Testimony of

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"THE MCCARRAN-FERGUSON ACT AND ANTITRUST IMMUNITY:
GOOD FOR CONSUMERS?"

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Good morning, Chairman Leahy, Ranking Member Specter, and members of the Committee. My name is Marc Racicot. I am President of the American Insurance Association (AIA), a national trade association representing major property and casualty insurers doing business across the country and around the world. I am proud to have spent much of my professional life in public service, including 8 years as the Governor of Montana, and 4 years prior to that as the State's Attorney General. Because of this experience, I have come to respect and appreciate the various responsibilities among and within the branches of state government, the complex relationships between state and federal government, the value of a stable and certain regulatory climate, and the impact of that climate on individuals and businesses. All of these issues are on display when discussing the McCarran-Ferguson Act (McCarran).

Last June, I had the privilege of testifying before this Committee on McCarran, and I appreciate the opportunity to be here again today. I would like to elaborate on three important aspects of the McCarran debate:

1. The role of McCarran in establishing the balance between regulation and antitrust enforcement for the insurance industry.

2. The scope and dimensions of McCarran's limited protection from federal antitrust laws.

3. The negative consequences that would flow from the repeal of McCarran's antitrust exemption.

McCarran's Balance of Regulatory and Antitrust Policy
McCarran was the product of extensive deliberations in Congress during the period following the 1944 U.S. Supreme Court decision in United States v. South-Eastern Underwriters. That decision held that insurance was a product that moved in interstate commerce, and was therefore subject to federal jurisdiction. At the time, the decision was controversial, and called into question the states' continued ability to tax and regulate the business of insurance. Further, at the time, the

Court's conclusion that insurance was a product within federal Commerce Clause jurisdiction threatened the viability of the insurance system, particularly since Southeastern Underwriters was a "price fixing" case, which immediately made many necessary, collective insurance activities subject to federal antitrust laws.

In the nine months following South-Eastern Underwriters, Congress labored to enact federal legislation that accomplished three goals: 1) delegation of authority to the states to the extent that the states regulate the business of insurance; 2) creation and maintenance of a broad insurance regulatory system; and 3) balancing regulatory objectives against antitrust policy objectives. McCarran's enactment furthered all three congressional goals. It entrusted to the states the authority to regulate and tax "the business of insurance," and said that no federal law should be presumed to interfere with that authority, unless it was clearly designed to do so. It gave the states three years from the 1945 enactment to put their regulatory systems in place, effectively suspending the application of the federal antitrust laws during this period. Finally, McCarran said that the federal antitrust laws would apply to the business of insurance "to the extent that such business is not regulated by State Law," or in any case where insurers had engaged in - or agreed to engage in - an act of boycott, intimidation or coercion. (15 U.S.C. Chapter 20, §§ 1012(b), 1013(b)).

In this way, McCarran authorized the states to determine how the balance of state regulatory oversight and federal antitrust enforcement would be drawn, knowing that the federal antitrust laws would apply to the business of insurance to the extent that a state chose not to regulate it.

The balancing of regulation and antitrust policy is familiar to those of us that have had extensive experience in government, particularly at the state level. The determination of how to draw the balance does not differ from industry to industry, but reflects an approach aimed at ensuring a certain and stable legal and regulatory environment that benefits all stakeholders and results in healthy private markets. That approach follows a simple principle: where there is an effective regulatory system in place, antitrust laws should not be used as a way to duplicate it. Conversely, where activity takes place outside the regulatory system, antitrust laws should apply to assure that otherwise regulated entities do not engage in anti-competitive behavior. This is a basic separation of powers principle that defines the distinct roles of the courts (and the state attorneys and private attorneys as officers of the court) and the executive branch regulatory agencies.

In the years following McCarran's enactment, the states used this approach as their roadmap, placing all collective activity by insurers under regulatory control, scrutiny and review - effectively replacing antitrust litigation through the courts with regulatory oversight of collective activity by state insurance departments, including activity to: (1) gather, analyze, and make predictions about data; (2) establish final prices; and, (3) create standardized insurance policy forms. Over the years, this basic approach has remained unchanged, except that state laws now overwhelmingly prohibit insurers from agreeing on final price, even under regulatory oversight. As part of the regulatory approach taken by the states, every organization that engages in data collection and analysis, or in the development of common policy forms, must be licensed or registered with the states and is subject to direct regulation by them. Any collective activity, including activity done through a licensed or registered entity (generally called an "advisory organization"), is subject to both the antitrust provisions in the state's insurance code and to the state's broad antitrust laws.

Equally important to the states' approach to balancing regulation and antitrust policy, during the 3-year post-McCarran "grace period," all states enhanced their regulatory systems by enacting state unfair competition and trade practices laws directed specifically to insurers. Those state laws included what were referred to as "little Federal Trade Commission (FTC)" statutes, because they adopted the FTC's unfair trade practices requirements and placed them on insurers directly through state law. States also adopted their own prohibitions on acts of boycott, intimidation or coercion by insurers, as well as Sherman Act and Clayton Act-type prohibitions on unfair restraints of trade.

It is safe to say that, in the McCarran world, state insurance regulation - in particular, regulation of insurance price and product options - is pervasive. Every state has an extensive insurance code that governs the insurance industry in every conceivable aspect of its operations, from financial solvency to market conduct to economic regulation. Every state regulates property-casualty insurance rates or policy forms, and often both. There are literally hundreds of filing requirements that states have implemented to regulate property-casualty insurers' rates and forms.

In addition, state regulation over unfair and deceptive trade practices and methods of competition is equally pervasive. All states have a general antitrust statute or antitrust language in their respective unfair trade practices laws. Most states have both.

We may disagree with the degree of state regulation of the business of insurance, particularly with respect to government economic regulation of rates and the content of policy forms, but there is no doubt that the states enthusiastically carried out McCarran's intent. And, while the degree of regulation of the insurance industry may be atypical, the balancing of regulatory supervision and antitrust litigation - as noted earlier - is not unique to insurance; it also takes place in other financial services industries (i.e., banks and the securities business) where federal courts have held that understanding the balance is critical and that antitrust scrutiny is inappropriate where the activity is subject to regulation. (See, e.g., Gordon v. New York Stock Exchange, Inc., 422 U.S. 659 (1975)).

The difference between banking and securities regulation, on the one hand, and insurance regulation, on the other, is that the banking and securities businesses are principally regulated by the federal government, while insurance is principally regulated by the states. This is a particularly important difference when looked at from an antitrust perspective. When federal antitrust law is balanced against federal regulation for a specific industry, the courts have a long and appropriate history of giving precedence to the specific regulatory system that Congress has set up for that industry over the broad, non-specific language of the antitrust laws that did not have that specific industry in mind.

Since insurance regulation, however, resides primarily at the state level as a result of Congress' delegation of authority under the Commerce Clause, McCarran is necessary to provide the kind of balance of "regulation vs. antitrust" enforcement for insurance as exists for federally regulated banking and securities businesses. This central point in understanding the true role of McCarran merits special emphasis, and is worth repeating: The McCarran-Ferguson Act balances regulation and antitrust enforcement for state-regulated insurance, just as that same type of balance has been established for the other two legs of the financial services sector, federally regulated banks and securities firms.

If McCarran did not exist, then the balance between state insurance regulation and federal antitrust law would be quite different. It would be governed by the "state action" doctrine - an antitrust principle first adopted by the courts in the years immediately prior to McCarran taking effect.

Under the "state action" doctrine, federal antitrust laws take precedence over state regulation, unless that state regulation is particularly intrusive and essentially replaces marketplace competition. Even in these circumstances, the primacy of the state regulation is dependent on whether the regulatory oversight meets an "active supervision" test, which can be determined only through litigation and which, therefore, means that there will be much litigation. Perhaps constant litigation.

So, for the purposes of state insurance regulation, that balance would be destroyed if McCarran were repealed.

The Parameters of McCarran's Limited Antitrust Protection

I hope that it is clear by now from my testimony that McCarran is less of an "exemption" from federal antitrust laws for the business of insurance and more of an approach that the states have followed in balancing the respective and complementary roles of regulatory oversight and antitrust enforcement. Nonetheless, there has been, and continues to be, a fundamental misunderstanding about the federal antitrust protection provided under McCarran, with advocates of McCarran repeal stating that McCarran provides a blanket exemption for insurers from federal antitrust law application, allowing insurers an unfettered right to engage in anticompetitive behavior.

This is not how McCarran's antitrust protection works. The exemption applies only to the "business of insurance" and not to the "business of insurance companies", and only to the extent that the business of insurance is regulated by state law. As I have noted, the exemption does not apply to agreements or acts of boycott, intimidation, or coercion. It does not matter whether those practices are regulated by state law or not - federal antitrust law applies. When determining whether the federal antitrust laws apply, the courts have consistently construed the exemption narrowly.

Equally important, McCarran does not protect insurer misbehavior from scrutiny under the broad range of state laws governing unfair methods of competition and unfair and deceptive trade practices. Every state provides some form of antitrust regulation of insurers, whether through broad state laws based on the federal Sherman and Clayton Acts, antitrust provisions in their insurance codes, or language barring unfair competition in the little FTC acts. Often, states have multiple avenues to address alleged anticompetitive behavior. So there is no lack of state antitrust authority with regard to insurers.

Moreover, the allegations that have been or are being leveled at insurers - whether they are related to private allocations of markets, collective price-fixing, or bid-rigging - can be brought under state antitrust, unfair trade practices, and insurance laws. Indeed, 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.

Upsetting The Balancing Approach Of McCarran Is Not The Solution

Over its more than 60-year life, we have seen McCarran's antitrust protection blamed whenever there is an affordability/availability problem in any specific line of insurance. The typical "solution" is to call for the repeal of that protection.

However, when the problem subsides in that particular line of insurance, the call for repeal generally also subsides, with those who had argued that McCarran was the cause of the problem never saying that perhaps McCarran should now be credited for curing the problem, as well. If insurer activities under McCarran were the reason that prices went up or insurance became less available, then insurer activities under McCarran must be the reason that those very same prices went down or insurance became more widely available.

The reality is that insurance is like the canary in the mine. When an insurance price spikes or availability shrinks, it is because an underlying problem (e.g., a particular cost driver) needs to be addressed. To be fair to all customers - not to mention to be able to stay in business - insurers must be able to price their policies to cover their likely losses. If they cannot do that, because of government price controls, they will be forced to pull back from the marketplace. This reaction is as inevitable as Newton's apple finding its way from tree to ground. Instead of looking at insurer activity under the McCarran-Ferguson Act as the issue, it would be better to look at the underlying problems and fix them.

With this entire context as background, we have reviewed the Insurance Industry Competition Act of 2007. As we read the Act, it would apply the Sherman and Clayton Acts to the business of insurance, without regard to whether the business was regulated by state law. Moreover, it would apply the FTC Act in the same fashion to the extent that the insurance activity involved an "unfair method of competition." In aspects of the business of insurance unrelated to unfair methods of competition, the FTC Act would apply to "fill the gap" to the extent that those aspects were not regulated by state law. Apparently, the FTC is being authorized to duplicate state regulation wherever it disagrees with a state about its regulatory decisions. Thus, the Act would repeal the McCarran antitrust exemption without changing the state regulatory dynamic and it would super-impose an additional federal layer of regulation.

If our interpretation of the Act is correct, enactment of its provisions would destroy any balance between regulation and antitrust enforcement, and create a multi-layer, multi-forum system of regulation that would generate confusion, uncertainty, constant litigation, and, ultimately, an unstable and unpredictable insurance system.

No one benefits from such a dysfunctional system. State insurance departments could not be certain that the regulatory standards that they promulgate today would not be second-guessed by the courts or the FTC. Insurer activities would be subject to judicial scrutiny under the state action doctrine, ensuring that a different level of regulation would be necessary for that doctrine to apply. Some advocates of McCarran repeal have expressed confidence that certain collective activities currently regulated under state law would not fall within the state action doctrine and therefore would result in antitrust verdicts against insurers. We believe them and have no doubt of their willingness to test their confidence through litigation.

All of these consequences suggest two paths, neither of which is desirable from the standpoint of good government and healthy markets. Either insurers will approach the states to plead for more regulation to foreclose incursions via the courts or federal antitrust enforcement agencies, or insurer practices will be tested through constant litigation - without regard to the level of regulation by the states or the federal government. It seems to me that our goal should not be to encourage over-regulation or duplicative regulation in a system already widely acknowledged to be in need of reform. Likewise, the goal of legislation ought not be the enrichment of antitrust lawyers. The more prudent course would be to find the appropriate balance of regulation and antitrust enforcement of competition within McCarran as it exists today. That course does not require repeal of McCarran's narrow antitrust protection, but it does involve a commitment to having a regulatory system that leads to stable, predictable, and healthy insurance markets that benefit consumers. We are prepared to make that commitment.

Mr. Chairman, thank you very much for giving us the opportunity to appear before you today. I would be pleased to answer any questions.