CFA **Consumer Federation of America**

March 27, 2007

Sen. Patrick Leahy, Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510-6275

Re; McCarran-Ferguson Antitrust Exemption
Hearing of March 7, 2007 – Questions from Sen. Specter

Dear Mr. Chairman:

Let me first thank you, Mr. Chairman, for the honor you gave me by inviting me to testify at this very important hearing.

Following are the responses to the questions posed to me by Ranking Member Specter in your letter dated March 15, 2007:

QUESTIONS

1. In your written testimony, you indicate that you believe the collection and dissemination of historical claims statistics would not violate the antitrust laws, but that manipulation of such statistics to project future losses and the distribution of such projections would violate the antitrust laws.

    a. Can you explain why you draw the line between legal and illegal conduct there? Does the fact that a third party develops the projections affect your analysis at all?
    b. How would you respond to those who argue that small insurance companies need the projections like those provided by ISO in order to stay in business?
    c. When McCarran-Ferguson was enacted, do you believe Congress intended to insulate conduct such as the joint development of claims projections?

2. In your written testimony, you suggest that advisory organizations such as the Insurance Services Office, modeling agencies and other third parties have facilitated collusion in the insurance industry. I find that deeply concerning, but I know some in the insurance industry have stated they believe information sharing is necessary for the industry to make accurate claims projections and therefore benefit consumers.

a. How would you respond to claims by industry that information sharing benefits consumers?

ANSWERS

Response to Question 1a:

Legal scholars have said for decades, particularly during hearings held by Chairman Jack Brooks of the House Judiciary Committee in the early 1990s, that the provision of joint historic data would not violate federal antitrust laws. What these legal experts saw as not passing legal muster was manipulating the historic data by making future projections as to rates or premiums. From my perspective in regulating and closely analyzing the insurance market for over 40 years, this distinction makes practical sense. The use of such joint historic information will help insurers to more accurately assess risk, enter new markets and offer consumers fair rates. However, manipulating and standardizing the process of projecting future losses and rates based on historic data is plain, old-fashioned collusion.

Smaller insurers, and even larger companies looking to enter new lines of insurance or new states, need historic data to effectively evaluate risk and make these competitive moves. But they do not need to agree on what will happen in the future. Once the data are available, there are plenty of independent consulting actuaries to make the projections. According to the 2007 Yearbook of the Casualty Actuarial Society, there are only 139 actuaries serving in the rating organizations and 895 actuaries acting as consultants.[1]

Decisions on what inflation will be, what events impact coverage, how much loss adjustment expenses will cost and other such determinations for the future are the stuff of competition which are snuffed out by joint pricing decisions today made routinely by ISO and other advisory and rating organizations.

The use of third parties (such as independent consulting actuaries) is not anti-competitive per se. However, when third parties serve as a vehicle for joint decision-making and rate making, their role is certainly anticompetitive. For instance, consider the role played by ISO and similar organizations in setting future projections high enough to assure that the least efficient member of the insurance cartel that ISO and other such organizations serve flourishes.

Response to Question 1b:

Small insurance companies (and large insurance companies) need to project their pricing into the future, just as providers of other services and products must do. But they do not need to do it jointly, just as other participants in the American economic system need not do so. If a small insurer cannot afford a consulting actuary for this service, I would argue that it is too small to be allowed to write insurance. Actuarial services are not

[1] Statistics shown on page 59 of the Yearbook.

prohibitively expensive. Small companies must hire actuaries for certain activities in any event (such as signing annual reports and other documents and setting reserves), and that has not stopped them from being viable.

Response to Question 1c:

It is clear that, when enacting McCarran-Ferguson, Congress intended that the antitrust laws fully apply to insurance after a short, two-year, moratorium. There was no intent to create a permanent exemption by either Congress or the Executive, as a review of the legislative history makes crystal clear.[2]

Response to Question 2a:

Collusive activity to underpay claims or to raise RMS hurricane model prices can never be favorable to consumers. Joining together to develop useful historic data is a good thing for consumers. Projecting these data into the future jointly, in a way that assures success for the least efficient member of the joint group, is unfavorable for consumers. Price fixing, even only for part of the rate (the largest part, the claims) is not helpful for consumers, ever.

If information sharing among erstwhile competitors is so good, why is the law of the land for almost every industry except insurance to the contrary?

It is high time that the insurance industry becomes a member of the competitive American economic system!

Yours truly:

J. Robert Hunter
Director of Insurance

[2] I encourage you to review the 1994 Committee report of the House Judiciary Committee on this issue.