UNITED STATE SENATE
COMMITTEE ON THE JUDICIARY
"THE MCCARRAN-FERGUSON ACT AND ANTITRUST IMMUNITY: GOOD FOR CONSUMERS?"
MARCH 29, 2007

RESPONSES OF THE AMERICAN INSURANCE ASSOCIATION TO QUESTIONS POSED BY CHAIRMAN LEAHY, RANKING MEMBER SPECTER, AND SENATOR LANDRIEU

Question from Chairman Leahy

1. At the hearing, I asked about a statement in your prepared testimony in which you acknowledge that certain collective activities by insurers would result in antitrust verdicts against insurers, were the federal antitrust laws to apply to the business of insurance. You responded that "anything that focuses upon price setting or collusion of any kind whatsoever would be clearly against the law and ought to be vigorously prosecuted." Does AIA therefore support statutory repeal of the antitrust immunity to prohibit "any activity that focuses upon price setting, or collusion of any kind" within the business of insurance?

There is a two-part answer to your question. First, AIA does not support statutory repeal of the limited antitrust protection provided by the McCarran-Ferguson Act (McCarran) because that will destroy the balance between state regulation and federal antitrust enforcement established by McCarran without addressing the pervasive and overly intrusive nature of state insurance regulation. The result will be a multi-layered regulatory and enforcement structure consisting of state regulation (including existing rate and policy form regulation), state antitrust enforcement (to the degree that the state is not engaging in regulation), federal enforcement of the federal antitrust laws subject to the "state action" doctrine, and private enforcement of those same federal laws through the courts.

It is important to remember that McCarran is a power-sharing statute that delegates authority to regulate insurance to the states, while creating an antitrust regime that respects the regulatory authority delegated to the states. By merely repealing McCarran's limited antitrust exemption, without addressing the ongoing delegation of regulatory authority to the states, Congress would expose the industry to a complex web of both state and federal enforcement and a different antitrust dynamic, which could cause the states or insurers operating in those states to seek even more regulation added onto an already burdensome patchwork quilt of state and federal oversight. Ironically, such a result would run counter to the purpose of the antitrust laws, which is to encourage, not stifle, competition in a free market environment.

Second, your question presents an opportunity to reiterate AIA's position on the application of federal antitrust laws to the business of insurance. Given the purpose of the federal antitrust laws – to enforce competition to the benefit of consumers in a free market environment – it would be wholly appropriate to apply those laws to competitors operating in such an environment. Unfortunately, the business of insurance, while involving thousands of competing insurers, does not take place in such an environment. As noted in the AIA written statement, every state regulates property-casualty insurance rates or policy forms, and often both, through the use of government price and product controls. Thus, the states have chosen to exercise government economic regulation where, for other industries, free markets determine the range of prices and products available to consumers. In this case, because of the extensive nature of government economic regulation over the business of insurance, it is wholly <u>inappropriate</u> for additional enforcement to occur through application of the federal antitrust laws. From AIA's perspective, were the regulatory environment to shift from one of economic regulation through government price and product controls to a free market orientation, then the dynamic would shift to federal antitrust enforcement. Absent that shift, removal of the McCarran antitrust protection will simply introduce an additional layer of regulation into an already pervasive state regulatory system, diminishing the opportunities for free markets to flourish to the benefit of consumers. This would not be a result that is consistent with good regulatory or antitrust policy.

2. In your prepared testimony, you state that the determination of how to draw the balance between regulation and antitrust policy "does not differ from industry to industry." The balance struck by the Supreme Court for virtually every other regulated industry is that the antitrust laws apply unless the challenged conduct was engaged in pursuant to a clearly articulated State policy actively supervised by the State. If, as you testified, the balance should be the same in each industry, should that standard not also apply to the business of insurance?

There seems to be a misconception that the only applicable standard is the state action doctrine. As discussed in the AIA written statement, that is not the case. For purposes of federal antitrust enforcement, insurance should be compared to the other two legs of the financial services sector – banking and securities – which are principally regulated at the federal level. Those federally-regulated industries are governed by the exclusive jurisdiction doctrine, not the state action doctrine. <u>See</u>, <u>e.g.</u>, <u>Gordon v. New York Stock Exchange Inc.</u>, 422 U.S. 659 (1975); <u>United States v. National Ass'n of Securities Dealers, Inc.</u>, 422 U.S. 694 (1975). This doctrine provides that federal antitrust lawsuits cannot be used to undercut the federal regulatory system established by Congress, and activities undertaken within that regulatory system. In the same way, the standard established by McCarran's balance of regulation and antitrust makes certain that the decisions made by state regulators and legislators on behalf of the public are not subject to collateral attack under the federal antitrust laws.[1] Were Congress to decide to reclaim

[1] It is noteworthy that a number of states have codified a regulated industries exemption that functions similarly to prevent state antitrust laws from interfering with state regulatory systems, and that states that do not protect regulated industries by statute do so through case law. <u>Insurance Antitrust Handbook</u>, American Bar Association, Section on Antitrust Law, at 39 (2nd ed. 2007).

regulatory authority over the business of insurance from the states through specific federal legislation, that doctrine would almost certainly apply in the courts.

In contrast, the state action doctrine is very different in its application, and much more oriented toward litigation than towards a stable legal environment that respects state legislative and regulatory decisions. Thus, for the state action doctrine to apply, the courts must decide in each case whether (1) the legislation had sufficiently articulated the state's policy to displace competition and (2) whether the state had actively supervised the conduct authorized by state law.

Therefore, it is not analytically appropriate to equate the exclusive jurisdiction doctrine, which is applicable to the other two federally-regulated participants in the financial services sector, with the state action doctrine. In this connection, the exclusive jurisdiction doctrine is much more respectful of both Congressional policies and the methods chosen by federal regulators to enforce those policies than is the state action doctrine with regard to state legislation and enforcement.

As noted above, ironically, a repeal of McCarran's limited antitrust exemption (which currently serves as the insurance industry's equivalent to the exclusive jurisdiction doctrine) and the resulting reliance on the state action doctrine to establish the relationship between state regulation and federal antitrust enforcement, will likely lead to even greater and more draconian state regulation, further stifling innovation and competition.

<u>Questions from Ranking Member Specter</u>

1. ***In your prepared testimony, you discuss the impetus for Congress's adoption of McCarran-Ferguson in 1945. Can you point to any evidence that Congress intended McCarran-Ferguson to permit the type of extensive information sharing that occurs in the insurance industry today?***

One of the leading U.S. Supreme Court decisions on the McCarran antitrust provisions points to legislative history to support the proposition that one of McCarran's primary purposes was to allow the insurance industry to share information pursuant to state regulation. <u>See</u>, <u>Group Life & Health Ins. Co., et al. v. Royal Drug Co., Inc., et al.</u>, 440 U.S. 205, 221-222 (1979) ("'<u>To prohibit combined efforts for statistical and rate-making purposes would be a backward step in the development of a progressive business</u>. We do not regard it as necessary to labor this point any further because Congress itself recently recognized <u>the necessity for concert of action in the collection of statistical data and rate making</u> when it enacted the District of Columbia Fire Insurance Rating Act.'" (quoting 90 Cong. Rec. A4405 (emphasis added))

2. ***In your prepared testimony, you suggest that states have placed all collective activity by insurers under "regulatory control, scrutiny and review." What about cases like Marsh & McLennan, where there was blatant bid rigging? Are you saying that***

[the] state regulatory system was effective in overseeing the collective activity involved in that case?

The bid-rigging actions were initiated entirely by state regulatory authorities, involving cooperation among state insurance regulators and attorneys general in multiple states. These regulators perceived a problem, investigated that problem, and prosecuted that problem pursuant to their state authority. As set forth in AIA's written statement, "the joint investigations into, and the private litigation over, broker compensation practices are a recent reminder of the ability and willingness of state insurance departments, attorneys general, and private litigants to pursue conduct that they believe violates the law."

3. ***In your testimony, you suggest that the balance between antitrust and regulation "does not differ from industry to industry." But, isn't it true that the insurance industry gets special protection from the antitrust laws, even where there is little applicable state law or state law is not enforced?***

a. In your testimony, you suggest application of the antitrust laws would duplicate an effective regulatory system. As you know, the state action doctrine stays the application of antitrust laws where there is active state regulation. Given the state action doctrine, why would repeal of the McCarran-Ferguson Act result in duplication of the regulatory system?

b. You suggest the state action doctrine would destroy the balance between state insurance regulation and antitrust laws. Doesn't the state action doctrine strike the balance between regulations and antitrust laws that virtually every other industry in America deals with?

Chairman Leahy has asked similar questions concerning the interplay between the McCarran antitrust provision and the state action doctrine, and the protections that are available to other industries. In this regard, we refer you to AIA's responses to those questions, at pages 1-3. In addition, in response to part (b) of your question, we do not believe that the state action doctrine strikes the appropriate balance between regulation and antitrust enforcement for the insurance industry, nor do we believe that application of that doctrine under the current regulatory construct places insurance on the same level playing field as other financial services sector industries. To the contrary, these other industries enjoy protection from federal antitrust litigation pursuant to general federal antitrust laws under the regulatory systems that Congress has enacted for those industries. Were the state action doctrine to replace the McCarran antitrust standard for the business of insurance, there would be no presumption of deference accorded to the insurance regulatory system established by the various state legislatures.

4. In some states, if collective activity by insurers is subject to state antitrust enforcement, why would such activity not be subject to federal antitrust enforcement?

As noted immediately above, if "federal antitrust enforcement" means application of the state action doctrine to insurance activities regulated under state law, then this enforcement will serve no purpose other than to undercut the prerogative of the state legislatures in establishing their respective insurance regulatory systems pursuant to McCarran's delegation.

5. Can you elaborate on why insurance companies should be able to share cost data, and how consumers benefit from such practices?

The U.S. Supreme Court has long held that the federal antitrust laws permit industry competitors to share cost data. See Maple Flooring Mfrs. Assn. v. United States, 268 U.S. 563, 583-584 (1925) ("It was not the purpose or the intent of the Sherman Anti-Trust Law to inhibit the intelligent conduct of business operations ... enlightened by accurate information as to the essential elements of the economics of a trade or business, however gathered or disseminated. Persons who unite in gathering and disseminating information . . . and who report market prices, are not engaged in unlawful conspiracies in restraint of trade . . . for the simple reason that the Sherman Law neither repeals economic laws nor prohibits the gathering and dissemination of information.") (emphasis added). See also Sugar Institute, Inc. v. United States, 297 U.S. 553, 598 (1936); United States v. Citizens & Southern National Bank, 422 U.S. 86, 113 (1975); United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978). The Maple Flooring Court went on to explain the consumer benefits that flow from the sharing and availability of cost data:

> "It is the consensus of opinion of economists and of many of the most important agencies of Government that the public interest is served by the gathering and dissemination, in the widest possible manner, of information with respect to the production and distribution, cost and prices in actual sales, of market commodities, because the making available of such information tends to stabilize trade and industry, to produce fairer price levels and to avoid the waste which inevitably attends the unintelligent conduct of economic enterprise. . . . Competition does not become less free merely because the conduct of commercial operations becomes more intelligent through the free distribution of knowledge of all the essential factors entering into the commercial transaction."

268 U.S. at 582-583 (emphasis added). Insurance consumers should not be denied the benefits that would accrue from the sharing of such data. Indeed, we would suggest that those benefits would be enhanced if the state regulatory system abandoned its preoccupation with government price and product controls, and instead allowed competition to flourish in a free market environment.

Questions from Senator Landrieu

The McCarran-Ferguson Act allows insurance companies to engage in a number of collective activities that may violate federal anti-trust laws, but for the exemption. One of these activities is the sharing of loss data. The information is collected by private "advisory organizations" – to use your description – that analyze

the data. It is my understanding that these advisory organizations also calculate loss trends. This analysis is used by insurance companies to set premium rates. I have a number of questions about these advisory organizations and the role they play in the insurance marketplace.

1. Please provide a list of the major advisory organizations for the property and casualty insurance industry. What is the ownership structure of these organizations? Do insurance companies have an ownership stake in these organizations? Do insurance company representatives sit on their boards of directors?

2. How do these advisory organizations develop the models they use for loss trend analysis? Do state government insurance regulators have any oversight over these associations or approval authority over these models? How often are these analytical models modified? Are such modifications subject to state government approval? Were these models altered after Hurricane Katrina?

3. Do state regulators have the expertise to properly assess these models or to create their own models? Is there a federal role for giving states guidance on reviewing these trending models or creating their own? What would your association's position be on a state and/or federal government involvement in assessing trending models?

McCarran only allows the insurance industry to engage in collective activity involving the business of insurance to the extent that business is regulated by state law. With regard to loss data, you are correct that this information is collected by organizations established to perform that function. You describe them as "private" organizations, but these organizations are licensed by state law and regulated by state insurance departments. Thus, while they are private entities, they are state regulated. Your understanding is also correct that these organizations develop loss trends using that collective data. It is important to understand that these advisory loss costs are filed with and reviewed by state regulators.

You have posed a series of questions concerning the nature, structure, and activities of advisory organizations. The largest insurance advisory organization is the Insurance Services Office, Inc. (ISO), located at 545 Washington Blvd., Jersey City, NJ 07310-1686 (Telephone: 1-800-888-4476). As AIA is not an advisory organization and is not in a position to answer those questions, we respectfully suggest that you contact ISO directly.