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Opening Remarks – Lou Pietroluongo

Good morning. We would like to thank you, Chairman Grannis and members of the Committee for the opportunity to testify at this hearing on the Insurance Department's suballocations to other State agencies. My name is Lou Pietroluongo and I am the First Deputy at the Insurance Department. I am joined today with Acting Secretary of State Frank Malano and Dennis Whalen, the Executive Deputy Commissioner of the Department of Health. You have a copy of our submitted testimony which is being submitted on behalf of the Departments of Banking, Health, Insurance and State, and the Division of Criminal Justice Services.

The Insurance Department's 2005-2006 operating budget, which was \$177.8 million, included \$62.8 million in the form of suballocations to other State agencies. The mission of the Insurance Department is to supervise and regulate the business of insurance in this State for the benefit of insurance consumers. While the Insurance Department is fully capable of conducting its regulatory functions, there are numerous insurance programs that could be implemented for the benefit of consumers that the Insurance Department does not have the requisite expertise, or in some cases, the appropriate jurisdiction, to implement and oversee. The choice then is to either fund the program through taxation, suballocations or not fund the program at all. As our submitted testimony demonstrates, the programs being funded through the Insurance Department's suballocations have a clear nexus to insurance consumers and the insurance industry, and in the long-run, generally produce savings for insurance consumers in the form of reduced premiums, better healthcare or lower property damage.

I think it is appropriate at this time to discuss briefly each of the programs that the Insurance Department funds either partially or fully from the use of suballocations and how the insurance consumer benefits. As you know, the Banking Department's Holocaust Claims Processing Office is partially funded from an Insurance Department suballocation. Before, during and after World War II, Jews and other minority groups that were victims of the Holocaust saw much of their personal property seized. Not only were physical items taken, but liquid assets were as well. In addition, insurance claims made by policyholders in relation to the Holocaust often went unpaid by the insurance companies. Many of these same insurance companies and banks are now in the process of making restitution for these actions; however, many records have been lost and finding claimants or claimants finding these records can prove almost impossible. The Holocaust Claims Processing Office fills in this need. Working either as a bridge between claimants and the international organizations leading the recovery, or directly pursuing claims, the Holocaust Claims Processing Office, through 2004, had helped to return over \$29 million in bank claims and \$11 million in insurance claims to claimants.

The public policy objectives served by the operations of the Holocaust Claims Processing Office are appropriately funded by the industries generally which hold or held the claimed assets. No other previous or current functions of the Banking Department were or are funded by the appropriations budgeted to the Holocaust Claims Processing Office. Locating the insurance claims process in the Holocaust Claims Processing Office and funding it by a suballocation from the Insurance Department obviated the need to duplicate this operation in the Insurance Department solely to handle insurance claims.

The suballocation from the Insurance Department is insurance related because it pays for costs associated with the recovery of unpaid insurance claims. There is a direct benefit to certain insurance consumers as prior policyholders who never received restitution for a legitimate claim. While it is true that this only concerns European companies, many Holocaust survivors or survivors of victims live in the United States and in New York. Without the Holocaust Claims Processing Office's assistance, these people may never have received their just compensation.

The Department of Health also receives funding from the Insurance Department's budget which enables them to implement various insurance-related disease prevention programs that improve the health of consumers, thereby reducing overall healthcare costs. These programs include the Center for Community Health which provides cancer prevention, heart disease prevention, diabetes control, and arthritis control. The following are examples of community health based initiatives which benefit insurance payors and health care consumers. Cancer screening is an evidence-based public health intervention that saves lives and costs to insurers and the State. Early stage breast cancer five-year survival rates are 98 percent while late stage survival is 26 percent. In the case of colorectal cancer, five-year survival decreases from 90 percent to 10 percent when the cancer is found at a late stage. In addition, the cost of treating cancer increases dramatically with disease stage. The cost of treatment of early stage cervical cancer is \$2,000 compared with a cost of \$30,000 for late stage cervical cancer. The Department of Health has provided, since 1994, over 778,000 uninsured individuals with breast, cervical and colorectal cancer screenings.

Another Department of Health Program is the Official Prescription Program also known as the Forge Proof Prescription Program that requires that drugs be prescribed on official prescription forms in order to reduce fraudulent prescription insurance claims, which drive up healthcare costs. This program has now been expanded so that the official prescription contains state-of-the-art security features specifically designed to prevent counterfeiting, alterations, and forgeries, all of which are fraudulent activities used to divert drugs to non-legitimate use. The Department of Health, along with federal agencies, has investigated numerous incidents where non-controlled substances have been fraudulently obtained and resold to pharmacies, then dispensed to unsuspecting patients. Because the quality, efficacy, and sterility of these medications cannot be guaranteed, they pose a threat to the public health.

Consistent with savings estimates provided by Medicaid, the Division of Budget has estimated that the expanded Official Prescription Program will save private insurers approximately \$75 million annually through the reduction in fraudulent prescription claims.

In addition to saving private insurers \$75 million through the decrease in prescription drug fraud, the Official Prescription Program is also designed to increase electronic prescribing. Electronic prescribing will save the private insurance industry millions of additional dollars by decreasing medication errors. It is estimated that 55 percent of all medication errors are due to misinterpretation of practitioners' instructions on handwritten prescriptions. The private insurance industry has recognized the benefits of electronic prescribing and is spearheading several major projects designed to encourage its use. Electronic prescribing will significantly reduce the estimated \$130

million in annual costs to New York's healthcare system caused by adverse drug events due to errors in written and oral prescriptions.

There are also two separate Insurance Department suballocations that support the Department of Health's regulation of the managed care industry in the State. Through the Office of Managed Care, the Department of Health shares responsibility with the Insurance Department for the regulation, oversight and monitoring of managed care organizations licensed under Article 44 of the Public Health Law. Over 6.9 million New Yorker's, approximately 36.6 percent of the State's population, get their health coverage through one of these health plans. In recent years, New York has turned to managed care delivery systems to provide health care to government programs including Medicaid, Family Health Plus and Child Health Plus. Since 1995, enrollment in Medicaid managed care has increased from approximately 650,000 to over 2 million. Over 500,000 adults are enrolled in managed care plans through Family Health Plus and over 300,000 children are enrolled in managed care through Child Health Plus. All three of these programs are administered by the Department of Health.

The Insurance Department also provides a suballocation to the Division of Criminal Justice Services that partially funds the continued roll-out of its TraCS Program. TraCS, which stands for the Traffic and Criminal Software, is a sophisticated, yet simple to use, electronic data collection and reporting tool for traffic tickets and accident reports. In fact, the entire suballocation was distributed to the Division of State Police to fund the purchase and installation of TraCS equipment in approximately 300 trooper vehicles. This purchase enabled the State Police to complete the roll out of TraCS equipment in all 1,203 trooper vehicles.

Long delays in accident report data processing have hampered the effort to reduce insurance fraud in New York. It is estimated that automobile insurance fraud in the State costs insurance companies approximately \$1 billion each year. Insurance investigators are unable to effectively combat this problem because they do not have timely access to the information contained on the accident report. Because of the backlog in data processing, it takes approximately 18 months to enter the data into the State Accident Information System and make the reports available for distribution.

Without the accident report, investigators are left to adjust claims based on the claimant's submission. As a result, tens of thousands of suspicious claims must be settled because investigators lack sufficient information to challenge the claim. An accident report created in TraCS can be electronically transferred from the police car, approved by a supervisor, forwarded for input in the Accident Information System and available for review by an investigator in a matter of days.

To develop effective traffic safety strategies and reduce insurance fraud, New York must receive and process traffic data from tickets and accidents reports on a real-time basis. TraCS is the solution.

The Insurance Department also funds various initiatives of the Department of State including its Office of Fire Prevention and Control (OFPC) programs that are targeted at preventing or reducing losses from fires and other emergency incidents which prevent or reduce fire, property, automobile or medical insurance losses and, ultimately, costs to consumers. One such program is for the implementation of fire safety standards for cigarettes. As you know, OFPC has implemented fire safety standards for cigarettes, to lower their risk of igniting, for example, upholstered furniture or mattresses. The

world's first regulation of the ignition strength of cigarettes requires that all cigarettes sold in the State meet an ignition strength performance standard.

Notwithstanding the short period this program has been in effect, its success is evident in the decline in the number of smoking-related fatalities. Deaths from fires caused by smoking materials declined from an average of 40 per year for the period of 1997 to 2002 to only 28 last year. The percentage of all fire deaths due to fires caused by cigarettes fell from an average of 24 percent to 18 percent. Through these types of initiatives, only six states in the nation have lower civilian injuries per thousand structure fires and only nine states in the nation have lower average property loss per vehicle. OFPC programs are clearly paying dividends to insurance consumers.

Further, the insurance industry recognizes the importance of training and fire department operations, which are the very programs that are being administered by OFPC. The Insurance Services Office, a rating organization that develops advisory forms and loss costs for the property/casualty industry, allocates 50 percent of a municipality's rating to the effectiveness of its firefighting operations which include fire department, water supply, alarm system and codes.

Another Department of State Program is its Urban Search and Rescue Program which provides technical rescue assistance to emergency responders with statewide capabilities. Members of the Urban Search and Rescue Program were deployed on September 11th, during the capsizing of the Stella Mare in Albany and in cave rescues in Schoharie.

Another important program within the Department of State is for its Division of Code Enforcement and Administration which provides direct benefits to insurance

consumers by facilitating the construction and maintenance of safe buildings. Safe buildings are less likely to contribute to catastrophe or loss of life in the event of a fire or natural disaster. As a result, consumers enjoy the benefit of fewer losses and reduced premiums.

Finally, the Insurance Department's suballocations provide funding to the Office of the Attorney General for two important insurance programs. The first is to investigate and combat no-fault fraud. Over the last decade, there has been a proliferation of no-fault fraud in New York, which I stated earlier costs an estimated \$1 billion per year. The prevalence of automobile insurance fraud in New York is a significant contributing factor to high automobile insurance rates in the State. Therefore, on May 9, 2001, Governor Pataki proposed a series of legislative and regulatory steps designed to confront the rising cost of automobile insurance in New York. Pursuant to Executive Order 109, Governor Pataki designated the Attorney General as special prosecutor to coordinate the investigatory and prosecutorial efforts related to fraudulent auto insurance claims.

This success of this program can be seen with the recent 72 count indictment of eight suspects and one law firm allegedly involved in submitting fraudulent no-fault and bodily injury claims to insurance carriers. These indictments seek the forfeiture of \$2.2 million in illegally obtained proceeds. To date, the Auto Insurance Fraud unit has brought felony insurance fraud and related charges against 272 defendants.

The actions of the Auto Insurance Fraud Unit have had a definite impact upon the marketplace. Since 2002, there has been a significant decline in losses for private passenger automobile insurance. Loss ratios have dropped from 0.86 in 2002 to 0.59 in 2004. The average claim paid has decreased from \$8,489 in 2002 to \$6,229 in 2004.

As a result of the success of the of the Auto Insurance Fraud Unit, as well as other measures implemented by Governor Pataki, the Insurance Department called on automobile insurers to reduce their rates. To date, the Insurance Department has approved a record number of auto rate reductions, saving policyholders almost \$400 million. More than 20 auto insurers, including the top three in terms of market share, Allstate, GEICO, and State Farm, have reduced or are reducing their rates an average of 5 percent in 2005.

The other suballocated program funds the Insurance Department's cooperative agreement with the Office of the Attorney General to provide for an ongoing joint investigation into broker/insurer compensation and pricing practices. The Insurance Department's joint investigation with the Attorney General over the last two years uncovered compensation arrangements in the insurance industry may have been lawful on their face, they have been used inappropriately and sometimes illegally as we saw with bid rigging and steering. Lack of an ethical yardstick led to these transgressions in the insurance marketplace and the need for additional scrutiny by regulators and prosecutors. These illegal or inappropriate practices became the catalyst for the current stream of criminal, civil and regulatory actions, imposed jointly by the Insurance Department and the Office of the Attorney General, resulting in the imposition of hundreds of millions of dollars in restitution to insurance consumers, not just in New York, but across the nation.

The Marsh & McLennan investigation resulted in an \$850 million restitution settlement agreement. Since then, major brokerage firms have admitted to steering clients to certain insurance companies, while soliciting fake bids in order to create the

perception of true competition. In addition to the Marsh settlement, the State also secured settlements with Aon Corporation, Willis North America, and UnumProvident Corporation. These settlements were financially beneficial to consumers, collectively returning more than \$1 billion to policyholders nationwide, and also required these firms to implement sweeping reforms designed to avoid conflicts of interest. Other investigations are currently in progress.

In conclusion, the Insurance Department's mission is to protect insurance consumers and the programs funded by suballocations advance this mission. The benefits gained by insurance and other consumers through the suballocated programs far outweigh the costs associated with these programs. If these important insurance-related programs were not funded from the Insurance Department's budget, either they would have to be eliminated and the benefits derived by consumers would be lost, or some other source of funding would have to be identified in instances where the program is fully funded through Insurance Department suballocations. In cases where a program is not fully funded through the Insurance Department's suballocations, elimination of the suballocated funding would most likely impair the effectiveness of the program to the detriment of consumers.

Thus, we believe that the current programs have positively contributed to the betterment of the health and welfare of all New Yorkers including insurance consumers and should be continued.

Thank you and we will be happy to answer any questions.