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Remarks of Harvey Rosenfield
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before the
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Insurance Reform in California

I want to thank the Drum Major Institute, and its Executive Director, Andrea Batista, for inviting me to New York City to appear before this prestigious organization. And my thanks to all of you for attending. Surprisingly few people are willing to get up early to talk about insurance. In fact, we have a name for that. We call it "the insurance syndrome." I'll explain.

The liability insurance industry is one of the biggest in the nation - $1.2 trillion in assets, $1 billion in premiums collected in the U.S. alone last year. The industry is a source of consumer outrage every month when those premium due notices have to be paid; it's notorious for not paying claims, as we're witnessing right now in Louisiana and Mississippi post-Rita and Katrina; its discriminatory practices, such as redlining and credit scoring, are legendary. And over the last few years – indeed, periodically over the last three decades – its pricing practices have severely destabilized family budgets, businesses and the national economy.

Yet despite the enormous size and profound impact this industry has, hardly any policy wonks ever discuss the liability insurance industry; scholars – at least those not on the industry payroll – rarely study it; few journalists cover it beyond reporting its financials; only a handful of advocacy groups, such as ours and the Center for Justice and Democracy here in New York, scrutinize the industry; no foundation that I have found will give you a grant to challenge what the insurance industry is doing in this country; and, with a few notable exceptions, almost no elected officials are willing to take it on.

This industry has perpetrated one of the greatest financial and public policy frauds on America in its history, and almost nobody is discussing it. In fact, the industry has been remarkably successful in changing the subject every time someone starts to talk about the behavior of the insurance companies. And it goes berserk when it can't change the subject.

I've got a theory about what causes "the insurance syndrome." It's that the insurance companies have spent a lot of money to silence the people who should be paying attention and complaining loudly. Not just donations, but more insidious strategies like sponsoring conferences, events, junkets. A lot of folks have been bought off this way -- including politicians, businesses, universities, unfortunately some non-profit advocacy groups, even some judges. It costs surprisingly little to buy the betrayal of people who aren't committed to the truth. But that's only part of the diagnosis. A major reason for "the insurance syndrome" is that the industry has managed to hide behind a surprisingly thin veil of complexity, which comes down to the fact that a lot of people have a math block.

In the next twenty minutes, I'm going to explain how California took this invisible industry that tried to change the subject and made it the number one topic in the state – with a little help from the industry itself – how we toilet trained the insurance companies. And I'll suggest a few lessons from California that might be applied elsewhere, and in other contexts.

Three Insurance Crises

The story I want to tell really begins three decades ago.

It's 1975, the economy is souring, and sudden increases in the price of medical malpractice insurance – the insurance that doctors and hospitals buy to cover themselves if they are sued for negligence – jolted doctors practicing in California.

Now, since it was the insurance companies that were jacking up everyone's premiums, you'd think they would catch the blame for it.

But in the 1975 crisis, the insurers pioneered a strategy that has proven amazingly successful ever since. They deflected the blame for the crisis from themselves to lawsuits: soaring malpractice claims, the insurers said, were forcing them to raise their rates.

Their solution: an arbitrary cap of $250,000 on the amount of compensation for pain and suffering a jury could order a negligent doctor to pay an innocent victim of medical error, or even of deliberate criminal conduct, and a cap on how much a malpractice victim could pay a lawyer to bring such a case. Doctors went on strike (sound familiar?), refusing to work until lawmakers passed the caps. The legislation was sponsored by liberal democrats and signed, on an emergency basis, by Governor Jerry Brown.

There was only one problem: medical malpractice premiums in California kept soaring.

Ten years later, another insurance crisis hit – this time the entire nation was afflicted by skyrocketing premiums, and the increases were across the board: motorists, homeowners, businesses (mostly small businesses), non-profits, municipalities, day care centers. Once again, the insurance industry blamed lawsuits, and embellishing on their propaganda, "trial lawyers" – the attorneys who bring suits, typically on a contingent basis, on behalf of people harmed by negligence or intentional conduct.

This time around, corporations became big backers of the campaign against civil justice rights, since the effect of restricting those rights was to alter, in favor of corporate profits, the cost-benefit analysis of whether to pollute a neighborhood or manufacture a dangerous car or prescription drug.

Almost every state legislature passed laws restricting the historic right of their citizens to go to court and have a jury decide responsibility. California passed more so-called "tort reform" too, even though the malpractice caps had not worked – med-mal premiums rose 450% between the passage of the caps in 1975 and 1988.

That's when some of us decided it was time to turn the discussion around and place the blame for the insurance crisis where it really belonged: on the insurance industry.

Real Insurance Reform

As in most states, the insurance industry had the best of both worlds those days in California. It had lobbied its way out of both regulation and the application of antitrust laws, so it wasn't even subject to the constraints of a free marketplace. After it became clear that the Democrat-controlled legislature was too beholden to the insurance industry to order either regulation or competition, we drafted a ballot measure, which became known as Proposition 103, that did the following:

First, it called for an immediate reduction and refund of 20% in the price of all forms of property-casualty insurance in California: auto, home, business, medical malpractice, etc.

Then it required insurance companies to open their books to the public when insurers apply for rate increases. Under this stringent regulation, insurers must comply with a formula unique to California and toughest in the nation that limits how much in profits, expenses and, of great interest to us for reasons I'll explain in a moment, the amount of estimated losses that insurers can pass through to the public in the form of rate increases.

Third, Proposition 103 banned such unfair and discriminatory practices as basing auto premiums on where people live, rather than their driving safety record; gave people the power to get around the practice of red-lining, which insurers have used to target low income and other disfavored communities; and applied, for the first time, California's civil rights and consumer protection laws to insurance companies.

Finally, to make sure that the reforms would be properly enforced, Proposition 103 made the insurance commissioner an elected position accountable directly to the voters (not to a politician who typically used the appointment to reward the insurance industry for donations); gave consumers the right to challenge violations of the law before the Insurance Department or in the judicial branch; and made insurers pay attorneys fees for consumers who brought such litigation to protect the public.

The Campaign for Proposition 103

Given the amount of money the industry stood to lose through the proposition, we expected the insurers to fight us with everything they had. Still, no one anticipated the stupendous size of the onslaught they brought back in 1988 – for now, it's still a record for any state in the nation, to my knowledge.

The insurance industry spent $80 million – more than the Presidential candidates spent in their national campaigns that election year. Most of it went to television ads and mailers, which reached a saturation level (a commercial every few minutes, dozens of mailings) three months before the election, and never let up. A good deal of that advertising was spent attacking me personally, which proved to be a strategic mistake – voters quickly figured out that anyone who had pissed off the insurance industry so badly was probably doing something right and that they ought to vote *for* whatever the industry wanted them to vote *against*. The insurers also sponsored three propositions of their own, in an effort to confuse the voters. One would have imposed a no fault system in California; a second, cap damages for pain and suffering in auto accidents; the third, cap the amount of money any person could pay a trial lawyer to represent them in a tort suit.

Our campaign for Proposition 103 was 100% grassroots. We borrowed $150,000 from three wealthy individuals and used the money to print up and mail petitions to registered voters to collect the 700,000 signatures we needed to get the proposition on the ballot. We got most of the signatures we needed that way, along with small donations, averaging $8, to pay for the mailings. All told, we spent $2.9 million, all but $400,000 of it on postage and printing. The $400,000 was what we ran the campaign on.

From Day One, our campaign was strongly supported by an unprecedented coalition of consumer, civil rights, minority, low income, senior, feminist and labor groups. (Of all the groups you would imagine would support it, only the trial lawyers association was absent: they were so worried about the insurers' tort initiatives, they ran their own counter-counter initiative).

The pocketbook issue proved to transcend all ideological and demographic categorizations. It passed by 1% - that's all you need in a democracy – by a combination of urban core Democrats and Reagan-country Republicans from Orange County – all of whom were fed up with the insurance industry. The insurers three counter-initiatives were crushed (as was the attorneys' measure).

The Great Payback

Proposition 103 resulted in $1.2 billion in premium refund checks for about seven million Californians. Between 1989 and 1999, it blocked over $23 billion in rate increases. It was one of the largest transfers of wealth from pickpockets to consumers in American history.

The impact on auto insurance premiums has been very powerful. In 1989, California had the second highest average auto liability premium in the nation. By 2001, it had dropped to 22nd in the nation, a total of 22%. Meanwhile, the average premiums around the nation went *up* 30% during that period.

Just in the last few years, using Proposition 103's right to challenge applications for rate increases, FTCR has blocked $230 million in premium increases.

And, in light of history, it's interesting to note that Prop. 103 gave doctors the rate reductions that the insurance companies had promised – but pocketed for themselves as windfall profits from the damage caps. Doctors got about $70 million in immediate refund checks – the full 20% reduction forced upon the malpractice insurers by 103. Since 2003, FTCR has challenged nine rate increase requests by malpractice insurers. Not because we really care how much doctors pay for malpractice insurance – its only about 3% of their gross revenues, and is tax deductible anyhow – but because we care about patients, and anything that might affect the cost of healthcare (even though all malpractice damage awards amount to four-tenths of one percent of all health care spending in the nation). Those recent challenges have saved doctors $64 million. As of 2001, medical malpractice premiums in California were, on average, less than what they were before Prop. 103 passed. (Another side benefit of 103: when we put the industry's executives under oath in California and asked why they needed rate increases when they had the caps on damages and fees, they admitted that the caps had no effect on premiums!)

The tremendous savings for Californians and our economy from Prop. 103 came despite hundreds of lawsuits, brought – ironically- by insurers, challenging the provisions of Prop. 103, all unsuccessful – though insurers are still abusing the judicial system with such frivolous suits to this day. Prop. 103 has also survived the insurers' financial corruption of one elected insurance commissioner who was forced to resign his office.

(BTW, insurers have tried to attack consumer groups for bringing these rate challenges – you know, the "greedy trial lawyer strategy" – but when we point out that our fees are approximately a quarter of a penny for every dollar we save the public, the insurers' attack goes nowhere.)

Why Insurance Regulation Works

Proposition 103 has worked because it targets the real cause of the crisis: the greed of the insurance companies. Insurers earn their money from investing our premiums. When the economy is roaring, as it was in the go-go 1990s, insurers under-price the risks they insure in a lunatic effort to capture more premium dollars to invest. When the economy sours, as it did in 1973, in the early 1980s, and when the Tech Bubble burst in the late 1990s, insurers' profits go down. Meanwhile, the policies they never should have written come back to bite them. Actually, it was a multiple whammy for insurance companies this time: the bear market cost the liability insurance companies $10.8 billion during the first half of 2002. And many insurers paid the price for abandoning their conservative investment practices during the Bubble: ten companies alone lost $250 million in investments in high-flying, crooked companies like Enron, Worldcom, Global Crossing, Tyco and Adelphia. Then there were record low interest rates. And the post-9/11 economic slowdown. So the insurers did the same thing they did twice before in the last three decades: they raised premiums to offset their investment losses.

It's astounding to learn how they got away with it. We have uncovered what we believe has been an industry-wide campaign by insurance companies to defraud not only the public and lawmakers, but state regulators, about the "crisis." You have often heard insurers lamenting that they are losing money – paying out more on lawsuits than they took in on premiums. But these statements are based on the insurers' own subjective estimates of what they *expect* they will end up paying out in claims. Industry accounting practices permit insurers to write-off these projections of future claims as if they were out-of-pocket losses. Thus, when their investments decline in value, insurers have an incentive to inflate their loss projections, making it look as if claims have soared, both to justify the price hikes to the public and to feeble state regulators, and to support their effort to blame lawsuits.

But guess what? A huge portion of these phantom losses never materialize. Later, insurers quietly turn the "losses" into profits. Examination of their financial statements reveals the extent of the scam: comparing their projections of malpractice losses during the crisis of the 1980s with what they actually ended up paying out over a ten year period, we have discovered that insurers inflated their losses by an average of 32%. At the height of the crisis, it was 40%.

That's why the industry that has claimed it was losing money and had to raise premiums in recent year is recording profits at record levels not seen since 1987 – the last crisis. First half profits this year are up 29% over 2004 - $30 billion – and profits that year were up 62% over 2003. Insurers also posted a $4 billion gain in investment income to $27.9 billion; increased dividends to their shareholders by 52% and, thanks to this pig-out, are now actually paying out only 58 cents in claims for every premium dollar they take in.

California has been spared the worst of this phony "crisis," thanks to Proposition 103.

Lessons Learned

Here's what we've learned from California's experience with insurance reform:

1. Pocketbook issues trump ideology. Proposition 103's promise of fair insurance united the middle class and the poor at the ballot box, erasing traditional right vs. left political lines in the common pursuit of regulation, and lower prices.

Want to know what other pocketbook issues are ripe? People are mad as hell about cell phone service. About credit card late charges. And about mortgage interest rates. How long would Americans tolerate the war in Iraq if they discovered that our adjustable mortgages are skyrocketing because of the cost of that conflict?

2. The complex can be made simple – and inspiring. People understand greed, and once the insurance scam is presented to them, they will support any reasonable and fair reform. (By contrast, the insurers have a lot harder time explaining why lawyers are responsible for higher premiums).

3. Offense, not defense. This is critical: it's not just offense, but a fearsome offense. We pull no punches, give no quarter and take no prisoners in our efforts on behalf of the public. We're not afraid to get bloody and dirty in the trenches. There are lives at stake here. If you want to take a look at the approach our organization employs, go to consumerwatchdog.org. If you are interested in what we have to say about our comic book Governor, check out Arnoldwatch.org.

And, interestingly, what we've seen since Prop. 103 is that when we meet the insurers' demands for "tort reform" with a hard-nosed public campaign for insurance reform, the insurers throw in the towel and sue for peace. This has happened in state after state, where insurers dropped out of the campaign against consumer rights just as soon as the news media and lawmakers started pondering serious regulation of the industry. Much as they need "tort reform" to back up their excuse for jacking up everyone's premiums, and much as they like the fact that the less they have to pay to victims, the fatter their profits, the insurers will do anything to avoid a debate over how carefully their practices are regulated and how cooked their books are.

We've also gone on the offense in the medical malpractice debate. First, we've pointed out that Republican Senate Leader Bill Frist's heavy sponsorship of caps on malpractice victims' rights isn't just about rewarding his donors. Caps would directly benefit his investments in the family business known as HCA, which provides managed care to millions of Americans and happens to own the nation's fourth largest medical malpractice insurance company. Our complaint to Senate ethics officials took on new meaning when we discovered that Frist seemed to have used inside knowledge to order the sale of HCA shares that were supposed to be in a blind trust outside his control – just before the value of the shares took a dive.

Meanwhile, nothing shuts up greedy anti-patient doctors faster than the threat that their salaries (a comparatively significant component of the cost of health care) will be capped, or that new safety measures will be taken to address the true malpractice crisis: the epidemic of medical mayhem that kills 150,000 Americans in hospitals alone each year. Funny how docs don't think caps sound so good when they become the target.

4. Jujitsu. We can't even begin to match the resources of the insurance industry. But as Prop. 103 showed, a clever grassroots campaign can use the insurers' money and greed against them.

The "Tort Reform" Lesson Unlearned

Some of you who aware of the successful dismantling of tort laws in Washington, D.C., and across many states might be wondering why the lesson about "tort reform" got learned in California and seemingly lost everywhere else. After all, in the last year alone the Congress has by stealth immunized rental car companies from state court lawsuits for negligently renting cars to people who then injure or kill someone else; just last week, Congress immunized gun manufacturers. And, in point of fact, there have been several more successful assaults in California on tort laws – to limit suits by uninsured motorists who are hurt by negligent drivers -- and, more recently, to restrict consumer protection lawsuits that have nothing to do with tort laws.

In fact, one can only survey the battlefield and conclude that we have lost most of the recent battles. But we have lost because the lessons of the fight against the insurers in California were not applied to repulse the attack being waged by a community of evildoers that has grown beyond the insurance industry.

First of all, there have been few serious efforts to pass insurance reforms in other states in recent years. Many states have no initiative process, and the insurance industry and its allies control the legislature, as they do the federal government. Whatever the reason, if there is no offense, there is only defense – and a public policy vacuum which the insurance-medical-business complex has learned to fill.

Second, insurers have succeeded in hiding under the white coats of the medical profession and other less reviled but no less greedy special interests. When history is written, the AMA's betrayal of its oath, "first, do no harm," will stand out as a vivid epitaph on this once honorable profession, who, as they were busy sacking patients' rights, were themselves quietly eviscerated by the managed care industry.

Similarly, other industries have begun pouring hundreds of millions of dollars into the politicians and think tanks, like this city's Manhattan Institute, to sponsor "tort reform" cloaked in a thin academic veneer. Their greasy corporate thumbs have actually begun to tip the scale of justice.

Third, the plaintiffs' bar – trial lawyers – bear some of the blame, maybe more than some. Unlike their opponents, who have worked hard and spent significant resources creating a broad national coalition that includes pseudo-academic think tanks and non-profit lobbying groups, the lawyers have approached the battles on a sporadic, idiosyncratic, state-by-state basis. And, particularly in recent years, they have not sufficiently contributed resources to protecting the civil justice system that they are sworn to defend. Too many of them do not wish to be distracted from their practices and are depleted by the preferred and ultimately unsuccessful insider strategy of donating to friendly legislators.

But we must also recognize that the lawyers are badly outgunned, which has made all the more devastating the catastrophic indifference to the attack on the civil justice system by other communities, such as civil rights groups, unions, and environmental organizations. They seem to think this is not their fight, when in fact it's about justice, plain and simple.

Anyone who thinks that the assault can be isolated to tort law is badly missing the big picture. The courts have become deeply politicized by President Bush and the Chamber of Commerce. As people and politicians become more overt in their demand that courts decide matters based on ideological or religious principles, public confidence in the integrity of the judicial branch has fallen sharply. Many Americans now look at the judicial branch as just another corrupt branch of government, open for business like the Congress and the Executive Branch. This is a deeply ominous development for those who view the legal system as the last bastion of freedom in our democracy.

To understand how partisan and damaging the attack on the system of justice has become, consider what the CEO of the world's largest insurance company had to say last year. AIG's Hank Greenberg said, "I call the plaintiff's bar terrorists." I guess he wanted to reserve the more modest title of "thief" for himself, since this year AIG had to erase $4 billion in phony earnings from its books not long after this leading light was ousted and had to take the Fifth.

Or consider what a major Republican operative frankly had to say about why Republicans should lockstep back federal medical malpractice damage caps:

"Trial lawyers are a bigger funder of the Democratic Party than labor unions. If this legislation is passed the people we have to argue with and fight with [i.e. the trial lawyers][will be] less powerful than they are today. That makes future fights possible."

That was the justification for limiting the rights of innocent victims of medical malpractice offered by a Washington, D.C. jihadist, Grover Norquist.

Finally, there is this statement: "It is a disgrace to be a lawyer." The same man said "every lawyer must be regarded as a man deficient by nature or else deformed by usage."

These days, that could have been a joke by a late night talk show host. It might even be something you might hear in a State of the Union address. But it wasn't. The man who said that was Adolph Hitler.

Thank you.