseeing insurance coverage? I for one would not like to see that happen.

For instance, a bill has been introduced this session in the WV House which would require the Insurance Commission to seek legislative approval for rule changes governing workers compensation insurance.

The commission was exempted from rule review when we privatized its state-run workers' compensation system.

Supporters of the current system say the proposal could chill the market, which opened to competition July 1.

Supporters of the proposal say workers should have some government protection over their rights.

It's an issue we undoubtedly will scrutinize carefully to ensure a fair and balanced system for all.

I have sponsored a few bills that I believe would provide consumer protection in lending practices:

*** SB 3 would authorize the Commissioner of Banking to enter into contracts with federally insured depository institutions to provide loan review services by Division of Banking employees.**

*** SB 105 would make changes to the disclosure requirements regarding fees in a mortgage loan, grant the banking commissioner the authority to issue a provisional mortgage license and includes a provision to change the time frame for hearings from 20 to 30 days after the commissioner received a timely written demand.**

In closing, I have another concept I wish to address. When I was first appointed to serve as the Chairman of Banking and Insurance 18 years ago, I thought "well... that's a match."

However, I see a gravitational attraction between the two worlds of banking and insurance.

In national meetings conducted throughout my service in the Legislature, I have shared discussions with my colleagues from other states who agree that there has been a major de-segmentation of finance, as regulatory and technological barriers have come down.

Information technology has spawned a much greater variety of insurance and banking products and made it easier to compete in each other's markets.

Risk management techniques have evolved in similar ways leaving bankers and insurers with a common language to address common problems.

The similar and increasingly convergent evolution of banking and insurance has also meant common challenges and responses to regulators and supervisors of the industries.

And, we all address accounting challenges...the industries are both in the process of adjusting to major changes in International Financial Standards.

Technology is changing, people are changing, times are changing...but we still remain the same. We will continue to "tweak" state law.

We will focus on health care insurance coverage, the state's pension liabilities, and budget and look at the possibilities drawn down from the federal economic stimulus package, our alleged judicial "hell hole"...but most importantly...our economy and its impact on our citizens.

The more things change, the more they remain the same. "It's deja vu, all over again."

Again, I thank you.

By the way, West Virginia's Rainy Day Fund now (2009) contains $448 million - a drop from the $581 million balance on June 30, 2007. Because the state invests the fund, last year's crisis on Wall Street burned away $133 million in West Virginia's reserves but our Standard and Poors Credit rating is AAA.

Thank you.