

Testimony of the  
National Association of Insurance Commissioners

Before the  
Committee on the Judiciary  
United States Senate

Regarding:  
**The McCarran-Ferguson Act and Antitrust Immunity:  
Good for Consumers?**

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Chairman Leahy, Ranking Member Specter, and members of the Judiciary Committee, thank you for inviting me to testify today.

My name is Susan Voss, and I am the Commissioner of Insurance for the State of Iowa. I serve as Vice Chair of the Financial Conditions (E) Committee of the National Association of Insurance Commissioners (NAIC), and on the Board of the National Insurance Producer Registry (NPIR). I also serve on a small NAIC antitrust working group charged with outreach to Congress and evaluation of legislative proposals that would impact the business of insurance.

I am pleased to be here today on behalf of the NAIC and its members to provide the Committee with our initial observations on congressional efforts to repeal the limited antitrust exemption for insurance activities granted by the McCarran-Ferguson Act (“Act”). 15 U.S.C. §1011 *et seq.*

Today, I would like to make a few primary points:

- NAIC supports the intent of Congress to protect consumers by enabling federal investigation and prosecution of bad actors that use the Act as a shield from federal antitrust laws.
- Although the NAIC understands there are practices that should be subject to both federal and state antitrust laws, we ask Congress to carefully evaluate the unintended consequences from outright repeal of the exemption. Repeal risks transforming certain insurance practices that help consumers, promote

competitiveness, and strengthen markets, into actionable violations of federal antitrust law.

- NAIC respectfully suggests that identification of the precise offensive conduct Congress wants to prohibit but cannot because current federal law does not permit investigation and prosecution should guide congressional consideration. As this Committee considers outright repeal of the antitrust exemption for the business of insurance, the NAIC asks that you contrast repeal against targeted alternatives, including amendments to strengthen existing criminal and civil actions and remedies that would lower the shield behind which bad actors hide, but preserve insurance market stability. The alleged bad behaviors driving congressional interest are, for the most part, not immune from federal investigation and prosecution under the Act's limited antitrust exemption.
- The NAIC believes that any federal legislation should include provisions that authorize federal-state collaboration to identify, investigate, and prosecute bad actors in the business of insurance who engage in anti-competitive practices.
- Overall, the NAIC would emphasize that a core mission of state regulation is to protect consumer interests. Efforts at regulatory modernization and investigations of alleged abuses demonstrate our commitment to that mission. While some of the insurance industry's largest players advocate for deregulation through a so-called federal charter and would encourage coupling the two issues, the NAIC supports re-consideration of the limited federal antitrust exemption as a separate and distinct policy matter.

The NAIC's antitrust working group, chaired by Illinois Director of Insurance Michael McRaith, represents the current phase in the evolution of the NAIC's position on repeal of the limited federal antitrust exemption. As you may recall, Director McRaith appeared before the Committee last June. He testified that: (i) insurance is a unique financial product, (ii) for which state supervision is well-suited, long-standing, and successful, and

(iii) that the state system operates to prevent and punish anti-competitive practices, demonstrating that (iv) the limited federal antitrust exemption has worked well for decades to maintain a vigorous and competitive market.

Presently, our antitrust working group is reviewing S.618, the *Insurance Industry Competition Act of 2007*, which is pending before this Committee. The Working Group expects to present this matter for discussion by all chief state insurance regulators during the NAIC's upcoming Spring national meeting that begins this weekend in New York City.

Mr. Chairman, if invited, we would be pleased to submit for the hearing record any relevant comments, recommendations, or outcomes from the NAIC Spring national meeting.

#### **Lower the Shield: Prosecute Bad Actors Who Violate Antitrust Laws**

The NAIC supports the policy intent that underlies legislative proposals like S. 618. Persons who violate state and federal antitrust laws should be investigated and, where the evidence points to an actionable violation, prosecuted. Currently, the Act gives the insurance industry a limited exemption from federal antitrust laws. An activity that qualifies for the exemption must: (i) constitute the "business of insurance"; (ii) be "regulated by state law"; and, (iii) not constitute "an agreement to boycott, coerce, or intimidate, or [an] act of boycott, coercion, or intimidation." 15 U.S.C. §§1012-1013. If an activity does not meet each of these three criteria, or where Congress enacts a law that "specifically relates to the business of insurance," then the exemption is unavailable. For instance, in 1994, Congress passed and President Clinton signed into law the *Violent Crime Control and Law Enforcement Act of 1994*. Pub. L. 103-322 (1994). The law includes provisions that "specifically relate" to the business of insurance by expanding federal criminal and civil actions against insurance companies engaged in certain acts of fraud, embezzlement, and obstruction of justice. 18 U.S.C. §§1033-1034 (2007).

It is hard to dispute Sen. Specter's remarks in his floor statement introducing S. 618 that "there is no reason to prevent federal prosecutors from going after antitrust violators just because those violators happen to work for insurance companies." 153 Cong. Rec. S2047 (Feb. 15, 2007). However, it is important to recognize that the federal antitrust laws and criminal code, including unfair and deceptive trade practices, already offer a wide range of legal weapons for prosecutors to wield against alleged bad actors. For instance, in the on-going insurance brokerage litigation involving alleged bid-rigging and client steering conspiracies, a federal district judge ruled last October that the challenged practices are not exempt from federal antitrust or RICO actions under the Act. *In re Insurance Brokerage Antitrust Litigation*, Slip Copy, 2006 WL 2850607 (D.N.J.) (Oct. 3, 2006). The judge held that, under the *Pireno* test of the "business of insurance," bid-rigging and client steering do not transfer or spread risk and are only tangentially related to the relationship between an insurer and insured. *Union Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The challenged practices involve interactions between brokers and insurers, but are "outside the sphere" of the policy relationship between insurer and insured. *In re Insurance Brokerage Antitrust Lit.* 2006 WL 2850607 at 10.

Of immediate concern to many members of Congress is whether Gulf Coast victims of Hurricanes Katrina and Rita, are victims now of alleged unscrupulous insurance practices. Belief that the limited antitrust exemption blocks federal investigation by the Department of Justice and the Federal Trade Commission overlooks the fact that the alleged unscrupulous practices generally involve claims payment and claims settlement disputes. The Act's limited antitrust exemption does not necessarily shield these matters. Likewise, there are allegations that some insurers colluded not to pay policyholder claims post-Katrina. The crime of "collusion" involves (i) a secret agreement among two or more persons, (ii) to commit a fraudulent act. Collusion would be an actionable offense under federal and state deceptive and unfair trade practices laws, and a prosecutor could perhaps frame an action under Section One of the Sherman Act of 1890. 15 U.S.C. §1. Demonstration of a Section One antitrust violation requires: (i) an agreement (e.g. conspiracy, "collusion"), resulting in (ii) anticompetitive effects (e.g. "restraint of trade"), and (iii) that involves an illegal action, which (iv) was the proximate cause of injury.

Alleged collusion not to pay has, arguably, an anti-competitive effect. It could generate market power in the form of wealth transfer to insurers that injure consumers who, in consideration of expected payouts on legitimate claims, paid premiums to insurers that do not assume the transferred risk by honoring the claims.

Although the shield of the McCarran exemption should not block either federal or state investigation or prosecution of anti-competitive agreements to capture market power, it is possible to distinguish those anti-competitive actions from pro-competitive joint practices, as determined under a “rule of reason” analysis.

Let me be direct: the NAIC is concerned that outright repeal risks ending certain pro-competitive practices when the real culprits are bad actors who engage in alleged unscrupulous anti-competitive practices.

### **Evaluate Unintended Consequences from Repeal**

NAIC respectfully asks Congress to carefully evaluate the unintended consequences for consumers and markets from outright repeal of the limited antitrust exemption for the business of insurance.

#### *Pro-Competitive Practices*

S. 618 is a relatively short bill, but with far-reaching implications. As I noted earlier in distinguishing between anti- and pro-competitive practices, outright repeal risks transforming certain insurance practices that promote competitiveness, help consumers, and strengthen markets, into actionable violations of federal antitrust law. Jeopardized practices include, for instance:

- (i) Loss Cost Data Sharing. Joint conduct that involves data collection and cost projections to help determine rates and cover and adjust claims; this conduct

includes “trending,” which involves the analysis of past data for the business of insurance to make actuarial predictions about the future;

- (ii) State Insolvency Funds. Operation of guaranty fund associations formed through contributions by insurers into a reserve fund to compensate consumers who suffer loss because of insurer insolvency;
- (iii) Policy Form and Standardized Risk Classification. Joint activities among insurers to establish risk classifications and product/form standardization;
- (iv) Operation of Ratings Organizations. Ratings/statistical organizations like the Insurance Service Office (ISO) and the National Council on Compensation Insurance (NCCI) that collect and disseminate statistical information, compile aggregated loss cost data, and provide other services that make it easier for small and medium-sized insurers to compete; and,
- (v) Joint Underwriting and Residual Market Mechanism. Cooperative activities that provide a “safety net” for individuals and businesses unable to secure coverage in the open market including for automobile insurance, medical malpractice, and workers’ compensation.

S. 618 does not provide for exemptions or “safe harbors.” Instead, the bill invites the U.S. Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ) to issue advisory opinions and business reviews, respectively, in response to requests for antitrust guidance on specific proposed conduct in the business of insurance. The bill, however, does not provide details that explain how the review process would operate. The history of joint antitrust enforcement guidance, as applied to health care practices, suggests an expedited process that involves a method of scrutiny comparable to a judicial “rule of reason” analysis. A “rule of reason” analysis is essentially a subjective balancing test between pro-competitive and anti-competitive effects from a particular practice on consumers and markets. Where the pros exceed the cons for a practice or conduct, a

decision against federal antitrust prosecution, absent extraordinary circumstances, is likely.

Current federal expertise and capacity necessary to evaluate certain practices and conduct for pro-competitive effects is limited, at best, because of the long and successful history of state regulation over the business of insurance. In contrast, the FTC has its own enforcement history as well as developed case law to evaluate the pro- and anti-competitive effects of certain practices in the health care arena. Should S. 618 and its FTC/DOJ joint antitrust enforcement review provision become law, it would take time for federal officials to become sufficiently expert in the business of insurance. During this ramp-up period, market uncertainty concerning federal and state antitrust enforcement policy would threaten consumers and insurers. Therefore, this Committee may want to consider adding a “firewall” provision that temporarily protects from federal prosecution those practices that come before the FTC and DOJ for antitrust enforcement guidance. This presumption of legality could help maintain stability for the business of insurance during a transition period.

Repeal of the limited federal antitrust exemption for the business of insurance invites unintended consequences that could create market uncertainty and harm consumers. Some of those consequences, according to the U.S. Government Accountability Office (GAO), might include the restriction of new products or insurers from entering the market, limits on product innovation, consumer choice, and competition. GAO-05-816R, McCarran-Ferguson Federal Antitrust Exemption, at 3 (July 28, 2005). Outright repeal jeopardizes: (i) competitive market benefits from the development of joint loss costs and policy language; (ii) standardized risk classifications and policy form language that make data more credible; (iii) consolidated collection and analysis of data that improve quality and aid smaller insurers with responsible rate-setting; and (iv) publication of advisory loss costs and common policy forms that make it less costly for small and medium-sized competitors to enter or expand in the market.



Outright repeal also opens the door for increased litigation to determine whether a certain practice is anti-competitive, or whether a particular state “actively” governs the practice.

### *Litigating Antitrust Boundaries*

Absent certainty in results from the application of FTC/DOJ antitrust enforcement guidelines and a “firewall” provision to provide a bridge of interim stability for consumers and markets, litigation will probably remain a preferred option for a party that seeks to probe the contours of insurer activities to determine which ones withstand federal antitrust scrutiny.

The “State Action” doctrine, first articulated in *Parker v. Brown*, 317 U.S. 341 (1943), provides a defense under federal antitrust law for some regulated conduct of the business of insurance. To raise this defense successfully, a defendant must demonstrate that the challenged practice is “regulated by state law”. This requires one to meet an additional two-pronged standard that compels evidence of: (i) a “clearly articulated” state policy (e.g. actual statutory language), and (ii) “active supervision” by the state of its policy. *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). One challenge with the test, according to a policy director with the FTC, is lack of judicial agreement about how to define and apply the “active supervision” factor to particular state regulations and statutes. Testimony of Maureen Ohlhausen, Director, Office of Policy Planning, U.S. FTC, Before the Antitrust Modernization Commission, September 29, 2005. The U.S. Supreme Court in *Midcal*, for instance, directed states to regulate, monitor, or engage in a “pointed re-examination” of regulatory conduct, dismissing the “gauzy cloak of state involvement” as insufficient to avoid federal antitrust law. *Midcal*, 445 U.S. at 106. Alternatively, the *Ticor Title* Court held that the “purpose of...active supervision inquiry is not to determine whether the State has met some normative standard...Its purpose is to determine whether the State has exercised sufficient independent judgment and control.” *FTC v. Ticor Title Co.*, 504 U.S. 621, 634 (1992).

One point for certain is that it will take years of litigation to develop uniform precedents among the circuits. Even assuming that courts apply the “State Action” doctrine uniformly, the likelihood of litigation remains strong because “decisions involving antitrust law are typically based on the facts and circumstances of each case.” GAO-05-816R at 2 (2005). Litigation will force states, generally, and state departments of insurance, in particular, to reallocate limited staff and financial resources away from more productive uses. It also may create sufficient uncertainty to chill the introduction of new insurance products, limit options for consumers, and impact prices.

### **Federal-State Prosecutorial Cooperation**

The NAIC understands that Congress wants to be responsive to the public and offer more than a phone number to their state’s chief insurance regulator. The NAIC, however, encourages the Congress to approach this policy matter from the perspective of “both-and,” not “either-or.” We believe this issue invites both federal and state action in a demonstration of cooperative federalism. Any federal legislation should include provisions that authorize federal-state collaboration to identify, investigate, and prosecute bad actors in the business of insurance who engage in anti-competitive practices.

#### *Protecting Consumers at the State Level*

Every state has its own antitrust and unfair competition laws. State regulators and attorneys general play complementary and mutually supportive roles in monitoring and investigating insurers, agents, and brokers to prevent and punish activities prohibited by those state laws. Monitoring involves reacting to conditions and changed circumstances. It also involves taking an active role and making adjustments to our methods and policies that anticipate new challenges that threaten consumers and market stability. State regulators’ primary responsibility is to regulate the “business of insurance” to maintain a stable insurance market that provides products that offer reasonable benefits to consumers. Every day conscientious and highly skilled regulatory professionals monitor

and investigate business activities related to the two major obligations insurers owe to consumers—issuing sound policies and paying claims on time.

Market conduct exams are part of the monitoring system. State insurance officials supervise the market conduct of industry participants by reviewing their business operations through market analysis, periodic examinations, and investigation of specific consumer complaints. When consumers have complaints about homeowners, health, automobile, and life insurance, they readily contact their state insurance departments. State officials earn consumer trust, in part, because they know the towns, cities and communities in which consumers live, and the nuances of the local insurance marketplace. Insurance products are difficult for many consumers to understand. Consumers expect state governments to have appropriate safeguards and an effective local response if problems arise. States have such systems in place.

Insurers, agents, and brokers also must accept responsibility for maintaining a competitive and fair marketplace by reporting business practices that appear to be harmful, anti-competitive, or unethical to state regulators. Preventing and correcting market conduct problems requires that regulators and responsible business participants work together toward a common goal of strengthening stability and fairness in the marketplace. We achieve such stability through extensive daily monitoring of solvency, review of rates and policy forms, and evaluating market behavior.

*State Insurance Regulators: “Cops on the Beat”*

An example of recent collaboration between state regulators and attorneys general is the effort over the past two years to address wrongdoing and potential conflicts of interest associated with broker compensation. In October 2004, then-New York Attorney General Eliot Spitzer filed a civil complaint against a large brokerage firm after months of investigation by the attorney general and more than a year of analysis by the New York Insurance Department. The civil complaint, which included claims based on violations of New York antitrust law, unfair business practice law, and common law

fraud, has resulted in a number of guilty pleas on criminal charges of fraud related to bid-rigging. The charges stemmed from contractual and implied arrangements between insurers and brokers in which the insurer pays extra commissions to the broker based on a number of factors, such as the loss ratio or retention of business placed through the brokerage firm. These commissions were in addition to regular sales commission, and often based on the performance of the insurer's entire book of business with an individual broker. Although these types of contingent commissions have been commonplace for more than a century, allegations of "rigged" competition among certain brokers and carriers emerged. Additionally, there were allegations that brokers would freeze out insurers with less favorable commission arrangements, regardless of whether the insurance fits a customer's needs. In terms of law enforcement and insurance regulation, this conduct constitutes fraud, an unfair business practice, and a violation of state antitrust law.

Without admitting or denying the allegations against them, five of the nation's top brokers entered into consent agreements with a number of attorneys general and state insurance departments. The agreements establish settlement funds ranging from \$27 million to \$850 million, which are available to policyholders who release the brokers from any liability associated with the settlements.

State experience with the business of insurance is long-standing. Existing state consumer protection, antitrust, and unfair trade practice laws provide necessary tools to help stop anti-competitive conduct. If Congress intends to provide federal authority to police for antitrust violations, then provisions for federal-state collaboration should be part of any legislation because the states have policed this beat longer.

## **Conclusion**

A priority of state insurance regulators is to protect consumers. We recognize that insurance is a unique financial guarantee product that is essential to protecting not just the American economy, but also the most cherished personal effects of individual consumers.

It is part of the social fabric and financial safety net that enables citizens, small businesses, and global corporations to move forward each day with confidence.

State regulation of the business of insurance under the limited federal antitrust exemption granted by the McCarran-Ferguson Act has protected consumers for over 60 years, as it did for many years preceding the Supreme Court's decision in the *Southeastern Underwriters Ass'n* case. 322 U.S. 533 (1944). We have used that time to sharpen market supervision and enforcement tools to promote a lawful and competitive marketplace for insurance companies. Although insurance products generally have been widely available and competitive throughout the United States, state regulators do and will continue to act when necessary to correct market imbalances by using our authority to mandate insurance coverage and appropriate rates.

The NAIC stands ready to work with this Committee and the 110<sup>th</sup> Congress to examine as a separate and distinct policy issue whether a targeted boost in existing federal enforcement power against bad actors in certain alleged anti-competitive activities would complement strong state regulatory authority—not compete against it.

Thank you.

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