

Antitrust Law and Insurance

The McCarran-Ferguson Act: What it Is, What it Isn't and Consequences of Repeal of the Insurance Industry's Limited Antitrust Exemption (1)

Legislation seeking to amend what is a very limited federal antitrust exemption for the insurance industry under the McCarran-Ferguson Act would likely reduce competition in the industry, resulting in less choice and higher costs for insurance buyers. Here's why.

What is the Issue?

- Legislation is being considered in Congress that would repeal the insurance industry's antitrust exemption, which has been in place for 64 years under the McCarran-Ferguson Act.
- Proposals seeking repeal of the McCarran-Ferguson Act are not new. The latest push for repeal is related to health insurance and comes as Congress weighs healthcare reform legislation. There were also efforts for repeal in the wake of Hurricane Katrina, which resulted in an estimated insured loss of \$40.6 billion, the largest loss in the history of insurance.

What the Limited Antitrust Exemption under McCarran Ferguson Allows

- The limited antitrust exemption under McCarran-Ferguson allows insurers to pool historic loss information so that they are better able to project future losses and charge an actuarially based price for their products. It also allows for joint development of policy forms.
- The act does not exempt insurers from state antitrust laws, which explicitly prohibit insurers (and all businesses), from conspiring to fix prices or otherwise restrict competition. The McCarran-Ferguson Act in no way results in any kind of restraint on competition.
- Under the act, insurers remain subject to rate and form regulation in every state.
- The act's exemption applies only if three conditions are met:
 1. The insurer's action pertains to 'the business of insurance'
 2. The action must be regulated by state law
 3. The action must not be designed to boycott, coerce or intimidate.
- Another crucial fact about the McCarran-Ferguson Act is that it has nothing to do with claims handling or settlement practices. Consumers are protected in every state by 'unfair claims' statutes that grant state insurance regulators the authority to investigate insurance companies that refuse to pay valid claims, and state courts provide a judicial remedy for contract violations and for torts committed by insurers. There are also consumer protection laws in every state, and these apply to insurance transactions as well.
- The net effect of the limited exemption under McCarran-Ferguson is actually to increase competition by giving small insurers, who otherwise would have too little data to develop actuarially credible (i.e. statistically reliable) rates, the tools to compete with larger insurers who have much more data on which to base rates. The principle is simple: better data produce rates that are more accurate, and rates that are accurate are fairer to consumers. The fact that a larger number of insurers can secure the data they need to compete under McCarran means that consumers are afforded more choices, not fewer.
- The property/casualty insurance industry historically has been a highly competitive business. In 2007, there were more than 2,700 P/C insurers operating in the U.S. Research by the Wharton

School of the University of Pennsylvania supports the view that repeal of McCarran Ferguson would likely reduce competition, increase the cost of insurance and reduce availability for some high-risk coverages, because the threat of antitrust litigation would make insurers unwilling to engage in efficiency-enhancing cooperative activities.(2)

- The pooling of loss data benefits customers of all insurers, both large and small. Here's why:- Use of pooled data by larger insurers allows them to enter new markets in new states and to offer new products. Without this data, larger insurers would not know how to accurately price their products. This would result in less choice for insurance buyers as larger insurers would not be able to offer as many products.

- For smaller insurers that do not have the resources available to accurately price coverage, the benefits of data-pooling are significant. Industry analyst Advisen notes that without access to pooled data, smaller insurers would not be able to compete as effectively and would be more prone to insolvency since they would be unable to actuarially price their products.(3)

- Smaller insurers are an important source of competition for larger national insurers and a large source of business for local agents. According to A.M. Best, of the 2,000 P/C insurers operating in the U.S., around one-third are small (companies with adjusted policyholder surplus of up to \$100 million).(4)

- The use of standard policy forms also has key benefits for insurance buyers because it allows agents to help their policyholders compare available coverages across the market. Comparison shopping not only gives policyholders greater choice but enables them to make a more informed policy selection.

About the McCarran Ferguson Act

- The McCarran Ferguson Act was passed by Congress in 1945. Subject to certain conditions, the McCarran Act essentially returned insurance regulation to the states. The Act was designed to ensure the preeminence of state regulation not to free insurers from federal antitrust laws.
- The act included a narrow exemption from federal antitrust laws for activities that are regulated by the states:- Under the act, "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or a tax upon such business."

- Federal antitrust laws would apply "to the extent that such business is not regulated by State law."

- The McCarran Act, as mentioned previously, establishes three requirements for the antitrust exemption to apply:
 1. The activity in question must fall within the business of insurance
 2. The activity must be regulated by state law
 3. The activity must not involve boycott, coercion or intimidation

The McCarran Act gives primary insurance regulation to the states. Some in the industry believe companies should have the option of being regulated by the states or the federal government. Others believe that the state system of regulation is most appropriate. All agree that the current state regulatory system needs modernization.

(1) Some of the content in this paper is derived or adapted from comments by Lawrence H. Mirel of Wiley Rein LLP and former insurance commissioner for the District of Columbia, February 9, 2007.

(2) The McCarran Ferguson Act Anticompetitive or Procompetitive? Patricia M. Danzon, the Wharton School of the University of Pennsylvania, Regulation - The Cato Review of Business and Government, 1991.

(3) Advisen QuickNote: Insurers? Antitrust Exemption Under Attack (Again), March 5, 2007.

(4) Based on A.M. Best 2008 Financial Size Category Information, 2008 Best's Ratings & Reports.

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