

Y 4  
.J 89/2

1042

96-92  
5-89/2  
96-92

96-92 INSURANCE COMPETITION IMPROVEMENT ACT, S. 2474

GOVERNMENT  
Storage



HEARING  
BEFORE THE  
SUBCOMMITTEE ON ANTITRUST,  
MONOPOLY AND BUSINESS RIGHTS  
OF THE  
COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 2474

MAY 29, 1980

Serial No. 96-92

Printed for the use of the Committee on the Judiciary

DOCUMENTS

MAY 3 1981



FARRELL LIBRARY  
KANSAS STATE UNIVERSITY

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1981

72-864 O



AY  
5/28/71  
SP-28

COMMITTEE ON THE JUDICIARY

EDWARD M. KENNEDY, Massachusetts, *Chairman*

BIRCH BAYH, Indiana  
ROBERT C. BYRD, West Virginia  
JOSEPH R. BIDEN, Jr., Delaware  
JOHN C. CULVER, Iowa  
HOWARD M. METZENBAUM, Ohio  
DENNIS DeCONCINI, Arizona  
PATRICK J. LEAHY, Vermont  
MAX BAUCUS, Montana  
HOWELL HEFLIN, Alabama

STROM THURMOND, South Carolina  
CHARLES McC. MATHIAS, Jr., Maryland  
PAUL LAXALT, Nevada  
ORRIN G. HATCH, Utah  
ROBERT DOLE, Kansas  
THAD COCHRAN, Mississippi  
ALAN K. SIMPSON, Wyoming

STEPHEN BREYER, *Chief Counsel*

EMORY SNEEDEN, *Minority Chief Counsel*

SUBCOMMITTEE ON ANTITRUST, MONOPOLY AND BUSINESS RIGHTS

HOWARD M. METZENBAUM, Ohio, *Chairman*

EDWARD M. KENNEDY, Massachusetts  
BIRCH BAYH, Indiana  
JOHN C. CULVER, Iowa  
PATRICK J. LEAHY, Vermont  
MAX BAUCUS, Montana

STROM THURMOND, South Carolina  
CHARLES McC. MATHIAS, Jr., Maryland  
PAUL LAXALT, Nevada  
ORRIN G. HATCH, Utah

HERMAN SCHWARTZ, *Staff Director and Chief Counsel*

STEWART W. KEMP, *Special Counsel*

PETER CHUMBRIS, *Minority Chief Counsel*

(II)

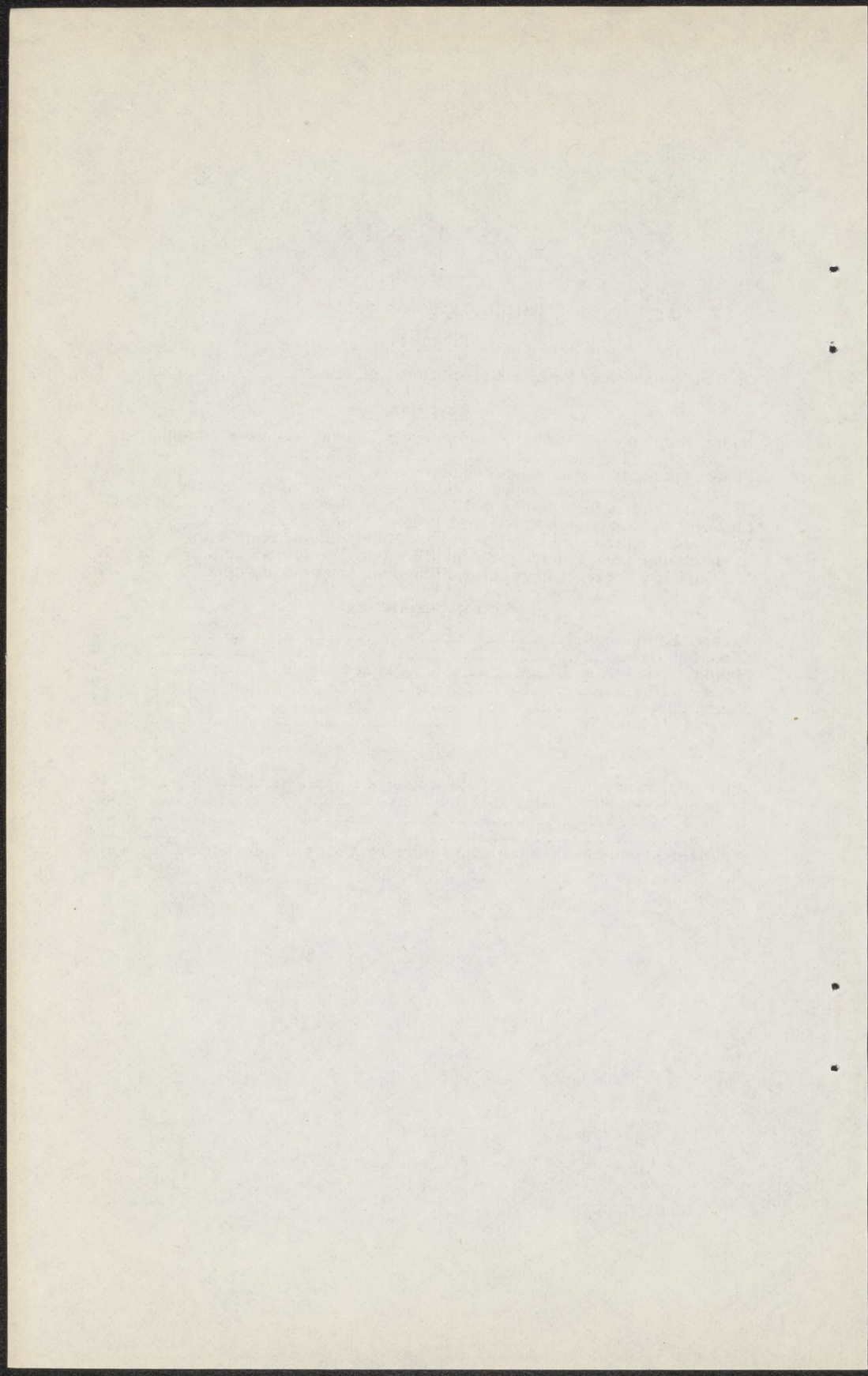
DOCUMENTS  
1 Y 3 1881  
FARRRELL LIBRARY  
KANSAS STATE UNIVERSITY

# CONTENTS

THURSDAY, MAY 29, 1980

| STATEMENT                                                                                                                             |           |
|---------------------------------------------------------------------------------------------------------------------------------------|-----------|
| Opening statement of Senator Metzenbaum-----                                                                                          | Page<br>1 |
| TESTIMONY                                                                                                                             |           |
| Nader, Ralph, and J. Robert Hunter, former Federal Insurance Adminis-<br>trator-----                                                  | 4         |
| Panel of property and auto policyholders:                                                                                             |           |
| Dunn, Austin, accompanied by Ashley Brown, attorney; Delores W.<br>Rodgers, Alberto Nunez, and Laurence R. Becker-----                | 30        |
| Cincotta, Gale, chairperson, National Peoples Action-----                                                                             | 66        |
| Mantovani, Andrew, president, New York Metropolitan Agents & Brokers<br>Association, accompanied by Sidney Glass, vice president----- | 79        |
| Maisonpierre, Andre, vice president, Alliance of American Insurers-----                                                               | 83        |
| PREPARED STATEMENTS                                                                                                                   |           |
| Becker, Laurence R-----                                                                                                               | 65        |
| Cincotta, Gale-----                                                                                                                   | 70        |
| Hunter, J. Robert-----                                                                                                                | 21        |
| Nader, Ralph-----                                                                                                                     | 19        |
| Nunez, Alberto-----                                                                                                                   | 64        |
| Rodgers, Delores W-----                                                                                                               | 63        |
| APPENDIX                                                                                                                              |           |
| Additional submissions of Andre Maisonpierre-----                                                                                     | 99        |
| Prepared statement of Edward Cirlin-----                                                                                              | 306       |
| S. 2474-----                                                                                                                          | 315       |
| Letters-----                                                                                                                          | 334       |
| Prepared statement of Professional Insurance Agents of New York-----                                                                  | 340       |





# INSURANCE COMPETITION IMPROVEMENT ACT, S. 2474

THURSDAY, MAY 29, 1980

U.S. SENATE,  
SUBCOMMITTEE ON ANTITRUST, MONOPOLY  
AND BUSINESS RIGHTS,  
COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 5110, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Present: Senator Metzenbaum.

Also present: Herman Schwartz, chief counsel; Stewart Kemp, special counsel; Marilyn Falksen, chief clerk; Peter N. Chumbris, chief minority counsel, and Joseph Lanham, chief minority economist.

Senator METZENBAUM. The subcommittee will come to order.

Today the Subcommittee on Antitrust, Monopoly and Business Rights will consider S. 2474, the Insurance Competition Improvement Act.

## OPENING STATEMENT OF SENATOR METZENBAUM

It is to me rather significant that this is a piece of legislation that has to do with eliminating a presently existing antitrust exemption.

But, I find in this Congress, and in this day and age, more and more effort to provide additional exemptions. We are all familiar with the battle having to do with the bottlers' bill, of carving out an exemption for franchise holders.

There is other legislation that has come out of one of the committees having to do with an extra amendment to the Webb-Pomerene Act. Again this is an additional exemption.

There was legislation pending having to do with creation of a commission to study the whole question of antitrust law application or whether there should be exemptions as pertains to overseas operations.

I think it is rather significant that at a time in our Nation's history when there are those who are claiming that the Congress is too much involved in the regulatory process, who are claiming "Let free enterprise operate without congressional involvement and without governmental involvement," what we really have at the moment is an effort to protect the lack of competition or else to provide an exemption so that there will be a lack of competitive forces.

To me, it is symbolic, and this legislation is somewhat symbolic of a movement toward trying to provide more strength for the free competitive system than that which presently exists, particularly in the field of insurance.



This legislation would limit the broad antitrust immunity granted the insurance industry by the McCarran-Ferguson Act.

It would also promote competition on the basis of price and service by deregulating the base rates insurers charge for auto and basic property insurance and guaranteeing consumers specific price information.

It sets minimum standards to protect motorists and property owners from arbitrary refusals to insure and unjustified surcharges.

It is a very sad commentary that so many who want to buy insurance can't buy insurance because it isn't available or, if it is available, it is only available on the basis of a surcharge.

The McCarran-Ferguson Act represents a delegation by Congress to the States of its authority to regulate the insurance business under the interstate commerce clause of the Constitution. The act expressly conditions the industry's special immunity from the antitrust laws on regulation by the States.

I remember so well when I was a legislator, back in the 1940's, that the insurance industry came forward and they were pushing for State regulation. But all you had to do was to read the legislation and realize that although it would appear to be State regulation, it was in effect pretty close to a nullity and didn't provide effective State regulation.

As we look across the country today, in 50 States, I would say that not more than four or five provide effective State regulation, and the others are too closely related to regulation in accordance with the concerns and dictates of the insurance industry.

Now Congress has the authority at any time to alter or terminate the regulatory scheme established by McCarran-Ferguson.

The act clearly implies a continuing congressional oversight responsibility.

Since the Judiciary Committee has jurisdiction over the McCarran-Ferguson Act, it has examined on a continuing basis the operation of the insurance business under the act since the 1950's. Under the leadership of Chairmen Kefauver, Hart, and Kennedy, the Subcommittee on Antitrust and Monopoly has carried this responsibility.

S. 2474 results from this continuing review as well as independent studies undertaken by other branches of government.

In 1977, the Department of Justice completed a lengthy examination of insurance markets and regulation; it found that an alternative scheme of regulation, without the antitrust immunity, would be in the public interest.

Early in 1978, the Subcommittee on Citizens and Shareholders Rights and Remedies held hearings which documented severe problems of availability, excessive prices, and unfair discrimination in property and auto insurance.

In January 1979, the National Commission for the Review of Antitrust Laws and Procedures recommended 19 to 2 that the antitrust exemption be repealed. The commission found that "there is simply no justification for retention of the immunity in its present form."

In October of 1979, the General Accounting Office released an exhaustive study of State insurance regulation. The GAO found "serious shortcomings in State laws and regulatory activities with respect to protecting the interests of insurance consumers."

In testimony before this subcommittee, the GAO testified that "risk classification and insurance availability were among several



issues we reviewed where insurance departments lacked sufficient information to regulate effectively."

Hearings held recently by the subcommittee have raised grave doubts about the effectiveness of State regulation in other areas, ranging from debit life to cancer to credit life insurance.

S. 2474 has been designed to promote competition for consumers, not against them.

The unique nature of the insurance product can in many instances result in competition not to insure people rather than to seek out more customers.

If a company suspects an applicant to be a bad risk—even without any direct evidence—it will typically refuse insurance or charge a higher-than-average rate. I use the word "suspect" advisedly, not if they know the person to be a bad risk, but if they suspect it, even without any direct evidence, they will typically refuse insurance or charge a higher-than-average rate.

The consequences to the company are negligible, but to the consumer they can be staggering. Hundreds or thousands of extra dollars to be paid, or no coverage at all. The consumer has no recourse.

Companies generally ask if an applicant has ever been refused coverage. They routinely refuse again if the answer is yes.

In most States insurance commissioners can do nothing. In too many States, even if they could, they would be disinclined to do so.

Rather than encourage competition by cream-skimming, S. 2474 would direct company rivalries toward price and service. Consumers would be protected from arbitrary surcharges and refusals to insure, although persons whose own actions demonstrated they were in fact worse risks would be charged higher rates.

While the bill specifies certain minimum standards, it does not impose Federal regulation on insurance. Its purpose is to improve State regulation, not to supplant it.

Enforcement and administration are vested in existing State officials, with Federal involvement limited to a private right of action in States which do not enact the standards. No Federal insurance agency is established, and no new Federal positions are authorized.

It is not contemplated or suggested anywhere in this legislation that there be a new Federal bureaucracy.

The bill's emphasis on price competition is especially important in the present inflationary era. The record of the insurance industry in holding down price increases is not impressive, especially in auto and health insurance. Out-of-control price spirals in workers' compensation, products liability, and medical malpractice have generated State and national crises.

Let me add that the bill does allow for the joint collection of loss data. Small companies which lack an adequate data base to make rates on their own are permitted to use the pooled data.

The bill does have provisions in it to protect the concerns and the interest of the insurance agents so that they may continue operating as they do. As a matter of fact, it provides extra protection for them in some respects.

I am very pleased to have with us today a panel of distinguished witnesses with insurance experience at a variety of levels. Some have dealt with insurers as consumers, others as brokers.



Two have been regulators, one at the Federal level and one as a State commissioner.

One of the largest insurance trade associations is also represented.

I regret that our schedule does not allow us to accommodate all the well-qualified persons who have requested to testify. However, the subcommittee does anticipate additional hearings on this legislation.

Our first witness certainly needs no introduction. I am very pleased to welcome Ralph Nader. Testifying with him will be J. Robert Hunter, casualty actuary and former Federal Insurance Administrator.

The committee has a number of witnesses today. I believe each of the witnesses has been advised that we would hope you would confine your oral presentation to 10 minutes, if that is at all possible. We would appreciate it.

Mr. Nader, we are happy to have you with us again.

**STATEMENTS OF RALPH NADER AND J. ROBERT HUNTER,  
FORMER FEDERAL INSURANCE ADMINISTRATOR**

Mr. NADER. Thank you, Mr. Chairman, members of the committee. It is a pleasure to be here today in response to your request to testify on S. 2474, "The Insurance Competition Improvement Act."

Mr. Chairman, I have followed your work on this matter over the last several years and commend you for your leadership in this vital consumer area, so untouched by Congress and the administration.

I have been particularly interested in the hearings you have held, both before this subcommittee and, previously, before the Subcommittee on Citizens and Shareholders Rights.

As a matter of fact, you are probably making many people here in Washington happy today. The legions of insurance industry lobbyists have been seized lately with an overwhelming boredom and lack of excitement concerning what is not happening in Washington. I am sure there are a number of reporters in the insurance trade press who are pleased to be able to report something that characterized even modest movement in this long overdue area of reform.

I am pleased that you recounted the efforts of your predecessors to look into some of the trends and abuses of this industry, so that we can have a perspective that calls for a greater sense of urgency. This is by no means the beginning of the process that is in advanced stages of congressional maturation in terms of hearings. I hope some action will be forthcoming.

Certainly the record you have compiled at these hearings and also, the GAO report's finding reveals that insurance consumers face unique and unusual difficulties in attempting to secure coverage often required of them by the same State that fails to protect their rights as consumers of insurance.

You have shown that consumers cannot easily secure insurance and, when they do get it, they pay rates that are too high in relation to often skimpy and slowly paid benefits.

Individuals are often discriminated against due to their sex, occupation, and marital status, both in terms of getting insurance, and in the price paid for the coverage, once secured.

Most importantly, you have documented that, with a handful of exceptions, the State insurance departments and their organization,



the National Association of Insurance Commissioners, have fallen far short of righting the imbalance against insurance consumers in this Nation.

According to the Federal Trade Commission, insurance premiums account for over 11 percent of the disposable income in the country.

Insurance premiums totaled \$175 billion last year, and investment income totaled another \$37 billion.

That is really quite an impressive portion of the consumer's dollar—11 cents out of every consumer's dollar spent goes to insurance. I think you will find that that begins to compare favorably with energy expenses.

Up until a few years ago, it compares even more favorably with energy expenses.

That is \$212 billion, a staggering figure virtually unobserved by the Federal Government.

Another way to look at this total is, if the auto manufacturers sold 30 million cars at \$7,000 each, they still would fall short of this industry.

Ten million cars in a year is a good year for the auto industry, so we have a feel for the dollar size and importance of the insurance industry to every citizen in America. This does not include trucks.

In 1944, the Supreme Court held that the business of insurance is interstate commerce, and, thus, subject to Federal regulation.

In 1945, Congress, under extreme pressure from the insurers and the States rushed to delegate this authority to the States. The insurers feared meaningful regulation and they rightly concluded that the States would not do that.

The States feared that if the Federal Government took over regulation, the States would lose the State premium taxing authority—the GAO found that only 4.4 percent of the \$2 billion of State premium taxes went to regulation, the rest going to general revenues.

Congress has the responsibility to constantly review this delegation of authority to assure that this huge sector of the economy, so involved in interstate and international commerce, is being handled in a way that does not abuse Americans. Congress has failed the public in this duty.

Prior to your interest, Senator Phil Hart was virtually alone in breaking the "let's hide our head in the sand" attitude of the Senate.

At last, we have a GAO report that states what everyone in the country, except apparently Congress, already knew that there are "serious shortcomings in State laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States." Just consider the documented abuses:

Too much whole life insurance is sold—at 100 percent first year commission levels—while consumers lose billions of dollars of savings interest to the insurers.

Reverse competition in credit life insurance drives up costs as car dealers, loan companies, and shady insurers get richer.

Medi-gap scams abuse our elderly.

This is one of the most abused areas. It was exposed repeatedly over 10 years ago in Senate hearings and still continues.

Industrial life insurance salesmen prey upon the poor.

Cancer care coverage plays on fear, pays few benefits.

Redlining abuses the poor, and, particularly, the minorities.



Millions are forced into second class assigned risk and FAIR plans without cause, by the whim of junior underwriters.

Discrimination in pricing without due process and without relation to risk abounds.

Mutual companies no longer belong to the policyholder, the management having taken away the policyholder rights.

Cartelized ratemaking organizations flourish, protecting the inefficient by use of rating procedures that do not rely on the effects of competition where it belongs, on expenses.

Where are the States? Where is the Congress? Who is watching?

The GAO report has a lot of answers for the question "Where are the States?" in its treatment of insurer-regulator relations.

For example, the report states:

Insurance regulation is not characterized by an arms length relationship between the regulator and the regulated—about half of the State insurance commissioners were previously employed by the insurance industry and roughly the same proportion joined the industry after leaving office.

The meetings of the National Association of Insurance Commissioners are numerically dominated by insurance industry representatives. Its model laws and regulations were drafted with advisory committees composed entirely of insurance company representatives.

The report goes on:

At the semiannual meetings [of the NAIC], many large insurance companies and trade organizations maintain "hospitality suites" to provide refreshments to participants,

no doubt built into rates consumers pay.

Excuse me, the coverage by social anthropologists was an insert by myself, not the GAO. They would never think of making such a characterization, just to correct the record.

Additionally, insurance commissioners and their spouses are taken out to meals and otherwise entertained by insurance industry representatives.

In short, the official meetings of the NAIC are not characterized by an arms-length relationship between regulators and regulated industry.

The NAIC has never made funds available to bona fide consumer representatives despite repeated requests that they do so.

It is not difficult to see why their meetings, held in swank hotels in distant places like Mexico City and Puerto Rico, have low consumer turnout.

In 1978, the proceedings indicated that there were 950 insurer representatives at the NAIC meeting, while five consumer representatives were present—one of the "consumers" represented the American Medical Association.

There were 220 insurance department personnel present. Each regulator had over four industry representatives and 2 percent of a consumer representative to deal with.

The industry obviously believes in an ample escort service. [Laughter.]

A review I had made of former NAIC presidents is also fascinating. Three of the last five presidents were removed from office by their governors under suspicion of wrongdoing.

Of the past 10 presidents which we were able to track to present employment, all either worked for the industry directly (8), or do



legal work for the industry (2). An 11th passed away, the 12th and 13th we could not locate.

It is high time—the present president of NAIC, Mr. Kinder, of California, stays on his job because the leading contributor to the campaign of Governor Brown wants him there.

It is high time that the Congress and the administration asserted the powers they have to look deeply into this key delegation of authority and to initiate a process whereby the regulators can be weaned away from the industry.

Today, the States are dependent upon the industry for advice, statistics, studies, et cetera. The Federal Government is a logical choice of such help and should develop capabilities to monitor this vital part of our economy.

S. 2474 is only one small step in the right direction, but an essential part of the reform required.

Technical assistance is also called for; standards for life and health insurance are critically needed; and ongoing oversight by Congress must be established.

Insurance department staff and the commissioners themselves must be made to focus on the public interest, not on the “revolving door.”

Just imagine the power of the insurance industry which now has succeeded in having Congress tell the Federal Trade Commission that the Federal Trade Commission, whose early authority at the beginning of this century ordered it to study and examine the workings of the national economy, now can't even study the insurance industry without the approval of one or two congressional committees.

The setting of minimum standards under which States will regulate seems an incredibly modest step, given the findings of GAO and your hearings.

Yet I know that the industry lobbyists are all over the Hill armed with huge war chests of policyholder-supplied funds, claiming that you, Mr. Chairman, are somehow usurping States rights.

What arrogance from the industry which has perpetuated the current state of affairs that has so abused the State regulatory process.

It is simply Congress duty to act to review the propriety of its previous actions, including delegations of authority. Setting standards for the States is essential.

Continued reliance on the current interpretation of the McCarran-Ferguson Act (Public Law 15) cannot suffice.

Insurers are protected even in no-regulation situations such as exist with respect to rates in Illinois today. Insurers apparently even believe that the civil rights laws are overridden by McCarran-Ferguson.

You must ask them to clarify this point. This is hard to believe that this is what they believe. Do they believe the civil rights laws are overridden by the McCarran-Ferguson Act?

It is too important, Mr. Chairman, for the Nation to leave this particular issue fuzzy. Do the insurers accept the fact that civil rights laws apply fully to them?

Congress must regain control of this key element of interstate and international commerce. It should enact S. 2474 and it should develop a set of standards for life and health insurance. Getting to the specifics of the bill, it is clear to me that most of the lack of competition in



the property-casualty industry for personal lines is due to the toleration of most States of insurers' hiding behind selection as a veil for continued inefficiency.

Therefore, consumers who would ordinarily move from service supplier to supplier with barely a thought, rarely shop for insurance. Why?

Consumers know the plight of those in assigned risk type plans and substandard markets, thus they are apt to stay in any more favorable situation rather than risk the fall from grace that the whim of a low-level underwriter can bestow.

S. 2474 appropriately requires insurers to deal with the buyers, overcoming the incredible competitive disadvantage that consumers face in having to buy, due to State law or lender requirements, but sellers not having to sell.

Neither your bill, Mr. Chairman, nor anyone in Congress calls for low rates for objectively proven bad risks. What we seek is open markets for essential insurance with insurers winning or losing, competitively speaking, on their published price lists.

The second major factor adversely affecting competition in insurance is the virtual lack of meaningful price and service information.

S. 2474 addresses this two ways, disclosure and more understandable language.

I endorse these steps as the least that must be done. These major provisions represent thoughtful and appropriate congressional response to real consumer needs.

The bill requires that "open price competition" regulate the rates. I do not believe that this industry has shown any willingness to let competition work in favor of the small individual seeking insurance for life, car, health, and home.

Quite the contrary, the American public has suffered dearly at the greedy hands of this money machine called the insurance industry.

In California, pointed to as the mecca of competitive rating laws for auto insurance, the insurance department estimated in 1978 that 20 to 30 percent of the drivers are uninsured, over 11 percent are written in the substandard market, and 3 percent are in the assigned risk plan.

Thus, well over one-third of the market is missserved in California.

To continue the right of selection and to grant a new right of jacking up the rates at will would be a disaster of the first order for consumers, Mr. Chairman.

Absent the full insurance availability aspect of the bill, any movement to "open price competition" will be fought by consumer groups.

It is doubtful whether this industry has the will to engage in competition for the business of individual Americans.

Investment income, for instance, will never be voluntarily reflected in competitive rates.

I do not believe that it ever has been reflected except in prior approval States. I suggest very careful consideration of this aspect of your bill. Perhaps the 18-month test is the appropriate approach to see if the insurers can compete.

The standard on discrimination is disappointing, Mr. Chairman, only because it ignored the plight of those suffering discrimination due to age in lines such as automobile insurance.



I believe that the use of this criterion is not valid, a form of surrogate for real risk factors, and relegates the young to paying dues to get into this exclusive club.

I recognize the statistical argument for use of age as a rating criterion, but we all know that fairness is an individual, not a group, more of our culture, unless an extraordinary advance of data analysis can come to the forefront to counter such a move.

Finally, I question if the "Remedies and Enforcement" provisions are sufficient to assure compliance from the States and this industry, given their performance over years of trial. Stronger carrots and sticks must be devised if this bill, when enacted, is to succeed.

The refusal of the States to go along with the will of Congress as respects the Holtzman amendment to the State FAIR plan should warn you about this nonenforcement possibility. Absent backup Federal authority, financial and technical assistance, the purposes of the bill may never be achieved.

Mr. Chairman, I applaud your efforts against what are extremely high odds. This industry has powerful and highly paid lobbyists all over Washington and in every State capital in the land.

They even put a provision for such collaboration into every premium that Americans pay, Mr. Chairman, and the States approve it, where collaboration is longstanding and well oiled.

That is why they are able to come at any attempt at reform with such large collective resources.

But do keep at it. The American insurance consumer, so under-represented in the States and in Washington, needs your sustained initiative and leadership.

Thank you.

Senator METZENBAUM. Thank you very much, Mr. Nader. I appreciate your thoughtful examination of the legislation and your comments on the industry. I appreciate your personal comments, as well.

I think before asking any questions, we will ask Mr. J. Robert Hunter, former Federal Insurance Administrator, for his testimony.

Mr. Hunter, in your testimony, it would be appreciated if you would indicate what you are doing now.

Mr. HUNTER. I have resigned from the Federal Insurance Administration this month, the 9th of the month. I am now doing consulting insurance-type work for States and consumers.

I have been 20 years in the insurance area, about half in the Federal Government and about half in the private sector.

I will try to greatly abbreviate my remarks. So, I would appreciate it if the statement could go in.

Senator METZENBAUM. The entire statements of all the witnesses will be included in the record in their entirety at the conclusion of each witness' oral presentation. I will make that a rule for the entire morning.

Mr. HUNTER. Thank you.

I consider it an honor to support your bill, Mr. Chairman. It is vital to the best interests of the American insurance consumer.

As a former Federal official, as an actuary, and as a consumer, I endorse S. 2474.



Why does America need this bill?

This most important reason is that competition in insurance works against consumers.

Why does competition fail in insurance?

In most part it fails because of selection competition, a phenomenon in which the insurance company underwriter can refuse to offer insurance service to an applicant for any or no reason.

This practice makes consumer freedom of movement in the marketplace a risky enterprise. One turndown, coupled with an honest answer to the question almost universally asked of applicants, "Have you ever been refused insurance?" will put you in purgatory of the assigned risk plan.

Competition fails due to the lack of independence of competing carriers. Groups have commonly "pup" running mates to shunt off "undesirable" risks from a low-rate company to the high-rate company, a member of the same group.

Even beyond that, companies often join large rating organizations and have even their expense dollars aggregated for ratemaking, clearly an anticompetitive and actuarially unnecessary manipulation.

Further, the committees of these rating organizations made up of insurers get together and agree as to the basic assumptions of rate-making, a practice which I know from experience yields higher than realistic answers for the companies that use the rates.

Thus, inefficient companies are protected and rate levels are established which set the stage for creaming and tracking by the larger companies.

Finally, the rating organizations publish circulars which reveal where the competition is using even higher rates, an invitation to further jack up the rates in certain areas.

Competition is also thwarted, if the above practices weren't enough, by the almost total lack of useful price information for consumers.

Which company is cheaper? Which provides good service? Who knows? The information is simply not available.

Product differentiation also obscures the coverage, and obscure policy language furthers consumer ignorance. Even if it didn't, the esoteric policy language would further such obscurity.

Senator METZENBAUM. Mr. Hunter, let me just interrupt you for a minute.

Mr. HUNTER. Surely.

Senator METZENBAUM. The statement you made is that it is very difficult for the consumer to find out prices of comparable companies.

Mr. HUNTER. Yes.

Senator METZENBAUM. The agents argue that "that is exactly what we are doing. We are trying to find the best buy for our insureds."

Would you care to comment on that from your own background and knowledge?

Mr. HUNTER. Surely. The agents—first of all, if its an agent, he is an agent of the company and dealing for the company. In many cases, agents have what are known as contingency commissions which—plus instructions, oral or written, as to who that company might deal with.

So, if you approach an agent, even though that agent may have several companies in his office, that agent will often times place you not in a low-rate company, not even advise you about the low-rate



company, but knowing what the insurer's underwriting criteria are and about his own contingency commission criteria, could shunt the individual off into a high-rate situation, not even advise the consumer.

I will give you a good example. There is a company in the District of Columbia that writes at rates several hundred dollars higher than the assigned risk plan and yet is one of the leading writers in the jurisdiction.

So you know that agents are not advising their clients in the District of Columbia that there is a much better, cheaper deal available, not that I think the assigned risk plan is great, but it is \$200 cheaper than this particular company.

Senator METZENBAUM. Don't the agents often times also tell their insureds, "Well, we better not do too much shopping. I think we are lucky to get this insurance. It is tough to get insurance these days."

Mr. HUNTER. Sure.

Senator METZENBAUM. My own agent tells me that. My premiums are quite high. He says, "Well, you better not." It is that kind of an approach. I guess I feel that the average person just does not have any chance to shop to buy insurance.

Mr. HUNTER. Well, particularly as you get toward the center cities agents may have no companies at all or just one or two companies, sometimes only substandard companies and the assigned risk plan, for instance.

So, if you go to that agent, that agent isn't going to say, "Gee, you can get a better deal over there," because that agent would then lose the commission.

Additionally, even in good areas, the agents normally only have a few companies in the office. The only place you can really find out is to go to your State insurance department and review all the manuals. You have to be an actuary, I would think, to really be able to shop the market.

The final straw that breaks the meaningful competition's back is the compulsion by consumers to buy these coverages. States require it through various approaches that drivers purchase auto liability insurance.

Lending institutions require fire insurance on your home and physical damage insurance on your car. The demand curve for this insurance is inelastic, the supply curve is elastic.

Stated less elegantly, the insurers are shooting fish in a barrel, and the fish are the American people.

As a result, the market for insurance looks, but is not—in any positive way—competitive. One rate does not clear the market. The rates vary widely. The market is so confused that in some places large writers can charge rates substantially over assigned risk rates, yet remain leading suppliers of coverage.

S. 2474 addresses these important anticompetitive aspects of insurance in an integrated and logical way. Those who have billions of excess profits at stake will probably try to claim that competition will be impeded rather than aided by this approach.

That is bunk, Mr. Chairman. How can making service and information available to consumers under a structure where competition will at long last be focused on price and service in this industry, possibly be anticompetitive?



But, the regulated always fear real competition. If your assets had grown from \$51 billion in 1968 to \$159 billion in 1978, would you want to see the groundrules change? Only the consumers of insurance seek a change in the game so stacked against them today.

What is the result of poor competition? In 1978, the residual market was the second largest writer of private passenger car insurance in America. Only State Farm Insurance Co. had more; even Allstate had less.

This country's consumers are not in good hands, Mr. Chairman.

But, Mr. Chairman, you ain't seen nothing yet. Mr. Richard Decker, president of National Industry Committee on Automobile Assigned Risk Plans, has predicted that the market will grow to more than 20 percent of the overall market by the year 2000, and be over 50 percent in the Northeast industrial States.

The reasons for this growth will not be the riskiness of those thrown into the markets. That isn't the reason they are in there today. The reason will be the international conglomerate thinking which is moving this industry swiftly away from personal lines insurance in this country.

From 1975 to 1977, while car registrations grew by 7.5 percent, voluntary insurance grew only 3.4 percent. But the residual market grew 78 percent, and uninsured motorists grew over 16 percent.

This is startling evidence that Mr. Decker is right and we are at the threshold of an era of insurance drought in this country for ordinary citizens. Your bill protects against this awful outcome, Mr. Chairman.

Senator METZENBAUM. Mr. Hunter, would you explain for the record the residual market.

Mr. HUNTER. The residual market that I am referring to here is the so-called assigned risk plans and the other mechanisms that they—the insurers—use to shunt off the undesirable risks.

Senator METZENBAUM. So it is anything that is left over where people can't get regular rated insurance?

Mr. HUNTER. That's right. They include the FAIR plan for fire insurance, where, for example, if an area is redlined or for whatever reason someone can't get normal insurance, his agent lost his company, for instance, all kinds of reasons, and these consumers end up in these residual mechanisms, the residual being what is left over.

Of course, if Mr. Decker is right, it is going to be bigger than the—the leftover is going to be bigger than the meal.

If the withdrawal from personal lines were due to huge dollar losses, it would be understandable, perhaps. I attached some charts to my testimony which show that this is not the case.

In the past 20 years this industry never once had a cash loss year. Over 20 years this giant industry has delivered only 48 cents in benefits, while spending 34 cents on expenses for each dollar of cash income received. The additional 18 cents was positive cash flow into investments, usually as reserves. Each dollar of benefits cost 70 cents to deliver, a frightfully high benefit cost ratio.

Uncle Sam is a partner in the operation of this industry, collecting taxes at the rate of only 8 percent of the profits announced by the industry.

The important point here is that the industry is not losing lots of money, and yet, it is in the process of tightening the market for the individual consumer.



Is America just like other countries in that the plight of the insurance consumer here is similar to the consumer's plight throughout the free world?

The Federal Insurance Administration's report, "Full Insurance Availability," studies this possibility. It states, for instance, that "Europe does not have a residual market problem."

Regarding classification, I am constantly appalled to see simple statistical averages put up as if that was all that mattered in proving actuarial relevance.

I have no doubt that there are thousands of statistical categories that might show statistical differences from overall averages, hair color, income level and race, for example, for auto insurance.

Statistical differences do not make them appropriate classifiers, however. The industry does not use these factors since to their credit, they recognize their inadmissibility despite their statistical variation probability.

Yet, they go on looking at the statistics on such an arbitrarily chosen factor as sex as if they believe that biology is destiny.

In doing so, they totally ignore these basic questions: Is this slot socially acceptable? Does this lot clearly identify the risk factor so that, by its use, there is no unfair discrimination and its use signals a loss prevention purpose to those who occupy the slot? Are there more direct ways to measure the risk which will be fairer and help reduce losses?

Focusing on statistics rather than on the key questions—calling this solely an actuarial question—is not correct and can mislead those studying this topic.

The adverse effects of excessive classification is appropriately handled in your bill, Mr. Chairman. I should point out the necessary integration of class reform with availability guarantees since, without the latter, class reform would be undone by insurers simply refusing to write the business.

I have some concerns about the specifics of the bill which I enumerate in my prepared statement. My major concern is that "open rating" not be adopted without the rest of the package that you propose.

I will be happy to meet with your staff, if you would desire, on the technical aspects of the bill.

Mr. Chairman, from my experience in the private sector and at the Federal level of Government, I can assure you that your bill is a very temperate approach to the extensive abuses that exist.

While several States are trying to move on their own, there has been far too little attention by the States and virtually no Federal Government response to the plight of consumers, as the GAO report showed.

Your bill takes great pains in not throwing the baby out with the bath water, in developing the minimum necessary step to begin an evolutionary process of reform at the State level.

The need for your bill and support from the Federal Government to lessen the reliance of the States on the industry, in developing rates, statistics, forms, and so on, is overwhelming.

If the industry succeeds in stopping this bill, I believe that the continued buildup of frustration and outrage by the public will result in much stronger measures ultimately being adopted.



I might add here, parenthetically, that I believe that your not having an additional bureaucrat, although politically attractive, may ultimately be a mistake. I think that there is need for technical assistance to the States to wean them, as Mr. Nader put it, away from the industry reliance.

I grew up in an insurance home, Mr. Chairman. My father was an average adjuster, and he still is, of ocean marine insurance. He convinced me that this great insurance mechanism has a great capacity for good. It can be and often is the bridge over financial oblivion for a family. It should be in the vanguard of social concern, a place where young idealists would flock to be part of an effort to help others in trouble. But tragically, it falls so far short of what it could be because of the shortsightedness of its leaders in their quest for long-range competitive advantage which reap no higher long-range profits but disenfranchise millions of Americans from affordable coverages.

While there is yet time, I would hope that the industry itself would come to its senses and support S. 2474, since this bill represents the last clear chance for continuation of privately provided insurance under State regulation.

I can only wonder if you will succeed in protecting this industry from itself.

I would be happy to respond to any questions you may have.

Senator METZENBAUM. Thank you very much, Mr. Hunter. We appreciate your comments as well as your able public service up until very recently.

Mr. Nader, in your testimony you discuss State regulation. Why do you think the States have not been more effective?

Mr. NADER. Several reasons—first of all, there is no comparable organization of consumers in the private sector, it is a State level, that would monitor, challenge and prod the insurance departments in these States.

Where you have that kind of vacuum, you will have that kind of result.

How to resolve that?

By requiring all insurance policies to have a notice on page 1 of the policy, which will invite consumers in State by State to join together and form their own insurance consumer protection group which would have a staff representing consumers before the insurance commissioner's office and in the courts and before the legislature.

Wisconsin has recently adopted a provision whereby utilities have to, several times at least, put in their utility bill a notice inviting utility consumers to join together, pool their annual dues and form such an organization.

Second, obfuscation. I have long thought that the insurance industry's—one of the insurance industry's most powerful tools is obfuscation, jargon, small print, a monsoon of abstruse material and information which tends to deter even Government officials, not to mention the average policyholder, from response and challenge.

Third, the insurance commissioners are very understaffed in terms of technical staff. They don't have enough actuaries. They don't have enough professional staff, period. This has been documented for years, and, with the exception of one or two States, not much has been done about it.



Fourth, insurance commissioners know that they are able to go through a revolving door. They can get a job in the insurance industry after their on-the-job training is over with. That tends to corrupt the regulatory environment as, indeed, does the industry prop for the National Association of Insurance Commissioners.

Going to one of their annual meetings is a real eye opener in terms of how unabashed and without shame the insurance regulators cavort and fraternize with the industry that they are supposed to be regulating.

Those are some of the reasons, I think, why State insurance regulation is inadequate. It is also inadequate because insurance is an interstate business.

Senator METZENBAUM. Mr. Hunter, have you not found that actually many insurance commissioners don't even have the authority to set rates or to affect the rates, but merely are filing offices.

I remember a call I made to the superintendent, in Ohio, at one point. He said he really had no independent authority and certainly had no staff to determine whether the rates filed were right or wrong.

Is that a generally prevalent situation throughout the country or am I incorrect in that?

Mr. HUNTER. I think certain States have so-called open rating laws and have no authority. Illinois is an example where there is no rating law at all.

California has—the commissioner does not even get filings of materials.

Other States get at least filings of materials. Quite a few States have no authority to do anything about it. Other States have what are known as subsequent disapproval authority which is rarely exercised.

I think the GAO report points out that the technical staff levels are insufficient, because there is a blizzard of filings coming in, several hundred filings a year, requiring technical expertise.

As a result, even where they do a good job, the insurance departments have to be rather selective as to where they do their analysis.

Senator METZENBAUM. Do you think that minimum standards are preferable to total deregulation of the insurance industry?

Mr. HUNTER. Oh, we absolutely need minimum standards. You are talking about compared to total deregulation?

Senator METZENBAUM. Yes, total. There are some who would advocate just repeal the McCarran-Ferguson Act and let competition operate.

Mr. HUNTER. Well, first of all, I think the basic reason that I would oppose that is that I do not believe that just competition works here, for the reasons I point out.

One form of competition, the most prevalent form of competition is selection.

Senator METZENBAUM. Many people would be deprived of the opportunity to buy insurance or if they did, it would be at an extremely high rate?

Mr. HUNTER. That is correct. No matter what classification structure you establish, some high percentage of the people within each slot fall below the average in terms of riskiness.

Senator METZENBAUM. There would be competition for the cream risks and no competition at all, in fact, an almost running away—



Mr. HUNTER. There are some studies that MIT did that indicated somewhere near 40 percent or 42 percent of the people in any given slot are likely to be "worse" than average.

Therefore, over time, very effective competition would result in 40 percent of the people uninsured, something like that.

Senator METZENBAUM. Mr. Nader, do you not find it unusual that the insurance industry, which is certainly a bulwark of the free enterprise system—and certainly competition is part of the free enterprise system—in this instance really resents any efforts toward moving into a competitive economy?

Mr. NADER. Why it resents? Is that what you are asking, Senator Metzenbaum?

Senator METZENBAUM. Well, what I am really saying is, as you look at some of the other activities in which you and your organization have been involved.

Mr. NADER. Yes.

Senator METZENBAUM. Is this not an anomalous situation where the industry is actually asking for Government protection to keep competitive forces from working?

Mr. NADER. No. This happens in other industries as well. A good deal of economic regulation in this country, at the State and Federal level, has been requested by the industries themselves, the airlines, the trucking industry, the railroad industry, even.

But this industry is in a way unique because a part of its merchandising strategy involves refusal to sell, unlike, say the auto industry, which has other merchandising strategies that need correction.

But the refusal to sell and the sophisticated way by which refusal to sell can be justified, involving collusive activity between insurance companies, and improper influence over State regulators, I think is a unique characteristic of this industry, and one that requires a transcendent analysis of the word "competition." The word "competition" in this industry is misused. It has to be given a much more profound elaboration. Otherwise, people will hear the data, well, there are a lot of insurance companies where there is only one telephone company, or one utility, and, of course, there is competition.

Reverse competition in credit life insurance, for example, is just the opposite of what competition is supposed to produce for the consumer. In other words, it increases prices; it is a competition for higher premiums and a kind of coerced sale.

You see, not only is there a refusal to sell, there is also a situation where you see an extraordinary degree of compulsory consumption, whether through the credit life-tie in or through the requirement to have auto insurance or other forms of insurance.

So, you have both a refusal-to-sell pattern, on the one hand, toward people who are guilty by association, or geography, or sex, or age, and you have an industry taking advantage of a pattern of compulsory consumption where people have to buy the insurance.

Senator METZENBAUM. One last question, Mr. Hunter. What is the appropriate role for the rating bureaus to play?

Mr. HUNTER. I can give you some of the inappropriate roles. As I stated in my testimony, I believe it is inappropriate for them to combine expense data. It seems to me that where competition should focus is on the efficiency of the companies.



One of the reasons I put my chart in to show that only 48 cents of benefits are delivered for each cash income dollar is because of that.

I think not only the selection itself protects the inefficient companies, but also the combining of expense experience protects the inefficient companies.

In fact, the rating organizations often combine only the expense experience of some of their companies, the high-expense companies, the companies writing in 40 or more States, that are stock members and blah, blah, blah. But what they are really saying between the lines in those rate filings is "We have picked out the high-expense companies upon which we base the rates for all companies that are members of our organization."

So I think that is very inappropriate. There is no reason for it. A company knows what its expenses are, even the smallest company.

Additionally, it is inappropriate for them, I think, to get together as actuaries and make judgment decisions. Is this trend up or down? Is it straight line? Those kind of judgments have a tremendous impact on rates.

I recently looked at a rate filing where just changing from an exponential line to a straight line took if from about a 20-percent increase to a 2-percent increase.

So, just that decision, if everybody gets together and decides we will do it exponential, everybody is going to get a 20-percent increase. There is a lot of room for judgment.

As a matter of fact, in that case, the analysis indicated that a straight line was appropriate.

So, those kinds of things. Getting together for things that are inappropriate.

I believe that there is a legitimate combining of loss data for small risks in order to get the law of large numbers idea, particularly under a take-all-comers approach which in effect you have in your bill, where in effect everybody—the market is everybody. They can walk in at their choice.

I think that is appropriate to combine that kind of data. I believe, however, that the States, since the statistical agents are State agents, should have a more active role in monitoring these statistical agents. Historically, they have done very little to monitor.

I am happy to report the beginnings of a more effective monitoring appear to be starting in a few of the States. So, hopefully they will do that.

By the way, I must add one other thing. They do not, they have not historically; the States go back into the company level detail to make sure that the company data that is reported into the statistical agent is in fact accurate.

Mr. CHUMBRIS. Mr. Chairman.

Senator METZENBAUM. Mr. Chumbris.

Mr. CHUMBRIS. Gentlemen, when Senator Hart was chairing the hearings in the middle sixties, he asked the commissioner of Pennsylvania, why would it not be appropriate that instead of having in Harrisburg, Pa., one-half the premium of Philadelphia, and the town in between Harrisburg and Philadelphia, to have one-half of what Harrisburg had, which would be one-fourth of Philadelphia, Senator Hart said, "Why wouldn't we have the whole State or maybe the



whole Nation have one premium, and let the bad and the good sort of equalize itself."

Now that is the difference between State regulation and a regulation through Washington, D.C.

How do you react to that?

Why should A subsidize B, who is a bad driver, whether he is in the same State or whether it is nationwide? That is one of the problems that we have had since 1958, when we started these hearings. I was there when we first started the first day of hearings. I have heard this now for 16 or 17 years.

Now, if you could answer that question, that the commissioner of Pennsylvania said to Senator Hart. Would you agree with Senator Hart's theory, or would you agree with the insurance commissioner of Pennsylvania?

Senator METZENBAUM. Before you answer the question, let me just point out that there is nothing in this bill that would provide for a national rate, nor even a State rate. There would be nothing in this bill that would create a problem for having different rates in Philadelphia and in Harrisburg and in the town in between.

Mr. CHUMBRIS. I agree with that, but some of the comments that have come from both of the witnesses would indicate that you could reach that event if you take this first step, you could go to the next step and the step next until you get to the point that Senator Hart says, "Let's have one rate for the entire nation."

Senator METZENBAUM. Mr. Hunter, if you want to respond, I would ask you to do it briefly. Because I would like to move on.

Mr. HUNTER. All right.

Territorial question is a part of classification. That is what you are really getting at. It is a classifier that is used today. You are quite right. There is nothing in this bill that would change that.

However, the States are beginning to even look at the question of territories.

In classifying anything what we are looking for is what is called "critical conditions of risks." Mileage, for example, for auto insurance, is a critical condition.

Population density has something to do with risk. So there is some logic, I believe, to territorial classification.

I think it may be overstated today, because I think there is an understatement of the fact that suburbanites, for instance, driving into Washington, increase the rates here, and there needs to be some offsets in the territorial ratemaking.

States such as Massachusetts are starting to look at those sorts of possibilities. I think that is appropriate.

But I don't think anybody is advocating a total abandonment of some kind of territorial ratemaking.

Senator METZENBAUM. Thank you very much, Mr. Hunter and Mr. Nader. We appreciate your testimony. We look forward to working with you and we take you up, Mr. Hunter, on your offer of cooperating with the subcommittee staff as we move along.

Mr. NADER. Thank you, Senator Metzenbaum.

Mr. HUNTER. Thank you.

Senator METZENBAUM. Thank you.



[The prepared statements of Messrs. Nader and Hunter follow:]

PREPARED STATEMENT OF RALPH NADER

Mr. Chairman, members of the committee, it is a pleasure to be here today, in response to your request, to testify on S. 2474, "The Insurance Competition Improvement Act." Mr. Chairman, I have followed your work on this matter over the last several years and commend you for your leadership in this vital consumer area, so untouched by Congress and the administration. I have been particularly interested in the hearings you have held, both before this subcommittee and, previously, before the Subcommittee on Citizens and Shareholders Rights.

The record you have compiled at these hearings and via the GAO report you ordered reveals that insurance consumers face unique and unusual difficulties in attempting to secure coverage often required of them by the same state that fails to protect their rights as consumers of insurance. You have shown that consumers cannot easily secure insurance and, when they do get it, they pay rates that are too high in relation to often skimpy and slowly paid benefits. Individuals are often discriminated against due to their sex, occupation, and marital status, both in terms of getting insurance, and in the price paid for the coverage, once secured. Most importantly, you have documented that, with a handful of exceptions, the state insurance departments and their organization, the National Association of Insurance Commissioners, have fallen far short of righting the imbalance against insurance consumers in this nation.

According to the Federal Trade Commission, insurance premiums account for over 11 percent of the disposable income in the country. Insurance premiums totalled \$175 billion last year, and investment income totalled another \$37 billion. Mr. Chairman, that's \$212 billion, a staggering figure virtually unobserved by the federal government. Another way to look at this total is, if the auto manufacturers sold 30 million cars at \$7,000 each, they still would fall short of this industry. Ten million cars in a year is a good year for the auto industry, so we have a feel for the dollar size and importance of the insurance industry to every citizen of America.

In 1944, the Supreme Court held that the business of insurance is interstate commerce, and, thus, subject to federal regulation. In 1945, Congress, under extreme pressure from the insurers and the states rushed to delegate this authority to the states. The insurers feared meaningful regulation and they rightly concluded that the states would not do that. The states feared that if the federal government took over regulation, the states would lose the state premium taxing authority (the GAO found that only 4.4 percent of the \$2 billion of state premium taxes went to regulation, the rest going to general revenues). Congress has the responsibility to constantly review this delegation of authority to assure that this huge sector of the economy, so involved in interstate and international commerce, is being handled in a way that does not abuse Americans. Congress has failed the public in this duty.

Prior to your interest, Senator Phil Hart was virtually alone in breaking the "Let's Hide Your Head In The Sand" attitude of the Senate.

At last, we have a GAO report that states what everyone in the country except apparently Congress, already knew, that there are "Serious shortcomings in state laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States." Just consider the documented abuses:

Too much whole life insurance is sold (at 100 percent first year commission levels) while consumers lose billions of dollars of savings interest to the insurers;

Reverse competition in credit life insurance drives up costs as car dealers, loan companies, and shady insurers get richer;

Medi-gap scams abuse our elderly;

Industrial life insurance salesmen prey upon our poor;

Cancer care coverage plays on fear, pays few benefits;

Redlining abuses the poor, and, particularly, the minorities;

Millions are forced into second class assigned risk and FAIR Plans without cause, by the whim of junior underwriters;

Discrimination in pricing without due process and without relation to risk abounds;

Mutual companies no longer belong to the Policyholder, the management having taken away the policyholder rights;

Cartelized ratemaking organizations flourish, protecting the inefficient by use of rating procedures that do not rely on the effects of competition where it belongs, on expenses.



Where are the States? Where is the Congress? Who is Watching?

The GAO report has a lot of answers for the question "Where are the states?" In its treatment of insurer/regulator relations. For example, the report states, "Insurance regulation is not characterized by an arms length relationship between the regulator and the regulated. . . . About half of the State insurance commissioners were previously employed by the insurance industry and roughly the same proportion joined the industry after leaving office. The meetings of the National Association of Insurance Commissioners are numerically dominated by insurance industry representatives. Its model laws and regulations were drafted with advisory committees composed entirely of insurance company representatives."

The report goes on, "At the semi-annual meetings (of the NAIC) many large insurance companies and trade organizations maintain 'hospitality suites' to provide refreshments to participants (no doubt built into rates consumers pay). Additionally, insurance commissioners and their spouses are taken out to meals and otherwise entertained by insurance industry representatives. In short, the official meetings of the NAIC are not characterized by an arms-length relationship between regulators and regulated industry."

The NAIC has never made funds available to bona-fide consumer representatives despite repeated requests that they do so. It is not difficult to see why their meetings, held in swank hotels in distant places like Mexico City and Puerto Rico, have low consumer turnout. In 1978, the proceedings indicated that there were 950 insurer representatives at the NAIC meeting, while five consumer representatives were present (one of the "consumers" represented the American Medical Association). There were 220 insurance department personnel present. Each regulator had over four industry representatives and 2 percent of a consumer representative to deal with.

A review I had made of former NAIC Presidents is also fascinating. Three of the last five presidents were removed from office by their governors under suspicion of wrongdoing. Of the past ten Presidents which we were able to track to present employment, all work for the industry directly (8) or do legal work for the industry (2) (an 11th passed away, the 12th and 13th we could not locate).

It is high time that the Congress and the Administration asserted the powers they have to look deeply into this key delegation of authority and to initiate a process whereby the regulators can be weaned away from the industry. Today the States are dependent upon the industry for advice, statistics, studies, etc. The federal government is a logical source of such help and should develop capabilities to monitor this vital part of our economy. S. 2474 is only one small step in the right direction, but an essential part of the reform required. Technical assistance is also called for; standards for life and health insurance are critically needed; and ongoing oversight by the Congress must be established. Insurance department staff and the Commissioners themselves must be made to focus on the public interest, not on the "revolving door."

Setting of minimum standards under which states will regulate seems an incredibly modest step, given the findings of GAO and your hearings. Yet I know that the industry lobbyists are all over the Hill armed with huge war-chests of policyholder supplied funds, claiming that you, Mr. Chairman, are some how usurping states' rights. What arrogance from the industry which has perpetuated the current state of affairs that has so abused the state regulatory process. It is simply Congress' duty to act to review the propriety of its previous actions, including delegations of authority.

Setting standards for the states is essential. Continued reliance on the current interpretation of the McCarran-Ferguson Act (Public Law 15) cannot suffice. Insurers are protected even in no-regulation situations such as exists as respects rates in Illinois today. Insurers apparently even believe that the Civil Rights laws are overridden by McCarran-Ferguson. You must ask them to clarify this point, Mr. Chairman, it is too important for the nation to leave this issue fuzzy. Do the insurers accept the fact that civil rights laws apply fully to them?

Congress must regain control of this key element of interstate and international commerce. It should enact S. 2474 and it should develop a set of standards for life and health insurance. Getting to the specifics of the bill, it is clear to me that most of the lack of competition in the property/casualty industry for personal lines is due to the toleration of most states of insurers' hiding behind selection as a veil for continued inefficiency. Therefore, consumers who would ordinarily move from service supplier to supplier with barely a thought, rarely shop for insurance. Why? Consumers know the plight of those in assigned risk type plans and substandard markets, thus they are apt to stay in any more favorable situation rather than risk the fall from grace that the whim of a low level underwriter can bestow.



S. 2474 appropriately requires insurers to deal with the buyers, overcoming the incredible competitive disadvantage that consumers face in having to buy, due to state law or lender requirements, but sellers not having to sell.

Neither your bill, Mr. Chairman, nor anyone in Congress call for low rates for objectively proven bad risks. What we seek is open markets for essential insurance with insurers winning or losing (competitively speaking) on their published price lists.

The second major factor adversely affecting competition in insurance is the virtually total lack of meaningful price and service information. S. 2474 addresses this two ways, disclosure and more understandable language. I endorse these steps as the least that must be done. These major provisions represent thoughtful and appropriate congressional response to real consumer needs.

The bill requires that "open price competition" regulate the rates. I do not believe that this industry has shown any willingness to let competition work in favor of the small, individual seeking insurance for life, car, health, and home. Quite the contrary, the American public has suffered dearly at the greedy hands of this money machine called the insurance industry. In California, pointed to as the "Mecca" of competitive rating laws for auto insurance, the Insurance department estimated in 1978 that 20 to 30 percent of the drivers are uninsured, over 11 percent are written in the substandard market, and 3 percent are in the assigned risk plan.

Thus, well over one-third of the market is missserved in California. To continue the right of selection and to grant a new right of jacking up the rates at will would be a disaster of the first order for consumers, Mr. Chairman. Absent the full insurance availability aspect of the bill, any movement to "open price competition" will be fought by consumer groups. It is doubtful whether this industry has the will to engage in competition for the business of individual Americans. Investment income, for instance, will never be voluntarily reflected in competitive rates. I don't believe that it ever has been reflected except in prior approval states. I suggest very careful consideration of this aspect of your bill. Perhaps the 18 month test if the appropriate approach to see if the insurers can compete. The standard on discrimination is disappointing, Mr. Chairman, only because it ignored the plight of those suffering discrimination due to age in lines such as automobile insurance. I believe that the use of this criterion is not valid, a form of surrogate for real risk factors, and relegates the young to paying dues to get into this exclusive club. I recognize the statistical argument for use of age as a rating criterion, but we all know that fairness is an individual, not a group, more of our culture.

Finally, I question if the "Remedies and Enforcement" provisions are sufficient to assure compliance from the states and this industry, given their performance over years of trial. Stronger carrots and sticks must be devised if this bill, when enacted, is to succeed. The refusal of the states to go along with the will of Congress as respects the "Holtzman Amendment" to the state FAIR Plan should warn you about this non-enforcement possibility. Absent back-up federal authority financial and technical assistance, the purposes of the bill may never be achieved.

Mr. Chairman, I applaud your efforts against what are extremely high odds. This industry has powerful and highly paid lobbyists all over Washington and in every state capital in the land. They even put a provision for such collaboration into every premium that Americans pay, Mr. Chairman, and the states approve it! That is why they are able to come at any attempt at reform with such large collective resources. But keep at it, Mr. Chairman, the American insurance consumer, so underrepresented in the states and in Washington, needs your sustained initiative and leadership.

Thank you.

---

#### PREPARED STATEMENT OF ROBERT HUNTER

Mr. Chairman and members of the Committee, I am happy to respond to your request that I appear here today to discuss S. 2474, The Insurance Competition Improvement Act.

I consider it an honor to support this bill, so vital to the best interests of the American insurance consumer. As a former federal official, as an actuary, and as a consumer, I endorse S. 2474.

Why does America need this bill?

Today, competition in insurance works against rather than for consumers; today, discrimination, unfair by any stretch of the imagination, is widely prac-



ticed by insurers with explicit state approval; today, rates are excessive, due to lax state oversight and ineffective choice for consumers; today, redlining practices are rampant; today, consumers have to buy insurance, but insurers don't have to sell it; today, consumers don't have near enough information to knowledgeably shop for insurance; today, predatory practices by the sharp dealers of near worthless coverages go on unabated in many states; today, competition for large risks moves capacity, and thus insurance at affordable rates, away from the average citizen; today, inefficient insurers are under little or no pressure to reduce excessive expenses—in some lines the phenomenon of reverse competition actually increases expenses and rates, and today, millions of loss free risks are thrown into high cost, low coverage assigned risk and FAIR Plans just because of where they live, because their agent was cancelled or other irrelevant reasons.

Why does competition fail in insurance? In most part it fails because of selection competition, a phenomenon in which the insurance company underwriter can refuse to offer insurance service to an applicant for any (or no) reason. This practice makes consumer freedom of movement in the marketplace a risky enterprise, to say the least. One turn down, coupled with an honest answer to the question almost universally asked of applicants, "Have you ever been refused insurance?" will put you into the purgatory of the assigned risk plan.

These plans are apparently disproportionately filled with minority persons, and their higher rates and inferior coverages represent a very real form of "economic apartheid" that would be eliminated if S. 2474 becomes law.

Competition also fails due to the lack of independence of competing carriers. Groups have "pup" running mates to shunt off "undesirable" risks from a low rate company to the high rate company. Consumers cannot follow the intra-group shuffle intricacies.

Even beyond that, companies often join large rating organizations and have even their expense dollars aggregated for ratemaking, clearly an anticompetitive and actuarially unnecessary manipulation. Further, the committees of these rating organizations get together and agree as to the basic assumptions of rate-making, a practice which I know from experience yields higher than realistic answers for the companies that use the rates. Thus, inefficient companies are protected and rate levels are established which set the stage for creaming and tracking by the larger companies.

Finally, the rating organizations publish circulars which reveal where the competition is using rates even higher than the inflated actuarial indications would indicate. Implicit in information of this sort is an invitation to jack up the rates in certain areas beyond the needed levels.

Competition is also thwarted, if the above practices weren't enough, by the almost total lack of useful price information for consumers. Which company is cheaper? Which provides good service? Who knows? The information simply is not available.

Product differentiation also obscures the coverage, and obscure policy language furthers consumer ignorance. People don't know what they have bought, until they have a claim.

The final straw breaking meaningful competition's back is the compulsion on consumers to buy these coverages. States require, through various approaches, that drivers purchase auto liability insurance. Lending institutions require fire insurance on your home and physical damage insurance on your car. The demand curve for this insurance is inelastic while the supply curve is elastic. The insurers are shooting fish in a barrel, Mr. Chairman, and those fish are the American people.

As a result, the market for insurance looks, but is not (in any positive way) competitive. One rate does not clear the market. The market is so confused that in some places large writers can charge rates substantially over assigned risk rates, yet remain leading suppliers of coverage.

The key faults in the marketplace derive from misplaced competition for profit—on the loss portion of the rate. Insurers either can or feel that they can maximize their profits by:

Selection. In every class no matter how refined, about half the risks will be "worse than average."

Claims denial or delay in payment of claims.

Competition directed toward losses is essentially bad for consumers, with the exception of loss prevention which is positive.

S. 2474 addresses these important anti-competitive aspects of insurance in an integrated and logical way. Those who have billions of excess profits at stake will



probably try to claim that competition will be impeded rather than aided by this approach. Bunk! How can making service, information, and a structure where competition will at long last be focused on price and service in this industry be anti-competitive? Only in the mind of someone with a lot of money at stake. But, the regulated always fear real competition. If your assets had grown from \$51 billion in 1968 to \$159 billion in 1978, would you want to see the groundrules changed? Only the consumers of insurance seek a change in the game so stacked against them today.

8.6 percent of the private passenger automobile insurance in this country was in the residual market in 1978 with over 5 million cars in the high rate, low coverage, second class assigned risk plans. This made the residual market the second largest writer of private passenger car insurance. Only State Farm Insurance Company had more; even Allstate had less. This country's consumers are in bad hands, Mr. Chairman.

Richard Decker, President of the National Industry Committee on Automobile (Assigned Risk) Plans stated, "It is difficult to grasp the size of the . . . (residual) marked unless it is put into some kind of perspective . . . in only 9 states does the total Property & Casualty business written exceed the countrywide automobile Shared Market volume . . . (it) exceeds the Allied Lines total of \$1.4 billion and Inland Marine total of \$1.8 billion. It is not far below the Fire Insurance total of \$3.1 billion."

But, Mr. Chairman, you ain't seen nothin' yet! Mr. Decker has predicted that this market would grow to more than 20 percent of the overall market by the year 2000, over 50 percent in the Northeast industrial states. The reasons for this growth will not be the riskiness of those thrown into these markets, it isn't the reason today, the reason will be corporate-international-conglomerate thinking which is moving this industry swiftly away from personal lines insurance in this country. In 1975, there were 106 million registered private passenger cars in the U.S. In 1977, there were 114 million, an increase of 7.5 percent. Voluntary insurance written went from 88 million to 91 million, an increase of only 3.4 percent. The residual market grew from 3.6 million to 6.4 million, or 77.8 percent in this same time period. The number of cars driving uninsured grew from 14.3 to 16.6 million. I submit that this is evidence, startling evidence, that Mr. Decker is right and that we are at the threshold of an era of insurance drought in this country for ordinary citizens. Your bill protects against this awful outcome, Mr. Chairman.

If this withdrawal from personal lines were due to huge dollar losses, it would be understandable, perhaps. Chart Number 1 shows that this is not the case, however. In the past twenty years this industry never once had a cash loss year. The second chart shows that exclusion of unrealized capital gains and losses makes the positive cash flow even more stable. The final chart reveals that this giant industry delivered only 48 cents in benefits, while spending 34 cents on expenses for each dollar of cash income received. The additional 18 cents was positive cash flow into investments as reserves. Several interesting comments could be made about these charts. The business is, in industry aggregate, stable and low risk. The benefits cost 70 cents to deliver for each dollar of benefit, a frightfully high cost/benefit ratio. Uncle Sam is a partner in the operation of this industry, collecting taxes at the rate of only 8 percent of the profits announced by the industry, less than 1 percent of cash income and 3 percent of positive cash flow. These data are displayed on Exhibits 4 attached to the statement.

The important point here is that this industry is not losing lots of money and yet it is the process of tightening the market for the individual consumer. The pattern of tightening market repeats itself in FAIR Plans, where more fire insurance is sold today than ever before—about 1 million policies.

Perhaps the reason is that America is just like other countries and that the plight of the insurance consumer here is similar to the consumer's plight throughout the Free World.

The Federal Insurance Administration's report, Full Insurance Availability, studies this possibility. It states, "With the exception of automobile insurance in Italy, there does not appear to be a residual market problem in any Western European country. All of the popular forms of personal lines and small commercial . . . insurance are readily available . . . there is negligible public dissatisfaction over problems of insurance supply . . . The key to the European approach has been to keep the problem out of the public domain by granting insurance to all comers under a rate structure that is not overly refined . . . In summary, Europe does not have substantial classes of insured who are 'rejects' or 'assigned



risks' nor does it have territorial 'redline' zones. It does not have a residual market problem."

The United States is rather unique in the world, Mr. Chairman, in wholesale refusal to insure the "bread and butter" personal lines market and in structuring complex and convoluted class plans that confuse the customer and price so many people out of the market for reasons unrelated to risk.

Which bring me to classification. As an actuary, I am constantly appalled to see simple statistical averages put up as if that was all that mattered in proving actuarial relevance. So often I have seen insurers try to prove that a class is legitimate by use of data that shows a different mean than another body of data.

It was the underwriters, many years ago, that selected and erected the classification schemes which essentially remain in force today. Even then, actuaries knew that what they were looking for in classes was what were called "critical conditions" of risk. Even then, actuaries knew that certain factors were "off limits," factors such as race (life insurers once used race related mortality tables but that has gone by the boards as society matured). I have no doubt that there are thousands of statistical categories that might show statistical differences from overall averages. Hair color, income level and race are examples for auto insurance. The statistical differences would not make them appropriate classifiers, however. The industry does not use these factors since, to their credit, they recognize their inadmissibility despite their statistical variation probability. Yet, on they go looking at the statistics on such arbitrarily chosen factors as sex and marital status as if they believe that biology is destiny. In doing so, they totally ignore these basic questions: "Is this slot socially acceptable? Does this lot clearly identify the risk factor so that, by its use, there is no unfair discrimination and its use signals a loss prevention purpose to those who occupy the slot? Are there more direct ways to measure the risk which will be fairer and help reduce losses?"

Focus on statistics rather than these key questions calling this solely an actuarial question is not correct and can mislead those studying this topic.

The adverse effect of excessive classification is appropriately handled in your bill, Mr. Chairman. I should point out the necessary integration of class reform with availability guarantees since, without the latter, class reform would be undone by insurers simply refusing to write the business.

One last thought on classes. If surrogate variables for real risk are eliminated, the insurance industry will be under a strong incentive to come up with direct ways, fair ways, to measure risk. Thus S. 2474 removes not only unfairly discriminatory class criteria, but increases the likelihood that legitimate classes will be developed that will measure the true riskiness of insureds. In the meantime, all your bill does, Mr. Chairman, is remove some surrogate slots, which add almost no precision to the rating process and to spread the risk, in the tradition of insurance itself.

I have some concerns about the specifics of the bill. For instance, the definition of "insurable risk" may be a loophole that will entice insurers to avoid the take all comers intention of the bill. I would recommend that you seek more precise language to limit the possibility of abuse.

"Open rating" should work under the total plan that you have proposed, Mr. Chairman, but we must beware of amendments that would weaken the take all comers approach while retaining "open rating."

Whether or not the enforcement concept in the bill is sufficient to achieve the desired result, I do not know. I merely raise the point because I am concerned that the benefits of full competition be delivered to the American consumer of insurance with no need for lengthy and expensive procedures to assure compliance.

The need for reform is not limited to property and liability insurance, but extends to life and health insurance marketing practices as well. Development of standards for these lines of insurance should proceed promptly.

I would be happy to meet with your staff, if you so desire, on the technical aspects of the bill.

Mr. Chairman, you have done well in putting forth this most important bill. From my experience in the private sector and at the federal level of government, I can assure you that this bill is a very temperate approach to the extensive abuses that exist. While several states are trying to move on their own, there has been far too little attention by the states and virtually no federal government response to the plight of consumers. In part this is due to the great deference to the states that we feel in Washington. But the fact remains that the states, as GAO pointed out, have fallen far short in the business of protecting consumers. I agree with GAO's assessment. Even in areas of well documented abuse the states have been slow to respond, in part because of the intense lobbying efforts of this powerful



industry at the state level. Your bill, takes great pains in not throwing the baby out with the bathwater, in developing the minimum necessary step to begin an evolutionary process of reform at the state level. The need for your bill and support from the federal government to lessen the reliance of the states on the industry in developing rates, statistics, forms, and so on is overwhelming. If the industry succeeds in stopping this bill, I believe that the continued build-up of frustration and outrage by the public will result in much stronger measures ultimately being required, such as federal regulation of insurance or federal provision of essential insurance directly to consumers.

I grew up in an insurance home, Mr. Chairman. My dad was, and is, an average adjuster of ocean marine insurance. As a boy, he told me how insurance companies would pay millions on the word of one person, must to keep the war effort going. My dad convinced me that this great industry has a huge capacity for good. It can be, and often is, the bridge over financial oblivion for a family. It should be in the vanguard of social concern, a place where young idealists flock to be part of an effort to help others in trouble. But it currently falls far short of what it should be because of the shortsightedness of its leaders in their quest for short term competitive advantage which reap no higher profits but disenfranchise millions from affordable coverage.

While there is yet time, I would hope that the industry itself would come to its senses and support S. 2474 rather than letting short term considerations dominate their thinking. I believe, Mr. Chairman that your bill represents the last clear chance for continuation of privately provided insurance under state regulation. I can only wonder if you will succeed in protecting this industry from itself?

I would be happy to respond to any questions you may have.

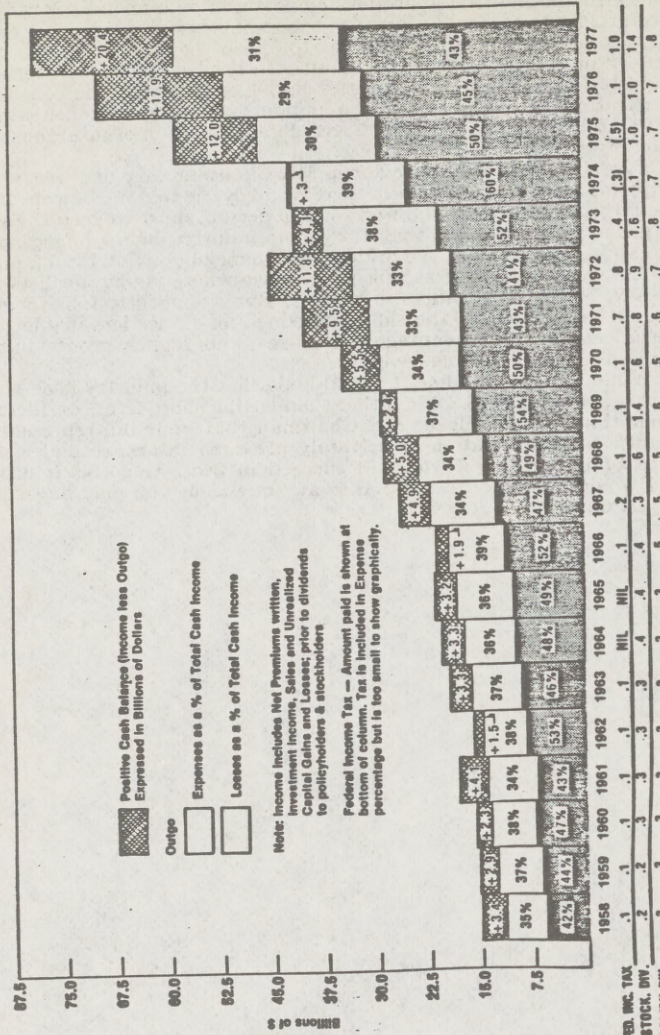
[Exhibits 1 to 4 follow:]



Exhibit 1

# PROPERTY/CASUALTY INSURANCE INDUSTRY ECONOMIC RESULTS

SOURCE: Best's Aggregates and Averages

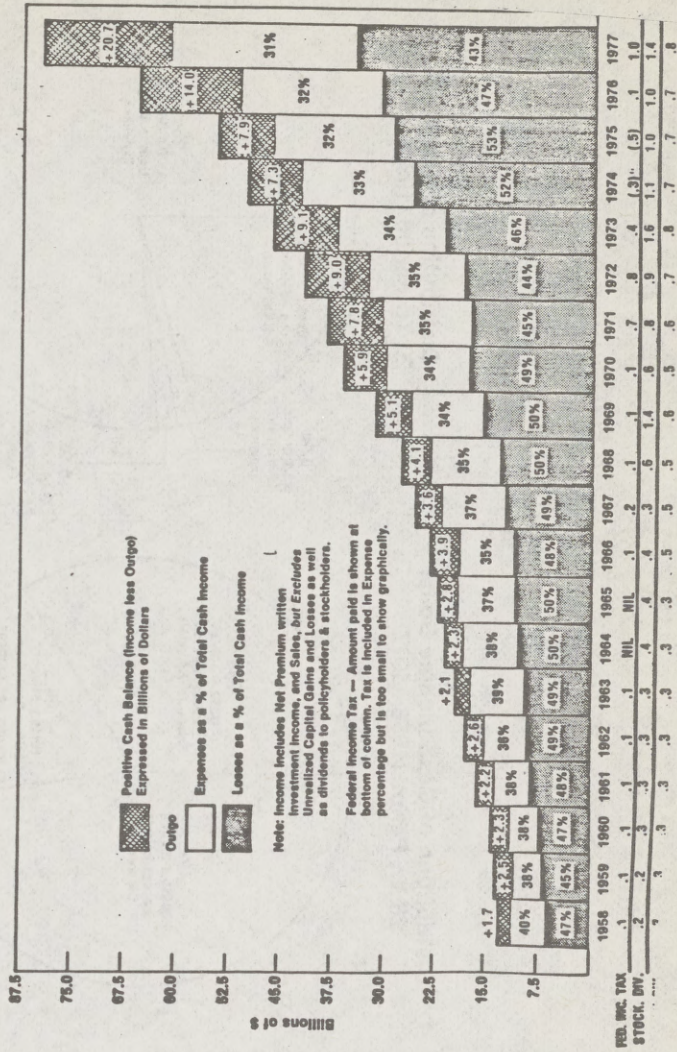




# PROPERTY/CASUALTY INSURANCE INDUSTRY ECONOMIC RESULTS

Exhibit 2

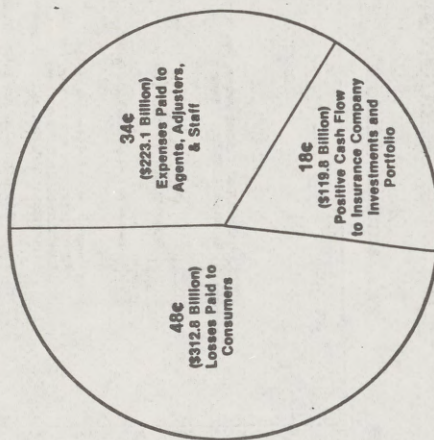
SOURCE: Best's Aggregates and Averages



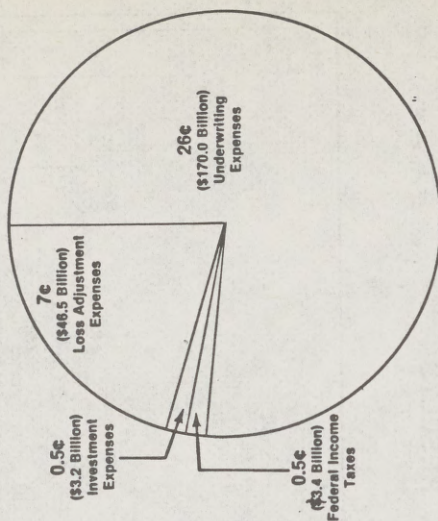


# PROPERTY/CASUALTY INSURANCE INDUSTRY

Distribution of Cash Income Dollar  
20 Yr. Period (1958 - 1977)



Distribution of Expenses  
20 Yr. Period (1958 - 1977)



SOURCE: Best's Aggregates and Averages



## Exhibit 4

PROPERTY CASUALTY INSURANCE INDUSTRY  
20 Year (1958-1977) Totals  
Key Statistics

|                                                               |                |        |     |
|---------------------------------------------------------------|----------------|--------|-----|
| Net Premiums Written                                          | \$ 603 Billion |        |     |
| Net Losses Paid                                               | \$ 313 Billion | Ratio: | 52% |
| Underwriting Loss<br>Adjustment Expense                       | \$ 217 Billion | Ratio: | 36% |
| Loss Adjustment Expenses<br>as a Percentage of<br>Losses Paid |                | Ratio: | 15% |

Federal Tax as  
a Ratio of  
Indicated Item

Federal Taxes Expressed as a Percentage  
of Various Indicia:

|                                                                              |                                    |  |            |
|------------------------------------------------------------------------------|------------------------------------|--|------------|
| Federal Income Taxes Paid                                                    | \$ 3.4 Billion                     |  |            |
| Overall Profit (Statement)                                                   | \$ 44.4 Billion                    |  | 8 %        |
| Positive Cash Bal. (Pre-<br>Dividends to Stockholders<br>and Policyholders)* | +\$120 Billion                     |  | 3 %        |
| State & Local Taxes Paid                                                     | \$ 16.5 Billion                    |  | 21 %       |
| Dividends to Stockholders                                                    | \$ 13.5 Billion                    |  | 25 %       |
| Dividends to Policyholders                                                   | \$ 10.1 Billion                    |  | 34 %       |
| State Tax Plus Dividends<br>to Policyholders & Stock-<br>holders             | \$ 40.1 Billion<br>\$ 40.1 Billion |  | 8 %<br>8 % |
| Federal Income Taxes as<br>a Percentage of:                                  |                                    |  |            |
|                                                                              | Gross Income                       |  | 1 %        |
|                                                                              | Premium Income                     |  | 1 %        |

\* Includes minimum double counting in realized/unrealized capital gains



Senator METZENBAUM. We now have a panel of property policyholders, Austin Dunn, accompanied by Ashley Brown, from Dayton, Ohio, and Delores W. Rodgers, from St. Louis, Mo.

**PANEL OF PROPERTY AND AUTO POLICYHOLDERS:**

**STATEMENTS OF AUSTIN DUNN, ACCOMPANIED BY ASHLEY BROWN, ATTORNEY, DAYTON, OHIO; DELORES W. RODGERS, ST. LOUIS, MO.; ALBERTO NUNEZ, CHICAGO, ILL., AND LAURENCE R. BECKER, BROOKLYN, N.Y.**

Senator METZENBAUM. I think what we will do is ask the panel of auto policyholders to come to the table at the same time, Alberto Nunez, from Chicago, and Laurence R. Becker, from Brooklyn, N.Y.

Mr. Dunn, we will be happy to hear from you.

Mr. DUNN. Thank you, Senator.

Senator METZENBAUM. We will ask each of the witnesses to confine themselves to the 10-minute rule, if you please.

Mr. DUNN. First of all, Senator, I would like to thank this committee for inviting me. It isn't every day that a citizen of the United States gets to come before the seat of Government, to register his complaints. I consider this an honor.

Senator METZENBAUM. We are happy to have you with us, sir.

Mr. DUNN. My name is Austin J. Dunn, Sr. I live at 41 Anna Street, Dayton, Ohio.

I live in West Dayton, an area whose composition is overwhelmingly black. I have resided at that address since December 1955.

I have invested a substantial portion of my income and my assets in purchasing and maintaining this property.

At the present the mortgage is paid off. My wife and I are the sole owners of the property.

From the time I purchased the home in December 1977, I insured my property through the Borchers Insurance Agency with the Midwestern Indemnity-Mid-American Fire and Casualty Insurance Co.

During that 22-year period, I filed only one claim for loss, and that claim was about a stolen bicycle that happened in another neighborhood. It was something like \$38 or change.

Senator METZENBAUM. You had one claim, \$38, not on this property, but in a different area.

Mr. DUNN. Well, the bicycle, Senator, was stolen in another area.

Senator METZENBAUM. Very well.

Mr. DUNN. Well, during those years, I always paid my premium on time and the insurance company described me as a good customer, with an excellent record.

In early November 1977, I received a letter from Midwestern Indemnity Co. informing me that my insurance would not be renewed on December 9, 1977.

The notice on there said that I should call my agent, and contact him for further information.

I talked and called my agent and asked him why was it that I was—Midwestern was no longer writing for Borchers. They informed me that "Don't worry about it." They said, "We will get you insured with another company."



During this time, about a week later, they sent me a letter saying they had tried everybody they could try and they couldn't insure me.

Then, at that time, I got on the phone and I called Borchers.

Senator METZENBAUM. Called Borchers?

Mr. DUNN. Borchers Insurance Co.

Senator METZENBAUM. They were the agent, were they?

Mr. DUNN. Yes; they were the agent.

Senator METZENBAUM. Very well.

Mr. DUNN. I called up Borchers and told them that—a lady answered the phone. I told her I would like to speak to the man in charge.

A fellow by the name of P. Borden Greathouse came to the phone. I asked him why they were canceling me out and they could not find anybody to take me, you know. He said—I went on to explain to him what a good customer I had been and how we had a neighborhood block club in our neighborhood, how we were trying to take care of our property and getting still other members in our neighborhood to take care of their property.

So, we got into a very heated conversation. During that conversation he told me, he says, "Look, you people out there are burning down your houses at the rate of two or three a week. So, we are not going to insure you."

You know, Senator, I have dealt with white people long enough to know that when they say, "you people," concerning us, they mean "you niggers." You know what I mean.

So, with that in mind, and as I said before, we had a very heated conversation. And the conversation concluded with him saying, "OK. We will send out the fair plan, an application for the fair plan."

As of this date, I haven't received the answer to it.

Senator METZENBAUM. Haven't received an answer to what?

Mr. DUNN. The fair plan.

Senator METZENBAUM. You sent the fair plan application in and to this day you have heard nothing from them?

Mr. DUNN. To this day, I have heard nothing.

Senator METZENBAUM. All right.

Mr. DUNN. Well, in fact this whole experience depressed me so that my investments were going unprotected, that I was extremely concerned about the safety and—while I didn't have insurance, my son in Cleveland, was supposed to get married on December 17. There was a big decision about all the family that wanted me to be there, naturally, me being his father, and the family on her side.

So, I had made a decision that since I didn't have the protection of insurance, that I would stay there and try to protect the home. Especially, with all the investment I had in it.

Senator METZENBAUM. Am I correct in my understanding—first of all, I have a picture—I gather it is your home. It is a sort of a red brick home; is that right?

Mr. DUNN. Yes, sir.

Senator METZENBAUM. I gather that prior to being nonrenewed by Midwestern, you had improved the wiring in the house, put in an entire new bathroom, installed a new central heating and air-conditioning system, and that you had intended to make further improvements, including painting it and installing storm windows and other energy-saving devices.



When you could not get the insurance, that caused you some concern as to whether you ought to keep putting more money into the house?

Mr. DUNN. Yes. That caused me great concern, Senator. It looked like it would be of no use to put money in it if I wouldn't have it protected, you know.

Senator METZENBAUM. Yes.

Mr. DUNN. Well, during the time that—between the time that I had this discussion with Borden Greathouse and Borchers and the time I got insurance with Allstate—Senator, I tell you, I am a little nervous today. I guess you understand why.

Senator METZENBAUM. I can understand that. There is no reason for you to be nervous. You have all these insurance company executives and lobbyists standing right behind you and concerned about your problem. [Laughter.] They are all on your side. [Laughter.]

Mr. DUNN. I got a letter from Midwestern after meeting with—well, I would like to get to—[Pause.]

Senator METZENBAUM. As I see your written statement, I gather that you contacted the fair housing center in Dayton, and after that, they contacted Midwestern, and Midwestern then sent you a letter explaining that they viewed you as a good customer, with an excellent record, and they would welcome doing continuing business with you.

Would you care to comment on that?

Mr. DUNN. Well, I called the agents when Mr. Brown sent this letter to Midwestern. One agent, he wanted to know how I got his phone number and who told me to call him.

Well, the way that I approached him, I approached him that I lived in West Dayton, and I wanted insurance on my property.

So, he said, "Well, I don't even want to talk about it unless you tell me where you got my phone number and who told you to call me."

So, that is when I told him about the letter I got from Midwestern. This was way after the fact.

Senator METZENBAUM. In the letter from Midwestern they told you that there were four agencies in Dayton which you might contact; is that right?

Mr. DUNN. Yes.

Senator METZENBAUM. So you contacted them. Did those four agencies indicate that they could get you insurance from Midwestern?

Mr. DUNN. Well, the one agent, it is like I told you, well, when I finally gave him or read the letter to him, then he quoted me prices and different areas of what the policy would set, which was higher than mine. I am talking about mine when I say mine, it is Allstate, the one I got from Allstate.

There is one other agent I had that told me, I called and they said they would get back with me. I never did—they never did call back as of this date.

Senator METZENBAUM. How much higher is the premium you are paying to Allstate as compared to what you are paying to Midwestern?

Mr. DUNN. Well, Midwestern I was paying about \$80-some and with Allstate I am paying about \$115. But I am also getting other coverage like \$250 more deductible, where I had \$150 deductible on my insurance with Midwestern.

Senator METZENBAUM. With Allstate you have \$250 deductible?

Mr. DUNN. Right.



Senator METZENBAUM. Is there anything else you would care to tell us?

Mr. DUNN. Well, I would like to tell you that—

Senator METZENBAUM. Tell me where you work. What do you do?

Mr. DUNN. Well, I work at Inland Manufacturing Division, in Dayton. I have been there 26 years.

Senator METZENBAUM. Did you ever have any special problems that would have caused the insurance company to cancel that you can think of?

Mr. DUNN. Did I have any special problems?

Senator METZENBAUM. Yes.

Mr. DUNN. No.

Senator METZENBAUM. In other words, did the insurance company indicate there was any special reason they were canceling? Had you just been in some sort of a law fracas or something?

Mr. DUNN. No.

Senator METZENBAUM. Nothing like that happened?

Mr. DUNN. No. Nothing like that, Senator.

Senator METZENBAUM. And they actually sent you a letter since that time saying you were a good risk.

Mr. DUNN. Right.

Mr. BROWN. Senator, the specific words he used was that he was a good risk—a good customer with an excellent record. That specifically is the way Midwestern described him after terminating him.

Senator METZENBAUM. Your name is Ashley Brown?

Mr. BROWN. That is correct.

Senator METZENBAUM. What is your relationship to this matter, sir.

Mr. BROWN. I am Mr. Dunn's attorney. Mr. Dunn is a plaintiff in a lawsuit against a number of the companies which redlined him.

I'll draw the conclusions of fact, even if the court hasn't yet.

Senator METZENBAUM. What has happened in the court case, Mr. Brown?

Mr. BROWN. Well, the case is currently in litigation. It is, as you know, Mr. Chairman, the first case in the United States which holds that the Fair Housing Act applies to the business of insurance, at least property insurance.

Senator METZENBAUM. The court has made that decision?

Mr. BROWN. The court did on a motion of the defense to dismiss the case.

Senator METZENBAUM. Go ahead. Proceed.

Mr. BROWN. Some of the things that Mr. Dunn has experienced are not really unique. I want to share with you a few of the other cases in Dayton, Ohio, and then talk specifically about some of the problems we have with State regulation in Ohio, which unfortunately, I suspect, Mr. Chairman, you may be all too familiar with.

In Dayton—Mr. Dunn's case is one of two which went to Federal court.

Another one which went shortly after his was the matter of Wildman versus State Farm.

Miss Wildman had renter's insurance in the suburb. She moved into the city and tried to transfer her renter's policy, and received a letter from her agent which is attached to my testimony, part of which is stating the reason why the agent would not transfer the renter's policy.



It is kind of a jackpot answer because it says: "Due to the area itself, and also by having no other supporting business, he does not wish to keep the renter's policy," that is, the agent does not wish.

It is a jackpot answer because the first reason for declination is redlining. The second is a possible violation of the Clayton Act.

I think it is interesting. That letter may have been a factor in State Farm's desire and willingness to settle this case very quickly.

But a couple key points that came out, one is that State Farm, one of the largest insurers, perhaps the largest in the United States, has in the Dayton metropolitan area, 51 agents. Not one is black.

In addition, of those 51, only one of them is located within the corporate limits of the central city of Dayton, and that person is literally smack on the city line.

So that became part of the settlement agreement. State Farm has agreed to hire minority agents. In fact, they are specifically supposed to have one on line by the end of this year.

They have committed themselves to a number of other things, including the payment—they did pay damages, attorney's fees, affirmative advertising and a number of things which would be beneficial to the community, which they were not willing to make up until the time litigation.

The second case I want to call to your attention is one that did not go into litigation, but perhaps should have, the case of Mr. and Mrs. Stanley Hurst, 51 Weller Street. They don't live too far from Austin Dunn.

The Hursts, for 30 years were insured by the Buckeye Union Insurance Co. After 30 years, and they didn't have a single claim after that entire period of time, after 30 years of coverage, Buckeye Union did not renew them.

The stated reason from the agent was, because of the value of the house which they appraised at \$7,000, was below the \$10,000 minimum of Buckeye Union.

I might say no appraisal was ever done of the house. Somebody did that sitting in an office some place.

So, despite the record and despite the fact that I wrote to Buckeye Union and specifically asked them why this policy was non-renewed, and they said they didn't know. Somebody in the Dayton office had initiated it, and that person was no longer in their employ and they had no idea what the reason was.

Despite that, they refused to pick up the policy. They sent the Hursts to the Fair Plan where they remain to this day, unable to get any conventional insurance.

The final case that I want to discuss in any detail is the case of Mr. and Mrs. Howard Breshers, who also live in west Dayton, although they happen to be white.

The Breshers, for 31 years, had insurance with the Indiana Insurance Co., with Indiana and the Buckeye Union Insurance Co.

In 1978, Indiana terminated them.

They bought a policy from J. C. Penney. J. C. Penney then canceled the policy within 2 months of selling it to them, saying that the house in fact was only worth \$14,000.

Mr. Larry Faxton, of the Westerville, Ohio, office of Buckeye Union informed me it was J. C. Penney's policy not to insure homes



whose market value was less than \$16,000, and there were no circumstances under which they would write that policy.

The agent did offer to the Breshers a surplus lines coverage from the Styveston Insurance Co., explained to them it was high risk insurance. The Breshers were high risk people, even though they had only two claims in 31 years.

The Breshers, as a matter of pride, simply refused to submit to the humiliation and the price increase, a substantial and hefty price increase, of going on to the surplus line companies.

Those are but a few of the complaints that we have had in Dayton, which probably come close to 200 complaints that we have been dealing with.

Briefly, we have had complaints from agents, particularly agents from Allstate who complained that in the city of Dayton they have to write \$250 deductible, whereas in the suburbs they can go down to as low as \$50 deductible.

Prudential Insurance, an agent has listed for me, it listed neighborhoods where Prudential did not want him to write insurance policies.

They had a high correlation, I might say, to minority population.

Most significantly, a former marketing representative of Economy Fire and Casualty Co., one William Lingo, told me that his company went so far as to actually have in their offices maps with red lines, indicating what neighborhoods they were not to write business in.

Mr. Lingo voiced rather vehemently his opposition to that policy. Shortly thereafter, and in part at least for that reason, he was dismissed from his job. He has been unable to get another job in the insurance industry. He is now an over-the-road, on-the-road truck driver. I hope he is able to get driver's insurance. I don't know. I don't know if Economy would insure him.

Finally, Mr. Chairman, if I might, I would like to share some of the experiences we have had in Ohio.

The Ohio Department, to my knowledge, and I deal with these things all the time, with community groups all across the State, the Ohio Department has never resolved a single complaint of redlining to the consumer's satisfaction.

I, myself, have sent two complaints to the Ohio Department. One, when I sent it, the company, Buckeye Union, changed their mind, and I withdrew the complaint.

The other, I didn't even get a response from the State department of insurance. So I have no idea what happened to it.

More recently, this department's performance has gotten even more incredible, because I have actually gotten people calling me on the telephone, telling me they have had such and such a problem with their insurance and the State insurance department told them to call the Legal Aid Society in Dayton, and that there was nothing the department could do about it.

You know, in all deference to the department I do think their powers are a little more substantial than those of the Legal Aid Society, and nonetheless, they refuse to deal with it and referred them to us.

In fact, for all intents and purposes, there is no insurance regulation in the State of Ohio. As you probably know, both Columbus Monthly and Cleveland Magazine describe the department as a giant filing cabinet.



I think that is a very appropriate description.

More recently, there was an attempt in the Ohio Legislature to pass a bill, it is still pending in the House, which would prohibit insurance redlining.

Now, Mr. Nader earlier testified as to the role of lobbyists for the insurance industry. I might say in Ohio we are unique. The industry is in a unique position. The lobbyists are not only around the legislature, they are in the legislature.

Five of the 11 members of the Ohio Insurance Committee are actively involved in the insurance business.

Needless to say, the redlining bill that came through the House Committee and will go to the floor some time in the near future is one which says basically redlining is a no-no, but if you do it, we promise and swear up and down we won't do anything to you for doing it.

There are no penalty provisions in the bill. It is—what it is clearly up to and I think the Dayton Daily News in an editorial, captured that very well. What is attempted to do is to make the argument that the State of Ohio, which up to date has passed no laws which regulate redlining, has made the decision to regulate redlining and therefore, any Federal suit would be an impossible action to bring because of the McCarran-Ferguson Act being a bar, since the State has chosen to regulate the question of redlining in insurance.

I think that particular position that the industry has taken in the legislature, and successfully to date, hopefully not ultimately, but successfully to date, that position is probably the best single reason I can think of, Mr. Chairman, for the passage of your bill.

It is clear what the industry is moving toward are absolutely empty prohibitions of redlining on the State level, to preclude any sort of Federal litigation of the sort that Mr. Dunn brought.

One final comment, if I might. Lenders in the Dayton community have come to me with complaints specifically saying they want to loan in the central city, they want to get away from their own allegations of redlining. Their affirmative efforts to market city property are severely hindered by the fact that so many of their customers can't get insurance.

In fact, the vice president of the largest savings and loan in Dayton, the second largest in our State of Ohio, indicated at a meeting with State Farm agents, that his institution was unable to get their master policy written in Dayton.

If that is the severity of the problem, such a large institution couldn't get their master policy for homeowners who were without insurance, could not get that master policy written in Dayton.

The problem is widespread. It is my personal belief that redlining is the most prevalent form of discrimination in the housing industry today. I applaud you, Mr. Chairman, for your efforts to bring an end to these kinds of activities.

Senator METZENBAUM. Thank you very much, Mr. Dunn, and Mr. Brown. I may have some questions and other members of the committee may have questions which we will submit to you in writing. If we do, we will mail them to you.

I will try to move along a little bit. I see the hour is rolling along here. Your testimony is very helpful.

Mr. DUNN. Thank you.



Mr. BROWN. Thank you.

Senator METZENBAUM. Mrs. Rodgers, we are very happy to hear from you.

Ms. RODGERS. Thank you, Senator Metzenbaum.

On February 23, 1976, I purchased a house located at 2027 Penrose Street, in the city of St. Louis, Mo.

The house was purchased from American Real Estate Co. located at 10943 St. Charles Rock Road, Overland, Mo. The price of the house was \$15,150.

The house is described as: single family, two-story dwelling, with full basement, seven rooms, four bedrooms, one and a half baths, composed of brick and frame construction, front yard and backyard.

At the time of purchase the house was not in need of any repairs and it was only 2 years old.

I purchased this house because at the time I was looking for a home where my children would be comfortable and this house was ideal.

I had asked each child exactly what they would want in a home, and this house had all the features, plus, I could afford it.

There were hardwood floors which were great because my daughter is asthmatic and allergic to carpeting and the dust that it holds.

My children would be free to play without disturbing anyone or interfering with their privacy. We would all be comfortable without being crowded. The property we would be caring for would belong to us.

At this time, I was a single woman with seven children ages 17 to 4 years, and this was my first house, I had never made this kind of venture before and I was very happy the day I closed.

My children were proud and I was proud of myself, I was making one step upward. I had prayed and my prayers had been answered.

The initial insurance that I purchased at the time I closed on the house expired in 1977 and I started to look for a more economical one.

The homeowners rate had gone up and the coverage was less than before.

At that time, I became aware of the problems of finding complete insurance. I invested a lot of time calling insurance companies and inquiring about their homeowners policies, costs and coverage.

As I've said before, this was my first home and the first time I really got upset trying to protect something I valued—my home.

My home was important to me and my family, and worth every penny I would pay for it, and I wanted protection for it.

When I called Allstate and found out that I could get insurance for it, I was ecstatic. Now I would have the coverage I needed with a company I thought at that time was at least dependable.

I trusted the name Allstate and when I got a policy for 10 percent less than the original price quoted, I was thrilled; the reason stated for the decrease in premium was because of the house being less than 5 years old.

The policy went into effect March 9, 1977, and was a deluxe homeowners policy, Allstate's best policy.

Then, approximately 1 month later, on April 14, I got a letter of cancellation with a returned check. I did not know why, and when I tried to get some information as to why I was unable to.

I called the agent who wrote my policy, Mr. McCullin, several times and he never returned any of my calls.



The cancellation letter said the cancellation was because of value, which did not mean anything to me; I needed to have an explanation of what value.

I was later given a number by the receptionist at Allstate to contact the home office in Shawnee Mission, Kans., collect, but the receptionist there refused the call and hung up.

When I called the office here in St. Louis, she explained to me that maybe they didn't understand the nature of the call, but Mr. McCullin was still not available.

As it suggested on the letter of cancellation, I did make contact with the Fair Plan, which I found out only provided fire insurance for the structure, not the contents, this was unsatisfactory. I wanted more than fire insurance; I wanted homeowners.

I then called Legal Aid and explained my problem to them and they suggested I talk with Arlene Zarembka, who handled housing complaints. I did.

I explained my problem to her and at that time I had not heard of redlining, except in the newspaper and it had not had a bearing on me because I was not a homeowner.

Now I got slapped in the face for living in the wrong part of town or being the wrong person; I didn't know which or why.

No one would talk to me or explain the reason, plus, to add insult to injury, the money paid for the insurance came out of my escrow account and the full amount was not refunded to me.

I could not understand. What had happened? What had I said? What had I done? Who had I offended? I got mad.

Arlene explained redlining to me and I got madder.

I still had to have insurance, so I spent 2 days at work calling every insurance company in the telephone book, and the officers at the police department where I work gave me agents to call.

Finally, I got in touch with Mary Krueger of the Krueger Insurance Co. and explained my problem to her. She said she would try to help me.

I got a policy with Mary Krueger in May of 1977, and it has been renewed for each year since then, I have never made a claim on that policy.

I have bars around the front of my windows and the back, also on the front and back doors and on the basement window. I'm not saying I live in a high-crime area, but I don't want to be a statistic. I have taken preventative measures.

In June 1977, Legal Aid filed a lawsuit against Allstate under the civil rights statutes, 42 U.S.C.A. 1981 and 1982. They sued for \$51,000 in damages, which included emotional distress, deprivation of my civil rights and punitive damages.

Only after the lawsuit was filed did I find out what Allstate meant when they said cancellation because of value.

The division manager of their underwriting department in Overland Park, Kan., stated in a deposition that my policy was cancelled because the value of my house did not meet their minimum, and because the replacement cost of my house was more than 125 percent of my market value.

Allstate had a requirement that houses had to have a market value of \$20,000 before they would give a homeowners policy.



I don't think it is fair that Allstate required that my house be worth a certain minimum amount. As I said, my house was only 2 years old when I bought it, it was in excellent condition, and I have never made an insurance claim on it.

In 1977, there were many homes in the St. Louis area in good condition that could be bought for less than \$20,000, so Allstate's requirement eliminated many people from being able to get a homeowner's policy.

I also don't think the 125 percent criteria between replacement cost and market value is fair. I understand that Allstate changed this criteria to 150 percent, but I still don't think it is fair.

With construction costs so high, the replacement cost of many good homes is much higher than the market value.

This criteria eliminates most homeowners in the city of St. Louis from being able to get homeowners insurance.

After about 15 months of litigation, my case against Allstate was settled for \$25,100. This settlement included reimbursing Legal Aid for thousands of dollars in costs they spent in preparing the suit.

Senator METZENBAUM. Ms. Rodgers, that was an excellent statement. It certainly clearly summarizes your own position and unquestionably the position of many others in similar circumstances.

I think both you and Mr. Dunn have been able to resolve your problems. You have been able to obtain insurance. I am much concerned; I feel quite certain that there are literally thousands of others who haven't had the intelligence, the aggressiveness, the assistance of others in the community and, as a consequence, I think the urban areas of our Nation are paying a very high price.

I guess that also would disappoint me much that the insurance industry would be permitting this to occur, when frankly, I think it is counter to their own best financial interests, and certainly to the best interests of the Nation.

It is my understanding that many people, many of your neighbors, are on the Fair Plan, which in essence means they are paying more.

Ms. RODGERS. Yes, sir, about two to three times more on the Fair Plan, just for fire insurance, and that is all.

Senator METZENBAUM. I appreciate your testimony very, very much.

Ms. RODGERS. Thank you, Senator Metzenbaum.

Senator METZENBAUM. Mr. Nunez, we are happy to hear from you, sir.

Mr. NUNEZ. Senator, my name is Alberto Nunez. I am 20 years old and I reside at 806 West Roscoe Street in Chicago.

I am employed as a contractor in a housing renovation project and and I go to trade school, part time.

I want to talk to you this morning about unfair automobile insurance rates in the city of Chicago. I cannot get insurance for less than \$2,000 a year on my 1980 Ford Bronco.

As a matter of fact, one broker cited me a figure of \$3,800. I simply cannot understand these high rates. I am either subsidizing somebody else's insurance or the insurance companies are getting rich off me and people like me.

The reason I do not understand these rates is that I have a perfect driving record for the 5 years I have been driving; no accidents, no traffic violations.



I do not use my car in my work and I drive less than 3 miles to get to work.

These factors should entitle me to a good rate, but the insurance companies do not look at it that way. They place more emphasis on what they see as negative factors—that is, that I live in the city of Chicago, and I am unmarried. I am only 20 years old.

Until 2 months ago, I had full coverage with State Farm at just over \$1,700 a year. The agent said I would be paying much more except that I listed my 28-year-old sister as the principal driver.

If I were the primary driver, he said the rate would be about twice as much as that. But if I got married, he said I could save 10 percent.

And, if I moved to the suburbs, he said I could save about another 25 percent. I do not see how any of this has to do with my driving ability.

I let the State Farm policy lapse in March because I could no longer afford \$1,700 a year for a car insurance.

When I went to find a lower rate, I was in for a rude awakening. Every other quote I got was even higher than State Farm, and some were much higher.

Here are some examples:

One broker I called about Kemper Insurance said Kemper would not insure a 20-year-old driver in the city of Chicago. Despite my totally clean driving record, she suggested I go into the Illinois assigned risk pool at \$3,800 a year for a policy no better than the State Farm one.

No. 2, another broker said the best she could do was place my collision and comprehensive insurance with a company called Delta for \$2,595 and liability coverage with Coronet Insurance for \$770. That adds up to \$3,365 a year.

Three, another agent for Aetna said I could save a lot of money if I moved to the suburbs or got married. I then told her I was considering moving to Bensonville in the Chicago suburbs and she told me I could get a rate there of \$1,290 a year—or about \$1,000 less than the Chicago rate. If I moved to Bensonville and got married, it would only cost me \$792.

Since I am not moving to Bensonville or getting married, I still have not found a rate I can afford. I guess I will just have to search for a policy for just liability. If I mess my car up and it is my fault, I am just out of luck.

There must be millions of other young people in the same predicament that I am. I hope the subcommittee can do something to force the insurance companies to make insurance affordable to us.

Thank you, Senator Metzenbaum.

Senator METZENBAUM. It is a very good statement, Mr. Nunez. We appreciate it. I think you have made your point very well.

[Pause.]

Senator METZENBAUM. I am sort of speechless. [Laughter.] You may get some offers of marriage as a result of this hearing. [Laughter.]

Mr. CHUMBRIS. Make sure she has a lot of money. [Laughter.]

Senator METZENBAUM. Mr. Nunez, you live in the inner-city of Chicago?

Mr. NUNEZ. Yes, I do.

Senator METZENBAUM. How do they know that you live in the inner-city? Do they ask you for your zip code or something when—



Mr. NUNEZ. Yes. When I call, the first thing they usually ask is what ZIP code I live in.

Senator METZENBAUM. Did anybody offer you a better rate when you told them you never had an accident?

Mr. NUNEZ. I guess not, they are so high, all of them.

Senator METZENBAUM. Nobody ever said, did they ask you much about your driving record?

Mr. NUNEZ. Yes. I tell them that I have a perfect driving record. These prices they give me is for a perfect driver. If I was a high risk, it would be even more.

Senator METZENBAUM. What is your annual income, Mr. Nunez?

Mr. NUNEZ. I make about \$15,000 or \$16,000 a year.

Senator METZENBAUM. Did any of the companies other than telling you to get married or to move to Bensonville or a suburb of Chicago, did any companies give you any advice as to how you could save on your rates?

Mr. NUNEZ. Usually they say, "Go to a higher deductible." Some of these prices I gave you were \$250 deductible. Any higher, I would not need insurance. [Laughter.]

Senator METZENBAUM. So that \$2,000 or \$3,000 insurance premiums, would actually cost you about 20 percent of your income before taxes are even taken out of your income?

Mr. NUNEZ. That is right.

Senator METZENBAUM. Mr. Becker, we are happy to hear from you, sir.

Mr. BECKER. Senator Metzenbaum, members of the committee, press, guests, my name is Laurence Becker. I am employed as a supervisor in special education for the New York City Board of Education.

I consider it an honor and privilege to be able to come before you today to discuss some of my experiences with automobile insurance as a resident of the State of New York.

I am a resident of the borough of Brooklyn and the owner of two automobiles which are covered by liability insurance as well as comprehensive, fire and theft, a 1976 Ford and a 1976 Chevrolet which are covered by liability insurance, as well as comprehensive, fire and theft too.

My annual premium for this coverage is \$2,254. I do not carry collision insurance because of the extremely high cost which would be an additional \$845, bringing my total premium to \$3,099, if I were to carry collision.

I am being penalized and discriminated against because I live in the Borough of Brooklyn and because I have two male drivers under age 25 in my family.

If I were to move or drive 4 or 5 miles on the parkway which is a block from my house, I would be in the Lindenwood area, of Howard Beach, where the premium would drop 15 percent.

If I went 4 miles in the other direction, I would come to the Verazano Bridge, and by crossing it, I would be in Staten Island, where the rate would be 40 percent less. It would be the same in New Jersey, which is rather close.

I have two male drivers under age 25 in my family. The span of years during which I have been and will be penalized for underage male



drivers, covers a period of 14 years. It began in 1976, when my oldest son reached the age of 18, and got his driver's license, and will continue until the year 1989, when my third and youngest son turns 25.

The total cost in surcharges over this period of time, using the current surcharge as a median rate, will amount to \$4,400. That is a conservative estimate. I am not allowing for inflation, which I am sure will increase it somewhat.

That \$4,400 is the approximate cost of a 4-year education in the City University which both of my boys now attend.

In addition to what I consider this rip off, I am being charged what I consider a discriminatory rate because of the borough in which I live.

I mentioned earlier, that moving to another borough or across the river would reduce my rate considerably.

Property taxes are at an alltime high in the city of New York. The insurance rates on my two cars now cost me more than the taxes on my home, which is a two-family, brick house, currently valued at approximately \$80,000.

Because of these discriminatory policies, many, and it is really more than many, as a good majority of my friends have registered their cars under the names of relatives in either Staten Island or New Jersey, who bear the same last name, fraudulently using these addresses as their own for insurance purposes.

I continue to resist this temptation, and I prefer to attempt to bring about change through a legal means. That is why I am appear here today and speaking.

The fact that I do not carry collision insurance, as is true of many of my acquaintances, means that I must insure the car myself for such damages because of the prohibitive cost of such coverage.

My friends who do carry collision insurance tell me that although they carry it, they are unusually afraid to make a claim because the increase in premium if they did make claims would often cost more than it would to fix the car themselves.

I had not prepared to mention my next item, but I couldn't help in hearing some of the previous witnesses talking about redlining.

We have a commercial on television, in New York, for Levi's Jewish rye bread. I don't know if you get it, if it goes outside of New York, or you people have ever seen it. Their slogan is, "You don't have to be Jewish to eat Levi's rye bread."

I must say, you don't have to be black to be redlined because I have been redlined on my homeowners policy. In essence this is what happened. I don't live in an undesirable neighborhood, either.

In February 1979, I received a call from my insurance broker that my insurance coverage on my home was going to be canceled by the company. He said it wasn't because of where I lived or because of my record of claims or anything else. It was because of where his office was. His office is in Laurelton Queens, in an area where he insures a great many minority people.

The company, so as not to be accused of redlining, the particular insurance company that had my homeowners policy, simply stopped doing business with this broker.

In essence, what happened was, they redlined the broker and everyone that he insured through that company. So, I lost my homeowner's policy. He was able to find another one, but I just think that



this is another example of the kinds of practices that are used that really are redlining, but it may be disguised as something else.

The attitude of the insurance company seems to be that they are doing us a great favor in selling us insurance, at a very high premium which must be paid promptly.

One however, must fear putting in a claim, and if it is valid, must frequently wait a considerable length of time before collecting.

It is my fervent hope that some relief will come to New York State motorists like myself who must suffer these discriminatory abuses.

Thank you.

Senator METZENBAUM. Thank you Mr. Becker.

Your \$2,200 rate, was that impacted by surcharges on accidents or moving violations?

Mr. BECKER. As far as I know, the company that writes my policy doesn't surcharge for moving violations, not as far as I know.

Senator METZENBAUM. I want to say to each of the witnesses, I think you make the point of this legislation very down to earth, very realistic.

We will hear insurance industry testimony today and probably at a later time, saying that insurance is available, saying that they don't need Federal regulation.

As a matter of fact, there is no Federal regulation in this bill, but they will be saying that. But I would hope that they would also address themselves to the problems of Mr. Dunn, and Ms. Rodgers, and Mr. Nunez and Mr. Becker, and so many others like you throughout the country.

But, I doubt very much they will. It is regrettable, because of all the industries in the country, this is the one in my opinion that should have a great deal of social responsibility.

I think what has happened to the four of you indicates a degree of social irresponsibility on the part of the industry.

I am grateful to you for your testimony. Thank you for being with us this morning.

[Affidavits of Mr. Dunn and Mr. Brown and prepared statements of Mrs. Rodgers, Messrs. Nunez and Becker follow:]



AFFIDAVIT OF AUSTIN DUNN

STATE OF OHIO :ss  
COUNTY OF MONROGHERY

Austin Dunn, being first duly cautioned and sworn, hereby deposes and says:

My name is Austin Dunn and I reside at 41 Anna Street, Dayton, Ohio, 45417.

My residence is located in that part of the City of Dayton known as West Dayton, an area whose racial composition is overwhelmingly black. I have resided at my current residence since December 9, 1955 and have invested a substantial portion of my income and assets in purchasing and maintaining the property. At present the mortgage has been paid off and my wife and I are the outright owners of the property.

From the time I purchased the house until December 9, 1977, I insured my property through the Borchers Insurance Agency with the Midwestern Indemnity/Mid-American Fire and Casualty Insurance Company. During that twenty-two year period, I filed only one claim for loss, and that was when my child's bicycle was stolen from my brother-in-law's house in another neighborhood. To the best of my recollection, that claim was filed in 1974, and was for thirty-eight dollars and change. During my twenty-two years of insurance coverage with Midwestern, I always paid my premium on time and the company has described me as a good customer with an excellent record.

In early November, 1977, I received a notice from the Midwestern Indemnity Company that my homeowner's insurance coverage would not be renewed by Midwestern when it expired on December 9, 1977. The notice indicated that if I had any questions I should call my agent. Shortly after receipt of the notice I telephoned my agent and spoke to a woman who worked at the Borchers Agency. She indicated to me that Borchers was no longer writing insurance for Midwestern and that Borchers would be able to obtain a policy from another company for me. Within a day or two of that telephone conversation, I received a notice from Borchers indicating that they had been unsuccessful in attempting to find me another policy and that they suggested that I obtain coverage through the Ohio Fair Plan. Upon receipt of that notice I telephoned Borchers and asked to speak to "the man in charge." A man by the name of P. Borden Greathouse came on the telephone and advised me that Borchers was unable to



obtain insurance for me. At this point I refreshed his recollection as to my record with Borchers, pointing out what a good customer I had been. The conversation continued with Greathouse telling me that the only coverage I could obtain was from the Fair Plan, and I explaining to him my disappointment and concern that I was unable to obtain insurance. The conversation grew progressively more heated, and finally Greathouse told me: "You people out there are burning your houses down at the rate of two or three a week and we're not going to insure them."

I have had enough dealings with white people over the years to know that when they get angry and say to a black man "you people", and particularly when a white resident of Dayton says to a black resident of West Dayton "you people out there", to know that those comments mean "you niggers." I was absolutely convinced that his remark was racial in nature. In any event, I immediately advised him that I was President of my Block Club and that I didn't know of anybody in our neighborhood burning our houses down. The conversation concluded when Greathouse again said there was no way that he could obtain insurance for my house and that he would send me a Fair Plan application. I received an application from the Fair Plan a few days later, completed it and returned it to Borchers. I received a further call from Mr. Greathouse asking me why I returned the Fair Plan application to him. I advised him that there was a section on the application for the agent to fill in, and he advised me that he would take care of that and submit it to the Fair Plan. To this date I have heard absolutely nothing from the Fair Plan.

My conversation with P. Borden Greathouse convinced me that my house was uninsurable. In fact, the whole experience depressed me enormously, as I had tied up much of my life and work in that house. My investment, both emotional and financial in the house, was enormous and I was extremely upset by the fact that my investment was going unprotected insurance-wise.

To this date, I have heard nothing from the Ohio Fair Plan. On December 9, 1977 my Midwestern coverage lapsed and I was extremely concerned about the safety and security of my house and family. Greathouse's comments effectively convinced me that any efforts to obtain insurance would be futile, and I resolved to protect the house myself. During the period of time in which I was uninsured I personally made certain that someone was physically



present in the house at all times. Unfortunately, my eldest son was scheduled to be married in Cleveland, Ohio on December 17, 1977. Needless to say, both my wife and son, as well as my son's future in-laws, were anxious that the entire Dunn family attend the wedding. I, of course, wanted very much to attend my oldest son's wedding, but I was caught in the dilemma between protecting my family's property and attending the wedding. Accordingly, I decided that everyone in the family would attend the wedding except myself, and I would remain home that weekend to watch over the house. As you can imagine, this entire incident caused great divisions and unpleasantness in our household. While my decision was an extremely difficult one for me personally, it was nevertheless one that I felt compelled to make.

In addition to the family problems that were created by our lack of homeowner's insurance, the experience of having my insurance terminated, coupled with Greathouse's comments, convinced me at the time that any future investment in my house would be unwise. Of particular concern to me, was the fact that just prior to my being non-renewed by Midwestern, I had substantially improved the wiring in my house, put in an entire new bathroom, and installed a new central<sup>heating</sup>/and air-conditioning system. I had also decided to make further improvements in the home, including painting it and installing storm windows and other energy saving devices. I was planning to make those improvements, but in view of my insurance experience, I decided at that point it would not be a good thing to do financially.

As time went on and I still had heard nothing from the Ohio Fair Plan, I decided to contact a large national insurance company whose advertisements I had seen on television. On December 27, I called the office of that insurance company to inquire into the availability of homeowner's insurance and was told to come in and put in an application. On the following day I did so and obtain coverage which was more expensive than my previous coverage had been, and which had a higher deductible.

A few weeks after these incidents, on the advice of my parish priest, I contacted the Montgomery County Fair Housing Center to explore what had happened that caused me to lose my insurance. Subsequently, through the Fair Housing Center, I obtained a letter from Midwestern explaining their reasons for terminating me as a customer, and further explaining that they viewed me as a good customer, with an excellent record and they would welcome



doing continuing business with me through one of their other agencies in Dayton. They listed four agencies in Dayton which I might contact in order to obtain coverage. Following their suggestion, I contacted each of those agencies. My contact was on the telephone, and I opened each conversation with the statement of my name and address and the part of the city I resided in. Of the four agencies, only one dealt with me on a fair basis and offered me adequate coverage, although at a slightly higher rate than I was then paying. Of the other three agencies, one told me that mine was a situation which required some computation and they would have to get back to me. That was in March or April of 1978, and I am still waiting to hear from them. Another agency quoted me a premium rate that was almost double what I had been paying for coverage. The fourth agent refused to talk to me at all until I told them who put me in touch with them. In fact, until I read the letter from Midwestern, this agent refused to quote me any rate at all. After I read the letter, he calmed down and quoted me a rate.

In conclusion, I want to share with you some of my feelings as a result of this experience. I might point out that my personal history is one that I believe would have made me very insurable. I have been employed by the Inland Manufacturing Division of General Motors for over 26 years. My employment record is a very good one. I am a member of Local 87 of the United Rubber Workers. I have lived in the same house for almost 25 years, been married to my wife for almost 28 years, have raised or am in the process of raising, six children, and have attempted to create a good home life for our family. In addition, I am the current, and have been for several terms, President of the Anna Street Block Club. We have organized our block, and I am proud to say that we have put pressure on any resident of our neighborhood who does not adequately maintain his or her property. I take great pride in the condition of properties in our neighborhood, and feel it compares favorably with any in the Dayton region. Additionally, I have been very active in the activities of my local parish. In brief, I have worked hard to make a good and secure life for my family. My experience with being redlined caused me severe doubts as to whether all of my efforts have been worthwhile. It was, for example, extremely difficult for me to explain to my children what had happened and why. I am not sure, even today, that I can fully explain to them why we were treated



so badly, other than attributing it to bias and prejudice. The trauma that we suffered at the hands of the insurance companies involved is one that I will not soon forget. Nevertheless, both for the sake of my family and my community I feel compelled to make my experience public and to fight to make certain that no one else suffers the indignities and humiliations I suffered in the experience I have shared with you in this Affidavit.

Further the Affiant sayeth not.

\_\_\_\_\_  
Austin Dunn

Sworn to and subscribed before me on the \_\_\_\_\_ day of May, 1980.

\_\_\_\_\_  
Notary Public



AFFIDAVIT OF ASHLEY C. BROWN

STATE OF OHIO

:ss

COUNTY OF MONTGOMERY

Ashley C. Brown, having been first duly cautioned and sworn, hereby deposes and says:

My name is Ashley C. Brown. I am an Attorney at Law with the Legal Aid Society of Dayton, Ohio. Prior to joining the staff of Legal Aid Society, I was the Legal Advisor to the Montgomery County Fair Housing Center in Dayton. In both of those capacities, I have been involved in investigation allegations of insurance redlining filed by clients. In the period of December 1977 to the present, I have been involved in the investigation of approximately two hundred (200) complaints of insurance discrimination and/or abuses. In this Affidavit, I will attempt to share some of the most significant and revealing of the cases that have come across my desk.

Two of the cases of insurance redlining have gone into litigation, and one of them remains in litigation at present. That one is the matter of Dunn vs. Midwestern Indemnity Company, et al., 472F.Supp. 1106, 1979 (S.D.Ohio) in which the United States District Court for the Southern District of Ohio has held, for the first time, that insurance redlining is a violation of the Fair Housing Act, 42 U.S.C. 3601 et seq. Inasmuch as that case is in litigation, I am limited about what I might say about it. Nonetheless, Austin Dunn, one of the Plaintiffs in the case, has offered his testimony to the committee as to those events that he has first-hand knowledge of in his case.

The second matter that went into litigation was the matter of Wildman vs. State Farm, et al. U.S.C. No. C-3-78-346 (S.D. Ohio) The Plaintiff there was a woman by the name of Martha Jo Wildman, who moved from an apartment in the suburbs to an apartment located in an integrated neighborhood in the City of Dayton. Prior to her move Miss Wildman had renter's insurance from State Farm. When she moved, she contacted her agent in an attempt to have the insurance coverage transferred from her suburban to her city apartment. At the time she attempted the transfer, she received a note from the office of David Leonard, the State Farm agent with whom she had dealt. The note said as follows:

"After Mr. Leonard looked over your change of address he informed me that he cannot write coverage on your contents at this residence.

"Due to the area itself and also by having no other supporting business he does not which(sic) to keep the renter's policy."



Subsequently, in a telephone conversation that I had myself with Mr. Leonard's secretary, a woman who identified herself as Janet, I was advised specifically that State Farm's rules precluded coverage at Ms. Wildman's address in the City of Dayton. These events occurred in May, 1978. I have attached to this Affidavit copies of both the note and the Complaint in that matter.

In pursuing the Wildman case, our office explored the history of the placement of State Farm agents in the Dayton metropolitan area. In tracing the location of State Farm agents in the Dayton SMSA, we reviewed fifteen years of yellow pages advertising in the Dayton telephone directory. The pattern of a general exodus from the central City of Dayton was clear. Indeed, at the present time, it should be noted that of the fifty-one agents of State Farm who advertise in the Dayton yellow pages, only one is located in the City of Dayton. The one who is located in the city is literally located on a lot which abuts the municipal boundary line. Additionally, of the fifty-one agents in the Dayton telephone directory, not a single one was black, despite the fact that the Dayton SMSA has a population which is approximately 12% black. Accordingly, in negotiating the settlement of the case, we demanded, and obtained from State Farm a commitment, that minority agents would be hired and placed at work in the Dayton area. State Farm has committed itself to having at least one minority agent active and on line by the end of this calendar year. Additional elements of the settlement included, the payment of compensatory damages to Ms. Wildman, the payment of attorneys fees, affirmative advertising by State Farm in the minority press, moving up the date of marketing of a modified replacement cost policy in the State of Ohio, zip code disclosure of policies in force by State Farm, and several other steps which State Farm agreed to take, including a meeting with all of the State Farm agents in the Dayton area which was addressed by officials of the City of Dayton as well as community activists living in the City. One further element of the settlement, was that a letter go out to Dayton agents advising them that redlining was contrary to the policies and procedures to be followed at State Farm. We are continuing to work closely and monitor closely State Farm's activities in the metropolitan area, and have called some additional problems to their attention to be handled privately and quietly in order to achieve resolution.

The second case I wanted to call to your attention is that of Mr. and Mrs. Stanley Hurst of 51 Weller Street in Dayton, Ohio. Mr. and Mrs.



Hurst are a retired black couple who have owned their home since 1945. Since purchasing their house, they have held insurance policies on their home sold to them by the W. J. Thornton Agency in Dayton. For several years prior to March 1978, the insurance coverage provided by Thornton was from the Buckeye Union Insurance Company, one of the Continental Companies. In March 1978, their policy was non-renewed by Buckeye. The non-renewal came despite the fact that in the entire period the Hursts had lived at their residence, they had never filed a single claim for loss. In checking on the reason for the non-renewal of the Hursts, I spoke with Joy Moorman at the Thornton Insurance Agency. She advised me that in her estimate the house itself was not worth more than \$7,000.00, though she was not aware and did not have the benefit of any inspection and/or field appraisal of the home in order to make that estimate. I have examined the house, and find it in generally good repair, with new aluminum siding covering most of the house. In any event, Ms. Moorman went on to advise me that the company had had a number of fire losses, but none of them related to the Hursts, and the company could not therefore be blamed for not renewing policies in the area. She advised me that the company did not desire any low value property business due to the many fire losses on such property. She also added that it was the company which initiated the non-renewal and not the Thornton Agency. On March 29, 1978 I contacted Mrs. Smith at the Buckeye Union Dayton field office who indicated to me that she had absolutely no idea why the non-renewal was initiated. She indicated she would have her supervisor call me. I am still waiting to hear from him. In the interim I wrote to the Buckeye Union Insurance Company on behalf of the Hursts to inquire into the reason for their non-renewal. Their response was that the Hurst policy was not renewed by the company but it was not due to any minimum coverage policies the company had in regard to standard fire insurance. On the other hand, they went on to say that the action was precipitated by an agent in the Dayton office, but "the file does not reflect the specific reason for the decision. The individual who originated the request is no longer employed by our company, therefore, we were unable to discuss the file with him." Despite my request in a letter of March 2, 1978 to the Buckeye Union that the Hurst policy be renewed, and despite the fact that Buckeye Union stated it had no idea why it had not renewed the policy, and despite the fact that the Hursts



had not filed a single claim during the entire thirty year period of ownership of their home, Buckeye Union refused to reconsider its decision and renew the policy of the Hurst family. The agent had advised Mr. and Mrs. Hurst that they were unable to obtain any coverage for the Hursts in the voluntary market, and as a result could only provide them with coverage through the Fair Plan. To this day the Hursts continue to be unable to obtain any coverage other than through the Fair Plan. The Fair Plan premium is \$81.00 per year, whereas their previous coverage from Buckeye Union was at a premium of \$111.00 for a three year period. In other words, their premium almost tripled when they were forced out of the voluntary market and into the residual market.

Subsequent to the formation of the Independent Insurance Agents Association, Dayton Action Committee, set up to deal with allegations of re-lining in the Dayton area, I referred the matter of the Hursts to that committee. In September 1978, the committee advised the Hursts through their parish priest, Rev. William Schiesl, that they had prevailed upon Buckeye Union to sell a market value policy to the Hursts with \$10,000.00 coverage on the dwelling. The annual premium for such a policy was to be \$150.00 per year, nearly double what they were paying for the Fair Plan, and more than quadruple what they had been paying for Buckeye Union previously. Needless to say, the Hursts rejected the policy offered them as being inadequate coverage at an exorbitant price. To date, as I indicated, the Hursts remain insured by the Fair Plan and are able to obtain no other coverage.

Mr. and Mrs. Howard Breashears are a retired white couple who live in West Dayton, a predominantly black neighborhood. The Breashears have lived in their home for thirty-one years. Until January 1978 they had maintained coverage with the Indiana Insurance Company, and during that period of time filed two claims for losses. One claim was honored and paid, and the company declined payment on the second claim. In January 1978, the Breashears were advised by their agent, the Swartzell Agency of Dayton, that coverage would no longer be available to them through the Indiana Insurance Company, and that Swartzell could only write the Breashears' homeowners coverage with the Stuyvestant Insurance Company. They offered the Breashears \$12,000.00 worth of coverage for a premium of \$138.00 per year. The agent further advised the Breashears that the premium was a high one but that the company specialized



in high-risk property insurance and that was all that was obtainable for the Breashears. Because they felt the price was too high, the Breashears purchased a policy from the J. C. Penney Company which afforded them \$20,000.00 worth of coverage for an annual premium of \$102.00 per year. Shortly after obtaining the policy, J. C. Penney cancelled it. On March 1978, just eight days after the effective date of cancellation, I spoke with Mr. Larry Thaxton of the Westerville, Ohio office of J. C. Penney. Mr. Thaxton advised me that Equifax Services had done an appraisal and appraised the house as being worth only \$14,000.00 and the policy was written for \$20,000.00. He suggested that the appraisal was a factor in the decision of J. C. Penney in that the company's underwriting standards prevented him from writing any insurance where the market value of the property was less than \$16,000.00, and that the policy had to be cancelled. A J. C. Penney agent advised the Breashears that the only kind of insurance available for the people in their neighborhood was high-risk insurance. By virtue of being on a fixed income and being unable to afford high-risk insurance, and also because of their idea that high-risk insurance carried with it a stigma of humiliation, the Breashears have refused to seek out any high-risk insurance and have, since 1978, gone absolutely without insurance. Ironically, despite being titled a "high-risk" by two insurance companies and an agency, the Breashears have not suffered any losses since the time they lost their insurance. While they have been fortunate, they perhaps best exemplify how the elderly, those with pride in their homes and pride in their life-styles, and those whose presence is so important in central city neighborhoods, are mistreated and abused by the insurance industry.

In addition to the cases that I have cited, I have personally received complaints from agents advising me that companies had told them not to do business in certain areas, or if they do do such business to do it on discriminatory terms. One example was an Allstate agent who complained that he had been instructed by his company not to write any insurance in the City of Dayton with a deductible of less than \$250.00, while he had the discretion to write insurance in the suburbs with deductibles down to \$50.00. One agent of the Prudential Insurance Company who visited my home in an effort to sell me a homeowner's insurance policy, advised me pursuant to my questions that he had no problems at all writing insurance in my neighborhood, but then rattled off



a series of neighborhoods where the company preferred that he not write insurance. Those neighborhoods that he mentioned were exclusively in the west side of the City of Dayton or in those predominately black suburbs located immediately to the west of the City of Dayton. All of the neighborhoods mentioned were predominately black. A former marketing representative of the Economy Fire and Casualty Company has advised me that the company actually maintained a map with red lines on it indicating what areas of the city they were not to write homeowner's insurance in. Those lines, he advised me, had a high correlation to the racial composition of the region. He was subsequently discharged by the company, in part, because he disagreed thoroughly and vehemently with the company's policy of redlining neighborhoods. I have attended innumerable neighborhood and community meetings where people have complained vigorously of being told by their agents or by their companies that they could no longer obtain satisfactory levels of insurance coverage, if any coverage was available at all, because of the neighborhood in which they live. When one such complainant, Junita Johnson, of the Dayton View neighborhood pursued the matter further, they company advised her confidentially "that the real reason for her termination by the company was that she had the habit of piling her dirty clothes in front of her washing machine until she had enough clothes to do a full load in the machine, and that indicated she was too sloppy of a housekeeper to be deserving of insurance coverage from their company." Mrs. Thelma Stovall, who also owned a home in the racially integrated Dayton View neighborhood, was advised by an agent that she could not obtain insurance on the home she owned because people in her neighborhood were too prone to arson. Mr. Ulysses Foster, a small businessman in predominantly black West Dayton, had his insurance terminated because he supposedly resided in a "high crime" neighborhood. Mr. Chester Russ, of West Dayton, has had great difficulty in obtaining insurance coverage because three companies believe the market value of his home was too low. I might add that the companies made these representations, despite the fact that Mr. Russ has invested quite heavily in rehabilitating and maintaining his home in recent years.

The litany of complaints and problems from insurance redlining in Dayton, Ohio could go on and on ad infinitum. Based on my own experience,

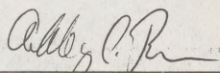


I am of the very strong opinion that insurance redlining is the single most widespread discriminatory practice in housing in the Dayton area today.

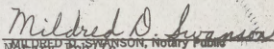
I would be remiss if I did not include some remarks about the insurance department in the State of Ohio. I know of no single complaint of insurance redlining, and I am in constant touch with community groups around the State of Ohio, in which the State Insurance Department has successfully resolved the matter. Indeed, incredible as it may seem, the State Insurance Department has actually referred complaints made to them from the Dayton area to me to be resolved. There is, for all intents and purposes, absolutely no insurance regulation in the State of Ohio. The record of the State Department is a shameful one. I am extremely heartened by the legislation proposed by Senator Metzenbaum in the Insurance Competition Improvement Act. I strongly urged its passage.

Finally, I would point out that the proposed legislation is consistent with the trend in federal regulation of lending institutions in barring discriminatory practices in the marketplace. In fact, lenders in Dayton have complained to me that their efforts to affirmatively market housing loans in inner city neighborhoods have been severely hindered by insurance availability problems. Thus, rather than viewing the proposed legislation as being a federal intrusion into insurance regulation, I am convinced that it ought to be seen as a federal effort to free lending institutions from manipulations in the insurance market which adversely effect their ability to expand their own market. In short, insurance redlining is not an expression of the free market, but rather is a form of interference by one industry with the free market forces in another industry.

Further the affiant sayeth not.

  
Ashley C. Brown

Sworn to and subscribed before me on this 23rd day of May, 1980.

  
MILDRED D. SWANSON, Notary Public  
Notary Public  
in and for the State of Ohio  
My Commission Expires June 26, 1982

Attachment:



UNITED STATES DISTRICT COURT FOR THE  
SOUTHERN DISTRICT OF OHIO  
WESTERN DIVISION

MARTHA JO WILDMAN  
1111 Richmond Avenue  
Dayton, Ohio 45405

CIVIL ACTION NO. .

Plaintiff

vs.

STATE FARM FIRE AND  
CASUALTY COMPANY  
1 State Farm Plaza  
Bloomington, Illinois 61701

and

DAVID M. LEONARD  
5898 Salem Avenue  
Dayton, Ohio 45426

COMPLAINT

Defendants

---

INTRODUCTION STATEMENT OF THE CASE

1. Plaintiff seeks damages for racially discriminatory practices and underwriting standards in the issuance and maintenance of renter's insurance policies by Defendants. Said practices and underwriting standards deprived Plaintiff of renter's insurance covering her place of residence, 1111 Richmond Avenue, Apartment 4, Dayton, Ohio 45405.

2. Plaintiff also seeks injunctive relief from the effects of said racially discriminatory practices and underwriting standards in the issuance and maintenance of insurance policies by Defendants.

3. Plaintiff asks that this Court take whatever steps and remedies are necessary to insure full and complete compliance with all applicable statutory and constitutional provisions.

4. Plaintiff also seeks costs and attorney's fees in this action.



I. PARTIES

5. Plaintiff Martha Jo Wildman is the lessee of the premises at 1111 Richmond Avenue, Apartment 4, Dayton, Ohio 45405. She is a white female.

6. Defendant State Farm Fire and Casualty Company is a corporation doing business as a casualty insurer in the State of Ohio.

7. Defendant David M. Leonard is an authorized agent and/or employee of Defendant State Farm Fire and Casualty Company. Said David M. Leonard acted at all times in the matters complained of herein in his capacity and within the scope of his status as agent and/or employee of the Defendant State Farm Fire and Casualty Company.

II. JURISDICTIONAL STATEMENT

8. The jurisdiction of this court is invoked under Section 812 of Title VIII of the Civil Rights Act of 1968, 42 U.S.C. Section 3612.

III. GENERAL STATEMENT OF FACTS

9. The area in which Plaintiff resides is characterized by racial integration in its residential living pattern.

10. Plaintiff desires and knowingly chose to live in a racially integrated area.

11. On or about July 6, 1977, Plaintiff purchased a renter's insurance policy from Defendants for a term of one year for the contents of her apartment located at 724 Hallworth Place, Trotwood, Ohio 45426.



12. The premium on said policy was \$48 per year. Plaintiff paid said premium.

13. On or about May 20, 1978, Plaintiff moved her place of residence and all her personal contents from 724 Hallworth Place, Trotwood, Ohio to 1111 Richmond Avenue, Apartment 4, City of Dayton, County of Montgomery, Ohio.

14. On or about May 23, 1978 Plaintiff notified Defendants of her change of residence.

15. On or about May 24, 1978, Plaintiff received notification from Defendant David Leonard that State Farm Fire and Casualty would not provide renter's insurance coverage at her new place of residence because of the area in which it was located.

16. Defendants' refusal to provide insurance coverage at Plaintiff's new place of residence was related to the racial composition of the area in which it is located.

17. Defendant State Farm Fire and Casualty employs underwriting standards and criteria which discourage the writing of renters and homeowners insurance in areas of concentrated minority group population.

18. Because of the racially discriminatory actions complained of Defendants herein in refusing Plaintiff renter's insurance at her new place of residence, Plaintiff's premises was made unavailable to her for many uses associated with the rental of property including but not limited to the security of her possessions, interfered with Plaintiff's rights to rent said property, interfered with



Plaintiff's rights to live in a racially integrated neighborhood thereby depriving Plaintiff of the benefits of interracial association and encouraged deterioration in said neighborhood thereby hindering Plaintiff's ability to fully enjoy her rights of quiet enjoyment of the leased premises.

#### IV. FIRST CAUSE OF ACTION

##### A. Parties and Jurisdictions

19. Paragraphs 5 through 8 are incorporated herein by reference.

20. Plaintiff sues on behalf of herself as a white lessee desiring to live in a racially integrated neighborhood.

##### B. Acts Complained of

21. Paragraphs 9 through 18 are incorporated herein by reference.

22. As a result of the discriminatory actions and/or standards complained of Defendants herein, Plaintiff was deprived of her rights pursuant to Title VIII of the Civil Rights Act of 1968, 42 U.S.C. Section 3601 et. seq.

#### V. RELIEF SOUGHT

Wherefore: for all of the above reasons Plaintiff prays as follows:

1. On behalf of herself a permanent injunction preventing each and every Defendant from: (a) acts of racial discrimination in the issuance of insurance policies, (b) using standards which are racially discriminatory in the issuance and terms of insurance policies, (c) denying renter's insurance coverage to



Plaintiff on the basis of the racial composition of her neighborhood, (d) employing underwriting criteria which are discriminatory toward areas with minority population concentration or racially integrated residential patterns.

2. On behalf of herself, Plaintiff prays for an order of the court instructing Defendant State Farm Fire and Casualty Company to formulate and implement a court approved plan for the affirmative marketing of property casualty insurance in order to prevent the occurrence of racial discrimination or practices which have that effect.

3. On behalf of Plaintiff the sum of \$10,000 in actual damages against both Defendants herein jointly and severally.

4. On behalf of Plaintiff the sum of \$1,000 in punitive damages against each Defendant herein.

5. Plaintiff prays for her costs herein and for reasonable attorney's fees pursuant to 42 U.S.C. 3612 (c).

6. Plaintiff prays for such other and further relief as this honorable court may deem just and proper.

Dated:

---

Ashley C. Brown  
Trial Attorney for Plaintiffs  
Montgomery County Fair  
Housing Center  
Suite 500  
333 West First Street  
Dayton, Ohio 45402



JURY DEMAND

Plaintiff demands a trial by jury as to  
all issues herein.

---

Ashley C. Brown  
Trial Attorney for Plaintiffs  
Montgomery County Fair  
Housing Center  
Suite 500  
333 West First Street  
Dayton, Ohio 45402



TO Martha Waldman  
1111 Richmond Ave  
Dayton, Ohio 45406  
L

DAVID M. LEONARD  
LOCAL AGENT



5898 SALEM AVENUE  
(Cor. WESTBROOK & SALEM)  
DAYTON, OHIO 45426  
Phones: 854-4040 - 837-0606

- ☐ Enclosed is your policy.
- ☐ Enclosed is Endorsement.  
Please attach to your ..... Policy
- ☐ Please see enclosed form.  
☐ Please complete & return to me.  
☐ Please sign where indicated and return to me.
- ☐ Enclosed is check for  
☐ Recent Claim  
☐ Premium Adjustment
- ☐ Enclosed is Premium Statement.  
Please submit in attached envelope.

- ☒ I have been unable to contact you.  
Would appreciate your calling my office.

☒ After Mr. Luxard looked  
over your change of address he  
informed me he cannot write  
coverage to your extent at  
this residence.

Due to the area itself  
and also by having no other  
supporting business he does not  
which to keep the Renters Policy.

Thank you.

DL.



## PREPARED STATEMENT OF DELORIS WOODLEY RODGERS

On February 23, 1976, I purchased a house, located at 2027 Penrose Street in the City of St. Louis, Missouri.

The house was purchased from American Real Estate Company located at 10943 St. Charles Rock, Road Overland, Missouri, the price of the house was \$15,150.00. The house is described as: single family, 2-story dwelling, with full basement, 7 rooms; 4 bedrooms, 1½ baths, composed of brick and frame construction, front and back yards.

At the time of purchase the house was not in need of any repairs and it was only 2 years old.

I purchased this house because at this time I was looking for a home where my children would be comfortable and this house was ideal! I had asked each child exactly what they would want in a home, and this house had all the features, plus I could afford it. There were hardwood floors which were great because my daughter is asthmatic and allergic to carpeting and the dust that it holds.

My children would be free to play without disturbing anyone or interfering with their privacy. We would all be comfortable without being crowded. The property we would be caring for would belong to us.

At this time I was a single woman with seven children ages 17 to 4 years, and this was my first house, I had never made this kind of venture before and I was very happy the day I closed. My children were proud of me and I was proud of myself, I was making one step upward. I had prayed and my prayers had been answered.

The initial insurance that I purchased at the time I closed on the house expired in 1977 and I started to look for a more economical one. The Home Owners rate had gone up and the coverage was less than before. At that time I became aware of the problems of finding complete insurance. I invested a lot of time calling insurance companies and inquiring about their Home Owners' policies, costs and coverage. As I've said before this was my first home and the first time I really got upset trying to protect something I valued: my home.

My home was important to me and my family, and worth every penny I would pay for it, and I wanted protection for it. When I called Allstate and found out that I could get insurance for it I was ecstatic. Now I would have the coverage I needed with a company I thought at that time was at least dependable. I trusted the name Allstate and when I got a policy for 10% less than the original price quoted I was thrilled; the reason stated for the decrease in premium was because of the house being less than five years old. The policy went into effect March 9, 1977, and was a Deluxe Homeowners Policy, Allstate's best policy.

Then, approximately one month later, on April 14, I got a letter of cancellation with a returned check. I did not know why, and when I tried to get some information as to WHY-I was unable to. I called the agent who wrote my policy, Mr. McCullin, several times and he never returned any of my calls. The cancellation letter said the cancellation was because of value, which did not mean anything to me; I needed to have an explanation of *what value*. I was later given a number by the receptionist at Allstate to contact the Home Office in Shawnee Mission, Kansas collect, but the receptionist there refused the call and hung up. When I called the office here in St. Louis she explained to me that maybe they didn't understand the nature of the call, but Mr. McCullin was still not available.

As it suggested on the letter-of-cancellation I did make contact with the FAIR PLAN, which I found out only provided fire insurance for the structure, not the contents, this was unsatisfactory. I wanted more than fire insurance; I wanted Home Owners.

I then called Legal Aid and explained my problem to them and they suggested I talk with Arlene Zarembka, who handled housing complaints. I did.

I explained my problem to her and at that time I had not heard of Red-lining except in the newspaper and it had not had a bearing on me because then I was not a homeowner. Now I had got slapped in the face for living in the wrong part of town or being the wrong person, I didn't know which or why. No one would talk to me and explain the reason, plus to add insult to injury the money paid for the insurance came out of my escrow account and the full amount was not refunded to me.

I could not understand. What had happened? What had I said? What had I done? Who had I offended? I got mad.

Arlene explained Red-lining to me and I got madder.

I still had to have insurance so I spent two days at work calling every insurance company in the telephone book, and the officers at the police department where I work gave me agents to call. Finally, I got in touch with Mary Krueger of the



Krueger Insurance Company and explained to her the problem I was having and she told me that she would try to help me.

I got my policy with Mary Krueger in May of 1977 and it has been renewed for each year since then. I have never made a claim on that policy. I have bars around the front of my window and the back, also on the front and back doors and on the basement window. I'm not saying I live in a high crime area, but I don't want to be a statistic. I have taken preventative measures.

In June, 1977 Legal Aid filed a lawsuit against Allstate under the Civil Rights statutes, 42 U.S.C.A. §§1981 and 1982. They sued for \$51,000 in damages, which included emotional distress, deprivation of my civil rights, and punitive damages.

Only after the lawsuit was filed did I find out what Allstate meant when they said they had cancelled my insurance policy because of value. The Division Manager of their underwriting department in Overland Park, Kansas stated in a deposition that my policy was cancelled because the value of my house did not meet their minimum, and because the replacement cost of my house was more than 125% of my market value. Allstate had a requirement that houses had to have a market value of \$20,000 before they would give a homeowners policy.

I don't think it is fair that Allstate required that my house be worth a certain minimum amount. As I said, my house was only 2 years old when I bought it, it was in excellent condition, and I have never made an insurance claim on it. In 1977 there were many houses in St. Louis in good condition that could be bought for less than \$20,000 so Allstate's requirement eliminated many people from being able to get a homeowner's policy.

I also don't think the 125% criteria between replacement cost and market value is fair. I understand that Allstate changed this criteria to 150%, but I still don't think it is fair. With construction costs so high, the replacement cost of many good homes is much higher than the market value. This criteria eliminates most homeowners in the City of St. Louis from being able to get homeowners insurance.

After about 15 months of litigation, my case against Allstate was settled for \$25,100. This settlement included reimbursing Legal Aid for thousands of dollars in costs they had spent in preparing the suit.

---

#### PREPARED STATEMENT OF ALBERTO NUNEZ

Senator, my name is Alberto Nunez. I am 20 years old and I reside at 806 West Roscoe Street in Chicago. I am employed as a contractor in a housing renovation project and I go to trade school part time. I want to talk to you this morning about unfair automobile insurance rates in the city of Chicago. I cannot get insurance for less than \$2,000 a year on my 1980 Ford Bronco. As a matter of fact, one broker cited me a figure of \$3,800. I simply cannot understand these high rates. I am either subsidizing somebody else's insurance or the insurance companies are getting rich off me and people like me.

The reason I do not understand these rates is that I have a perfect driving record for the five years I have been driving. No accidents, no traffic violations. I do not use my car in my work and I drive less than three miles to get to work. These factors should entitle me to a good rate, but the insurance companies do not look at it that way. They place more emphasis on what they see as negative factors—that is, that I live in the city of Chicago and I am unmarried. Let me show you how these factors influence my rates.

Until two months ago, I had full coverage with State Farm at just over \$1,700 a year. The agent said I would be paying much more except that I listed my 28-year-old sister as the principal driver of the car. If I were the primary driver, he said the rate would be about twice as much. But if I got married, he said I could save 10 percent. And, if I moved to the suburbs I could save another 25 percent. I do not see how any of this has anything to do with my driving ability.

I let the State Farm policy lapse in March because I could no longer afford \$1,700 a year for insurance. When I set out to find a lower rate, I was in for a rude awakening. Every other quote I got was even higher than State Farm, and some were much higher. Here are some examples: 1) one broker I called about Kemper Insurance said Kemper would not insure 20-year-old drivers in the city of Chicago. Despite my totally clean driving record, she suggested I go into the Illinois Assigned Risk pool at \$3,800 a year for a policy no better than the State Farm one; 2) another broker said the best she could do was place my collision and comprehensive insurance with a company called Delta for \$2,595 and liability coverage with Coronet Insurance for \$770. That adds up to \$3,365; and 3) an Aetna agent I called cited me a rate of \$2,286. Like the State Farm agent, the



Aetna agent said I could save a lot of money if I moved to the suburbs or got married. I then told her I was considering moving to Bensonville in the Chicago suburbs and she told me I could get a rate there of \$1,290 a year—or about \$1,000 less than the Chicago rate. If I moved to Bensonville and got married, it would only cost me \$792.00.

Since I am not moving to Bensonville or getting married, I still have not found a rate I can afford. I guess I will just have to search for a policy for just liability. If I mess my car up and it is my fault, I am just out of luck. There must be millions of other young people in the same predicament that I am. I hope the Subcommittee can do something to force the insurance companies to make insurance affordable to us.

---

#### PREPARED STATEMENT OF LAURENCE R. BECKER

Senator Metzenbaum and members of the committee: My name is Laurence Becker. I am employed as a supervisor in special education for the New York City Board of Education. I consider it an honor and privilege to be able to come before you today to discuss some of my experiences with automobile insurance as a resident of the State of New York. I am a resident of the boro of Brooklyn and the owner of two automobiles which are covered by liability insurance as well as comprehensive, fire and theft. My annual premium for this coverage is \$2,254. I do not carry collision insurance because of the extremely high cost which would send my total premium out of sight.

I am being penalized and discriminated against because I live in the boro of Brooklyn and because I have two male drivers under age twenty-five in my family. The span of years during which I have been and will be penalized for underaged male drivers covers a period of fourteen years. It began in 1976 when my oldest son reached the age of 18 and got his drivers license, and will continue until the year 1989 when my youngest son turns 25. The total cost in surcharges over this period of time, using the current surcharge as a median rate, will amount to \$4400.00. This is the approximate cost of a 4 year education in the City University of New York which my two boys now attend.

In addition to this rip off I am being charged, what I consider a discriminatory rate because of the boro in which I live. Friends and relatives living in Staten Island and New Jersey pay a considerably lower rate, as much as 40% lower, because of their place of residence. Property taxes are at an all time high in the City of New York at this time. The insurance rates on my two cars now cost me more than the taxes on my home which is a two family brick house, currently valued at approximately \$80,000. Because of these discriminatory policies, many of my friends have registered their cars with relatives either in Staten Island or New Jersey who bear the same last name, fraudulently using these addresses as their own for insurance purposes. I continue to resist this temptation and prefer to attempt to bring about change through legal means which is why I am appearing here today.

The fact that I do not carry collision, as is true of many of my acquaintances, means that I must insure the car myself for such damages because of the prohibitive cost of such coverage. My friends who do carry collision insurance tell me that although they carry it they are usually afraid to make a claim because the increase in premium would often cost them more than it would cost to fix the car themselves.

The attitude of the insurance companies seems to be that they are doing us a great favor in selling us insurance at a very high premium which must be paid promptly. One, however, must fear putting in a claim and if it is valid must frequently wait a considerable length of time before collecting.

It is my fervent hope that some relief will come to New York State motorists like myself who must suffer these discriminatory abuses on the part of the insurance companies.

Senator METZENBAUM. We will hear from Ms. Gale Cincotta, chairperson, National Peoples Action, and Mr. Andrew Mantovani, president, New York Metropolitan Agents and Brokers Association, on the next panel, which will be in about 2 or 3 minutes.

[A short recess was taken.]



## STATEMENT OF GALE CINCOTTA, CHAIRPERSON, NATIONAL PEOPLES ACTION

Senator METZENBAUM. Ms. Cincotta, we are very happy to hear from you. You have a rather lengthy statement. I wonder if you could be good enough to summarize it.

Ms. CINCOTTA. Yes. You said it would be put in the record, whole. I would like to take excerpts of it.

Senator METZENBAUM. Yes. Your entire statement will be inserted in the record at the conclusion of your oral statement.

Ms. CINCOTTA. Thank you for inviting me to the hearings.

For myself and the people I represent, the crisis of insurance availability has been documented for many, many years.

I think the first time I testified in Congress was in front of Senator Hart's committee, in 1972. One of the issues was the insurance redlining at that time, also.

Senator METZENBAUM. Tell us, Ms. Cincotta, who is the National Peoples Action?

Ms. CINCOTTA. The National Peoples Action is a national network of neighborhood organizations throughout the United States, and most urban major cities.

At our last national conference, we had about 126 cities represented. It was started in 1962. Again, it was our first time in Congress, testifying.

What I would like to talk about is a little bit about some of the different ways that insurance companies discriminate. I think to show it more graphically, there are four exhibits that I attached to my testimony, if you want to look at them as we go along on it.

One is the practice of terminating and denying insurance based upon the geographic location of the risk.

What I have attached, on exhibit No. 1, is a list from one of Chicago's largest insurance brokers, W. W. Vincent & Co. The parent company is the Insurance Company of Illinois. Up to about a year ago, they were using a list such as this, that had "acceptable, non-acceptable," zip codes listed.

From my own personal experience, I lived in one of the unacceptable zip codes. So, I wasn't insured through W. W. Vincent, but our insurance on our house, I was telling my husband that we are almost paid up on our home. And as soon as we are paid up on our home, watch and see how fast our insurance gets canceled. We had a 3-year policy.

Sure enough, the insurance was due and was nonrenewed. They referred us to the fair plan.

This is a house lived in for 15 years, no claims ever on the insurance policy. When I called up and accused them of redlining, the person got very upset and said, "I'll find you another insurance company to insure you. Call me back the next day."

He said the next day, I found you another insurance company for the same amount of insurance that you had before that I was paying \$100 a year. They said they had another company that would charge \$384 for the same insurance.

I said that was also discriminatory and redlining and I didn't want that insurance.

So, I called up Allstate Insurance Co. They bound it over the phone.



Two months later, they sent back the check, part of the check and said I was canceled, referred it to the fair plan and just checked the box that says "underwriting standard."

Nothing had happened different in this house when all this was going on, except I was one of the last white families left on the block, and we did pay up our mortgage.

In fact, in the process of these few years, where we had maybe 10 FHA vacant homes on the block, 5 years ago, they were all fixed up now.

So, no agent, no company, no underwriter, nobody had been there at all.

So, I was arguing with the second insurance company, and in the process, I didn't have any insurance on that house. I didn't want to go to the fair plan because it was almost an immediate stigma. Once you are on the fair plan it is very hard to get insurance with a conventional carrier.

So what I did, we took photographs of the house, the front and back and so on, and got the insurance reinstated on the house, finally, after several months of being uninsured.

When my husband died a few years ago, I moved—I sold this house, bought another one a few blocks north, in another ZIP code. First thing, and this is after we had been organizing on the issue, had tried to stop some of these policies, got pledges from these insurance companies that they would not discriminate, again, they would not use the ZIP code lists, the first thing the insurance person, agent said, "What ZIP do you live in?"

I didn't know that they had these lists at that time. I was up an acceptable list. So, they wrote me a deluxe homeowners policy from Allstate. I was now in 60639.

After I bought the house and moved in, I am now bound by that insurance policy. I updated the electricity in the house for \$1,000, put in 220 lines and all that. My insurance on the other house was better. Just because I had moved a couple blocks, in a different zip, they assumed that house was OK, never looked at that house either. I have since put in about \$5,000 or \$6,000 worth of work in that house.

So that if they were looking, one house maybe was better, even though it was in a different ZIP than that house. It didn't make any difference. It just meant where I lived.

The other thing, when we keep talking about inner city neighborhoods, I live on the west side of the city of Chicago. The one house was six blocks from the city limits. This house is 1 block from the city limits. So that the inner city neighborhoods are almost anywhere within city limits. You don't have to live inside, somewhere deep inside the city or near the loop or anything. You just have to live in the city and you are discriminated against.

I wonder how many other companies other than W. W. Vincent has this kind of a list. It is very much like the list that the banks and S. & L.'s had on ethnic origin before they would give you a loan.

The other practice of discrimination is terminating and denying insurance on the age of the dwelling. I attached, again, as exhibit No. 2, a risk selection guide put out by the Travelers Indemnity Co. of Illinois.



I wanted you to look at this exhibit, the words, "Of Illinois," are typed in. So I assume that the other States, they just use the same form and type in the other States, also.

No. 9 is dwellings over 40 years of age. At the top it says "Following types of risks are not to be bound in the Travelers' homeowners program,"—automatically, dwellings over 40 years of age.

According to the U.S. Census information we have, 7 out of 10 residential dwelling units in Chicago are 40 years of age. All of the major older cities, I assume, are about the same kind of statistic. So that when you have the Traveler's Insurance Co. putting out that kind of information, you know they really don't want to write in the cities.

One of the reasons that Mr. Cameron who is the senior vice president of Travelers referred—he referred to the particular issue called "insurance urban homes." He also wrote, "Most buildings are old and the cost to replace them would be significantly higher than their actual market value."

He says, "Under the circumstances, what sense does it make to encourage an individual to buy a policy covering 80 percent of replacement costs?"

He says, "Only in one sense: to provide the incentive to burn the structure."

This was out of Protection magazine, September 1979, published by Travelers Insurance Co.

What he is saying to me and other people who have chosen to live in the city, that if we insure you at the replacement cost of your house, you are going to burn down your house.

He is assuming that we are all arsonists. That our goal in life is to overinsure our house and burn it down with our families probably in it.

This is the attitude of the insurance companies, of Travelers, of other companies, of their attitude toward city people who choose to live in the city.

The other thing is, third is the termination of and refusal to appoint insurance agents in urban neighborhoods.

Again, exhibit No. 3, this is Hartford. Hartford selected placement of its insurance agents. In the whole south and west side of the city of Chicago, they have four agents. Downtown they have 42. On the north side, 27. In the suburbs, 62.

Again, availability of insurance comes also with where they place the agents. You will find in most of the neighborhoods, that you do not have an agent that knows the neighborhood, that is located in the neighborhood or will even write your insurance.

So, that is another way, if you—first you have to even find an agent. If you find him, then they give you another reason not to insure you. First, just even being able to have access to an agent that lives in the neighborhood and knows it and or knows you is practically impossible by the way most insurance companies have their agents.

To us, it is not an isolated case. It is happening in every city that we have affiliates in also.

Fourth, is discrimination in the pricing of insurance. Our understanding of insurance, maybe being naive, is that it is a shared risk. Spread the risk out, lower the cost for everybody, and everybody shares in. Somebody has an accident, somebody has a claim, and everybody shares its risk.



Evidently that is not how the insurance companies decide. It is mostly how you live, and they have either a rating territory.

Right now in Illinois, State Farm decided to have 60 rating territories. They have lowered it down to zip codes.

None of this has anything to do with the individual, their home, what kind of construction it is, how they take care of it, what is your risk factor.

Again, it is an arbitrary decision that somebody has made. And, my feeling is that the insurance companies are looking to make more and more money and forget what they are in business for, to insure everybody. You have to have insurance. You can't get a mortgage if you can't get insurance. You are not supposed to drive if you don't have car insurance. So that a thing like the last people testified, you are caught in that bind and you are caught like that young fellow who testified before.

What would be the difference if he lived in Bensonville and worked in Chicago? He would have to drive into the same neighborhood every day. But it is also forcing people to live outside the city.

The other thing that we see happening very much, as I said before, is whether you call it redlining or convention market dysfunction, is that people are pushed in to Fair Plans, one of the largest insurers within the metropolitan areas.

In 1975, the Illinois Fair Plan, the seventh largest in the country, insured 44,600 homes.

By the end of 1979, another 31,000 people had found their way into the Illinois Fair Plan.

You can go State-by-State and it seems to be more of a rule of thumb that they are pushing more and more and wanting to practically get out of this business.

Other than endorsing the legislation you have pending, we would like to ask for a couple of changes. Under the portion you call under disclosure, we would like to have this on a quarterly basis. I think the way it is proposed in the legislation it would be very hard to make sense out of the data coming in for people who are trying to follow this along.

We would recommend that it be put out on a quarterly basis. It is done in Illinois that way. It is working. Everybody who writes insurance in Illinois has figured out a way to disclose so it will work.

Our second recommendation is to eliminate entirely the provisions in section 6, of the bill, that would allow for any difference of rates based on geographical location of a risk.

We feel also that one of the things you are doing by this legislation is again, not creating another Federal bureaucracy, but it is giving an enlightened viewpoint and some direction to the States of how they should increase competition.

If the rest of the Senators don't realize, they are very scared of what you do and what you say, even if you give as in this bill, a direction of what they should be doing right now and to fighting this kind of legislation that really shouldn't hurt them in any way.

They are running around with big ads in the newspapers. Aetna Life & Casualty is spending millions of dollars on ads saying how they can insure themselves instead of having you do it.

I think that since 1972, I have been working on this, and back to 1968, and they still haven't figured a way to do it.

Thank you.



[The prepared statement of Ms. Cincotta follows:]

PREPARED STATEMENT OF GALE CINCOTTA

The crisis of insurance availability and affordability has been well documented by community organization as well as by local, state, and federal authorities for over fifteen years. We in the neighborhood movement have experienced on a first hand basis the litany of abusive and discriminatory practices on the part of the insurance industry that has served to severely limit the availability, accessibility, and affordability of the most basic property and casualty insurance, particularly in this nation's urban areas.

I would like to take this opportunity today to highlight a few of the more blatant practices that have the most direct effect upon limiting the availability and affordability of insurance and that would in fact be remedied if the Insurance Competition Improvement Act now before this Committee is adopted.

(1) The practice of terminating and denying insurance based upon the geographic location of the risk. As an example of this, I refer you to Exhibit 1 attached to this testimony: a directive that until last year was used by one of Chicago's largest insurance brokers, W.W. Vincent and Company, and its parent company, the Insurance Company of Illinois, to designate by zip code twenty of Chicago's sixty neighborhoods as "not acceptable" for conventional insurance.

At the request of National People's Action and its Chicago affiliate, the Metropolitan Area Housing Alliance, the Illinois Department of Insurance conducted an investigation of the insurance company and its broker and found them both guilty of redlining.

So that there will be no misunderstanding as to the extent of industry involvement, here it is worth noting that the brokerage firm, W.W. Vincent, represents over fifty major insurance companies including Economy-Kemper, Fireman's Fund, Banker's Standard, and the Hartford.

Because W.W. Vincent's clients include almost all of Chicago's savings and loans, the effect of its redlining has been no doubt to make it more difficult if not impossible for many potential Chicago homeowners to acquire a mortgage with adequate insurance protection as is required by law in Illinois.

(2) The practice of terminating and denying insurance based upon the age of the risk.

As an example of this, I refer you to exhibit 2: The Travelers Indemnity Company of Illinois Risk Selection Guide that lists those risks that are "not to be bound in the Travelers Homeowner Program."

(It should be noticed that the words "of Illinois" have obviously been typed on the Guide after its initial printing which brings up the question of whether this list is in circulation in states other than Illinois.) While we have some grave questions regarding the arbitrary and vague nature of many of the criteria listed, of particular concern to us is #9 which directs Travelers' agents not to insure "dwellings over 40 years old."

According to the U.S. census information we have, seven out of ten residential dwellings in Chicago and well over a majority of such structures in many large and small cities are well over 40 years old and therefore would be automatically excluded from the opportunity to purchase a standard Travelers replacement cost homeowner policy. F. Harvey Cameron, Senior Vice President of Travelers' Casualty-Property Personal Lines Department referred to this particular issue of insuring urban homes when he wrote:

"Most buildings are old and the cost to replace them would be significantly higher than their actual market value. Under the circumstances, what sense does it make to encourage an individual to buy a policy covering 80% of replacement cost? Only in one sense: to provide the incentive to burn the structure." (Protection Magazine, September, 1979, published by the Travelers Insurance Company.)

There is a categorical assumption expressed by Mr. Cameron on behalf of Travelers that if insured with a standard replacement cost policy, most urban residents would actually arson their own homes! It is an assumption and a premise upon which a vast majority of the industry now bases its underwriting policies and practices. It is, however, an assumption that besides never having been substantiated, is a direct insult to the hundreds of thousands of homeowners who after years of organized efforts to secure conventional mortgage credit now find their hard earned victories redlined once again—this time by the insurance company.

(3) The termination of and refusal to appoint insurance agents in urban neighborhoods.



As an example of this, I refer you to exhibit 3: A tabulation by zip code of the number of agents that the Hartford has appointed in the Chicago metropolitan area. If the competitive process within the industry is indeed working so well under the anti-trust immunities granted by the McCarran-Ferguson Act, then why is it that Hartford, the nation's fourth largest property and casualty insurer, maintains only 4 of its 139 Chicago metropolitan agents on the city's south and west sides?

This, however, is not an isolated case. In a 1979 survey of over 25 major insurers, the Illinois Department of Insurance found that only 14 percent of the combined total of 2,100 agents appointed in the Chicago area were located on the south and west sides.

And it is no mere coincidence that these areas of Chicago that enjoy so few agents and policies are the very same neighborhoods that house over 85 percent of the city's minority population.

(4) Discrimination in the pricing of insurance. If the purpose of insurance is the sharing of risks in order to minimize the cost of coverages, then there needs to be an agreement and direction as to what is a reasonable statistical base from which to operate.

The present practice of determining insurance rates simply based on some arbitrarily defined geographic territory and without any regard to individual experience is by its very definition discriminatory.

The situation in Chicago where there is absolutely no rate regulation whatsoever—a condition that the industry would have us believe is most conducive to competition—is now so absurd that State Farm last year announced that instead of continuing to figure rates for Chicago motorists by 4 geographic areas, the company will now base its rates on the experience in each of 60 rating territories: 1 per zip code!

The attempt by State Farm and others to localize down to smaller and smaller territories their "losses" is having the negative effect of penalizing to a greater degree with higher prices those loss free policyholders who choose to live in our cities while at the same time subverting the whole concept of shared risk upon which the business of insurance was founded.

Experience has demonstrated to us that there are a variety of other ways, in addition to those I have presented, in which the availability of insurance is limited. Some of the more common methods used to exclude urban neighborhoods from the conventional marketplace include the refusal by insurers to offer coverage because of the market value of the dwelling, or because the dwelling, although in excellent condition, is of frame construction, or for no real risk related reason at all!

Whether termed redlining or conventional market dysfunction, these discriminatory practices have reached such epidemic proportions that in the case of the property insurance market, over 1 million urban homeowners and businesspeople are now insured—a better word for it is relegated—to the residual market of state sponsored FAIR Plans.

These 28 state FAIR Plans, with the exception of 4—Illinois, Wisconsin, Massachusetts, and Rhode Island—offer absolutely no theft or liability coverages whatsoever—only minimal fire protection, and often on just an actual cash value basis.

All of the FAIR Plans charge their commercial clients far more for coverage than would be the case if they were insured conventionally and five of the state sponsored FAIR Plans have refused to voluntarily comply with a federal mandate to equalize residential insurance rates with those of the conventional marketplace. The five state FAIR Plans that are now overcharging residential policyholders are Iowa, Minnesota, New York, Oregon, and Virginia. In the case of the Iowa FAIR Plan, according to the Federal Insurance Administration, policyholders may pay as much as 120% more for certain classes of insurance than they would if the insurance market was indeed as competitive as the industry would have us believe.

Moreover, the FAIR Plans, once designed for only those risks in specifically defined riot affected areas, are now the major insurer of good risks in neighborhoods that were not then and never have been subject to extreme environmental hazards.

In 1975, the Illinois FAIR Plan, the 7th largest in the country, insured 44,600 homes and businesses. By the end of 1979, an additional 31,400 homeowners and business people found themselves with no insurance alternatives other than the FAIR Plan. Today, the number of FAIR Plan insureds stands at 76,000—a 70 percent increase in just 5 years. And nearly 9 out of 10 of those 76,000 FAIR Plans are concentrated in Chicago's older neighborhoods.



In many other states, the situation is no better. The number of risks now insured by the Ohio FAIR Plan has increased over the last five years by 90 percent to 38,700, on the New Jersey FAIR Plan by 117 percent to 81,853, on the Pennsylvania FAIR Plan by 107 percent to 115,160, on the California FAIR Plan by 54 percent to 132,400! Even in states where the FAIR Plan is not large, there have been significant and alarming increases. Although, for example, the number of FAIR Plans in Indiana is comparatively small—4,450—the fact remains that that is 92 percent more FAIR Plan in that state than existed five years ago.

Indeed, it has become a "rule of thumb" within the insurance industry that it is really the geographic location of a risk, and the race of the policyholder, rather than the condition of the dwelling, that determines whether he or she is insured conventionally or dumped in the FAIR Plan.

In Chicago's older, predominately minority and integrated neighborhoods, 1 out of every 4 homeowners is insured by the state's FAIR Plan as contrasted to only 1 out of 25 in the city's predominately white north side and only 1 out of 100 in the city's white southwest side (Exhibit 4).

Studies by the Federal Insurance Administration have confirmed that this is true in most urban areas.

There is, in fact, a most insidious notion that now permeates the insurance industry and many State departments to the effect that the only solution to the problems that beset us is to equalize the availability, accessibility, quality, and coverages of the FAIR Plans with that of the conventional insurance market.

Perhaps the best way to demonstrate the serious implications of so naive an approach to the problem as "separate but equal" insurance availability is to point out that residents of many neighborhoods now commonly refer to the FAIR Plan as "back of the bus" insurance.

The sad irony of this predicament has not been lost on the neighborhoods. Many of these neighborhoods have worked long and hard over the past decade to eliminate the residual FHA mortgage market and secure commitments from banks and savings and loans for conventional credit only to find that their new won investments will be insured by a high priced "last resort" insurance that offers little more than minimal coverage. Perhaps a better term for the FAIR Plan is the "FHA of insurance."

Of course, we have been told that such practices as I've noted here, while appearing to be discriminatory, are merely precautions that the industry finds necessary to "minimize losses and maximize profits." While we have some serious questions about the industry's current claim that it is having a hard time making ends meet—profits for many of the largest insurance companies have increased well over 100% in the last few years—we do not question the basic right of a business to make a fair profit. What we do question however is when these profits are made at the expense of terminating risk free policyholders, when those profits are made by conducting a company policy of writing off in a wholesale manner this nation's most vital resource—its cities and their neighborhoods.

In Chicago's neighborhoods, there is not one conventional insurer, with the exception of Allstate, that insures more than 7 percent to the homeowners market. State Farm, Economy-Kemper, INA, Aetna, and Hartford—all ranking within the top ten homeowners insurers in Illinois—write a combined total of less than 12% of the residential insurance market in Chicago's neighborhoods. Travelers, the fifth largest property and casualty insurer in the country, did not write 1 homeowner policy on Chicago's west side in the last 18 months!

A variety of solutions to the problems of redlining have been available to the states for some time. Yet, even with enormous grassroots pressure, action on the part of the states has been at best slow and sporadic.

Presently only three states—Illinois, New York, and Missouri—even require the disclosure of policy placement and termination figures with which appropriate programs can be designed to increase availability. Few states have enacted into law even the most basic of anti-redlining measures. In fact, it is still quite legal in almost every state in this country for an insurance company to deny essential coverage simply on the basis of where a person lives and how old his dwelling is.

The responsibility to address these issues has to date been placed upon the states by virtue of the passage of the McCarran-Ferguson Act in 1945. However, as has been documented time and again—in reports to Congress by the U.S. Commission on Civil Rights, by the Federal Insurance Administration, by the National Commission on Neighborhoods—and as has been stated most recently in a major study of state insurance departments by the Government Accounting Office, "serious shortcomings exist in state laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States."



The legislation you now have before you—the Insurance Competition Improvement Act—if adopted will contribute significantly toward alleviating the problem of redlining that now plagues our country.

Before adoption, however, we would recommend two changes in the bill.

The first is in regard to the provision for disclosure as spelled out in section 12 of the bill. As written now, insurers—and we trust that this would include the FAIR Plans—would be required to disclose policy applications, issuances, and terminations only at the time of a rate filing and only on the basis of whatever geographic rating territories a particular insurance company utilizes. Because the times of rate filings vary widely among insurers as do the boundaries of their rating territories, the resulting information will be so diverse in nature as to be of little use in developing uniform, comprehensive and equitable remedies to redlining.

Rather, National People's Action recommends that the Committee seriously consider and adopt an amendment to section 12 of this bill that would simply require disclosure on a quarterly basis by zip code.

Quarterly zip code disclosure has been required by law in Illinois since 1977. Therefore, many large and small insurers, by virtue of the fact that they do business in that state, have already demonstrated their capability to provide this information.

Our second recommendation is to eliminate entirely the provisions in section 6 of the bill that would allow for any difference of rates based upon geographical location of a risk.

The bill, as written, states in section (6) that primary emphasis on the determination of rates is to be given to the "broad distribution among insureds of the costs of environmental hazards over which insureds have little or no control." And section (6) also states that emphasis is to be given to the comparability of classifications and territories to "widely held social values." If this is the case, then there is no need for more than 1 rating territory in any given state. In short, let the prices be determined solely on the basis of both the experience of the company's entire market in a state in combination with factors that relate only to the condition of dwellings taken on a case by case basis. To do otherwise would be to compromise, indeed subvert, the whole idea of the equitable sharing of risks that legislation claims as its basic purpose.

The significance of this legislation is that while it guarantees and protects the right of the states to continue to regulate the business of insurance, the bill also enables the Congress and Federal government to provide, where necessary, a direction for reform.

Finally, although the law does not provide for any federal enforcement—except the right of an individual, if necessary, to seek private recourse through the federal courts—it does provide the states with a much needed framework from which to develop appropriate solutions to the insurance crisis before us.

In that respect, your opportunity to affect in a positive way the behavior, attitudes, beliefs, and practices of all those concerned with these issues should not be ignored or underestimated.

Attachments.



EXHIBIT 1

THIS ZIP CODE LIST WAS ACTUALLY DISCOVERED BEING USED BY ONE OF CHICAGO'S LARGEST INSURANCE BROKERS, W.W. VINCENT COMPANY, AND ITS PARENT COMPANY, THE INSURANCE COMPANY OF ILLINOIS.

SAYS AN AGENT WHO WORKED WITH VINCENT: "I'VE BEEN IN THE BUSINESS FOR OVER 20 YEARS AND THIS IS THE FIRST TIME IT WAS THAT PRECISE -- 'UNACCEPTABLE' AND 'ACCEPTABLE' ZIP CODES. USUALLY, THE LARGER COMPANIES GIVE YOU STREET BOUNDARIES AND THAT'S IT."

W.W. VINCENT REPRESENTS 75 INSURANCE COMPANIES INCLUDING AETNA, ECONOMY FIRE AND CASUALTY AND FIREMAN'S FUND.

PAGE 9

*3 ppts & Hq. file*  
*P10/23/78.*  
 P.H.L.

Zip Code List

SMP 20 BAD 21

*IV*

Acceptable

Not Acceptable

60625  
 60629  
 60630  
 60631  
 60632  
 60633  
 60634  
 60635  
 60639  
 60641  
 60642  
 60645  
 60646  
 60648  
 60652  
 60655  
 60656  
 60658  
 60659  
 60666

60600  
 60607  
 60609  
 60615  
 60617  
 60618  
 60619  
 60620  
 60623  
 60626  
 60628  
 60636  
 60637  
 60643  
 60644  
 60649  
 60650  
 60651  
 Chicago Heights  
 Robbins  
 Calumet City  
 Maywood  
 Markham  
 Gary Ind.  
 SOUTH BELLWOOD  
 HARVEY  
 Phoenix



## Insurance redliners fined \$100,000

By Janet Key

THE LARGEST fines ever imposed by the Illinois Department of Insurance for the flouting violations have been levied against the Insurance Company of Illinois (ICI) and its manager, W.W. Vincent and Co., Inc., The Tribune has learned.

Illinois Insurance Director Richard L. Mathias is expected to announce fines totaling \$100,000—the stiffest the department may impose—against the Chicago brokerage house and its insurance company at a press conference Sunday morning. Each company was fined the maximum \$50,000 allowed under state law.

The action climaxes a seven-month investigation of W.W. Vincent and ICI which established what one source called "a clear pattern of geographic discrimination" in the writing of homeowner insurance.

REDLINING IS THE commonly used phrase for the denial of homeowners insurance to people living in certain designated geographic areas, particularly those characterized as black, Hispanic, "changing," or decaying. The practice has been prohibited by the Illinois Insurance Code since September, 1977.

The source, who was not named, said with refusing to write homeowners insurance in its residential areas by the Metropolitan Area Housing Alliance (MAHA), a

coalition of community groups, in October.

The charges were based on a list of "acceptable" and "unacceptable" zip codes allegedly supplied by W.W. Vincent to at least one local savings and loan association for which it wrote insurance.

THE INSURANCE department report charges that such a list was used by W.W. Vincent for the period examined in the first nine months of 1978, to steer homeowners in "unacceptable" areas away from ICI and to other companies for which Vincent solicited insurance.

In the so-called "unacceptable" zip codes ICI through Vincent wrote only 4 per cent of its business, while companies trading 73 per cent of its business in the "acceptable" zip codes. The remaining 23 per cent of its business was in undersigned zip code areas.

However, the distribution of business for other companies was completely even, led by Vincent-Actua Life Insurance and the now-insolvent Reserve Insurance Co. (a subsidiary of American Reserve Corp.)—contrasts sharply with ICI's.

Eighty-two per cent of the business which was generated for Actua fell in "unacceptable" zip codes while 85 per cent of the Vincent-generated business for Reserve fell in that category.

"It's clear that there was a steering

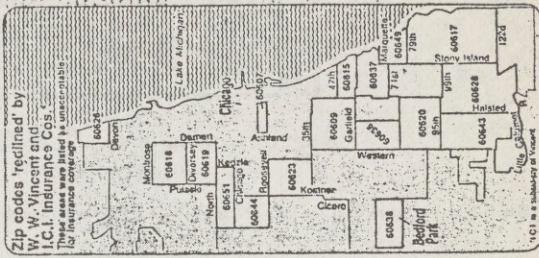
process going on," said a source close to the investigation. "Vincent favored their own company, ICI, by steering away what they thought was undesirable business to Actua and Reserve."

MATHIAS ALSO is expected to release the text of a letter advising officials of both companies that further regulatory action may require them to set up a program to remedy the alleged discriminatory practices.

Reliable sources said the plan would include recruiting Vincent and ICI to insure the people now without insurance as a result of Reserve Insurance Co.'s insolvency this week.

THE OFFICERS OF W. W. Vincent and Insurance Company of Illinois are the same people, and both companies are owned by the same holding company, W.W. Vincent is a wholly owned subsidiary of Chicago Title and Trust Co., which is in turn a subsidiary of the Lincoln National Corp. in Ft. Wayne, Ind. ICI is a direct subsidiary of Lincoln National.

Vincent acted as an agent for 57 insurance companies, including ICI, Actua, Peoples Insurance, Economy-Temper, Farmers Fund, and the Hartford. In addition, he acted as a broker for some of the city's largest savings and mortgage companies, such as First Federal, Talmah, Home Federal, Bell Federal, and Percy Wilson Mortgage Co.



Ylvisaker Graphic



EXHIBIT 2

The Travelers Indemnity Company of Illinois  
RISK SELECTION GUIDE.

The following types of risks are not to be bound in The Travelers Homeowners Program:

1. Applicants who have been refused similar insurance for underwriting reasons.
2. Applicants who have exhibited loss frequency or a large loss within the past three years.
3. Applicants who are not personally known, or the residence has never been seen by the agent.
4. Applicants who are unemployed other than retired.
5. Applicants requesting Comprehensive Personal Liability coverage of more than \$300,000.
6. Dwellings where the amount of insurance requested is less than 90% of the full replacement cost.
7. Dwellings where the amount of insurance requested is less than \$18,000 or more than \$150,000.
8. Dwellings where the amount of insurance requested exceeds the market value by more than 15%.
9. Dwellings over 40 years of age. \*
10. Dwellings of low quality construction.
11. Dwellings that are located in a fire protection class rated as totally unprotected, i.e., Protection Class 10 (or equivalent).
12. Dwellings that are subject to flood, wavewash, landslide, brush fire or isolated from public view.
13. Dwellings that are classified as mobile homes, trailer homes, house trailers, modular homes, or homes constructed of fiberglass or similar plastic materials.
14. Condominium risks where Loss Assessment Coverage exceeds \$10,000; or that are rented to others in excess of three months; or where located in a converted apartment house; or a mercantile business is conducted on the premises; or the age exceeds 10 years.
15. Tenants where the amount of insurance requested is less than \$8,000 or more than \$25,000.
16. Secondary dwellings where coverage on the primary dwelling is not provided by The Travelers Companies.
17. Risks involving agency reinsurance.







1978

THE FAIR PLAN -- LEGALIZED REDLINING !!!

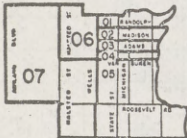
TOTAL: CHICAGO - 50,351 ... ONE OUT OF EVERY 8 HOMEOWNERS

0,587 FAIR PLANS  
ONE OUT OF EVERY  
25 HOMEOWNERS

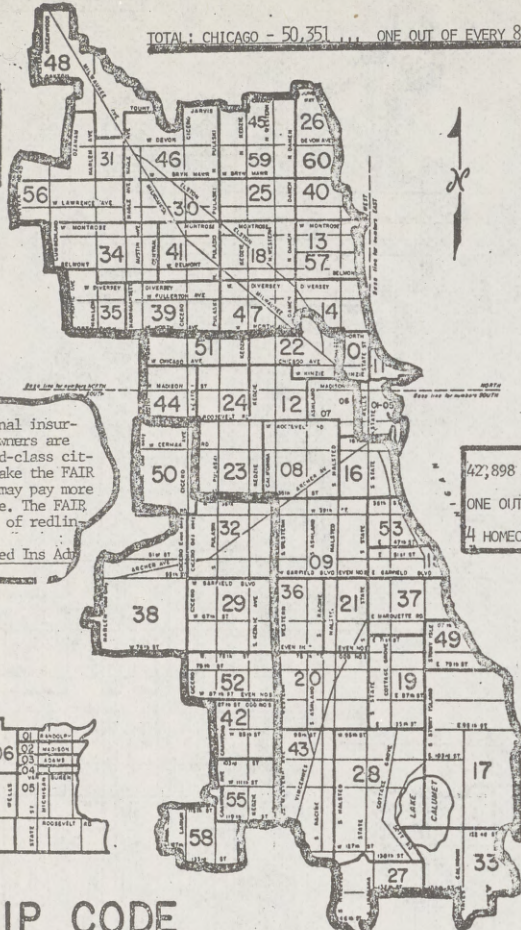
"Denied conventional insurance, many homeowners are treated as second-class citizens who must take the FAIR PLAN where they may pay more for less coverage. The FAIR PLAN is a symbol of redlining."  
Gloria Jimenez, Fed Ins Ad

866 FAIR PLANS  
ONE OUT OF EVERY  
100 HOMEOWNERS

42,898 FAIR PLANS  
ONE OUT OF EVERY  
4 HOMEOWNERS !!!



ZIP CODE  
LOCAL ZONES  
CHICAGO, ILLINOIS  
FOR 4 TWO DIGIT 3-DIGIT ZIP CODE





Senator METZENBAUM. Thank you very much, Ms. Cincotta.  
Mr. Mantovani.

**STATEMENT OF ANDREW MANTOVANI, PRESIDENT, NEW YORK  
METROPOLITAN AGENTS & BROKERS ASSOCIATION, ACCOMPANIED BY SIDNEY GLASS, VICE PRESIDENT**

Mr. MANTOVANI. Mr. Chairman and other distinguished members of the committee, I am president of the New York Metropolitan Insurance Brokers and Agents Association. I have been a practicing insurance broker and agent for 29 years.

I am a graduate of the College of Insurance. I am a Chartered Property and Casualty Underwriter, and I am an attorney at law, admitted to practice in the State of New York and in the Southern and Eastern Districts of the Federal Courts.

I am thankful for this investigation, for it may be the beginning of much needed Federal legislative relief. At the age of 19, I was appointed an agent for the Royal Insurance Co. Twenty-five years later I was awarded a plaque, with various accolades. In the 26th year, I was advised that my agency would be terminated. The termination was based upon an alleged adverse loss ratio. In my case, I was lucky. When I refused to accept the termination, the company reconsidered and I still have an agency with the Royal Insurance Group.

My office is located in Bronx County, an area heretofore redlined. It appeared that the insurer wished to reduce the writing of insurance within the geographical boundaries of my office. Many brokers and agents located in New York City and other urban areas of New York State have suffered similar experiences. Unfair termination of agents or brokers as a result of losses incurred by the risks they insured, statutorily in some cases, in declining areas.

New York law, effective August 1979, now "prohibits the termination of an agent's or broker's account on the basis of the geographical location of the risk or the geographical location of the agent or broker. All cancellations or nonrenewals shall specify the reasons therefor." This law, on its face, appears to protect the agent or broker located in formerly redlined areas. However, under regulation 90, promulgated by the New York State Insurance Department, the mechanism for implementing the law, all insurers need do is to document their losses and thus, lawfully terminate an agency.

A terminated agent or broker consequently would mean mass cancellation of insureds in need of essential insurance located in areas in which the New York State Legislature has expressed its interest that insurance be obtained by voluntary means. Therefore, to give an example, if, in a given agency or brokerage account, 10 risks out of 100 have caused losses, the account is closed. The broker is left with 90 good risks without a voluntary market in which to place them. As a result, the remaining good risks are placed in the residual markets with less commissions for the broker, and generally, at a greater cost to the consumer, with windfall profits to the insurance companies.

What, then, under the circumstances, was accomplished by the New York Legislature? In the example given, an agent was not lawfully protected and 90 accident-free insureds were redlined de facto.



This appears to me to be hypocrisy in its highest form—the only gain, the misleading news releases from the Governor's office that he signed into law a ban on insurance redlining.

At a recent conference with Superintendent of Insurance Lewis, Mr. Lewis advised our association that although such practices are unfair to brokers, he did not have the authority to declare such acts of terminations of agents or brokers illegal. It is our association's contention that no level of government should tolerate injustice to any class of working people, and to hold anyone responsible, as the insurers do, for losses that cannot be controlled, is indeed unjust.

While I testify before this committee, someone who is insured by my agency may have been involved in an accident. Why should such a fortuitous event be blamed on me?

I submit, when an insurer cancels a trustworthy, competent agent or broker for reasons beyond the control of the agent or broker and still continues to write similar insurance for other agents in our State, the insurer is guilty of an unconscionable act and an unfair trade practice. Public Law 15 of the 79th Congress entrusted the various States, including New York, with the elimination of unfair methods of competition and unfair or deceptive acts or practices.

How, therefore, can the present system be considered in any way fair competition? And how can the superintendent with such broad powers under section 273 of the New York State insurance law, which relates to unfair and deceptive practices, say that he lacks the legislative authority to prevent an agent or broker from being unfairly terminated? How can the State of New York, that professes to be an equal opportunity employer, deny 50,000 brokers and agents equal opportunity to practice insurance brokerage?

At a recent hearing by the New York State Insurance Department, this subject was raised. The State insurance department indicated that it was not in the department's interest to offer job security to affected agents or brokers.

I pointed out to them that the brokers and agents of our State were not looking for job security, but rather for equal opportunity to practice insurance brokerage. I was surprised that the learned men of the department did not recognize the difference. I know that this committee will see that difference.

The insurers and others in Government who support them shout freedom of contract is basic. A principal must be able to sever his relationship from his agent at will, but through the decades, the law has recognized in many essential areas that such freedom must be tempered with conscionable thoughts and acts.

It is my opinion that the thunderous cannons of the insurance companies fire their salvos of intimidation and coercion not only at brokers and agents, but at insurance officials as well, the intimidation being that if the insurance department is not cooperative with its application of regulatory laws, the affected insurers will withdraw from the State. In plain language, if the insurance department does not play ball, the companies' way, the companies won't play at all.

Since the State regulators' hands appeared to be tied, the only possible hope is for Federal legislation with a view toward obtaining open markets for all agents and brokers, to put a halt to insurers redlining and discrimination, and to prevent acts of boycott, coercion or intimidation in the insurance industry.



McCarran-Ferguson has afforded exemptions to insurance companies only if the States properly regulate them.

To discriminate against race, color, age, sex, or national origin is wrong.

To participate in de facto redlining is wrong.

To deny equal opportunity to brokers and agents is wrong.

The Congress can no longer be silent.

Thank you very much.

Senator METZENBAUM. Thank you, Mr. Mantovani.

Ms. Cincotta, do you see any evidence of insurance companies competing for business, attempting to obtain business, as far as your group's members are concerned?

Ms. CINCOTTA. What I see mostly is in the areas where the citizens are organized, they can force the insurance companies and maybe the States or departments of insurance, to do some things about the redlining.

But, other than that, the only thing I see evidence of like I talked about, is a lot of ads in the paper showing how they can be self-regulated.

They seem to spend more money and time going about how to keep the Congress from regulating them in any way or the State from regulating them in any way.

Senator METZENBAUM. Mr. Mantovani, do you see any effort on the part of the insurance companies to obtain more business from a competitive standpoint?

Mr. MANTOVANI. Not at all, they in fact do quite the opposite. They attempt to tighten the market so that the insurance is not available. They do it by the termination of agents and brokers, as I have indicated.

Senator METZENBAUM. Where there has been pressure through your group, Ms. Cincotta, insurance becomes more readily available?

Ms. CINCOTTA. One of the things we have been pushing them very hard on is to put agents in the neighborhood. We have a pilot program going with Aetna, in five cities, where they are placing agents in neighborhoods and with that, they have written several hundred more policies.

But again, with a couple of the companies, it was waiting a year for that agent to get placed in the neighborhoods.

If the agents are there, you will see an increased amount of policies being written.

Senator METZENBAUM. Mr. Mantovani, what happens to people who can't obtain normal coverage insurance? Do they fall into the residual market, and then what happens to the agent in those circumstances?

Mr. MANTOVANI. They do fall into the residual market. The New York Auto Assigned Risk Plan or the New York Fair Plan. Of course, the agent receives a reduced commission because of it. The rate is higher to the consumer.

Quite frankly, the residual markets are just used entirely too much.

Senator METZENBAUM. How do you account for the fact that so many of the agents appear to be opposed to this piece of legislation?

In my own opinion, most of them do not know what it contains. But, how do you account for the agents' opposition?



Mr. MANTOVANI. I think they are extremely intimidated. I think that they wave the company flag. This is the reason why you don't get many complaints to governmental agencies too.

In fact, when I sit here today and I speak to you, I concern myself with possible irregularity in my own agency where the department could come in and cite this irregularity and I worry about the domino theory. Will I then lose my insurance broker's license? Will I then be disbarred? These are the things that go on in my mind.

I can assure you, that many of the agents and brokers in our State are concerned about any confrontation with the State insurance department. They would much prefer to avoid it.

Senator METZENBAUM. One of the main problems of the insurance agent or insurance broker is getting companies to represent, instead of the company wanting to do more business. It is very difficult to find companies to represent?

Mr. MANTOVANI. That's correct. In fact, they use one particular credit report outfit, the O'Hanlin Reports, and quite honestly, as soon as he finds out that one company terminated you, you could never get another company. They all draw from this same source of information.

Senator METZENBAUM. I think that that may be one of the reasons that they are so anxious to be immune from the antitrust laws, because it would appear to me that that in and of itself might be an antitrust violation.

Mr. MANTOVANI. I would think so.

Senator METZENBAUM. I thank both of you very much. I am not certain I know who this gentleman is.

Mr. GLASS. My name is Sidney Glass. I am vice president of New York Metropolitan Agents and Brokers Association. I just came up with Mr. Mantovani, to perhaps assist him in a question or two that you might have asked him and perhaps he might not have elaborated fully on it.

If I may be permitted to make one comment, I would only take a moment.

Senator METZENBAUM. If you would be brief.

Mr. GLASS. The insurance companies are very busy in the secondary market, which nobody has touched upon. In order to escape all regulation, they formed insurance companies with home offices throughout the various countries in the world.

They come into the States and write insurance policies. That way they are not regulated by the State, because they are an alien insurance company.

In order to lull some of the policyholders, and I am talking now primarily about commercial insurance, in order to lull some of the policyholders into thinking that this secondary company is a viable company, they put their own company name on the policy.

Let's say you have a company, for example, I saw something just recently, the name of the company was INA, which we all know is the Insurance Company of North America.

There were two other companies listed underneath that name, each with a box next to it, and an X in the box that that insurance policy was issued for.

The X was in the box for Allied Insurance Co. Now that policyholder—it involved a \$32,000 premium, he believed he was insured by



INA, when in fact he was not. It was Allied Insurance Co., who is not a licensed insurance company in the State of New York.

The fact that INA owns this company does not mean that INA's assets would back up this unlicensed company. This unlicensed company has to stand on its own merits.

Senator METZENBAUM. Are more and more unlicensed companies writing insurance in this country?

Mr. GLASS. Most or all of your major carriers are into the unlicensed insurance company concept. They are all doing it.

Senator METZENBAUM. They do that with a foreign-based operation? Is that it?

Mr. GLASS. Yes. They are based in foreign countries and by tightening the market and creating an artificial shortage of insurance, they are then able to come in with the unlicensed company, at a higher rate, and of course, free of regulation, because they are not regulated.

Senator METZENBAUM. That is very significant testimony. We appreciate very much your helping us in our deliberations. Thank you all.

Mr. MANTOVANI. Thank you.

Mr. GLASS. Thank you.

Senator METZENBAUM. Mr. James M. Stone, who was to be the last witness today, will not be with us this morning. He will appear on another occasion.

So, our last witness this morning will be Mr. Maisonnier. He is representing the Alliance of American Insurers.

Mr. CHUMBRIS. Mr. Chairman.

Senator METZENBAUM. Mr. Chumbris.

Mr. CHUMBRIS. The usual reservation of opening statements for any Senator or to submit questions in writing.

Senator METZENBAUM. There is never any problem. We are always happy to have opening statements, interim statements, concluding statements or questions in writing from members of the subcommittee. We are happy to have them.

#### **STATEMENT OF ANDRE MAISONPIERRE, VICE-PRESIDENT, ALLIANCE OF AMERICAN INSURERS**

Senator METZENBAUM. Mr. Maisonnier, I am happy to welcome you, sir.

Mr. MAISONPIERRE. Thank you, Mr. Chairman.

Senator METZENBAUM. I look forward to hearing your testimony. As a matter of fact, I like your name.

Mr. MAISONPIERRE. Mr. Chairman, if you have to spell Maisonnier 35 times a day, as I have to, you would not like it.

Senator METZENBAUM. Do you think Metzenbaum is so easy? [Laughter.]

Mr. MAISONPIERRE. I was almost positive though, that my children would change the name as soon as they were of legal age to do so. But I am surprised, and in some respects happy to see that they are sticking to the full Maisonnier.

Senator METZENBAUM. They are just a natural set up to open either a hotel or a restaurant, I think. [Laughter.]



Mr. MAISONPIERRE. There is a restaurant by that name in New Orleans. When I went there 1 day, the owner didn't believe me, but I said, "My name is Maisonpierre." [Laughter.]

Senator METZENBAUM. Do you get a special rate at the Pierre, in New York?

Mr. MAISONPIERRE. No; I think they charge me about three times as much. [Laughter.]

Senator METZENBAUM. Very well.

Mr. MAISONPIERRE. We appreciate very much, Mr. Chairman, the opportunity to testify today; as requested, we will, of course, summarize our statement. We would appreciate it if the full statement could be made part of the record.

Senator METZENBAUM. It certainly will be. It will be inserted into the record at the conclusion of your oral presentation.

Mr. MAISONPIERRE. Thank you very much.

Our statement addresses three issues.

One, the effect which the repeal of McCarran-Ferguson would have on the insurance industry, insurance markets and on competition.

Two, the function of rating bureaus.

Three, a General Accounting Office report on State insurance regulation.

We address the effect of repeal of McCarran-Ferguson first, since we are convinced that few States would likely enact into their insurance codes, the extensive and onerous regulatory trade practices which this legislation would force upon them.

The clear effect will be that small companies will be forced to merge and greater concentration will result.

Senator METZENBAUM. Mr. Maisonpierre, may I just interrupt you for one moment?

You have not read this part of your written statement, but in your written statement you make a comment that such sections of the legislation, that is, the regulatory language, come under the jurisdiction of the Senate Committee on Commerce, Science and Transportation, and we will address those sections when that committee has its own hearings.

Mr. MAISONPIERRE. Yes, sir.

Senator METZENBAUM. Let me say to you that I respect your right to have that opinion, but this committee does not cede that jurisdiction to the Commerce Committee.

I did not want to let your statement go unchallenged in the record. We have joint jurisdiction of this legislation in its entirety.

Mr. MAISONPIERRE. I recognize your position, Mr. Chairman. We went by the ruling of the Senate Parliamentarian.

Senator METZENBAUM. I am afraid that the ruling of the Senate Parliamentarian in this instance was that this bill has been jointly referred to the two committees, because there was, indeed, a dispute as to which committee had full jurisdiction.

In resolving the matter, both committees have jurisdiction on the basis of the referral. In all fairness, the issue is not one that concerns you as such, except as an interested participant.

But, I did not want your statement to go into the record without letting you know that the chairman of this subcommittee does not agree with it, but does respect your right to have an opinion.



Mr. MAISONPIERRE. Thank you very much.

Mr. CHUMBRIS. I do not know whether Mr. Maisonpierre knows that the Judiciary Committee and the Commerce Committee have been fighting for 25 years on jurisdictional matters. We don't step back at all on our prerogatives.

Mr. MAISONPIERRE. Incidentally, Mr. Chairman, we felt that our statement was big just to tread on these issues. If we had found the other issues, it probably would have been substantially larger than this. I am sure it would be at a substantial cost to the taxpayers to print all this in the record.

Senator METZENBAUM. If we save on the insurance costs which run about \$212 billion a year, if we would only save 1 percent, it would adequately cover the printing bill, and leave a little left over. [Laughter.]

Mr. MAISONPIERRE. I would say there is a substantial saving already taking place in insurance costs. If only we could control some of the costs which are going into the insurance products, such as the costs of automobile replacement parts, construction parts, et cetera, and inflation, we would be able to save a great deal on the cost of insurance.

As I was saying, Mr. Chairman, we feel the clear effect of repeal of McCarran-Ferguson would be, one, that the small companies would be forced to merge and greater concentration would result, that companies would abandon certain lines of insurance and territories in which they lack substantial penetration.

This also will create a greater concentration in the marketplace. Consumers will be at a loss to do comparative shopping, due to proliferation of insurance policies, forms and coverages. The insurance coverage and capacity for large commercial risks will dwindle due to likely abandonment of voluntary pooling mechanisms.

The Federal Government will be forced to interfere in property and casualty insurance marketplaces and will need to develop an extensive regulatory bureaucracy to substitute for many of the present State activities.

Yet, since not all State insurance regulatory practices will cease, there will exist substantially greater regulation, at higher cost and accompanied by traditional inefficiencies which dual and conflicting regulation bring about.

The end result for consumers will be higher insurance prices, considerably restricted competition, probably considerably less opportunity to purchase insurance coverages designed to meet specific individual needs.

The rationale for these predictions was presented to the National Commission for the Review of Antitrust Laws and Procedure, in a statement dated July 26, 1978.

We have made the statement part of our presentation to the subcommittee.

We are, of course, fully aware of that the National Commission recommended a reevaluation of McCarran-Ferguson.

Our statement notes, however, that the Commission not only disregarded the report of its own economic advisory panel as respects the impact which McCarran-Ferguson Antitrust immunities had on insurance pricing and competition. But it was also denied the oppor-



tunity to examine academic studies whose conclusions and recommendations run counter to the prevailing mood.

In those few States which would accede to S. 2474, existing statistical rating and advisory bureaus would be transformed into limited loss data collection agencies.

The subcommittee's staff summary and explanation accompanying the legislation states that such limitation is necessary because bureau activities tend to chill wholly independent pricing.

This demonstrates a totally erroneous and superficial understanding of the role, influence, and function of insurance rating bureaus.

To test the hypothesis concerning the effect which rating bureaus had on price and competition, the Alliance commissioned Dr. Patricia Munch, a noted regulatory economist, to analyze the effect of the McCarran-Ferguson antitrust exemption and the impact of rating bureaus on price competition in the property and casualty insurance business.

Her biography and paper are attached to our statement.

Dr. Munch structured her analysis of the role of insurance rating bureaus using a number of testable predictions which characterized the bureaus under either a cartel or a service model configuration.

The characterizations are detailed in her report. Her conclusion is unequivocal. None of the testable predictions which would evidence that insurance rating bureaus lead to cartelization can be sustained.

Rather, all of the testable predictions evidencing the role of rating bureaus as service models are fully and rationally supported.

Her conclusion is that rating bureaus as characterized by the insurance services office survive only to the extent that they provide valuable services to members.

Additionally, Dr. Munch applied a number of classical economic tests of competition to the insurance business. These specific tests were suggested by Alfred Kahn, a member then of the commission, as a measure to be used by the commission to assess the presence or absence of competition in any industry under study.

The commission did not apply the current tests to insurance; Dr. Munch did.

Again, the results were unequivocal. She found that although all of the evidence of the influence of rating bureaus, as exemplified by ISO is of necessity indirect, no evidence that they exert a significant cartelization influence was discovered.

To the contrary, considerable evidence that they do not was demonstrated, and most importantly, considerable evidence was uncovered for the alternative hypothesis that bureaus provide valuable services to their members and subscribers.

There is general agreement and rational consistency between Alliance member company perceptions of the impact which major changes in McCarran-Ferguson would have on their operations, procedures, and marketing profiles, and the information secured through a survey conducted for presentation to the National Commission and the previously reported findings of recognized economists.

Such overwhelming evidence demonstrates that insurance competition is not adversely affected, nor are premiums artificially inflated by McCarran-Ferguson or the operation of rating bureaus.

Therefore, neither repeal nor major amendment to McCarran-Ferguson is warranted.



Finally, Mr. Chairman, a word about the General Accounting Office report on State regulation of the business of insurance.

We find the report to be fundamentally flawed by important omissions and obvious distortions of fact. These are detailed in our statement.

We recognize, however, that the report does contain certain information which can be helpful in evaluating some State regulatory practices although the information is not comprehensive and complete enough to provide a balanced picture.

There are pitfalls in relying on the factual information contained. Because of the inconsistencies pervading the report, its conclusions just do not follow.

We do not believe that the report can be used to make an effective argument for imposing Federal regulation on the insurance business, or for repeal of McCarran-Ferguson.

In conclusion, Mr. Chairman, the Alliance believes that our existing State system of insurance regulation works. State regulation encourages competition and the large public need to be fulfilled promotes innovation.

For these reasons, and in light of the anticipated chaos which would occur with passage of S. 2474, we urge that the existing State system of insurance regulation be endorsed and McCarran-Ferguson Act be left untouched.

Thank you very much.

Senator METZENBAUM. Thank you, Mr. Maisonpierre.

You heard two witnesses today speak on the general aspects, Mr. Nader and Mr. Hunter. You heard four witnesses who have had great difficulty in procuring insurance.

You talk about competition working.

We had two other witnesses who talked about the difficulty of obtaining insurance, Ms. Cincotta and Mr. Mantovani. None of them have recognized any competition as actually existing; in fact, they have each categorically denied its existence.

How do you reconcile their testimony with your testimony that there is competition in the industry?

Mr. MAISONPIERRE. It is very easy, I find, Mr. Chairman, to fall into a trap of generalizing from the particular. I think that the witnesses who preceded me today were talking about specific experience related to specific problem areas.

I was rather surprised, and frankly, somewhat shocked at the way the preceding witnesses interpreted the existence of Fair Plans. They intimated in some way that Fair Plans were some kind of a diabolical scheme by the insurance industry to make more money, and as one witness indicated, looked upon this as a "ripoff scheme."

If my memory is correct, Fair Plans' origin dated from recommendation of a Presidential commission appointed by President Johnson to examine the problems associated with insurance in inner cities following the burning of our inner cities in the mid-1960's.

The Fair Plans really are a creation of Congress. When legislation—when Congress enacted legislation addressing Fair Plans, Congress provided a carrot, both to the States and to the insurance companies to participate in Fair Plans by providing a Federal riot reinsurance program applicable to the companies.



So, the allegation that Fair Plans, there is something wrong with Fair Plans, that they are some kind of a ripoff scheme is hard to understand, since Fair Plans are really a creation of Congress.

Senator METZENBAUM. Fair Plans cause people to have to pay about three times the rate and get less coverage. Would you say that is the general rule?

Mr. MAISONPIERRE. It is not a general rule, Mr. Chairman. In some States there are some variations. The largest variation today, I believe, is in New York, where the maximum which a Fair Plan can charge over and above the voluntary rate is  $1\frac{1}{2}$  times.

In your State of Ohio, I don't believe there is any variation between the Fair Plan and the voluntary market.

Senator METZENBAUM. Wasn't it 5 to 1 up until a few months ago?

Mr. MAISONPIERRE. It was until a couple of years ago. It was about 4 to 1.

The New York law specifically stated that fair plans had to be "self rated." In other words, self-supporting.

In your State of Ohio, I believe, I am quite sure that the fair plan rate is identical to the voluntary market rate. In your State—

Senator METZENBAUM. Mr. Ashley Brown is shaking his head quite vigorously to the effect that this is not the case in Ohio.

I do not want to get into an extended discussion, but I would guess that he, a practicing lawyer, involved in insurance programs and insurance law, and if he says it is not so, I would guess—

Mr. MAISONPIERRE. What I will do, Mr. Chairman, I will provide for the record, a specific breakdown.

Senator METZENBAUM. Very well.

But the fact is—

Mr. MAISONPIERRE. I would like to add this too, Mr. Chairman. In your State of Ohio, the figures provided by the Ohio Insurance Institute would indicate that about 30,000 risks are covered by the Fair Plans, as against total property insured in Ohio, which is in the millions.

So, about 99 percent of the property insurance provided in the State of Ohio is provided in the voluntary market and is not provided in the fair plan.

Senator METZENBAUM. That does not help those who have to go into the Fair Plan. It does not make them feel any better about it.

Mr. MAISONPIERRE. I agree. But then, let me give you two specific examples of some of the difficulties which the insurance industry has in communicating directly with policyholders that claim or believe to be aggrieved by the system.

One recent one involves a television appearance, a joint television appearance, in Cleveland, involving the mayor and insurance company representatives urging people in Cleveland to provide to an insurance committee all the complaints which they have with respect to insurance.

This was not only on property insurance or on allegedly redlining—it was price, automobile, and what have you.

Approximately 18 complaints followed that television interview.

Another example, in Mr. Brown's city, I believe in Dayton, Ohio, I believe it was some consumer group approached the insurance industry, asked if we would, we the Ohio insurance industry would, in cooperation with a consumer group, set up a meeting, open meeting,



a forum, to allow people with grievances to appear and file their complaint and discuss their complaints.

The consumer organization established the date. The matter was advertised in the press, et cetera. Two people showed up at the meeting.

We want and we are anxious to discuss the problem.

Senator METZENBAUM. Well, Ms. Cincotta has submitted an exhibit which indicates that in some areas of Chicago, one out of every four homeowners is in the Fair Plan, pointing out that in all of Chicago, one out of every eight homeowners is in the Fair Plan.

In some areas, a very small percentage, such as 1 out of 100; in others, 1 out of 4.

The Fair Plan only provides fire coverage, no theft, contents or liability.

I really have difficulty—

Mr. MAISONPIERRE. Excuse me, Mr. Chairman. I know for a fact that in Chicago the rate in the Fair Plans are equivalent to the voluntary markets. The Fair Plan in Chicago does provide full coverage.

Senator METZENBAUM. It may be so in Chicago, but the fact is that Fair Plans generally are places where people go because they can't get regular insurance.

Now we have had testimony from some people who just could not obtain insurance. Many of them are forced into it, something like buying rated automobile insurance without having any special reason to do so.

The statement of this young man today is that because he lives in a certain area, because he is unmarried, he gets a high rating.

The whole thrust of my question to you, Mr. Maisonpierre is—you say there is competition in this industry. The thrust of this legislation is that the free enterprise system ought to be permitted to work and that insurance companies, who are so major a factor in our economy, ought to welcome anything that helps competitive forces work. Because otherwise they are on a program of self-destruct.

They of all groups in this society ought to be wanting to compete. You are saying that there is competition. And, frankly, I can't find any competition.

I say to you, as a man who was in the business world, there wasn't competition. I believe that you are dreaming if you think there is truly much competition in the insurance industry.

As a businessman I did not see it. As a personal buyer of insurance, I don't see it. I think I am in a better position to purchase insurance than many others in our society just by reason of the title that I hold.

I must say to you that I am told by my staff that they do not provide theft insurance in Chicago. You must buy additional Federal crime insurance.

Now, is that correct?

Mr. MAISONPIERRE. I don't understand your staff—I can assure you that the Ohio fair plan—excuse me, the Chicago fair plan provides full homeowners coverage.

Senator METZENBAUM. Now let me ask you some other questions. You testified the National Antitrust Commission was wrong to recommend repeal of your industry's antitrust immunity.

Do the members of your organization get together and fix prices?

Mr. MAISONPIERRE. No sir, we do not fix prices.



Senator METZENBAUM. Why do they need immunity from a law against price-fixing?

If you are not doing it, why do you need to be immune from the law?

Mr. MAISONPIERRE. McCarran-Ferguson allows the establishment of bureaus and the statement which we have provided for the record clearly demonstrates that the function which the rating bureaus provide their members is a service function. It is a function which allows for greater efficiency in the production of the insurance product, which in turn is to provide for lower cost to the public and greater competition.

Senator METZENBAUM. But if there—

Mr. MAISONPIERRE. If you did not have those bureaus operating as they do, Mr. Chairman, it would not affect companies such as State Farm, such as Allstate. It would affect, on the other hand, many small companies which would find it extremely costly to be able to develop the type of information necessary to deal, to compete with Allstate and State Farm.

Senator METZENBAUM. Well, we have an exemption for that. The small companies, large companies, they can all get together for joint data collection. We have no problem with that. We specifically provide that.

Mr. MAISONPIERRE. Mr. Chairman, joint data collection is only one very small item of the services being provided by the bureaus. The bureaus are providing extensive services in the area of forms, in the areas of policies, in the areas of actuarial assistance which small companies would find absolutely impossible.

Senator METZENBAUM. Are the rating bureaus actually engaged sort of sub rosa in helping the companies engage in price fixing?

Mr. MAISONPIERRE. No, sir, they are not.

Senator METZENBAUM. Then why do you need an immunity from a law against price fixing? Then the rating bureaus could still continue their activities. We are only talking about violating the law.

Mr. MAISONPIERRE. Mr. Chairman, your legislation would do tremendous offense to the present activities of the bureau which are not price-fixing activities.

Senator METZENBAUM. Mr. Maisonpierre, are your member companies involved in mergers which substantially lessen competition?

Mr. MAISONPIERRE. I am trying to remember, Mr. Chairman, when is the last time any of our companies had any major mergers. Our companies do not merge. For the most part, our companies are mutual companies. Merging of mutual companies is a very difficult thing.

We have had one merger in Massachusetts of one of our companies merging with a Massachusetts company which was becoming insolvent.

Senator METZENBAUM. If they do not merge then why do they need immunity from a law prohibiting such mergers?

Why do you want immunity from that if you are not doing it?

Mr. MAISONPIERRE. Mr. Chairman, what I am objecting to is attempting to restructure a regulatory system which we believe works very well.

Senator METZENBAUM. For whom?

Mr. MAISONPIERRE. It works well for the public.



Senator METZENBAUM. For whom? For the American people or for the insurance companies?

Mr. MAISONPIERRE. It works well for the American people.

Senator METZENBAUM. How does it work so well if people can't buy insurance? Here is that lady, Ms. Rodgers, who comes here and tells a wonderful story about buying a home and wanting to get insurance, thinking it is the American dream. Her American dream was turned into a nightmare.

Here is this young man, Mr. Nunez, who says he can't get insurance on his car because it takes about 20 or 30 percent of his total earnings in order to get insurance on it.

Mr. MAISONPIERRE. Again, Mr. Chairman, this is a generalization from the particular.

Senator METZENBAUM. That is not a generalization. That is a particular. What do you mean that is a generalization? Do you think Mr. Nunez thinks it is a generalization?

Mr. MAISONPIERRE. I think that your statement is. I would also point out, Mr. Chairman, that we are being accused by another congressional committee, under Senator Percy, of being totally reckless in our sale of insurance; that we are selling insurance without any consideration for the effect which the sale of insurance has and that we are encouraging arson, the insurance industry is a factor in encouraging arson because of the sale of insurance without inspection of premises, without careful limitation as to the limits to be provided policyholders.

Senator METZENBAUM. Mr. Maisonpierre, I understand what you are saying to the committee.

Mr. MAISONPIERRE. I would be glad to make their statement—their report a part of the record of your committee.

Senator METZENBAUM. Pardon.

Mr. MAISONPIERRE. I believe that their report, the report of the Senate Investigating Committee accusing the insurance industry of recklessness and encouraging arson in their activities on the sale of insurance should be made a part of this record.

Senator METZENBAUM. This legislation has nothing to do with that. I am not saying people should be buying insurance in order to or that you should be required to sell them insurance so they can burn down their houses. Let us not confuse the issue.

What concerns me about your testimony and about the attitude of the insurance industry is where is the milk of human kindness? Where is the concern about people?

This is such a tremendous industry, and really with some very able people in leadership roles. There isn't any evidence, well, there is a little bit of evidence about concern for the problems that Ms. Cincotta talked about, about concerns for problems that Mr. Mantovani talked about.

But as a general rule, that is the reason legislation of this kind is pending here, and it probably will have great difficulty in getting passed because the lobbyists are really having a heyday. But the question is, is that a responsible position or is it indicative of a kind of indifference in trying to use the law to provide protection. That is what concerns me.

You may prevail. We may not get the legislation passed. I am not so sure that you will have prevailed in the greater scheme of things.



Mr. MAISONPIERRE. Mr. Chairman, the billions of losses which the insurance industry has sustained through the residual market mechanism, the fair plan, the automobile insurance plans, et cetera, are certainly an indication of a social consciousness.

I would be glad to make available to you and your staff, for the record, a very recent analysis which the Alliance has completed, analyzing, on a State-by-State base, the actual losses which the industry has sustained by residual market mechanisms.

It indicates that the losses have been in the billions of dollars.

Senator METZENBAUM. Well, Mr. Maisonpierre, as a matter of fact, some companies do nothing but handle and deal in the residual market and they made very good money; isn't that the fact?

Mr. MAISONPIERRE. I am talking here, Mr. Chairman, in terms of the fair plan and the automobile insurance plan, the wind damage pool, the mudslide pools, et cetera.

Senator METZENBAUM. Mr. Maisonpierre, if an insurance company came to you and said you had to pay a special rate because you lived in a certain place, because your name had more than a certain number of letters in it, because you were too young or too old, because you recently were divorced or widowed, wouldn't you resent that?

Mr. MAISONPIERRE. Mr. Chairman, I think that our society has accepted the concept of classification. Let me draw a couple of analogies.

In most States voting is permitted at age 18. I know of teenagers age 14 and 15 that can make a very good judgment and should be allowed the right to vote because they are well informed.

I also know of adults who are age 50, who should not be allowed to vote because they have no way of making a proper judgment as to who their elected officials should be.

Why do we deny the 15-year-old the right to vote? It is a classification system.

Another example, many states have recently increased the permissible drinking age from 18 to 19 or many States to 21. Again, you and I are well aware of many teenagers who are fully capable of handling liquor and denying them the right to drink is an injustice to them. Yet, this is being done.

I also know many adults shouldn't be allowed to drink one drop of liquor because they cannot handle their liquor.

Again, it is a matter of classification.

To the extent that we can identify groups of people with similar characteristics, we in society have identified them and we have helped them. We have assessed certain privileges to those groups.

Under your legislation, there would be unfair discrimination required, since it would require us to charge the same rate to the elderly and today, many companies are charging lower rates for the elderly.

Senator METZENBAUM. I don't think you read the bill. We don't prohibit age discrimination. Do you think we should?

Mr. MAISONPIERRE. No. I think age discrimination is a fair way of doing things.

Senator METZENBAUM. We have not prohibited that.

Mr. MAISONPIERRE. I am delighted to hear that.

Senator METZENBAUM. Well, I am happy we delighted you in one respect and not in some others. [Laughter.]



Mr. Maisonnier, you talk about classifications.

Mr. MAISONPIERRE. Yes.

Senator METZENBAUM. We recognize that. The bill recognizes that in some instances. It is a question of what kind of classification.

The question is, this young man, if he moves into the suburbs and he drives in the same place, to work, he can save 25 percent, but he lives in the wrong place.

What is there about his home that makes him a higher risk?

What is there about the fact of marriage—will marriage quiet him down? I know a lot of people who get a little bit more emotional and more tense after they get married than they were before. [Laughter.]

Mr. MAISONPIERRE. Well, unfortunately, the statistical record indicates quite clearly that married people have a more stable life, and records are clear showing that young married people have a much better accident loss record than young unmarried people.

With respect to territories, your own legislation allows for variation in territory. It is quite obvious to me that if I live in the suburbs, that my automobile will be exposed to a lot less damage than if it is garaged in the streets, in a city.

Senator METZENBAUM. Yes; but we have a limitation as to what the variation may be, not the kinds of variations that are now taking place.

Let me ask you a question. Are you married?

Mr. MAISONPIERRE. Yes, I am.

Senator METZENBAUM. Does your wife drive?

Mr. MAISONPIERRE. Yes.

Senator METZENBAUM. Is she a good driver?

Mr. MAISONPIERRE. Yes.

Senator METZENBAUM. Do you think if you walked out of here and dropped dead, hopefully not of course, but if you did, do you think there is any reason why the insurance company that covers her insurance should charge her a higher rate because you dropped dead?

Mr. MAISONPIERRE. I am confident that my insurance company would not.

Senator METZENBAUM. Well, yours may not, but the woman we had testify before this committee some months ago, her insurance company did that and she had no recourse at all. The rate went up 86 percent because she had the misfortune of losing her husband.

Do you think that is right?

Mr. MAISONPIERRE. Well, Mr. Chairman, again you are asking me for specific questions without having all of the facts.

Senator METZENBAUM. I am giving you all the facts. There are no more. Just on that, those facts alone, do you think it would be right for an insurance company to increase the rate 1 percent, let alone 86 percent as they did in that case?

Mr. MAISONPIERRE. If the insurance company is unable to justify by way of statistical base, that its policyholders—widowed policyholders have a higher loss record than married policyholders, then I don't think they do.

It is a matter of whether or not it can justify that or not. As I said before, my company would not do that. My company has not identified that as a specific item for ratemaking purposes.

Senator METZENBAUM. You say "your company." Are you—

Mr. MAISONPIERRE. The company which insures me. You asked me what would happen to my wife.



Senator METZENBAUM. Yes.

Are you sure they wouldn't?

Mr. MAISONPIERRE. Yes, sir, I am sure, because I have asked them.

Senator METZENBAUM. Oh, you have asked them?

Mr. MAISONPIERRE. I have.

Senator METZENBAUM. I see. But other companies do do that.

Mr. MAISONPIERRE. I don't know, sir. I don't know. I don't have firsthand knowledge of that to be a fact.

Senator METZENBAUM. The lady who was forced to pay an 86 percent higher rate had a perfect driving record for 25 years prior to being widowed. Now the very fact that your company doesn't do it and that another company does do it, and that this woman had no recourse—her own insurance commissioner was not in a position to do anything about it—doesn't that sort of make a case for the need to have some national standards to which States would have to come up?

Mr. MAISONPIERRE. Not at all, Mr. Chairman. To the contrary, I think it shows that there is variation in competition in the industry. One company does things one way and another company does things another way which demonstrated that we don't have this cabal which—or this collusion which some people think exists in the industry. We have tremendous variation in the industry.

Senator METZENBAUM. Most antitrust prosecutions are directed at certain companies, not at an entire industry. There are more than 3,000 insurance companies.

Could you be absolutely confident that none of them would ever engage in conduct in restraint in trade, and if not, then don't we need some law to see to it that the antitrust laws are applicable to insurance companies?

Mr. MAISONPIERRE. Mr. Chairman, there are some of the Federal antitrust laws applicable to the insurance industry. Some restraint of trade, interlocking directorates, for instance, have been applied to the insurance industry.

Senator METZENBAUM. Why wasn't the McCarran-Ferguson Act applicable in that case?

Mr. MAISONPIERRE. The Federal Trade Commission brought action against a number of companies for interlocking directorates, and this was settled out of court.

Senator METZENBAUM. So the decision was not actually made?

Mr. MAISONPIERRE. No; but obviously the Federal Trade Commission indicated it had jurisdiction over the issue.

Senator METZENBAUM. Your testimony claims that certain collective insurer practices are essential. Doesn't it make more sense to immunize only such key practices rather than continue a blanket immunity which may shield a host of anticompetitive activities as well?

Mr. MAISONPIERRE. The problem with that, Mr. Chairman, is that you cannot anticipate all of the needs arising in the marketplace.

What is needed today may not be needed tomorrow, but what will be needed tomorrow may not be anticipated today.

So, we would have to come back to Congress or to the legislature, to the Justice Department any time a need arises.

When a need arises, quite often the time is not there to allow the luxury of legislative debate.



Senator METZENBAUM. Your testimony includes as an appendix an article by economist Paul Joskow. Mr. Joskow makes several observations about rating bureaus. He states, "The need for pooled industry-wide loss data for class-rated risks does not necessarily imply the need for an industry-controlled trade association to collect it."

Do you agree with that?

Mr. MAISONPIERRE. No; I don't agree with him on that point, particularly since Mr. Joskow says the rating bureaus have minimal if any effect on competition in the industry and on the pricing of the industry system.

Senator METZENBAUM. S. 2474 includes a provision prohibiting discrimination on the basis of race in the sale or underwriting of property or auto insurance.

Do you support that provision?

Mr. MAISONPIERRE. We do, Mr. Chairman, I believe our companies are not practicing discrimination based on race in the sale of automobile or property insurance.

Senator METZENBAUM. Would redlining be discriminatory on the basis of—

Mr. MAISONPIERRE. Mr. Chairman, I don't know what "redlining" means after today's hearings.

For instance, if a—we are told a person is being redlined, but if he were to move into another territory, he would be able to get insurance.

We are told in some prior testimony before the Federal Insurance Administration, a black person testified that he was being discriminated against and redlined; however, he was told if he moved to the suburbs, he would have no problem getting insurance.

The definition of redlining as exemplified in testimony before your subcommittee today no longer has a racial connotation.

Senator METZENBAUM. Well, is it not the fact that redlining has occurred more in black neighborhoods than in any other part of the community?

Mr. MAISONPIERRE. Again, I don't like to use the term "redlining." I will agree with you, Mr. Chairman, that in inner cities we have found for obvious reasons a greater reluctance on the part of companies to voluntarily write property insurance.

We have thus found in the inner cities, many more properties insured through residual market mechanism, hence the FAIR Plan.

But that doesn't mean it is because the person owning the property is black, red, yellow, white, what have you. It is because of probably the hazard involved, and not because of the nature of the ownership.

Senator METZENBAUM. Is it not the case that in many instances areas have been redlined by insurance companies without any supportive evidence that there is any greater risk, but that it was the opinion of some that blacks are moving in, it is a changing neighborhood, or Hispanics are moving in and that therefore, it is a changing neighborhood and we are not going to provide coverage there?

Mr. MAISONPIERRE. Mr. Chairman, it is not because blacks are moving in, because it is a changing neighborhood. It is because of the problem of inner cities.

I can point to some areas in the District of Columbia itself which is an area where whites are moving in and where the whites are having some very difficult problems getting insurance.



Senator METZENBAUM. Is that because all the blacks haven't moved out yet? [Laughter.]

Mr. MAISONPIERRE. Some of the reconstructed areas.

Senator METZENBAUM. Does the Alliance take the position that the National Civil Rights Laws apply to the insurance industry?

Mr. MAISONPIERRE. I think that when you talk about national civil rights laws, we are talking in terms of a whole spectrum of Federal legislation.

If we talk in terms of legislation applicable to the community in general, general legislation, again, without having reviewed all of the specific laws, I would say that probably those laws apply to insurance as well as to anybody else.

When it comes to specific legislation addressing specific industries such as the housing industry, we do not believe that this legislation or this law applies to the insurance industry; in fact, we believe the report, the congressional report and the floor debate accompanying the enactment of the fair housing laws in 1968, if I recall correctly, clearly excluded the application of insurance.

The matter of course, is in litigation now, and is again before Congress, for review, but that law applies specifically to the housing industry and not to the insurance industry.

Senator METZENBAUM. Wouldn't the Alliance feel that the insurance industry should be covered as other industries are covered by civil rights laws?

Mr. MAISONPIERRE. We believe that we are covered, Mr. Chairman, as other industries are covered, to the extent that those are general coverages.

We believe that with respect to racial discrimination that State fair trade practice laws, State insurance codes are the approaches to that.

Senator METZENBAUM. Are the proper approaches?

Mr. MAISONPIERRE. That is correct.

Senator METZENBAUM. Why? Because they are less effective?

Mr. MAISONPIERRE. No, because the responsibility for regulating insurance laws with the State and not the Federal.

Senator METZENBAUM. Well, forgetting about the responsibility, employment is normally regulated in a local area, State regulation, if any. Other kinds of procedures are State regulated. But we have laws against discrimination as far as employment is concerned on a Federal basis.

Why should your industry not support legislation, if it be needed, to provide that the civil rights laws are equally applicable, and the National Fair Housing Act is equally applicable to the insurance industry?

Mr. MAISONPIERRE. You have given me the answer, Mr. Chairman. You have said, "If it be needed." We don't believe that it is needed, because the States have acted in this area.

Senator METZENBAUM. Well, not all States have, have they, Mr. Maisonpierre?

Mr. MAISONPIERRE. Either by implication or directly or indirectly.

Senator METZENBAUM. Well, isn't it the fact that very few States have really done much as far as civil rights laws are concerned? It is becoming more difficult to get them enacted rather than less.



Mr. MAISONPIERRE. Mr. Chairman, I can assure you that most States have either by the Fair Trades Practices Act, or through State insurance regulations, prohibited racial or discrimination in the sale of insurance.

For that matter, every single State provides a ban on the insurance practice of unfair discrimination. I can assure you that any court would readily find that discrimination based on race would be unfair discrimination.

We cannot discriminate unfairly in the sale of insurance in any State. We support that.

Senator METZENBAUM. Mr. Maisonpierre, I respect you, but I respectfully disagree with you. You talk about there being competition in your industry. I don't find it to exist. The witnesses today, as well as on other days, do not recognize its existence.

You talk about nondiscriminatory practices by the insurance companies and that there are State laws to provide adequate protection. I don't believe that is the case. You are really a favored industry. You are a special kind of industry. You have exemption from the antitrust laws. You are arguing that exemption from the civil rights laws, although I was pleased to see Mrs. Rodgers collected \$25,000 for violation of her civil rights by an insurance company.

Mr. MAISONPIERRE. I would say, Mr. Chairman, that is an example of State regulation.

Senator METZENBAUM. Well, it is maybe an example of her having a strong advocate and that in that instance there was a State law.

Was it under Federal law?

Mr. BROWN. Under the Federal law.

Senator METZENBAUM. The Federal law, so I guess that adequately rebuts your statement that it happened under State regulation.

I think that it is high time for the insurance industry to take stock, to take stock about not what you can do in the congressional halls, but what you should do, because we may not be successful this week or this month, but at some point the Congress is going to find the insurance industry ought to be equal and meet the same responsibilities that other parts of American industry do.

Thank you very much.

Mr. MAISONPIERRE. Thank you, Mr. Chairman.

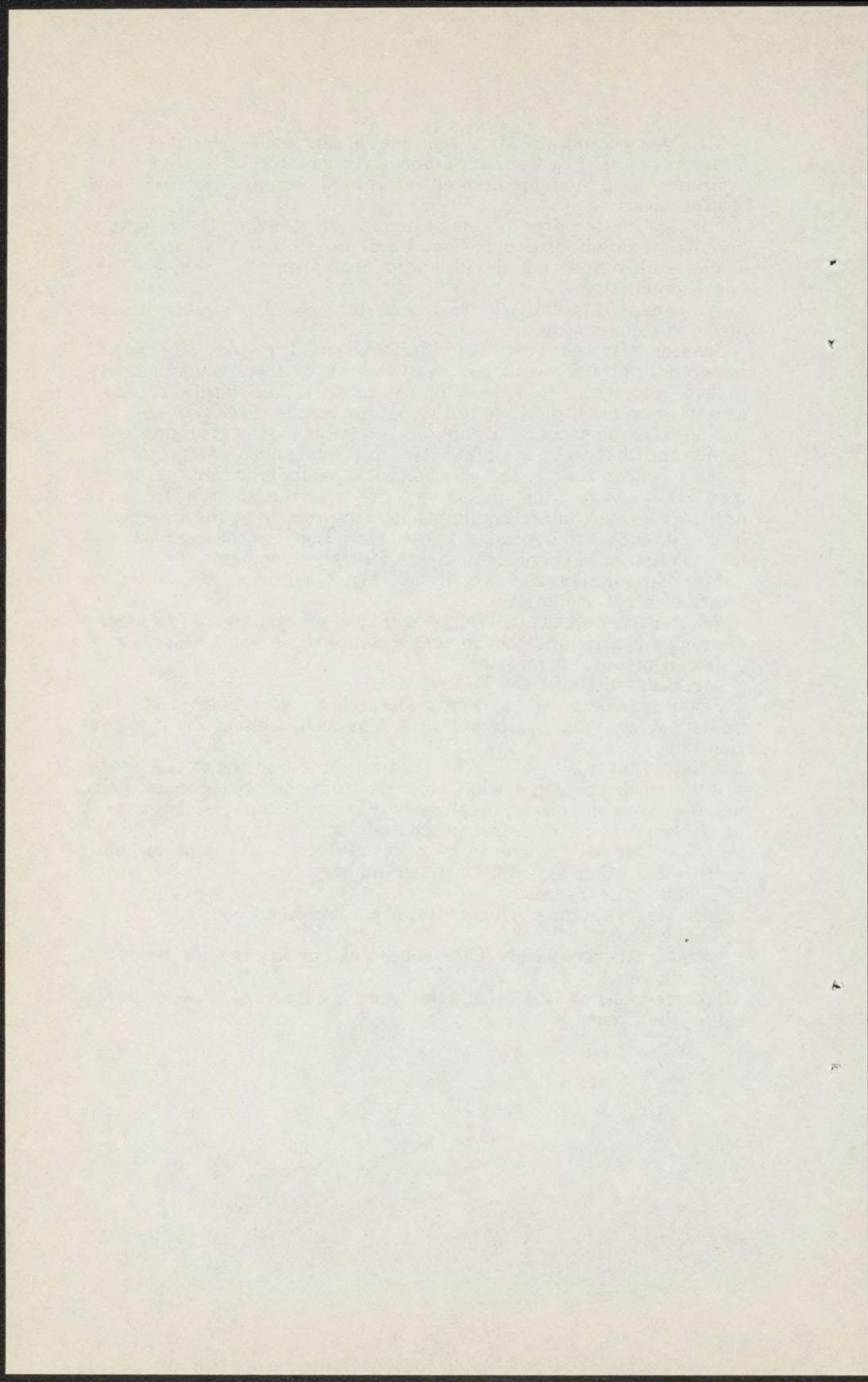
Thank you.

Senator METZENBAUM. That concludes our hearing for today.

Thank you.

[Whereupon, at 12:45 p.m., the hearing adjourned, subject to the call of the Chair.]







## APPENDIX

*Library Copy*

OFFICE OF THE ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE

FILE

D. C. 20530

EXPERIENCE SUPPORTS McCARRAN-FERGUSON POLICY,  
ARGUES AGAINST REVISION OR REPEAL

STATEMENT OF THE  
ALLIANCE OF AMERICAN INSURERS  
BEFORE THE  
SUBCOMMITTEE ON ANTITRUST, MONOPOLY AND BUSINESS RIGHTS  
OF THE  
SENATE COMMITTEE ON THE JUDICIARY  
ON S.2474  
"THE INSURANCE COMPETITION IMPROVEMENT ACT"

MAY 29, 1980



## HIGHLIGHTS OF ALLIANCE STATEMENT

1. Enactment of many of the standards proposed under the federal Insurance Competition Improvement Act (S.2474) would create chaos in the insurance marketplace. Similar proposals already enacted into state law have had this effect. (pages 1, 2)
2. It is likely that many states would balk at legislating the federal standards contained in S.2474. Consequently, under terms of the Act, the McCarran-Ferguson law would then no longer apply in those states and the expressed intent of Congress that insurance be state regulated would be thwarted. (pages 2, 3)
3. Repeal of the McCarran-Ferguson law would severely limit the ability of property and casualty insurers to meet changing market demands and would lead to much less competition in the insurance industry, as well as higher prices for consumers. (pages 4, 5; Appendices I, II)
4. The Economic Advisory Panel of the National Commission for The Review of Antitrust Laws and Procedures concluded that insurance rating bureaus have but minimal impact on inhibiting price competition. (page 4)
5. The Panel's conclusion as well as other findings and conclusions by academic experts were ignored in the Commission's Report recommendation to re-evaluate McCarran-Ferguson. (page 5)
6. An analysis of the role of insurance rating bureaus by noted regulatory economist Dr. Patricia Munch indicates that the bureaus are fulfilling a service function and not having a cartelization effect in the insurance industry. (pages 6-8, Appendix III)
7. A survey of Alliance member companies shows that severe restrictions on rating bureau activities would lead to greater market concentration in the insurance industry; proliferation of insurance policies, forms and coverages; and higher insurance rates and premiums. (page 9, Appendix II)
8. The principal source of criticism directed to the existing regulatory system--the General Accounting Office report on state insurance regulation--is flawed by critical omissions, distortions of fact and illogical conclusions. (pages 10,11; Appendix IV)
9. The GAO report inaccurately evaluates the professionalism and the work priorities and procedures of state insurance departments. It also ignores significant activities which have been undertaken by the National Association of Insurance Commissioners to make state regulation of insurance effective. (pages 11-15)
10. GAO's conclusion that the insurance regulators are captives of the industry has been disproven by empirical studies. Data in the GAO report itself also contradicts this conclusion. (pages 15, 16)
11. State regulation of insurance encourages competition, fulfills public needs and promotes innovation. The Alliance urges that the existing state system be endorsed and the McCarran-Ferguson Act be left untouched. (page 17)



## TABLE OF CONTENTS

|            |      |                                                                                                                                                        |    |
|------------|------|--------------------------------------------------------------------------------------------------------------------------------------------------------|----|
|            | I.   | INTRODUCTION                                                                                                                                           | 1  |
|            | II.  | REPEAL OF McCARRAN-FERGUSON ACT                                                                                                                        | 2  |
|            | III. | THE ROLE OF RATING BUREAUS IN PROPERTY<br>LIABILITY INSURANCE MARKETS                                                                                  | 6  |
|            | IV.  | WHAT DOES ALL THIS MEAN?<br>(Empirical Analysis of Effects of<br>McCarran-Ferguson)                                                                    | 8  |
|            | V.   | THE GENERAL ACCOUNTING OFFICE REPORT ON<br>STATE REGULATION OF THE BUSINESS OF<br>INSURANCE                                                            | 10 |
|            | VI.  | CONCLUSION                                                                                                                                             | 17 |
| APPENDICES | I.   | Report of the Economic Advisory Panel to<br>the National Commission for the Review<br>of Antitrust Laws and Procedures                                 |    |
|            | II.  | Statement of the Alliance of American<br>Insurers before the National Commission<br>for the Review of Antitrust Laws and<br>Procedures - July 26, 1978 |    |
|            | III. | The Role of Rating Bureaus in Property-<br>Liability Insurance Markets                                                                                 |    |
|            | IV.  | GAO Report on Insurance - A Critique                                                                                                                   |    |



My name is Andre Maisonpierre. I am vice president of the Alliance of American Insurers, a major association of property and casualty insurance companies. Our member companies provide personal and commercial line insurance protection in all 50 states and the District of Columbia. We appreciate the opportunity to appear before the Subcommittee to comment on S.2474, the Insurance Competition Improvement Act.

Our statement will address three specific areas:

- The effect repeal of McCarran-Ferguson would have on the insurance industry, on insurance availability and on competition.
- The function of insurance rating bureaus, with special attention to misconceptions regarding both their functions and day-to-day operations.
- A critique of the General Accounting Office report on state insurance regulation.

We will not comment on the specific federal trade regulatory standards which S.2474 would impose on both the insurance industry and the marketplace. Such sections of the legislation come under jurisdiction of the Senate Committee on Commerce, Science and Transportation, and we will address those sections when that Committee has its own hearings.



- 2 -

Suffice it to say that enactment of many of the proposed standards would unquestionably bring about complete chaos in the insurance marketplace. One need look no further than the states themselves where similar proposals have already become law in certain instances. We should add that these state programs have themselves substantially disrupted normal competitive forces within insurance markets. They have also created serious hardships on insurance consumers. It is difficult for us to understand, therefore, why Congress would seek to impose such unnecessary dislocation on a countrywide basis when disastrous effects at state level are so obvious.

#### REPEAL OF McCARRAN-FERGUSON ACT

We wish to emphasize for the record the statement of the Joint House and Senate Conferees on the FTC Reauthorization bill setting forth the current position Congress has taken on insurance regulation. "The conferees," it said, "wish to indicate their strong reaffirmation of the basic policy of the McCarran-Ferguson Act that the business of insurance is to be regulated by the states."

Yet, S.2474 calls for the repeal of McCarran-Ferguson in states failing to meet the insurance trade practice requirements which would be imposed by this legislation. Obviously the measure is out of step with both the times and this Congress. Further, the effect of applying those requirements on both insurers and consumers would be devastating, since it is quite likely that many states would balk at legislating concepts imposed by Wash-



- 3 -

ington. Hence, an untenable situation would inevitably occur whereby McCarran-Ferguson would no longer be applicable in those states. This would directly thwart the will of Congress that "the business of insurance is to be regulated by the states."

Critics of the McCarran-Ferguson law have repeatedly stated that:

- McCarran-Ferguson is an aberration of our federal anti-trust laws, providing special and unwarranted immunities to a limited sector of the economy. As such, the critics claim, the law represents a deviation from basic national antitrust policy and cannot be condoned.
- The immunity from federal antitrust laws has had the effect of severely restricting competition in insurance markets with a resulting tendency to "cartelize" insurance prices.

Both assertions are completely false and without foundation. They are based solely on unsubstantiated rhetoric.

McCarran-Ferguson is not an aberration of federal antitrust policy. It is an integral part of our complex antitrust system, which relies on state and federal antitrust laws working together as well as on limited immunities from some of these laws as necessary to meet special needs of important segments of both production and service sectors of our economy.



- 4 -

Neither the basic federal and state antitrust statutes nor their applicable exemptions separately constitute the "basic law of the land" with respect to antitrust matters. Together all such statutes, including exemptions thereto, provide an integrated basic national policy which is both rational and consistent.

As to the effect which McCarran-Ferguson has had on price competition in insurance markets, the Report of the Economic Advisory Panel to the National Commission for the Review of Antitrust Laws and Procedures is most illuminating. That report, prepared by a panel of distinguished national economists, clearly express disbelief that McCarran-Ferguson immunities, in and of themselves, could have "much of an effect on price competition in the property/casualty insurance industry."

The Report further recognizes that "there are simply too many firms, selling to too many customers a package that varies from customer to customer, for collusive behavior to be feasible without coercion, intimidation and boycott (conditions not exempted by the McCarran-Ferguson Act) in most lines of insurance." (See page seven, Appendix I.)

On the other hand, repeal of McCarran-Ferguson would produce results diametrically opposed to the very objectives of S.2474. Repeal not only would severely limit the ability of the property and casualty insurance business to meet continuously changing market demands, but also would unquestionably lead to greatly diminished competition in the insurance industry as well as to higher prices for consumers.



- 5 -

A detailed examination of changes in market structure, product choice, service and price which we anticipate would occur with either repeal or major amendment to McCarran-Ferguson was presented on July 26, 1978, by the Alliance in an extensive statement to the National Commission for the Review of Antitrust Laws and Procedures. That statement also included a survey evaluating the effects which such legislation would have on individual Alliance companies.

Conditions have not changed in the meantime to modify either the analysis we prepared for the National Commission or our evaluation of the effects of repeal on our member companies. Accordingly, we are appending to this statement our complete presentation to the National Commission in support of McCarran-Ferguson and our affirmation that repeal of the law would be a great disservice not only to the insurance industry but, more importantly, to both individual and commercial insurance consumers. (Appendix II)

We are, of course, fully aware that most members of the National Commission recommended a re-evaluation of McCarran-Ferguson. Frankly, this recommendation by the Commission is not well-founded. Besides disregarding the Report of its own Economic Advisory Panel and without any evidence to the contrary, the Commission was denied the opportunity to examine academic studies whose conclusions and recommendations ran counter to the prevailing mood.

Further, no concrete evidence was developed to demonstrate how repeal would improve insurance markets or make them more competitive. In fact, all of the Commission's insurance recom-



- 6 -

mendations parallel pre-conceived concepts which have been expressed time and again by the Antitrust Division of the Department of Justice. That Division, incidentally, has traditionally been the principal proponent of the simplistic theory that the McCarran-Ferguson Act represents an aberration of our nation's antitrust programs.

THE ROLE OF RATING BUREAUS IN PROPERTY LIABILITY INSURANCE MARKETS

Section 3 of S.2474 would amend the McCarran-Ferguson Act in those states where the act continues to apply -- those states having adopted the impractical trade regulation standard proposals -- by severely limiting the role of rating bureaus. The Committee staff Summary and Explanation accompanying the introduction of the legislation states that such action is necessary because bureau activities "tends to chill wholly independent pricing." This demonstrates a totally erroneous and superficial understanding of the role, influence and function of insurance rating bureaus.

Yet, it should be noted that the staff assumption is not fundamentally different from similar assumptions accepted without objective analysis by the National Commission for the Review of Antitrust Laws and Procedures. The Commission, after observing that existing trucking industry regulation and collective activities create "a strong upward pressure on rates" commented that "there is no evidence that insurance premiums are not similarly affected."



- 7 -

To test the hypothesis concerning the effect of rating bureaus on prices, the Alliance commissioned Dr. Patricia Munch, a noted regulatory economist, to analyze the effect of the McCarran-Ferguson antitrust exemptions and the impact of rating bureaus on price competition in the property and casualty insurance business. Her paper is attached, Appendix III.

As Dr. Munch states, critics of existing insurance antitrust exemptions visualize the purpose and result of rating bureaus as "cartelization." An alternative view is held, however, that the insurance business is structurally competitive and that any attempt to cartelize would be unrealistic in most states and lines of insurance.

The purpose of Dr. Munch's paper is "to attempt to apply empirical evidence to discriminate between those two views of the role of rating bureaus (cartelization vs. service bureaus) in the insurance industry." Direct and indirect evidence was used in her research. Direct evidence was drawn both from existing research as well as from empirical data which identified conditions where the patterns of adherence to bureau rates occurred among members of the leading bureau, the Insurance Services Office (ISO).

Dr. Munch also applied the four basic economic tests suggested by Alfred Kahn, chairman of The Council on Wage and Price Stability and a member of the National Commission. This provided both indirect and direct evidence that conditions of cartelization do not exist, nor do antitrust immunities for insurance have anti-competitive effects in the insurance marketplace.



- 8 -

Dr. Munch structured her analysis of the role of rating bureaus using a number of testable predictions which characterize a bureau under either cartel or service-model configuration. The characterizations are detailed in her report. Her conclusion is unequivocal. None of the testable predictions which would evidence that insurance rating bureaus lead to cartelization can be sustained. Rather, all of the testable predictions evidencing the role of rating bureaus as service models are fully and rationally supported. Her conclusion is that "there is no evidence that ISO exerts a significant cartelization influence in the auto insurance market. "One must conclude," she says, that it (ISO) survives only to the extent it provides valuable services."

With respect to the indirect evidence, applying Chairman Kahn's tests, Dr. Munch concludes that an objective evaluation of these tests suggests once again that "the potential for significant cartelization due to the operation of ISO is surely trivial."

WHAT DOES THIS ALL MEAN?

On one hand we have an observation by the National Commission that "there is no evidence" that insurance regulatory mechanisms and rating bureaus do not create upward pressures on rates similar to those that have been demonstrated in the trucking industry. Yet, as noted above, the National Commission completely overlooked the evidence of its own Economic Advisory Panel which unequivocally stated that the effect of the McCarran-Ferguson immunities on price competition in the property and casualty insurance industry is, at most, minimal.



In addition to the report of the Economic Advisory Panel, we have the further extensive evaluation of the role of rating bureaus in property and casualty insurance markets prepared by Dr. Munch. Dr. Munch concurs with the National Commission's Economic Advisory Panel that rating bureaus do not act as a cartelizing influence but, rather, provide services to members and subscribers which support extended insurance markets, lower distribution costs and enable more efficient market distribution of a broad spectrum of insurance coverages.

Yet another empirical analysis of the role rating bureaus perform is found in the comments by Alliance member companies participating in a survey conducted in preparation for our statement submitted to the National Commission in July, 1978 (Appendix II, pages 18 to 47). Specifically, our companies indicated that severe restrictions on present bureau activities would lead to:

- Abandonment of certain lines of insurance and territories in which companies lack substantial penetration.
- A merger of smaller companies and greater market concentration.
- Proliferation of insurance policies, forms and coverages, making it impossible for consumers to do effective comparative shopping.
- Increases in insurance rates and premiums.

Finally, there is considerable agreement and rational consistency between Alliance member company perceptions of the impact of major changes in the McCarran-Ferguson Act on their operations,



procedures and marketing profiles and the findings of the Economic Advisory Panel to the National Commission. This unanimity is fully supported by Dr. Munch's empirical analysis of the role of rating bureaus in insurance markets and the interplay between antitrust immunities and competition.

Such overwhelming evidence demonstrates that insurance competition is not adversely affected nor are premiums artificially inflated by McCarran-Ferguson or the operations of rating bureaus. Therefore, a case for repeal or major amendment of McCarran-Ferguson is totally unwarranted and without validity.

THE GENERAL ACCOUNTING OFFICE REPORT ON STATE REGULATION OF THE BUSINESS OF INSURANCE

Another reason cited by proponents of S.2474 for repeal or revision of McCarran-Ferguson is the assertion that state regulation of insurance has not been effective or responsible - that it has, in effect, failed.

Paradoxically, it should be noted that, while the intent of The Insurance Competition Improvement Act is to stimulate greater competition in the insurance business, its sponsors have curiously and repeatedly expressed special admiration for insurance regulatory environments which substantially curtail competitive pricing and innovation (North Carolina and Massachusetts).

The principal source of criticism directed to state insurance regulation is the General Accounting Office. However, thorough review of GAO's report on state regulation convinces us that its content is at best quite uneven and it is fundamentally flawed



- 11 -

by important omissions and obvious distortions of fact. A critique of the GAO report is attached to our statement (Appendix IV).

An objective evaluation of the report reveals on the plus side that it does contain certain information which can be helpful in evaluating state regulation of insurance even though the information is not comprehensive and complete enough to provide a balanced picture. There are pitfalls in using the factual information contained, however. Because of the inconsistency with which it is treated, the Report's conclusions just do not follow. Accordingly, we believe that the GAO report cannot be used to make an effective argument for imposing a federal regulatory role on the insurance industry or for repeal of McCarran-Ferguson. Incidentally, it should be pointed out that, in reviewing both alleged shortcomings and positive aspects and trends in state insurance regulation, GAO went out of its way in Congressional testimony to avoid making any recommendations with respect to a federal role.

These are some of the major criticisms of insurance regulation identified in the GAO report, and our comments on those criticisms:

- It is alleged that state insurance departments lack professionalism.

The Report, however, notes that the professional qualifications of department personnel have improved since earlier Congressional studies. In particular, senior staff, apart from most commissioners, have had many years of experience in insurance regulatory work -- the equivalent of more formal training. Furthermore, the Report recognizes that data on budget expenditures, staffing and pro-



- 12 -

professionalism only represent the potential for effective regulation. It then demonstrates that substantial improvements have occurred in establishing effective regulatory resources; that money is being spent more effectively today by insurance departments; and that personnel have become more highly qualified due to length of experience and other factors.

- The Report alleges that many state insurance departments do not have adequate information for evaluating the financial stability of companies they regulate.

The fact is that the National Association of Insurance Commissioners has established an Early Warning System which provides all insurance departments with extensive computerized data on the financial strength of all but the very smallest of companies. A team of financial examiners reviews the computer runs and financial history of every insurer which may exhibit a precarious financial position. These tests are used as an "alert" by insurance commissioners to focus attention on such companies. The information is made available to all state insurance departments, not just some regulators as the report suggests.

- The GAO Report alleges that the quality of insurance examiners needs to be improved.

The Report fails even to mention the extensive NAIC work performed in conjunction with professional societies in developing academic training programs for insurance financial examiners.

- GAO criticizes financial insurance regulation because it fails to require and/or depend on CPA audits.



- 13 -

The fact is that most insurers of any size do business in at least one state where extensive CPA audits have already been conducted as a matter of course and where there are mandatory CPA audit rules.

- The GAO was critical of state insurance departments which did not systematically use complaint data as a regulatory tool.

Here again the conclusions do not flow from the facts presented. GAO found that all insurance departments visited considered complaint handling an important function, so important that they have established special procedures and staff to deal with complaints. The states in fact appear to be doing a much better job of consumer complaint handling than the Federal Trade Commission itself, which, according to a prior GAO Report, is totally lacking in its ability to handle individual consumer complaints that result from unfair or deceptive business practices. (So much for the elusive benefits of federal regulation).

- The GAO alleges that states do not have consistent quantitative and qualitative standards for use by examiners in their market conduct examinations.

Again, the facts are at odds with the GAO Report. The NAIC Market Conduct Examination Handbook, which has served as a resource book for the states since its publication in 1976, contains very specific guidelines for conducting such examinations.



- 14 -

- The GAO was critical of insurance departments for not investigating problems nor collecting data to monitor automobile risk classification and insurance availability problems.

In this instance, GAO failed to recognize the extensive activities undertaken by the NAIC, including the development of model property disclosure and cancellation laws, which provide the very insurance information that GAO considers important.

- GAO condemns state insurance departments for "not yet (having) examined the current classification plans with sufficient rigor."

Yet, the Report recognizes that state insurance departments "may be justified in waiting for the results of further study before acting on the issues raised by personal classification." Such internal inconsistencies are widespread throughout the Report.

- GAO seems very critical of the fact that highly complex issues which have only become problems in the last few years, e.g., risk classification, have not been completely resolved by state regulatory systems. GAO contends that regulators should have anticipated these problems and corrected them before they became "an issue."

This allegation reflects a fundamental misunderstanding of the entire political and governmental process in America. To say that state governments have not recognized problems before they



- 15 -

manifest themselves or are too deliberate in resolving such problems does not lead to the conclusion that the federal government would have addressed these same problems any earlier or more efficiently.

Has Congress or the federal apparatus solved the energy crisis, inflation, housing problems or a host of other critical economic and social issues? Of course not. The logic of the matter is that certain social, governmental, political and economic pressures exist in tandem making it difficult for anyone to find an easy solution.

- The GAO Report criticizes the alleged lack of independence of insurance regulators and the numerical domination by insurance industry representatives at NAIC meetings.

The GAO conclusion that the regulators are "captive" of the industry has been disproven by empirical studies. Such studies negate the "Stiglerian hypothesis" that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits." In fact, the GAO Report itself contradicts the Stiglerian hypothesis with respect to insurance since it recognizes that "there is little difference in the price of insurance, as measured by loss ratios, between the states that regulate rates directly and those that have open competition systems."

A particularly disturbing aspect of the GAO Report is its lack of objectivity in arriving at its conclusions. For instance, the



- 16 -

GAO Report makes a strong plea for federal activity in the final version of the chapter on automobile risk classification. Yet, GAO's first draft of this chapter came out with the exact opposite conclusion, based on identical data. Not one word was changed in the final content of the chapter, only the conclusions were altered 180 degrees between the draft and final copy!

Although the reasons for such an about-face are not relevant to this analysis, the fact that the same data were used by GAO to support both an affirmation of state regulation and a call for federal activity -- two diametrically opposing views -- indicates either unbalanced, unprofessional analysis or other problems which have affected GAO's objectivity.

Finally, GAO admits that its analysis of insurance issues and regulation was limited to a static rather than a dynamic review of the facts; that the Report's evaluation relates only to whether particular problems were being addressed at the time they were observed. It has not put these issues into a historical time frame, nor measured progress which the states have made in solving the problems over the years. Can an accurate evaluation of the effectiveness of state government versus the effectiveness of federal regulation be made on such a simplistic and unobjective basis? We think not.



- 17 -

CONCLUSION

The Alliance of American Insurers has developed effective, convincing evidence that our existing state system of insurance regulation works. State regulation encourages competition, allows public needs to be fulfilled, and promotes innovation. For these reasons and in light of the anticipated chaos which would occur with passage of S.2474, we urge that the existing state system of insurance regulation be endorsed and the McCarran-Ferguson Act be left untouched.



REPORT OF THE  
ECONOMIC ADVISORY PANEL  
TO THE  
NATIONAL COMMISSION  
FOR THE REVIEW OF  
ANTITRUST LAWS AND PROCEDURES

Barry P. Bosworth

Paul L. Joskow\*

Paul W. MacAvoy

James C. Miller, III\*

W. F. Mueller\*

Roger Noll\*

Almarin Phillips

F. M. Scherer\*

Irwin M. Stelzer

George J. Stigler

Murray L. Weidenbaum\*

\*Authors

November 9, 1978



COMPETITION AND REGULATION IN THE  
PROPERTY/CASUALTY INSURANCE INDUSTRY

Paul L. Joskow

The McCarran-Ferguson Act, passed by Congress in 1945, exempts the "business of insurance" from the federal anti-trust laws to the extent that such business activities are regulated by the states. Prior to the 1944, the business of insurance was exempt from the antitrust laws by virtue of a Supreme Court determination that the sale of insurance did not constitute interstate commerce. In 1944 the Supreme Court reversed its position, declaring that insurance was interstate commerce and therefore subject to the antitrust laws. The McCarran-Ferguson Act was passed in response to this court decision. Its passage reflects the concerns of the states that the Court's 1944 decision might void their rights to tax and regulate insurance companies and arguments by the insurance industry that the application of antitrust laws would lead to "destructive" competition and make necessary cooperative activities illegal. Following the passage of the McCarran-Ferguson Act, most states enacted legislation to regulate a wide range of insurance activities, including insurance rates and rate classifications.

The McCarran-Ferguson exemptions allow insurance firms to engage in a variety of cooperative activities, which might otherwise be illegal under the Sherman Act, to the



extent that such activities are regulated by state law. In addition, the insurance industry is immune from prosecution under the Federal Trade Commission Act for unfair business practices to the extent that such practices are also regulated by state law. As I understand it, the Sherman Act exemptions are relevant primarily to the property/casualty insurance industry. The life insurance industry appears to operate under the assumption that it is subject to the Sherman Act and in any case the kinds of cooperative activities which might be illegal under the Sherman Act are engaged in primarily by the property/casualty firms through their rating bureaus. Immunity from FTC regulation is of relevance to all segments of the insurance industry. Furthermore, the immunities are not absolute. Coercion, intimidation and boycotts remain subject to antitrust review.

My discussion here will focus primarily on the property/casualty industry, both because it is this segment of the insurance industry that I know the most about and because the antitrust immunities granted by the McCarran-Ferguson Act are most relevant to it.

#### The Nature of the Industry

There are about 2,900 firms licensed to sell property and casualty insurance in the United States. Many of these



firms are quite small, selling insurance within only a single state and serving specialized markets there. Many other firms are quite large, operating in many or all states. About 900 firms sell insurance in a regional or national market and offer several different lines of insurance. By conventional standards concentration in most lines of insurance is very low and entry is relatively easy. In the past twenty years about 600 companies have entered the industry to sell one or more lines of insurance in one or more states. Under current institutional arrangements (the most important of which is the use of rating bureaus to provide a variety of actuarial and ratemaking services), economies of scale in marketing insurance through independent agents appear to be modest. Scale economies appear to be much more important for marketing insurance through exclusive agents and direct mail. At appropriate scale the marketing costs through exclusive agents (whether salaried or on commission) and direct mail appear to be lower than that through independent agents.

In my opinion, the structural characteristics of this industry are such that competitive market forces can work effectively to regulate prices in most insurance lines. There is neither the danger of monopoly pricing absent rate regulation nor the prospect of "destructive" competition.



Competitive market forces would insure that all insurance demanded would be provided efficiently at actuarially fair rates. The major substantive issue here with regard to the antitrust immunities alone is the determination of which types of cooperative activities are required to assemble the actuarial data for efficiently determining insurance premiums and to insure large and special risks and whether or not these requirements can be met under existing antitrust law. I will return to this issue below.

#### The Role of State Regulation

Following the passage of the McCarran-Ferguson Act, most states enacted legislation which required prior approval of rates and rating classifications by the state insurance commission. California was a notable exception to this trend, allowing companies considerably more rate freedom under its "open competition" law. It should be noted, however, that state regulation encompasses much more than just rate regulation. State insurance departments are involved in solvency regulation, regulation of residual markets, entry, taxation, and other aspects of the business of insurance. The major focus of most economic analysis of this industry has been on rate regulation, but the antitrust immunities may also have important implications for the operation of residual market mechanisms, insurance of large and special risks and state guarantee funds.



State regulation of insurance rates has evolved considerably over time. Prior approval rate regulation in the 1950's tended to discourage competition and innovation. Aggressive firms often found it difficult to obtain approval for rates lower than those filed by the industry rate bureaus and to promulgate rates based on different rating classifications. However, in many of the larger states rate regulation has become considerably more flexible, even where prior approval statutes remain in force. In addition, many states have enacted "open competition" laws patterned after the experience in California, increasing the opportunities for price competition and innovation. Fears of destructive competition and monopoly pricing have not been sustained by our experience to date with open competition.

It would be wrong to assume that rate regulation in many states consists of a rigid enforcement of cartel-like rates determined in concert through state insurance rate bureaus. There is considerably more flexibility in practice, although there appears to be significant differences from state to state. Nevertheless, especially in prior approval states, rate regulation has led to certain performance characteristics which many economists would find unsatisfactory. These performance characteristics include:



1. Higher average premiums in states with prior approval regulation than in states with open competition laws.

2. Restrictions on the ability of firms to charge actuarially fair insurance premiums leading to supply shortages and the subsidization of high risk consumers by lower risk consumers.

3. Protection of inefficient firms via restrictions on the ability of rates to fall to competitive market levels reflecting the most efficient mix of marketing techniques and the size distribution of firms.

In my opinion, the primary restriction on competition in the property/casualty insurance industry today arises from restrictions imposed by state rate regulation, not directly from the antitrust immunities granted by the McCarran-Ferguson Act. In this regard, it should be noted that the "public interest" rationale for state rate regulation has changed considerably over the past thirty years. Originally it was billed primarily as a necessity to protect consumers against the threat of insolvency, leading regulators to focus extensively on minimum rate regulation. Today more and more state insurance commissions have become



concerned with broader social implications of insurance rates. In particular, they have become concerned about the income distributional implications of actuarially fair insurance rates and have questioned whether actuarially fair rates satisfy other standards of fairness. This concern has been accompanied by increasing restrictions at the federal level on the use of sex and age as factors in establishing rate classification, even if these factors are the best available predictors of losses. I will return to these issues below.

#### The Role of the McCarran-Ferguson Act

In the absence of state regulation I find it doubtful that the McCarran-Ferguson immunities would have had much of an effect on price competition in the property/casualty insurance industry. Although these immunities now allow firms to get together to collect loss data, calculate trend factors, determine rating classifications, industry-wide rates and even publish detailed rate books, there are simply too many firms, selling to too many customers a package that varies from customer to customer for collusive behavior to be feasible without coercion, intimidation and boycotts (not exempted by the McCarran Act) in most lines of insurance. Much of the history of the property/casualty insurance



industry indicates that sustained cartel pricing behavior in the absence of legal enforcement by the states through rate regulation has been difficult or impossible in most lines of insurance. Experience in states which have enacted open competition statutes reinforces this conclusion. Without the help of government, this industry simply has none of the characteristics which make formal or informal oligopolistic coordination likely (this conclusion does not apply to certain lines of insurance such as title insurance and medical malpractice insurance where industry structure makes such oligopolistic coordination of more concern). While I do not think that many of the cooperative activities now engaged in are particularly conducive to competition, especially the determination of actual premiums by rating bureaus and the publication of rate books, it would be extremely difficult to enforce such uniform rates if all firms were free to charge whatever rates they choose to. If the bureau rates are set above competitive levels, many firms will have strong incentives to undercut them to attract a larger share of the market. (Recall that individual states have as many as 1,400 firms selling property/casualty insurance.)



In light of these facts, my feeling is that the repeal of the McCarran-Ferguson Act alone will have little if any effect on the extent of price competition in this industry. If the goal is a more competitive market for property/casualty insurance, removing the ability of the states to regulate rates, rate classifications, etc., would be a much more potent instrument.

Does the Insurance Industry Need Antitrust Immunity to Operate Efficiently?

The major objections to the repeal of the McCarran-Ferguson antitrust immunities by the industry center on claims that many of the cooperative activities engaged in are necessary to the business of insurance, but might be illegal under the Sherman Act. It is argued that at the very least, the considerable uncertainty associated with the application of the antitrust laws, in terms of the precise boundary between legal and illegal cooperative activities, would cause chaos in the short run. In addition, some insurance firms expressed concern that the application of the vague mandates of the FTC Act would duplicate existing state regulatory activities and open the door to extensive federal regulation of all aspects of insurance. Problems engendered by state regulation would be compounded by efforts of the federal government to regulate the insurance business.



The arguments presented by the industry cannot be dismissed out of hand. The nature of the insurance business is such that firms need large amounts of actuarial data on losses to set appropriate insurance rates. Individual firms usually do not have sufficient internal data to make the appropriate actuarial calculations. There are almost certainly substantial scale economies associated with collecting and processing industry-wide loss data for different lines of insurance. Even the very largest insurers, such as State Farm (which supports major changes in McCarran-Ferguson and increased rate flexibility), feel the need for pooling of loss data. But to collect and organize loss data the industry argues that some collective decision about classifications must also be made. And to use the data to make rates for the future, it is argued that some effort to project historical trends is required. Smaller companies and even larger companies such as Allstate which sell relatively small amounts of some types of insurance, argue that they need the help of the rating bureau to calculate the actual insurance rates themselves, at least as a guideline, because the cost to the individual company to calculate rates would be extremely high. The question is, where do we draw the line? Precisely where do the costs of



cooperative behavior, in terms of price rigidity and a retardation in innovative ratemaking, outweigh the benefits associated with economies of scale? There is little if any impartial research that has been done to allow us to draw a definite line. And despite the DOJ's assurance that many of these "necessary" activities would not violate the antitrust laws, there remains considerable legal uncertainty that would have to be resolved either through litigation or detailed specification in any new statute.

The problems alluded to above are relevant primarily to class rated risks such as auto insurance, homeowners' insurance and other personal lines. When we turn to commercial hazard insurance which is schedule rated, other arguments for the necessity of continued cooperative activity emerge. For example, if fire insurance rather detailed schedules for assessing the risk of a particular structure based on its structural characteristics and location have been developed. These schedules are used by all firms to at least determine relative risks if not absolute insurance premiums. It would be extremely costly for individual firms to develop their own basic rating schedules. It would also be extremely costly for each firm to send inspectors to particular commercial properties to determine the presence



or absence of the various risk factors that go into rating a large commercial property. Once again, the arguments supporting this type of cooperative rating activity cannot be dismissed out of hand. The question remains, where do we draw the line as a theoretical matter and where does the antitrust law now draw the line as a practical matter?

For schedule rated property the cooperative efforts to arrive at risk schedules and to rate properties by inspectors is probably desirable, and the competition for such insurance is so intense that it is probably not worth any public policy concern. My own feeling, however, is that while some of the cooperative activities that are now engaged in are indeed necessary to provide insurance efficiently, the range of necessity that is claimed by the industry, especially for class rates risks, is excessive.

The need for pooled industry-wide loss data for class rated risks does not necessarily imply the need for an industry controlled trade association to collect it. Nor does it necessarily imply that only a single firm is required to offer such actuarial data. Nor does it necessarily imply that all firms must agree on the specific rate classifications that will determine how the data are presented. Finally, it certainly does not imply the need to have a



cooperative enterprise transform "pure premium" information into rates based on industry-wide operating cost data and an industry-wide profit rate.

With current computer data processing capabilities appropriately coded data can be easily and cheaply arranged in any way a particular firm wants to obtain useful pure premium information. The rating bureaus could be transformed into data banks. With thousands of firms in the market to purchase such actuarial data there is no reason why insurance consulting firms could not evolve to do the work that individual companies find too expensive to do internally. Indeed, the evolution of a more competitive market for providing actuarial services would help to enhance price competition and probably lead to a greater array of rate categories. Finally, if some firms are too small to determine rates efficiently, with the help of consultants, if necessary, but without resorting to published rate books, then they probably should not be in the business of insurance. The one cooperative activity that really concerns me at all is the formulation of specific retail premium rates and the publication of bureau rate books (although for most lines of insurance this doesn't concern me too much either).



These last two points deserve further comment. The presentations by the industry before this Commission confuse the preservation of particular competitors with the preservation of competition. It has long been recognized in economics and antitrust law that the preservation of competition and the preservation of particular competitors are not the same thing. There is no public interest served by preserving inefficient firms merely for the sake of having more firms. In most insurance markets there are hundreds of firms competing. We don't need hundreds of firms to insure competitive behavior. It certainly makes no sense to force consumers to pay higher prices or to waste the resources associated with inefficient production merely to increase the number of firms. There are more than enough efficient firms to insure competitive market behavior. The arguments here are reminiscent of those made of stock brokerage firms trying to preserve the old fixed-commission system. The elimination of fixed commissions has led to a sharp reduction in the number of brokers, but it has also yielded significant benefits to consumers. Commission rates now more closely reflect costs and have fallen for many customers. The brokerage product has been "unbundled" so that consumers can purchase the services they want. Small innovative firms



have entered the market to provide specialized trading services. It may well turn out that increased competition in the insurance industry will mean fewer competitors, but fewer competitors will not disadvantage consumers -- quite the opposite, since the reduction in the number of firms would be caused by lower price and more efficient marketing.

There are other cooperative activities not directly related to rates which also may be brought into question under the Sherman Act. These include the pooling of large risks among two or more firms, state guarantee funds, and the operation of residual market facilities. Pooling of large and special risks should be and probably is legal under the antitrust laws. Any new statute should clarify this, however. I see little if any reason why unfunded state guarantee funds organized and operated by the insurance companies are superior to government-run prefunded guarantee funds such as those used to insure bank deposits. If the maintenance of such funds operated by the insurance industry conflicts with the antitrust laws, government-run funds can readily take their place. The antitrust treatment of industry-run funds should be clarified, however, to insure an orderly transition if this become necessary. Finally, the need for residual market facilities would be reduced



with competitive ratemaking. If individual states seek to organize such facilities as needed, there is no reason why the insurance companies should not be allowed to participate in them. Again, this should be clarified in any new statute.

Precisely what role the FTC would have in the absence of FTC Act immunity is unclear. It would almost certainly try to get involved in issues associated with the provision of information by insurers to consumers. I also suspect that it will try to get involved indirectly in ratemaking itself, though efforts to examine classification systems. In particular, there may be FTC interest in whether insurance firms are using the most efficient methods of differentiating among risks, especially if cooperative ratemaking continues to be permitted. The FTC could become a significant regulatory force in the insurance area if McCarran-Ferguson is modified or repealed. Whether or not this would be desirable remains unclear and little information is available to help us make a definitive conclusion.

Issues related to the kinds of information provided to consumers, especially individuals, are real and worth further investigation. Some states have made significant efforts to make policies comprehensible and to provide information to consumers which would be helpful to them in



deciding on the types of coverage to purchase and from whom to buy it. Other states have done little. This is not an area in which I have any expertise, but my casual impression is that more could be done at little cost to provide individuals with additional information which would allow them to make their insurance decisions more intelligently. In principle, I would prefer to leave these kinds of tasks to the states, which are closer to the individual insurance needs and problems of their population than is the FTC. It would certainly be worthwhile at this stage to conduct an investigation aimed at determining how well the states have played this role. If the states have not done a good job in this regard, an expanded FTC role may be desirable if a convincing case can be made that the FTC can do a better job.

I am much less sanguine about the prospect of the FTC getting deeply involved in ratemaking itself through efforts to control insurance rate classification systems. If we choose to promote competition by eliminating the power of the states to regulate rates and restrict the Sherman Act immunities now available, I don't really see any need for additional enforcement by the FTC. Allowing the FTC to intervene in the presence of real anticompetitive acts



would, of course, be desirable, but some effort should be made to insure that the FTC does not extend its reach further than this.

#### Public Policies for Promoting Competition

If the Congress truly wants to promote competition in the property/casualty insurance industry, I believe that there are a number of things which can be done to do so. Let me make clear that I do not believe that the appropriate thing to do at this stage is merely to repeal the McCarran-Ferguson Act. As I pointed out above, the act alone almost certainly has minimal effects on price competition in this industry. Some cooperative practices, such as the determination of actual premiums and the publication of rate books, are probably undesirable and should be restricted. However, other cooperative activities are almost certainly in the public interest. They may be legal under the Sherman Act, but given the current legal uncertainties, blanket repeal is likely to cause serious transitional problems. A modified McCarran-Ferguson Act should make clear what cooperative activities are legal to minimize litigation, uncertainty and confusion. To have a major impact on competition the modified act would also have to restrict the



ability of the states to regulate rates (either maximum or minimum). In this regard, it would be worthwhile to include a provision allowing states to petition the Justice Department to reimpose rate regulation for lines of insurance which are not workably competitive. The DOJ could develop criteria for evaluating such requests. In the spirit of "deregulation" I would hope that some way could be found to restrict the FTC's role in direct "economic" regulation to behavior that would ordinarily be illegal under the Sherman Act subject to any residual immunities that might be granted to the insurance industry. I am inclined at this time, however, to allow the FTC to have generally broad latitude in the area of information provision discussed above.

Before any new legislation is enacted an in-depth congressional investigation in two areas would be worthwhile to collect additional information:

(1) More detailed and impartial information on the kinds of cooperative activities that are "necessary" for the business of insurance to operate efficiently. Congress should not restrict itself to how things have been done in the past, but seek insights into how things might be done better in a more competitive market in the future.



(2) More detailed information on how well the states have provided useful price and quality information to consumers and where problems in this area continue to exist.

The first part of the investigation would help to define more appropriate boundaries for Sherman Act immunities. The second would help to define more appropriate boundaries (if any) for FTC Act enforcement.

Let me note that the legislation proposed by State Farm comes closest to what I would think would be desirable if we want to promote competition in this industry. The amendments to the McCarran-Ferguson Act proposed by State Farm contain the following substantive changes in the present statute:

1. removes state authority to regulate rates, rate classifications, rating territories and policyholder dividends for personal lines insurance (auto, homeowners, etc.);

2. removes the Sherman Act exemption for ratemaking activities associated with the provision of personal lines insurance;

3. specifically grants Sherman Act immunity for cooperative activities associated with the collection and use of statistics on loss experience or to the discovery, identification, classification and use of information relating to causes or prevention of losses;



4. specifically continues to allow states to require that rates, rating plans, rate classifications, etc., be filed with the relevant insurance agency;

5. specifically continues state authority to establish or approve residual market mechanisms, including approval of rates, rate classifications, etc. However, the states may not disapprove any associated rates which reasonably reflect expected losses and expenses.

The State Farm bill does not make any changes in the McCarran-Ferguson Act regarding the application of the FTC Act. As I indicated above, the role of the FTC needs further study. Nor does the State Farm proposal deal with state guarantee funds run by the industry. However, although the State Farm proposal may need further clarification on these and other points, it is an excellent starting point for sensible reform legislation.

Social Ratemaking: Do We Really Want More Competition?

As I mentioned above, in the last several years many state commissions have become increasingly concerned with various social aspects of insurance ratemaking. Two areas have received special attention: first, the income distributional consequences of actuarially fair rates (what the industry calls the affordability problem); second, whether



actuarially fair rates are really "fair." The second question goes to the heart of all insurance ratemaking in the United States Massachusetts Insurance Commissioner Stone's presentation to the Commission is perhaps the clearest articulation of these concerns. I have attached an editorial from the Boston Globe which endorses this position.

The income distributional issue is the most familiar. At least in some states there appears to be a very high negative correlation between insurance rates and family income. For example, in Massachusetts, the correlation coefficient between territorial rate relativities and median family income in the corresponding territory is  $-.978$  (see Hill). The correlation between territorial relativities and the proportion of the population that is black in Massachusetts is  $0.532$  (see Hill). Unfortunately, an extensive state-by-state analysis of the relationship between insurance premiums and family income and race has never been conducted to my knowledge. Yet the conventional wisdom (probably true) is that automobile, fire, and homeowners' premiums tend to have large negative correlations with family income and high positive correlations with the proportion of the population from minority groups.



The conventional response to this perception has been to try to reduce premiums in the high-risk area through cross-subsidization. Efforts to accomplish this goal have involved the use of state regulatory powers to lower approved rates in high premium areas and to raise them in other areas or else to consolidate otherwise high premium territories with otherwise lower premium territories which has the same effect. We have essentially no information about how effective such efforts have been at redistributing income. We do have fairly good information indicating that one undesirable effect of such efforts has been to force large proportions of the "high risk" subgroup into the residual markets where they can often obtain only limited amounts of insurance and may receive poor service.

Under current institutional arrangements, such efforts as cross-subsidization end up forcing many individuals into the residual market because individual companies have no interest in insuring customers at rates below the actuarially fair level. Even if the regulator tries to achieve this goal by establishing very broad territorial classification, the insurance firms still know where the profitable and unprofitable risks lie. Thus poor people may face lower rates, but they may also find it difficult to get the quantity and quality of insurance that they desire.



It is not my purpose to argue for or against the use of insurance premiums as tools for income redistribution. Like all efforts to use commodity taxation to redistribute income, it is necessarily an imperfect instrument. Precisely how imperfect, we just don't know because we have little information on the correlation between actuarially fair rates and income, whether insurance firms are actually using the best technology for determining risk classes, or what the net effects of regulatory efforts at cross-subsidization have actually been. It is clear, however, that the use of insurance ratemaking to redistribute income is inconsistent with deregulation and increased competition. On the contrary, effective use of insurance rates as redistributive instruments would probably require even more regulation. If our experience with regulation in other industries is any guide, efforts to use insurance rates to redistribute income is likely to lead to little redistribution in practice and may cause serious distortions. (Lest there be any mistake, insurance firms do not set rates based directly on family incomes. The large negative correlation, to the extent that they exist as a general matter, are the result of territorial classifications which turn out to have such a correlation.)



Concerns about the "fairness" of actuarially fair insurance rates are more recent. The argument here appears to be that it is unfair to put an individual in a high-risk class based on class characteristics when the individual herself does not have individual characteristics which justify her being identified as a "high-risk." For example, some young men are good drivers and some young men are bad drivers. As a class, young men have a lot of accidents and pay high insurance premiums because the insurance companies may have no way of differentiating the good driver from the bad driver based on information other than age, sex and location. Similarly, men pay more than women, urban drivers more than rural, etc. As a result, there appears to be a growing movement to restrict the abilities of insurers to differentiate risks based on age, sex or location, restricting them to the use of individual characteristics such as driving record.

I am not about to argue here for or against efforts to impose such "fairness" criteria on insurance rates. Reasonable ethical arguments can be advanced to support a variety of views on this subject. There are several points that I believe are worth noting, however. First, in each situation in which a class of individuals pay rates below what would



otherwise be the actuarially fair level, some other class of individuals pays higher rates than it otherwise would have. This raises additional "fairness" questions. Second, efforts to "defeat" actuarially fair rates through cross-subsidization are likely to result in serious supply-side distortions. As discussed above, insurers are not going to want to take on customers who appear to them to be unprofitable based on the best actuarial data available. More and more customers will be thrown into the residual market. They may face lower rates there, but their range of insurance options may likewise be restricted and the quality of service reduced. Third, individual characteristics would be used to determine insurance rates in a competitive market in conjunction with group characteristics, to the extent that such characteristics are observable and are good predictors of losses. Driving records, driver education, burglar alarms, etc., are used by many companies to differentiate among risks. Unfortunately, the rigidities of state rate regulation have probably restricted the use of individual characteristics rather than promoted it.

Finally, I would like to note that it is possible that there may be a theoretical efficiency rationale that could be advanced in favor of this type of cross-subsidization.



This theoretical rationale would go along the following lines. Let's say that on average young drivers have more accidents than older drivers. But some young drivers may be good drivers, even better than some of the older drivers. If we had some way of identifying the good drivers from the bad drivers more effectively with some variable other than age, rates would be based on this variable. Since age is the best observable predictor, however, actuarially fair rates are based on it rather than on the "true" probabilities which we can't observe directly. If there is some responsiveness in the demand for automobiles to the price of insurance or some responsiveness in the amount of insurance purchased to its cost, then the actuarially fair rates based on age (the best observable predictor) will not be efficient. Some good drivers will face prices that are too high and some bad drivers prices that are too low. Under these assumptions, it is possible that some amount of cross-subsidization would lead to a more efficient solution than the competitive market solution.

I am not aware of any published theoretical or empirical work which allows me to go further than to make this observation. Clearly, trying to develop a more efficient price system via cross-subsidization in situations where such



problems may exist would require considerably more theoretical development and empirical information. As a practical matter, I do not think that this observation should distract us. Even if a strong theoretical case can be advanced here, the likelihood that regulators in the real world could obtain the required information and use it in such a way as to correct any such distortions is extremely remote. Rather, this line of reasoning will more likely be seized upon as justification to pursue a wide array of other social and political goals under the guise of promoting economic efficiency. In addition, any attempt at cross-subsidization will run into the supply side problems discussed above.

In my opinion, insurance ratemaking is not a particularly potent instrument for promoting either income redistribution or other vague and often conflicting social goals. Efforts in this direction are likely to cause more problems than they cure. However, if the Congress wishes to allow the states to engage in cross-subsidization for one reason or another, such efforts will be inconsistent with increasing competition in the insurance industry. At this stage I feel that we have more to gain from increased competition than from allowing state regulatory agencies to embark down the road of increased cross-subsidization. But this is certainly a view that others are likely to disagree with.



There appears to me to be a growing body of public support for the imposition of objectives such as these on the insurance ratemaking process. However, the achievement of these goals is likely to be inconsistent with unregulated price competition. As a practical matter, it may also be inconsistent with the real capabilities of administrative regulation and the increasing political pressures that such regulatory agencies must deal with. At the present time the resolution of public policy controversies over these conflicting goals is taking place in an ad hoc manner in the courts and through the efforts of individual state insurance companies. Some of these issues strike at the heart of traditional insurance ratemaking and raise important issues of social and economic policy. Whichever way we proceed there will be gainers and losers. I believe that the resolution of these issues is so important that they should be completely and systematically considered by Congress. Before Congress can proceed with regulatory and antitrust reform in this area, the overall direction of public policy toward insurance ratemaking must be resolved. Will we try to increase competition or will we try to restrict it further so as to try to achieve a grab-bag of other social goals through the process of rate regulation and cross-subsidization?



. In light of these considerations I feel that the question of antitrust immunities for the insurance industry cannot be answered in isolation from a complete reevaluation of public policy toward the provision of insurance. The time is ripe to formulate such a policy and to seek legislation to implement it. If we opt for more competition, as I hope we do, we have or can develop the information for sensible reform legislation. If we opt for social rate regulation we may be embarking on a difficult road, fraught with considerable uncertainties as to the ultimate results and their economic and social costs. However, if we go down the second road we should do it with our eyes open and with full recognition of the difficulties involved.



**INSURANCE REGULATION**

**The McCarran-Ferguson Act**

Statement of the  
Alliance of American Insurers

before the  
National Commission for the Review  
of Anti-Trust Laws and Procedures

July 26, 1978





HIGHLIGHTS OF ALLIANCE STATEMENT

|                                                                                                                                                                                                                                                      | Pages |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Basic Federal anti-trust statutes and the applicable exemptions together provide an integrated basic national anti-trust policy which is rational and consistent.                                                                                    | 1-4   |
| Today both the state and federal government are actively pursuing the regulation of insurance.                                                                                                                                                       | 5-7   |
| This flexible regulatory environment has allowed the property and casualty insurance business to meet continuing changing market demands.                                                                                                            | 6     |
| The goals of insurance regulation are to maintain a viable insurance market in which consumers may secure their insurance needs, at reasonable cost, in a competitive environment. The means to achieve those goals are, to some extent conflicting. | 10-17 |
| Living with Federal anti-trust - A survey of Alliance membership on how they perceive major changes to McCarran-Ferguson Act would impact on their operations, procedures and markets.                                                               | 18-23 |
| <ul style="list-style-type: none"> <li>• Insurance prices and premiums will increase.</li> </ul>                                                                                                                                                     | 29-32 |
| <ul style="list-style-type: none"> <li>• Companies will abandon certain lines of insurance and territories in which they lack substantial penetration.</li> </ul>                                                                                    | 32-35 |
| <ul style="list-style-type: none"> <li>• Smaller companies will be forced to merge and greater concentration will result.</li> </ul>                                                                                                                 | 35-38 |
| <ul style="list-style-type: none"> <li>• Consumers will be at a loss to do comparative shopping due to proliferation of insurance policies, forms and coverages.</li> </ul>                                                                          | 38-39 |
| <ul style="list-style-type: none"> <li>• Insurance coverage and capacity for large commercial risks will dwindle due to likely abandonment of voluntary pooling mechanisms.</li> </ul>                                                               | 40-41 |
| <ul style="list-style-type: none"> <li>• The level of regulation of insurance by the states and the federal government will increase substantially.</li> </ul>                                                                                       | 41-47 |
| Repeal of McCarran-Ferguson will lead to diminished competition in the insurance industry and higher prices for consumers.                                                                                                                           | 47-48 |



TABLE OF CONTENTS

|                                                                                                               | Page |
|---------------------------------------------------------------------------------------------------------------|------|
| I. INTRODUCTION                                                                                               | 3    |
| A. Historical Background                                                                                      | 3    |
| B. Present Status of Insurance Regulation                                                                     | 5    |
| C. Insurance and the Competitive Environment                                                                  | 6    |
| II. McCARRAN-FERGUSON HAS ALLOWED THE PROPERTY/CASUALTY<br>INSURANCE BUSINESS TO MEET BASIC PUBLIC OBJECTIVES | 8    |
| A. Incorrect Assumptions Used by Justice Department                                                           | 8    |
| B. The Objectives Of Insurance Regulation                                                                     | 10   |
| III. LIVING WITH FEDERAL ANTI-TRUST                                                                           | 18   |
| A. Introduction                                                                                               | 18   |
| B. Survey of Alliance Company Membership                                                                      | 19   |
| 1. Bureau Rate Making                                                                                         | 19   |
| 2. Rate Manuals                                                                                               | 21   |
| 3. Standardized Policy Forms                                                                                  | 22   |
| 4. Participation in Pools                                                                                     | 22   |
| 5. Innovative or Creative Marketing Activities                                                                | 23   |
| 6. FTC Jurisdiction                                                                                           | 23   |
| C. Repeal of McCarran-Ferguson as Defined by Justice                                                          | 24   |
| D. Justice's Objectives and Considerations                                                                    | 26   |
| IV. IMPACT OF THE REPEAL OF McCARRAN-FERGUSON                                                                 | 29   |
| A. Impact on Prices or Insurance Premiums                                                                     | 29   |
| B. Impact on Insurance Markets                                                                                | 32   |
| C. Impact on Industry Concentration                                                                           | 35   |
| D. Market Dislocations and Impact on Consumers                                                                | 39   |
| E. Regulation                                                                                                 | 42   |
| VI. CONCLUSIONS                                                                                               | 47   |
| APPENDIXES                                                                                                    |      |
| A. Survey of Alliance Membership                                                                              |      |
| B. Impact of Repeal of McCarran-Ferguson                                                                      |      |
| C. Entries and Retirements of Companies                                                                       |      |



The Alliance of American Insurers is a major association of property and casualty insurance companies operating in all fifty states and the District of Columbia. The Alliance has over 100 member companies, some of whom are relatively large, as viewed within the context of the property and casualty insurance business. Most of the Alliance members, however, are either medium size or small companies. We very much appreciate the opportunity to present our position with respect to the Regulation of Insurance to the National Commission for the Review of Anti-Trust Laws and Procedures.

We welcome the Commission review of the McCarran-Ferguson Act, which has come under question in recent months. The basic public policy of allowing the individual states to regulate insurance embodied in the McCarran Act has been criticized recently on three grounds. First, it has been claimed that the Act represents an anomaly and runs counter to the basic anti-trust "laws of the land." Second, there are those that view property and casualty insurance as "big business." As such, it is alleged that because the industry has national impact, it should be regulated directly by the federal government, not by the states. Third, it is alleged by some that state regulation of insurance has failed. These allegations are fueled by what is perceived to be today's high cost of insurance and a number of market problems that have arisen either in some lines of insurance or certain territories.



- 2 -

We are convinced, however, that a review of the limited immunity provided by McCarran-Ferguson will lead you to the conclusion that the Act is just as appropriate today as it was when enacted into law, in 1945.



## I. INTRODUCTION

### A. Historical Background

It has been alleged that any exemption from federal anti-trust laws represents a deviation from basic national policy, and cannot be condoned. This, however, is just not so. Our nation's governing anti-trust activities are necessary and complex because our economy is so extensive and our economic infrastructure so inter-related. Specific exemptions and exclusions from the Sherman and Clayton Acts were established by Congress only after careful review and analysis, to meet the peculiar needs of important segments of the production and servicing sectors of our economy. Neither the basic federal anti-trust statutes nor the applicable exemptions separately constitute the "basic law of the land" with respect to anti-trust matters. Together, the basic statutes, as well as the exemptions, however, provide an integrated basic national policy which is both rational and consistent.

Enactment of McCarran-Ferguson by Congress as the basic federal law upon which the parameters of state and federal regulation of insurance rest, came about following careful and extensive congressional hearings extended over a period of better than two and one half years. McCarran-Ferguson, in its final form, represented a substantial compromise from the initially passed House bill which had granted the insurance industry total exemption from all federal anti-trust statutes. State insurance regulators and many sectors



of the insurance industry, including the Alliance, however, did not seek such a total exemption and were instrumental in limiting the exemption to the language finally accepted by Congress.

The legislative history of the Act underscores the extensive care and scrutiny attached to its enactment. Of course, the insurance industry itself was active in seeking to formulate a legislative program under which it could continue to serve its markets. Likewise, state insurance commissioners were deeply involved, seeking federal legislation which would allow sufficient flexibility so that the peculiarly local geographic and market characteristics of insurance needs, as well as existing insurance regulatory concerns, could be met. The White House recognized that the responsibility for the regulation of the business of insurance should be left with the states, but at the same time, did not advocate that the federal anti-trust laws be emasculated with respect to the business of insurance.

The legislative history of McCarran-Ferguson makes it clear that neither Congress nor the Administration felt that federal regulation of insurance would be desirable. The thrust of the debate was not whether the states should continue to have the legal authority to regulate insurance, but how such authority could be integrated within our federal system.



B. Present Status of Insurance Regulation

The result has been that today, both the federal and state governments are actively pursuing the regulation of insurance. While there is a tendency to think of insurance regulation solely as a state function, a partial listing of both state and federal responsibility with respect to insurance regulation, will suffice to indicate the pervasive and complex nature of the existing dual regulatory environment in which our industry operates.

For instance, state regulation of insurance has primary responsibilities in the following areas, among others.

- Rates and rating plans
- Financial examination and regulation for solvency
- Formation of companies
- Admission of companies
- Qualification of officers
- Qualifications and licensing of producers (agents)
- Qualifications and licensing of personnel
- Regulation of residual market mechanisms
- Market surveillance examination
- Taxation

In the case of federal regulation, the following primary responsibilities can be cited:

- SEC regulations apply to some aspects of insurance accounting, mergers, acquisitions and to companies with publicly traded stock



- 6 -

- Annuity contracts which are regulated under the Investment Companies Act of 1940
- Federal Trade Commission's regulation of insurance company mergers, advertising of mail order insurance, etc.
- HUD regulation of crime, FAIR Plan and Riot Reinsurance programs
- The Interstate Commerce Commission's specifications of coverages required of interstate common carriers
- An international agreement, negotiated by the federal government establishing civil liability for airline passengers in international travel
- The Price Anderson Act which determines limits of liability and establishes absolute liability on operators of nuclear reactors
- The Small Business Administration which administers the Surety Bond Guaranty program
- Both HEW and Labor are involved in the Black Lung program for coal miners.

C. Insurance and the Competitive Environment

This flexible regulatory environment has allowed the property and casualty insurance business to grow and diversify as needed to meet continuing changing market demands. Yet, the exemption from federal



anti-trust laws provided by McCarran-Ferguson, did not result in industry concentration. In fact, most students of the property and casualty insurance industry have characterized the industry as "atomistic." The property and casualty insurance business is transacted through approximately 2800 companies. Over the past five years, only two of the twenty largest property and casualty insurers have increased their market share annually. In fact, market shares of nine of the twenty largest companies were less in 1977 than five years earlier.

The ease of entry into a market by a new company is another gauge used by economists to measure the degree of competition and/or economic control in a market. It is generally agreed that state regulation of insurance has greatly facilitated the entry by new companies into the property and casualty insurance field.

Finally, we believe that state regulation of insurance has fostered healthy price competition in most states among the companies. At the same time, the insurance public has been granted protection from company insolvencies by state regulators who conduct periodic and exhaustive financial operations, examinations and supervise state guarantee funds.



II. McCarran-Ferguson has Allowed the Property and Casualty Insurance Business to Meet Basic Public Objectives

The Report published by the Anti-Trust Division of the Justice Department (The Pricing and Marketing of Insurance - January 1976) argues that both the insurance industry and its public would be well served if the federal anti-trust immunity granted the industry by McCarran-Ferguson were repealed. The Report contends that competition would then act as a regulator of insurance prices, that price stability would be enhanced, and that competition would be fostered. Further, according to the Report, existing state regulation of insurance has generated unhealthy and undesirable subsidization of poor insurance risks and that repeal of McCarran-Ferguson would be effective in helping to eliminate the residual insurance market.

A. Incorrect Assumptions used by Justice Department

We believe that the Justice Department Report is based, in part, on certain assumptions, and cause - and - effect relationships which do not fit the reality of today's insurance regulatory environment. Such assumptions include the following:

- that "regulation" and "competition" cannot coexist and are opposite, mutually exclusive terms. In reality, there is strong price competition with the state insurance regulatory system (with few exemptions), and strong competition of other kinds as well.



- that regulation artificially keeps property-casualty insurance rates higher than they otherwise would be. In reality, competition and trends in loss experience are the primary determinants of insurance rate levels, whether the rates are regulated or not. The effect of regulation on rate levels is usually short term, and almost always involves delays which means that rates tend to lag behind actual experience in an inflationary economy. Moreover, regulation often means reductions in proposed rate increases.
- that replacing state regulation with federal anti-trust regulation would bring about more price competition in the property-casualty insurance industry. On the contrary, a more probable result would be a reduction in both the number of competitors and the ability of consumers to make meaningful price and product comparisons among surviving companies.
- that price competition is a public good that overrides all other public policy objectives. In practice, both Congress and state legislatures have given equal or greater priority to other goals, such as preventing insolvency, protecting consumers against unfair rate discrimination, and guaranteeing access to coverages at affordable rates.



- that mass merchandising of property and casualty insurance would be widespread by now, were it not for state laws restricting growth. The fact is that mass merchandising of consumer lines such as automobile insurance, has not made much headway today, even in states where there are no statutory impediments. The reason is that most car owners who qualify as standard or preferred risks can obtain lower rates on their own than they would have had to pay as members of a large group. Another is that mass merchandising has not demonstrated that it can successfully reduce rates for personal lines below existing levels. Consumers will seek insurance through this medium only when employers are ready to pay all or part of the cost, which, to date, they have not been willing to do.

B. The Objectives of Insurance Regulation

To measure whether McCarran-Ferguson has succeeded in meeting basic public objectives, one must define these objectives.

The goals of insurance regulation were stated by the National Association of Insurance Commissioners in 1960 to be:

1. "That insurance coverages desired by the public should be generally available to the public from licensed insurers;
2. that the cost of such insurance coverages to the public should be reasonable and not excessive;



- 11 -

3. that the solvency of insurers should be maintained in the interest and for the continued protection of their policyholder
4. that each insured should bear his fair share of insurance cost."

Simply stated, these goals seek to maintain a viable insurance market in which consumers may secure their insurance needs, at reasonable cost, in a competitive environment.

The means of achieving these goals, however, are complex. To some degree, these objectives conflict. For instance, it would be possible to assure that "solvency of insurers should be maintained" by requiring that minimum insurance rates be pegged to meet the needs of the least efficient insurers. However, this would unquestionably lead to excessive insurance prices for consumers in the market.

On the other hand, if insurers artificially limited the cost of insurance to all policyholders so that the cost would be always "reasonable and not excessive," then in times of rapidly escalating claim costs (such as today), insurers would be unable to cover their outlays for claims and expenses and insolvencies would become a major problem.

Clearly, the true measure of the efficiency of insurance regulation is not how well each of the above mentioned objectives is reached by and of itself, but how well they are balanced in combination in the actual world.



The insurance laws of most states express these regulatory objectives in statutory language by specifying that insurance rates shall not be "inadequate, excessive nor unfairly discriminatory."

We believe that rate regulation, pursuant to these standards, has generally produced a price structure reasonably related to cost. That is, this careful balancing of regulatory objectives combined with reasonable rate standards when applied objectively, permits rates that are designed to cover losses and expenses, to provide a fair rate of return, and be reasonably affordable to most policyholders

In the recent past, however, in a few states, the regulation of insurance has been politicized by the simple expedient of artificially maintaining inadequate rate levels. While this may have temporarily provided consumers with "bargain price" insurance, in those states where this has occurred, those markets have become unstable, resulting in serious availability crises, and a withdrawal by companies who cannot continue to sell insurance below cost. Thus, short run, temporary consumer advantages are quickly lost, and in the long run, the insurance public is ill-served by such short-sighted policies.

We emphasize, however, that regulation is only one of the factors which influence insurance company operating results. Several other factors frequently are more influential, especially in the long run. These other factors include competition for share of the market,



the rate of return on capital, inflation in the cost of goods and services purchased by claim dollars, the incidence of storms and other natural disasters, interest rates, the financial markets, and political decisions such as wage and price control.

The sale of insurance is distinguished from the sale of most other products, in that the major costs to be incurred by the seller - the insurance company - are unknown at the time of sale. The product is priced in the present, based on past data, to pay losses in the future. Hence, unlike other business enterprises, an insurance company must attempt to forecast future economic and social changes because these will control the expenses the company will ultimately incur.

Because of the atomistic nature of the insurance industry, only a very few of the very largest insurance companies have enough premium volume and penetration in any insurance line, in any state, or classification to be able to generate past loss and expense information sufficient to estimate likely future losses and costs. It is only through the use of data pooling mechanisms - whereby companies pool their past experiences - that a sufficient data base can be created to accurately project individual company costs by state, product line and by classification.



- 14 -

Without the protection of McCarran-Ferguson, many insurance companies would be unable to accurately price their products. Such companies could not adequately anticipate or identify the dual threat of economic and social inflation. That is one of the key reasons for retaining McCarran-Ferguson. Under this statute, the industry has been able to provide a highly stable insurance market where all costs can be identified and rationally allocated commensurate with growing exposures to loss.

State insurance regulation has been blamed, by a minority of critics, for the rising cost of insurance, and for market availability problems which have developed in some geographical areas, particularly in personal insurance markets. For example, the Justice Department Report goes so far as to claim that "unrestricted price competition can provide an effective substitute for rate regulation as a means of achieving reasonable prices and maximum efficiency in the sale and distribution of insurance -- competition fosters independent pricing, operating stability and flexibility in the pricing structure."

The Alliance supports state "open competition" regulatory laws. Further, we believe that these laws do provide, in the longrun, "reasonable prices and maximum efficiency in the sale and distribution of insurance." But, open competition or, for that matter, "unrestricted price competition" as envisioned by the Anti-Trust Division, can neither stem the tide of rising insurance cost in an inflationary economy nor provide an insurance market for those risks which have essentially become uninsurable, at any cost.



Consider the cost of automobile insurance, for example, which has now become unaffordable for a growing number of inner-city residents and young drivers. In identifying the factors which have caused such problems for consumers, we must first recognize that high automobile insurance premiums are a direct function of spiralling costs for health care and auto crash parts exacerbated by a tort system that has proven to be unreliable and inequitable for many. The insurance system must translate spiralling claim costs into increased insurance premiums. This it has done by allocating such costs to those territories and policyholder classes where claims have occurred. The trouble with matching premiums to actual loss producing potential (loss exposure) is that this produces higher premiums for some groups such as younger drivers and residents of congested urban neighborhoods. Critics of the present insurance rating system fault state insurance regulation for allowing such socially undesirable consequences to occur. These critics believe that some groups of consumers should be provided with insurance at subsidized rates, and that the subsidy should be handled internally within the insurance system. This could be accomplished. However, it would add another objective to insurance regulation - the establishment and maintenance of an income transfer mechanism. Frankly, we question whether this is a legitimate goal of insurance regulation. If public policymakers decide that some policyholders should be provided with insurance at subsidized rates, the amount of the subsidy should



be decided periodically by legislators. Transfer payments should then be made openly in a way that will have the least impact on free market forces, and be equitable to all policyholders.

It is interesting to note that increasingly higher costs have become a routine phenomena in our economy affecting many of the goods and services we purchase, including food, energy, housing, health care and insurance. Affordability problems are by no means limited to insurance coverages. However, some insurance critics and social theoreticians believe that the insurance industry should be uniquely responsible for finding a way to subsidize the cost of insurance for those unable to afford it. And further, that such subsidies should come from consumers who are already paying their fair share of insurance costs. Those who criticize state insurance regulation for its failure to guarantee insurance at affordable rates for all policyholders without taking their actual loss exposure into consideration, fail to grasp the overall purpose of insurance regulation - that it must balance often conflicting objectives - not select one by sacrificing all others.

We must point out that the Anti-Trust Division seems to agree with us on this point. Its Report concluded that "the reliance of an 'internal' subsidy in New Jersey and Massachusetts to drivers under the assigned risks plan provides a 'highly imperfect' and 'very crude device for egalitarian objectives.' In addition, the 'internal' subsidy interferes with the operation of the free market in relating the price of insurance to the cost protection."



- 17 -

In summary, the objectives of insurance regulation could never have been achieved without the protection of McCarran-Ferguson. Without such protection, many insurance companies would be unable to price their products. Such companies operating independently would be unable to adequately anticipate and identify the dual threat of economic and social inflation. McCarran-Ferguson has enabled the insurance industry to provide a highly stable and competitive insurance market where ease of entry is unquestioned, and cost can be identified and allocated commensurate with growing exposures to loss.



### III. Living With Federal Anti-Trust

#### A. Introduction

The Alliance and its member companies are greatly concerned about the fundamental restructuring of the insurance industry which would occur with a repeal or significant modification of the existing McCarran-Ferguson Act. We are convinced that the nature and scope of the impacts of repeal have not heretofore been adequately identified nor properly understood by the Administration and Congress. We have therefore, surveyed our member companies, utilizing a structured questionnaire to establish just how repeal of McCarran-Ferguson would effect their operations and their ability to compete in the insurance marketplace.

This section of our statement initially summarizes our companies' comments with respect to the questionnaire. It then sets forth the objectives identified by the Justice Department for anti-trust policy and insurance regulation as they effect the insurance industry. This is followed by the identification of those probable changes which most observers agree would occur if McCarran-Ferguson were repealed. Finally, we review, in some detail, how the repeal of McCarran-Ferguson would materially and fundamentally alter the insurance industry. In particular, we will demonstrate that repeal of McCarran-Ferguson will have the opposite effect of stimulating and enhancing competition.



This section, then, is organized to catalogue Alliance members' concerns. Then, we identify the Justice Department's objectives and considerations with regard to anti-trust and regulatory policy. We next analyze the potential changes in insurance company operations and markets if McCarran-Ferguson would be repealed. Finally, we review the various impacts relative to the objectives of the Justice Department. We have also prepared two appendices to our testimony. The first is a synopsis of the various types of initial and subsequent impacts, in case of repeal, as they relate to the anti-trust objectives of the Justice Department. The second is a sampling of specific comments by our member companies on the impact of repeal of McCarran-Ferguson from their particular perspectives, large and small companies alike.

B. Living With Federal Anti-Trust - A Survey of Alliance Company Membership

This is a summary of the comments provided us by our member companies with respect to the particular procedures, existing business practices and services, individual companies would discontinue or alter were McCarran-Ferguson immunities to be repealed.

1. Bureau Rate-Making

The first group of questions pertained to rate making and how companies would cope if bureaus were limited under the anti-trust laws to collecting and pooling past loss statistics.

- The overwhelming majority of companies cited problems of increased cost, especially in the area of personnel, and



data management, as the single most important impact on their "operations."

- The problem of finding and hiring competent, well trained actuarial people was also mentioned frequently.
- Most respondents stated that small companies would have the hardest time establishing rates due to a lack of access to broadly-based experienced statistics in most lines
- Specialty insurance lines would probably be phased out by many companies.
- Expansion activities to new lines of coverage and new states would be discouraged.
- A constriction of the market would probably occur as companies pull out of low volume states and lines.
- Higher operating costs would be converted directly into higher premium costs for consumers.
- Only giant workers' compensation and automobile insurers could cope with rate making on an individual company basis.
- Products liability and medical malpractice lines would probably be dropped or avoided by all the companies which do not specialize in these lines.
- Commercial property rate making was seen to be particularly vulnerable to storms and catastrophies. Individual detailed inspections would be required every time a company was requested to underwrite a new commercial risk.



- 21 -

With respect to the effect of company operations, the companies had the following comments:

- Most companies mentioned sharply increased expenses as a significant factor.
- The problem of small volume lines producing inadequate rates and leading to insolvency was seen as a threat by many.
- Several companies predicted that markets and territories would become more limited.

With respect to continued support of bureau activities by companies if bureaus were limited to collecting past loss experience:

- Our larger companies indicated that their decisions would depend on a cost/benefit analysis, but if only small companies participated in bureau activities, then the larger companies would no longer support bureaus.

## 2. Rate Manuals

The companies were asked to comment on the effect of their rate making activities if anti-trust laws called for the abolition of bureau rate manuals.

- Higher cost, again, was cited by a large number of companies as the most important effect of this change.
- Another effect would be the need for new staff to handle separate manuals and rates for every company.



- 22 -

- Some companies stated that such developments would lead to chaos and drive them out of business.
  - Several smaller companies predicted less frequent rate level revisions.
3. Companies were asked to comment on a possible prohibition of joint efforts to develop standardized policy forms.
- A large number of companies mentioned the high cost of such change as being very consequential.
  - A number of companies predicted a flood of minimum coverage policies which could have adverse consequences on consumers.
  - Many feared a new wave of litigation testing and interpreting revised policy language.
  - Several carriers saw the public facing great difficulty and uncertainty in selecting appropriate coverage at a reasonable cost.
  - Policy form stagnation was also mentioned as a probable consequence of this change.
4. The companies were asked to comment on their continued participation in pools.
- A large number of companies indicated that they would avoid all participation in pools for fear of anti-trust problems.
  - A number of additional companies indicated that they would reduce participation and "proceed cautiously."



5. Companies were asked what, if any effect, would a period of legal uncertainty, following the hypothesized regulatory changes, have on innovative or creative marketing activities.
  - The vast majority responded that innovation and creativity would be stifled, and a period of stagnation would probably occur.
6. Companies were asked to comment on the application of FTC jurisdiction to the insurance industry.
  - Most respondents cited the general problems of dual regulation and the conflicts between state and federal government as being very troublesome.

A brief summary of this extensive survey indicates that the tremendous additional cost problems are one of the greatest threats to insurers if McCarran-Ferguson were to be repealed. Small companies generally appeared to believe that they would have a difficult time surviving if each company was forced to promulgate its own rate manuals. Increased expenses would either drive many out of business, or force consolidation and mergers. This would inevitably result in less competition in the industry, and a shrinking of the market for all type coverages.



C. The Repeal of McCarran-Ferguson as Defined by the Justice Department

In its Report, wherein the anti-trust exemption was analyzed - The Pricing and Marketing of Insurance, January 1977 - the Anti-Trust Division set forth certain conditions which might accompany the repeal of the McCarran-Ferguson Act. These conditions in capsule form are as follows:

1. The insurance industry would no longer enjoy federal anti-trust immunity, but would be subject to federal anti-trust laws, including the Sherman and Clayton Acts.
2. The various states would continue their responsibility for overall "regulation" of the insurance industry within the context of federal anti-trust laws. They would be further authorized to continue collecting state premium taxes.
3. Under federal anti-trust laws, insurance rates would no longer be subject to regulation, but rather would respond totally to free market forces. Believing that unrestricted price competition is superior to rigid rate regulation as a way to achieving reasonable prices, the price of insurance should be controlled exclusively by market forces as a substitute for state regulation.<sup>1)</sup> Further that under a fully competitive system, inefficient insurers would be expected to be forced out of the marketplace, and that an

---

<sup>1)</sup> It is anticipated that under this shift to competitive pricing, solvency regulation could be used by the states as an indirect means of regulating insurance rates.



established guarantee fund mechanism would be utilized to safeguard policyholders in the event that regulatory controls failed to detect a financially unsound company.

4. Competitive pressures would adequately control unfair price discrimination that may arise in the distribution of insurance. Market controls would be substituted for state regulation, including regulation against inadequate, excessive or unfairly discriminatory prices. To prohibit invidious discrimination in the sale of insurance, Justice would require federal disclosure of pricing and underwriting experience as essential to the fair exchange of information in a competitive environment.
5. Statistical organizations could be established and/or continued. However, their purpose would be limited to the collection, aggregation and distribution of pure claim data. Such statistical organizations would not be allowed to collect expense data from subscribing member insurance companies.
6. Federal anti-trust laws would not prohibit the trending of future losses on a composite basis as long as such trending was done by independent consulting firms, independent of the companies they would be serving. By definition, such trending could not be accomplished by statistical gathering organizations which compile information, but must be accomplished by third parties.



- 26 -

7. The proposed pooling of loss experience would, of course, have to be consistent with federal anti-trust standards as there would no longer be any special exemption for the insurance industry in this regard.

There are other conditions which one could extract from the Report by the Justice Department if McCarran-Ferguson were repealed. However, the above should suffice to establish the basis to graphically highlight how insurers would, in fact, be affected.

D. Justice Department Objectives and Considerations

Let us briefly consider, for a moment, the objectives set forth by the Justice Department and its considerations with respect to a modified or repealed McCarran-Ferguson. First and foremost, Justice desires a regulatory framework and an anti-trust policy that is in the public interest, recognizing that the regulation of insurance entails "diverse and sometimes conflicting economic and social goals." Secondly, Justice wants an environment that is essentially structured to achieve the benefits of greater competition. This environment is defined as one in which reasonable prices are based on the cost of rendering services; efficient services are rendered at the lowest possible cost; and innovation of new and improved products and services and methods of distribution is promoted. In effect, Justice wants to "allow for greater competition among insurers without direct interference with insurance regulation as now practiced." It does not



believe that competitive pricing would either lead inevitably to competitive rate wars, or to the demise of many insurance companies.

In this regard, it is most interesting to note that Justice found that "a predominant segment of the property liability insurance industry is favorably structured (today) for competition with a large number of competitors, relatively moderate concentration, ease of entry, a standardized service, a relatively simple and short term contract, and an increasingly price sensitive consumer market." Further, Justice concluded that rigid state rate regulation had been detrimental both to insurance companies and their policyholders. In its report on the pricing and marketing of insurance, Justice concluded that rigid state regulation had:

- led to instability in insurance company operations;
- established cross-subsidization between good and bad drivers;
- imposed unnecessary restrictions on the collective merchandising and the direct writing of insurance; and
- had aggravated the availability problem in which marginal or high risk drivers have difficulty in obtaining coverage, in the voluntary market at prevailing rates.

Justice further took the position that voluntary risk sharing arrangements such as insurance pools and reinsurance agreements that serve a legitimate business purpose without lessening competition, would be compatible with existing anti-trust policies.



In summation, the position of the Justice Department appears to be the following:

The application of the federal anti-trust laws would not interfere with the basic policy objectives of insurance regulation, as set forth earlier in our statement. The anti-trust exemption for the insurance industry should be modified and/or repealed so that insurance would be treated like other economic entities in interstate commerce.



IV. Impact of Repeal of McCarran-Ferguson

The most useful approach to analyze the repeal of McCarran-Ferguson is to study its impact relative to the broad objectives associated with federal anti-trust policy. We have, therefore, organized our comments regarding such impact under the following headings:

- a. The Impact on Prices or Insurance Premiums
- b. The Impact on Industry Concentration and Share of Market
- c. The Impact on Market Innovation/Consumer Services and the Equitable Operation of the Insurance System
- d. The Level and Scope of Government Regulation

A. The Impact on Prices or Insurance Premiums

The Justice Department's principal objectives in repeal of McCarran-Ferguson are to create a more competitive environment that would ostensibly lower insurance premiums for many; assure that premiums would be directly related to cost; and finally assure that services would be efficiently provided to the insurance public.

In response to our member company survey and our own analysis of Justice's proposal, we are convinced, to the contrary, that insurance prices rather than decreasing, would substantially increase for many policyholders; that in many instances, the relationship between premiums on one hand and losses and expenses on the other would be lessened, due to the inability of many companies to properly allocate expenses to the insurance products they sell.



Every company responding to the Alliance's survey pointed out that their costs would increase significantly, were they unable to utilize the services of a statistical organization to provide them with bureau rating data that was statistically credible. Throughout this overall section on Living with Federal Anti-Trust, the impact and ramifications of this prohibition on the aggregation, compilation and publication of expense data will be discussed.

What expenses, in particular, will increase for insurers if they are unable to utilize a rating bureau for the purpose of compiling and allocating expense cost, and the development of bureau rates? These will, of course, vary from company to company. However, as a general rule, the smaller the insurance carrier, the greater is the reliance on a rating bureau to assist in providing information, rate manuals, etc., essential for pricing insurance products.

However, it should be pointed out that many companies which are subscribers or members of rating organizations do not, in fact, utilize the rates promulgated by those organizations. A substantial number of companies deviate from bureau rates, or if they are large enough, utilize their own experience to establish independent rates.

Although it is generally believed that the larger insurance carriers could generally adjust if present rating bureau operations were found to be in violation of federal anti-trust, they would, of necessity, restrict their operations and restrict some of their present markets. The impact on others, however, would range from extensive



to devastating. Let's look, for a moment, at the additional cost of operation in the event rating bureaus were no longer able to function as presently:

- Substantial revamping and upgrading of existing data base and data processing facilities, organization configuration. This would include input, validation, storage, analysis, and programming functions which were not heretofore required to the same degree in order now to allocate expenses and establish separate insurance rates.
- Substantial purchases of additional data processing equipment including computers, input and output devices, storage mechanisms would also be required.
- All insurance carriers would have to substantially augment their existing actuarial and statistical support staffs in order to accomplish the rate making function.
- All companies would have to establish their own special rate manuals which breakdown the price of insurance by product, by classification and sub-classification, and/or by territory. This is a task of major proportions and would be extremely onerous or impossible for small companies to accomplish without increasing their cost to such an extent that their premiums would be non-competitive in the marketplace.



- 32 -

- Additional accounting services and/or staff would also be required to properly aggregate and allocate the costs essential for pricing of insurance products.
- In order to accommodate the above functions, additional office space would, of course, be required, organizational structures would need to be realigned, staff hired, support facilities added, etc.

The above costs identified are not all inclusive but they are indicative. They would, without question, have to be passed on to policyholders in a form of additional premiums. (The substantial additional cost alluded to above, would not, in any sense, be offset by reductions in the cost of supporting existing statistical gathering organization/rate bureaus).

B. The Impact on Insurance Markets

It is probable that many insurers who have limited penetration in certain territories would find it difficult, if not impossible, to allocate costs credibly in those market areas. Consequently, we have been advised by many of our companies that they would seriously have to consider dropping some lines of insurance, closing certain branch offices and/or terminating existing agency agreements with the concomitant non-renewal of insurance for policyholders in those states and market areas in question. Further, we have been advised



that many small insureds would pull out of ancillary insurance lines that are provided now on an accommodation basis wherein small insurance carriers have been able, in the past, to service the insurance requirements of an entire account. We would expect, therefore, that certain insurance carriers would stop writing certain forms of general liability, product liability, and professional liability insurance where these coverages are provided now on essentially an accommodation basis.

Inevitably, we are convinced that the type of experiences identified above will lead to increased expenses for those insureds, and this means higher premiums to existing insurance policyholders. Note that the combined loss and expense ratios of most companies, in most lines, today are close to or in excess of 100%. Hence, companies would not be able to absorb the rising cost of operation and would have to pass such increases to their customers.

Finally, with respect to price, we believe that large companies who have the data and can continue to develop their own rates using internal cost allocation will be in a commanding position in their ability to price their products. Further, we believe that many small companies will tend to look to large insurance carriers for leadership in establishing premiums and rates which on balance will lead to an element of price rigidity rather than flexibility as large companies will tend to become price leaders.



- 34 -

If large companies decide not to continue their affiliation with statistical organizations, and hence, do not supply loss data to these organizations, it would substantially weaken and diminish the credibility of the statistics produced by those statistical organizations. It is not difficult to envision a condition where those statistical organizations would cease to be viable without the continued support of large insurers.

Were such statistical organizations to cease operation due to lack of sufficient credible data/support, we would expect that a very substantial number of small insureds would be unable to continue operations (without loss data allocated by insurance product, class, territory).

The abandonment by large companies of statistical bureau operation is a very real possibility if McCarran-Ferguson is repealed. It is only logical that many such companies would question their continued investments in bureaus if they perceive that their limited operations would be of little help to them, and would primarily benefit their competitors. In fact, operating under the Sherman and Clayton Acts would encourage individual companies to develop their own individual rating classes, territory and rating plans peculiar to their own operations. Combining bureaus of such diverse systems would produce an amalgam which many individual companies would find of little use in the development of their own individual rates. Hence, one



should anticipate that absent regulation and absent restriction on the diversity of classification plans, most large insurers would no longer support bureau operations. The effect that this will have on the smaller companies has already been described. The result will produce less competition and more concentration.

C. The Impact on Industry Concentration

The Department of Justice has suggested that existing insurance regulation has led to limited concentration and ease of entry, two characteristics which are important objectives of this nation's anti-trust policies. We are convinced, however, that Justice's suggested changes in McCarran-Ferguson will lead to increased concentration in the insurance industry, and will limit or diminish the ease of entry by potential insurance carriers. It should be recognized that the property and casualty insurance business is dominated by very small companies. There are an estimated 2886 such companies in existence today. However, 1,400 of these write an estimated 95% to 98% of total premium volume. There are, therefore, almost 1,500 insurance carriers that are extremely small, and who have carved out highly selective and discreet market segments and/or territories in which to market their products. Commensurately, these very small insurers have very limited ability to substantially adjust or modify their operating posture without severe economic hardship.



Data compiled by the Insurance Information Institute from A.M. Best's Company, identifying the number of new entries into the insurance industry over the past 10 years on a year-to-year basis for both property-casualty and life companies, is attached as Appendix C. Also included are the number of companies which have withdrawn year to year. The important conclusion to reach from a review of these statistics is that there has been great activity both in entry and exit from the industry, both historically and at present under existing exemption to anti-trust and within the state regulatory environment.

Although it is not possible to quantify our assertion that market concentration will increase with a repeal of McCarran-Ferguson, we believe a review of the supporting factual data is certainly convincing to demonstrate that concentration will occur to some significant extent

- First of all, large companies which today have large actuarial, statistical and accounting staffs will have substantially fewer additional costs with the demise of rate bureaus than will small companies. Hence, the cost of doing business will increase considerably more for the smaller companies. The cost differential will be significant and will need to be reflected in premiums charged to policyholders. Therefore, large companies will be in a much better position to price their products more competitively to increase share



of the market. This does not necessarily mean that large companies' premiums would be reduced. To the contrary, we would expect insurance cost to increase from present levels - with premiums charged by the large companies increasing at a lower level than their small competitors.

- Secondly, as pointed out in the prior section on pricing, we believe that small companies will have to pull back from certain markets (classifications, products, and territories), wherein they will be unable to develop adequate statistical data to establish premiums for those products. This will directly decrease insurance availability in those areas, and increase market share of the dominant carriers.
- Thirdly, we believe that higher costs and difficulties in operation particularly for small companies, will lead them to merge, be acquired or consolidate with other small companies or with larger carriers to obtain economies of scale and establish rates leading to more intensive concentration in the industry.
- In like manner, we believe that the higher costs and difficulties in operation caused by the repeal of McCarran-Ferguson would negatively impact potential new entries.



- The Justice Department has suggested that inefficient insurers would be forced out of business under a truly competitive marketplace. We believe this is true, and is also true today. But inefficient carriers would not be the only ones forced out of business. As a result of the substantially increased costs of developing rates and rate manuals and reorganization associated therewith plus the uncertainty of meeting anticipated costs with reliance on an inadequate data base, many small companies will be thrust into insolvency. Without adequate assistance from rating bureaus, many small companies will either price their products too high to be non-competitive with their large counterparts or too low and be unable to recover costs leading to serious solvency problems.
- Not only will insolvencies of small companies lead to increased concentration, but the resultant pressure on state guarantee funds which must be supported by all licensed insurance carriers would create an undo differential pressure on remaining small carriers and could create conditions wherein domino-type of effect would cause other marginal insurers to face insolvency.

The impacts cited above are not hypothetical. We believe they are real, and that they will occur, leading inevitably to a greater concentration in an industry which, to date, has been characterized by the Justice Department as having only limited concentration while providing important ease of entry.



D. Market Dislocations and Impact on Consumers

The Justice Department has indicated that one of its objectives, with regard to insurance markets, is to increase innovation to make the delivery of services more efficient, and in general, promote a more entrepreneurial and flexible spirit among participants in the insurance industry. We believe that the repeal of McCarran-Ferguson would lead to conditions in which great uncertainty would prevail, where market dislocation would become prevalent, and where the interest of consumers would be placed in jeopardy.

The inability of insurers to cooperate in the development of their products would lead to a lack of standardization in the development of insurance policies and forms. This, we submit, would not be in the interest of insurance consumers. Clearly, diversity of policies and forms would make it more difficult for the average layman to compare insurance products provided by competing companies if they utilize non-identical policy forms, providing different levels and/or scope of coverage. This would obviously also lead to substantial litigation as various interpretations and expectations for policy coverages would be experienced by insurance consumers.

With respect to standard policy forms, we believe that some insurers might well produce special forms with reduced coverages and additional exclusions which in one sense could be more manageable for the insurance carrier, but could lead to difficulties for insurance consumers.



We are convinced that there would be some non-renewal and retrenchment of product lines and territories by all companies but, particularly by small insurers. This would lead to extensive market dislocation. Without question, we believe this would increase pressure on existing residual market mechanisms for automobile, workers' compensation and related types of insurance, as more risks fell into these various plans.

Because of the uncertainty, the market dislocation and the confusion which would result from a repeal of McCarran-Ferguson, we believe that a period of stagnation will likely ensue rather than the hoped for innovation of the Department of Justice. In effect, many smaller insurers would lack the resources and know-how to be innovators in such a stormy environment. Furthermore, the types of changes envisioned by a repeal of McCarran-Ferguson could lead many insurers to compete harder for the good risks, while shunning poor risks or those with uncertain loss exposures. In effect, there may well be greater interest in the good risks to "play it safe" during this period of turmoil and confusion in insurance markets.

It is inevitable that higher costs of operation will reduce taxable income and similarly diminish after tax retained earnings and surplus. Such reductions would lead to higher premium to surplus ratios and to a reduction in the capacity of many insurers to write additional premiums at a time when the demand for insurance is increasing between



15% and 20% per year. Because of solvency concerns, states would be expected to review premium to surplus ratios carefully, and such capacity limitations would certainly have a pronounced impact on the overall insurance marketplace, ostensibly exacerbating existing availability and affordability problems in some lines of insurance.

We believe that the full application of the Federal anti-trust laws to the pricing of insurance would have adverse effect in the continuation of the practice of pooling large risks among a number of insurance companies. Such pools require the use of a common rate and common forms among normally competing insurers. Such pooling devices play an important role in providing insurance coverage and capacity in many industrial fields, such as aircraft, nuclear energy, the food industry, the oil industry, etc. Additionally, in large commercial risks, insurance brokers routinely get many different insurers to accept a portion of the risk, at a common rate and in common forms. In all such situations, insurers must agree on what the price for the particular risk should be.

It is true that a good case should and would be made that such commercial arrangements substantially enhance competition, and are at times the only way through which enough insurance capacity can be created to insure certain exposures. Our survey indicates that there exists, however, considerable doubt among company executives as to whether the legality of such practices will be upheld by the courts.



- 42 -

These executives have advised us that they would be deterred from continued participation in such plans until their legality had been established.

The fact that conflicts with federal anti-trust laws may exist do not, obviously, make these practices undesirable from a consumer standpoint. Many of these practices were created to make insurance available to broader publics in a more competitive environment. But, the courts have not necessarily held that a clear public benefit is of itself sufficient to overcome a legal barrier. If companies believe such pooling devices would be illegal or that the courts would prohibit the use of common rate and forms, we would well see the demise of these pools and many large risks would find it difficult, if not impossible, to secure adequate insurance coverage. Obviously, this would be to the detriment of the insurance-buying public.

#### E. Regulation

The Justice Department has indicated that its overall objective with respect to government regulation would be to end the state regulation of insurance prices, and decrease overall regulation as it effects the insurance market so as to promote innovation and an entrepreneurial spirit. Given the types of impacts previously identified in our testimony, we believe that the very opposite effect would occur. First of all, the insurance regulatory function at the state level, rather than diminishing would have to be augmented substantially to cover the following types of incremental responsibilities.



- to handle increased problems of insurance availability and non-renewal caused by market withdrawal;
- to accommodate to a multiplicity of policy form approvals from admitted insurers;
- to monitor and/or participate in the approval of substantially increased merger, acquisition and consolidation among existing insurance carriers;
- to manage increases in insurer insolvencies and the concomitant requirement for insurance guaranty funds and management of same;
- as market dislocations were compounded, we would expect surplus lines and excess lines insurers to increase their activities requiring regulatory oversight for state insurance departments to these types of insurers;
- state insurance departments are expected to require a sharp increase in their actuarial support requirements to carry out their regulatory responsibilities under repeal of McCarran-Ferguson. In particular, there are only a limited number of professional actuaries today, and coupled with sharp demands in the need for new actuarial support both in the private sector and regulatory area, we would expect that the salary and compensation for such actuaries would increase markedly were McCarran-Ferguson to be repealed.



One does not require a crystal ball to forecast a substantial turnover in the composition and scope of the residual market.

Inevitably, this would require additional regulatory oversight to assure that the operation of residual market plans was accomplished in a fashion that led to reasonable rates and solvent operations.

There is great concern among insurers that the workers' compensation system now administered and operated at the state level, will be thrown into chaos with the repeal of McCarran-Ferguson.

In workers' compensation insurance, the experience of individual employers, to a very high degree, depends upon the safety consciousness and efforts of both employers and employees coupled with the loss prevention activities of the individual insurance companies. As a result, it is not only a sound pricing procedure, but it is also highly desirable, both from a humanitarian point of view and as a matter of public policy, that there be direct financial incentive for the employer to hold industrial accidents to a minimum. Such incentives are predicated on uniform experience rating plans which have been developed and are applied on a mandatory basis. These plans modify manual premiums by debits or credits reflecting the degree to which the experience of a specific employer is either worse or better than the average in his class. Through such experience rating techniques, competition in workers' compensation has been channelled into such socially desirable ends as loss prevention, rehabilitative activities and promptness in claims handling. While this line of



insurance is subject to the highest degree of regulation in the business, competition has not been stifled. It has been enhanced where it has been of enormous benefit to our economic society and to individual workers. Additionally, the high degree of regulation of the workers' compensation rating system has avoided the precipitation of the mushrooming of individual company classification systems and individual pricing systems based solely on competitive factors. As a result, the workers' compensation statistical system has not been impaired. Rather, it has prevented the opportunities for large employers with superior bargaining power to obtain rate concessions at the expense of small employers. This, we believe, is certainly in the public interest.

A number of our member companies have indicated a very real concern that their operations as company "fleets" would be adversely affected by a repeal of McCarran-Ferguson. These company fleets essentially are related corporate entities which provide different insurance products and services to policyholders under an overall corporate umbrella. There is a question as to whether these economic entities under common ownership would, in themselves, be able to pool loss and expense data and make rates. A number of companies, for example, have one affiliate which services one segment of an insurance market such as risks meeting certain criteria for fire or personal automobile insurance, and another affiliate insurance carrier which might handle



- 46 -

substandard risks. Changes in fleet organization, licensing, etc., will place a direct requirement for additional regulatory support.

The amount of litigation generated by a repeal of McCarran-Ferguson can only be speculated upon. It would undoubtedly affect insurers and regulators alike requiring a direct increase in the size of legal departments. We also believe that it is a distinct possibility that with the limitations on the utilization of statistical organizations that the federal government, itself, would feel a need to step into the breach to collect loss data, which in turn, would lead to an indirect regulatory role over insurance industry operations. Certainly such a data collection function, which has already been suggested as a potential function for the Federal Insurance Administration, coupled with increasing problems with insurance affordability and availability would place great pressure on policymakers in Washington to interject the federal government directly into the regulation of insurance and the establishment of competing insurance underwriting capabilities and operations.

In summary, we believe that the level and scope of regulation of insurance will increase significantly with the repeal of McCarran-Ferguson, both at the state and the federal level. We are also convinced that the states will continue to have significant "indirect" rate regulatory responsibilities through their authority to monitor and impact the solvency and investment conditions of admitted insurance carriers.



#### V. CONCLUSIONS

Repeal of McCarran-Ferguson would not be in the public interest. This law has fostered a healthy insurance market, highly competitive and able to meet the needs of a continuing expanding and changing economy.

Repeal will lead to chaos, confusion and market restriction. It will lead to the demand for legislation to correct the resulting market dislocations. Such legislation will most probably take the form of specific immunities granted the industry to allow it to meet the public needs. However, the public needs are ever changing, and providing specific immunities will lack the needed flexibility which the industry requires to meet continuing changing market demands.

Repeal of McCarran-Ferguson will predictably lead to more, not less, regulation of insurance. In addition to increased regulatory controls by states trying to cope with diminishing insurance capacity, there would be superimposed degrees of new federal laws and regulations.

The basic purpose of anti-trust laws is to increase competition so that the corollary benefit of less expensive product may be realized. If the fundamental shared function of centralized data collection and interpretation, advisory rate making and standardized products filing were lost, we envision a bonanza for lawyers, actuaries, product experts and the few large companies. A further result would



- 48 -

be high prices, fewer insurers, and less extensive operation for the smaller insurers who do survive. In essence, the result of the application of federal anti-trust laws to insurance could be to drastically reduce competition, virtually eliminate the ability of entry into the market and increase the price to the consumers.

In summary, the existing system of regulation of insurance works. It has fostered competition, allowed the public needs to be fulfilled and has encouraged innovation. In view of this and in light of the anticipated chaos which would occur with the repeal of McCarran-Ferguson we urge that the existing system of insurance regulation be left untouched.



APPENDIX AWITHDRAWAL FROM EXISTING INSURANCE MARKETSSmaller Companies

- "If public law 15 is repealed, companies our size and larger will not be able to survive, we could not afford to promulgate our own rates."
- "In order to have credible loss statistics and expense factors we may see many regional companies merge or consolidate to develop premiums that can be trended and can then afford the cost of actuarial, auditing, accounting and financial expenses."

Larger Companies

- "The advantage of wide open price competition to a large organization would be more flexible, more competitive, more timely rates. Smaller companies would be required to hire actuaries and increase staff organization in order to compete. In the long run, many smaller companies would cease to exist and increased concentration in the industry could be expected."
- "In each instance where an insurance pool was dissolved because of withdrawal of member companies in face of new anti-trust exposure, the impact on the market place would be the elimination of one competitor...the insurance pool."
- "Where participation in residual market plans is mandated by state statutes. Where participation is voluntary and anti-trust exposure exists, our organization would not participate in the face of such exposure."
- "Most companies would make an effort to concentrate their activities in those (insurance lines) and in those geographic areas where they could hope for greater (statistical) credibility and more cost effective operation."



WITHDRAWAL FROM EXISTING INSURANCE MARKETSSmaller Companies

- "Because of very small premium volumes in many states...it may not be cost effective to maintain a policy writing ability in some states."

Larger Companies

- "Certain lines of insurance which are minor for us and which we currently write as (an) accommodation for our policyholders would be difficult for us to maintain. I suspect we would drop these small lines."



DIFFICULTIES IN FUNCTIONING WITHOUT A RATE BUREAUSmaller Companies

- "Difficult areas in auto rate making would be class differentials, bodily injury increased limits factors, and other areas where very large volumes of data are required to properly price an individual (classification)."
- "Today, the bureau promulgates general rules and state exceptions to those rules. Maintenance of such a manual at the company level would be extremely difficult."
- "It would be necessary for our company to develop our own rate manual. In this manual we would include risk classifications and general rules affecting the rating of risks and so on. I see no alternatives to having this type of information available."
- "If we do not have bureau standards, where would we get policy language for such low volume classes as glass, burglary and theft, mobile homeowners and so forth."
- "Due to our size, there is no way we can develop a rating system that we could substantiate. We have definite need of rating bureaus based on many companies volume and experience."

Larger Companies

- "The x company would be required to develop additional statistics and expense information internally. With some incremental internal costs our ability to accurately determine adequate rates would not be impaired."
- "It is doubtful that we would continue to supply loss information to bureaus in the area(s) where we feel we have adequate exposures to determine our own rates."
- "Only giant companies would be able to cope. Yes, it would be an intolerable situation (workers' compensation)."
- "(If Bureau Rate manuals were abolished the effect would be) chaos - we could perhaps cope in areas of concentrated volume."



DIFFICULTIES IN FUNCTIONING WITHOUT A RATE BUREAUSmaller Companies

- "There would be a very serious need for common stat plans of the industry. The need for detailed (statistical) information (by each company) would likely be counter productive and cut deeply into the efficiency of (our existing) employees due to recordkeeping."
- "Commercial property would be a problem in new states (for us) and in new risks -- no basis on which to compare components of the rate with our own anticipated costs."
- "No basis for handling low volume classes or statistics to produce our own rates."
- "Each company, ours no exception, would have to make a cost vs. benefit analysis by line to determine whether or not it was economically feasible to continue to supply and use statistics."

Larger Companies

- "Ratemaking for commercial risks (specifically rated fire risks) simply wouldn't work unless you abandoned specific rates and used a scheme based on loss costs per class furnished by the bureau -- and then modify this by individual risk characteristics which would require either a very detailed application or an inspection by the agent or company prior to rating (probably both with attendant cost increases)."
- "Greatly added complexity for a producer (insurance agents) who must then have separate manuals for each company (and each line of insurance) (note most agencies represent several insurance carriers)."
- (If some larger companies did not supply loss information to statistical organizations then) the point could be reached where rates charged by the larger companies would dictate the marketplace price and smaller companies would merely follow. At that point bureaus would be of little or no value (to smaller companies) and they would probably discontinue supporting the bureaus.



DIFFICULTIES IN FUNCTIONING WITHOUT A RATE BUREAUSmaller Companies

- "Due to (our) size, our figures are not considered by present regulatory agencies as credible and we must rely heavily on national averages and stats reported to Bureaus and combined, (providing) us guidelines, which we then follow as experience dictates."
- "Many small companies do not have a refined accounting by line by territory, and the result (making rates with our own aggregate expense data) could produce rating errors... (It would) be very difficult to develop(c) such a rate structure when entering new states or introducing new lines of coverage (without essential expense data)."
- "Smaller volume lines will not produce credible statistics which could result in insufficient rates."
- "We would probably not support a (pure) loss collection bureau as we know them today."



MARKET DISLOCATION EXPECTEDSmaller Companies

- "If repeal of McCarran-Ferguson goes beyond (competitive rate-making) it would result in a vast restructuring of the industry greatly restricting this company."
- "It would also be difficult to expand into new areas or states, as there would be apparently little information upon which to make value judgements."
- "(Although) independent decisions on rate levels...could produce lower competitive prices to the consumer (these lower prices)...would be short lived and would at the expense of insolvency of many smaller companies and an overall contracting of the marketplace for the consumer."

Larger Companies

- "The smaller the company, the more the effect. (If antitrust laws called for the abolition of rate manuals) -- a definite disadvantage to the small company."
- "We feel that competition would be lessened rather than increased. Small companies would tend to become more localized in their operation because of the amount of expertise and volume of work required -- the preparation of rates and forms. The extremely large carriers with this capability would undoubtedly increase their share of the market."
- "Companies would not join (pools) if threatened by charges of anti-trust violation."
- "(A lack of standardized policy forms) would make it impossible to have standardized coverage as required...on most large projects...would result in considerable litigation as the courts interpreted the multitude of new policy provisions."



CONSUMER CHOICES LIMITEDSmaller Companies

- "I believe we would see the enactment in each state of statute required language and could end up with different required language in each state for each line of insurance. ...I don't believe the insurance-buying public is capable of making the technical comparisons between policies. They have enough difficulty understanding the differences between standard bureau forms and innovative or non-standard forms."
- "Lack of standardization would lead to confusion of agents and policyholders."

Larger Companies

- "We continue to believe that standard minimum coverage forms are in the public interest."
- "The elimination of bureau rate manuals could cause insurance agents to reduce the number of companies they write for because of the problem of dealing with many individual company rate manuals."
- "Limitations on the development of standard policy forms...would fall most heavily upon the public who have become increasingly interested in simplified, comparable policy language and coverage. Additionally, the limitation on industry cooperation would inevitably produce an increase in the number of law suits involving policy construction"
- "Not be in public interest (to prohibit joint efforts to standardize products, i.e. policy forms)...(Foresee) chaos in the marketplace when consumers must choose amongst different coverages, etc."
- "We feel it of the utmost importance to continue standardization of  
1) policy forms, 2) classifications,  
3) manual rates."



INNOVATION AND CREATIVE MARKETING STIFLEDSmaller Companies

- "There would be a clamor to secure the 'manuals' of the leaders in volume and profits in a territory and copy the same."
- "Federal regulation will (would) stymie innovation."
- "Being small anyway - and without rate structure backing from a rating bureau, we see no chance to be creative."
- "A small (insurance) company is fairly restricted when it comes to innovative or creative marketing in a time of legal certainty. In a time of legal uncertainty, it would be prohibitive (to be an innovator)."
- "I hope and pray that our company and others like us would not be subjected to this chaos (repeal of McCarran)."

Larger Companies

- "During the period of uncertainty, we would innovate little until rate and form structure become clear."
- "There would be a period of confusion - we would be extremely cautious before embarking on any innovative or creative activity."
- "Our company, and any other company, in my opinion, would not be doing much innovative or creative marketing during the...fundamental change in regulations. We would (concentrate) on substantial increase in work (and in developing procedures for individual company rate development)."
- "(We) would be extremely cautious because of legal uncertainty. Many years would pass to begin to resolve these legal uncertainties by legislation; problems too numerous for court machinery."
- "There would be slower reaction to changing social and market conditions... We would proceed only with utmost caution."
- "Independent rating would allow development of new concepts."
- "During the period of uncertainty, we would have to concentrate on adjusting our standard products to the new environment. After that, creative marketing might be possible."



INCREASED GOVERNMENT REGULATIONSmaller Companies

- "Without...regulation (residual markets) could not operate."
- "It will only be a matter of time until some government agency will be controlling rates (at least a cap). From there, we will have an opportunity to see how well the government can provide for an insurance program."

Larger Companies

- "Given the erosion of the Parker Brown Doctrine, the ability of states such as Massachusetts to establish automobile insurance rates would appear to be in doubt. In this area particularly, two important public policy goals appear to come in direct conflict with each other, that is the concept of vigorous independent price competition and the concept of providing insurance of residual risks at affordable rates. In a vigorous competitive environment, the most intense competition would be directed toward markets whose loss exposure would produce the desired return on investment. In turn, less desirable markets from a loss standpoint might expect higher rates or unavailability of insurance in a truly elastic pricing scenario."
- "It is unlikely that the vacuum created by the serious erosion of effective state regulation of the business of insurance would not be filled by federal regulators almost immediately."
- "In certain highly specialized markets, a few companies have...captured large shares (i.e. mortgage guarantee insurance) a practice which is currently permissible under and regulated by state insurance laws. If the state regulatory scheme were removed from these highly concentrated markets, and the few companies involved in each were free to set prices independently, then the only recourse available to the consumer in the event of dissatisfaction with the practices of the companies would be an attack under the Sherman Act to break up the companies. It seems clear that a state regulatory scheme better serves the interests of the industry and the consumer than anti-trust litigation."
- "Open price competition could produce severe availability and affordability problems in markets which are undesirable from a risk standpoint. Under this scenario, the pressure on the federal government to intervene to deal with these public policy issues would be enormous."



INCREASED GOVERNMENT REGULATION (cont'd.)Smaller CompaniesLarger Companies

- "In the event that...(McCarran-Ferguson were repealed)...we would expect in the long run that marginal competitors would be eliminated from the market and that larger companies who are in a position financially to develop internal rating mechanisms would continue to develop, perhaps at the expense of smaller companies. ...The federalization of the insurance industry would provide a more flexible climate with open price competition. It is difficult to imagine (however) that such a business environment could exist for even a short period of time without extensive federal regulation."
- "We foresee increased insolvency, thus, increased (state guarantee fund) assessments."
- "Some form of residual market (will result). I am not sure we would participate voluntarily...operations would have to be spelled out (read regulation) under a new climate."



INCREASED OPERATING EXPENSES/PROBLEMSSmaller Companies

- "The company is too small to effectively develop its own contracts and endorsements...uniform policies and endorsements are a necessity. To outlaw standard forms and prices would be disastrous on risk pooling."
- "This would be a very costly, time consuming process with a very acute need of personnel with actuarial and rate making abilities. Staffing would be a very serious and costly problem.... current personnel are not capable of handling the volume of needs in this area. Trending would be very difficult on a company by company basis, as this can only be done by very detailed costly and time consuming studies on a very broad base."
- "I foresee this requiring more sophisticated computer hardware, capable of much more capacity and the handling of many more functions."
- "The problem is one of staffing. This could be costly. Historically, as a direct writing dividend paying company, we have used bureau rates. We foresee problems, and have already taken steps to adjust -- such as hiring an actuary. Marketing our product may be more difficult, expenses will be greater and adjustments will have to be made to operate on a sound operating basis."
- "Costs (to develop our own policy forms) would be prohibitive."

Larger Companies

- "The cost in terms of rate making, filing manuals, etc., would be increased greatly. But reduced bureau assessments would partially offset this."
- "In workers' compensation, the National Council's uniform classification system involving several hundred classifications could be abolished. In that event, the burden would fall most heavily upon the smaller companies who would be faced with the dilemma of either making their own calculations at a relatively high cost in relation to their premium volume, or independently paralleling the rate making decisions of the larger companies with the risk of establishing rates that are too low for the companies' cost structure."
- "Commercial fire insurance could be effected if ISO were no longer able to produce loss costs based upon inspection of specifically rated risks. Elimination of the ISO practices necessitates change in the rating approach of the entire industry. It seem logical to conclude that the insurance agent would evaluate several quotations from different insurers, each based upon independent inspections. The increase of the number inspections would produce an increase in cost; therefore, it appears that industry efficiency and maintenance of low costs to consumers requires continuation of ISO inspections."
- "Increased operating cost at least - eliminate Fleets at worst - we have common agents...tremendous problems develop for us." (Fleet - an organizational alignment wherein a parent insurer maintains a number of subsidiaries)"



INCREASED OPERATING EXPENSES/PROBLEMS (cont'd.)Smaller CompaniesLarger Companies

- "Generally, we could adopt to such a system but only with a large increase in personnel working on pricing of coverages."
- "The biggest single problem would arise if interchange of data for experience rating plans was prohibited (workers' compensation) also experience necessary for compilation of information (table) for retrospective rating would be a major problem."
- "In addition to actual loss experience by classification, data necessary to calculate loss development factors, trend factors, and increased limits tables would need to be compiled and distributed. Guide (a) rates for loss (statistical) reliability classes (i.e. products liability would be a definite problem."
- "The rating of commercial property without the bureau would become inaccurate."
- "For large automobile and general liability risks, individual risk rating plans would become difficult to impossible to administer"
- "A major problem of expense loading would become necessary for low volume (miscellaneous risks such as burglary, glass, etc.) lines."
- "We would need to increase substantially our actuarial and H.O. underwriting staff to assume responsibility for making rates."
- "(Individual) company rate manuals would become an expensive necessity."
- "Staff would have to be substantially increased."
- "Expect industry support of independent research organizations to escalate dramatically."
- "We would expect the use of consultants to increase."



INCREASED OPERATING EXPENSES/PROBLEMS (cont'd.)Smaller CompaniesLarger Companies

- "Industries with anti-trust restrains participate in joint ventures and I believe underwriting pools would fall in the same category."
- "We would have to incur the expense of maintaining our own manuals, but we probably would simplify and reduce the complexity of the manuals."
- "Our expense statistics would have very low credibility and rates would be very volatile. At any given time, certain rates could be inadequate or excessive despite our best efforts. This would, of course, affect profit and loss."
- "Excessive expenses of computing rates (in some miscellaneous lines) might result in some lines being dropped."
- "A substantial increase in expenses caused by repeal of McCarran-Ferguson would make it more difficult to make a profit and increase surplus -- but we could and would make any necessary adjustments."
- "It would be very costly (for us) to write and maintain our own rate manuals."



## APPENDIX B

## Impact of Repeal of McCarran-Ferguson Act on Competition, Prices, Concentration, Entry and Regulation in the Insurance Industry

- o Indicates moderate impact  
• Indicates severe impact

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | Increased Insurance Premiums         | Constricts Competition | Increased Industry Concentration | Impairs Entry of New Firms      | Leading to More Government Regulation |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|------------------------|----------------------------------|---------------------------------|---------------------------------------|
| 1. Will see a proliferation of non-standard policy forms and interpretations (difficulties faced by policyholders to compare policies from competing carriers - agents may reduce number of companies represented).                                                                                                                                                                                                                                                   | o                                    | •                      |                                  | o                               | •                                     |
| 2. Increase in operating expenses.<br>- Additional actuarial personnel<br>- Additional accounting/support staff<br>- Reprogramming, data processing, storage input validation, retrieval, analysis related rate making functions<br>- Purchase of data processing equipment, new personnel to operate<br>- Development of separate rate manuals for each company, publication distribution<br>- Development and distribution of new/revised policy forms/endorsements | o<br>o<br>•<br>•<br>•<br>•<br>•<br>• |                        |                                  | •<br>o<br>•<br>o<br>•<br>•<br>• |                                       |



- 2 -

Impact of Repeal of McCarran-Ferguson Act on Competition, Prices, Concentration,  
Entry and Regulation in the Insurance Industry  
(cont'd.)

|                                                                                                                                                     | Increased<br>Insurance<br>Premiums | Constricts<br>Competition | Increased<br>Industry<br>Concentration | Impairs<br>Entry of<br>New Firms | Leading : : More<br>Government<br>Regulation |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------------------|----------------------------------------|----------------------------------|----------------------------------------------|
| - Separate staff and department required to rate commercial property/fire risks - inspections                                                       | •                                  | •                         |                                        | •                                |                                              |
| - Larger legal/ research staffs                                                                                                                     | •                                  |                           |                                        | •                                |                                              |
| - External consulting assistance for reorganization and change in operations                                                                        | •                                  |                           |                                        | •                                |                                              |
| - Consulting assistance for loss trending                                                                                                           | •                                  |                           |                                        | •                                |                                              |
| 3. Reorganize corporate structure, add additional divisions for rate making, form development, etc.                                                 | •                                  | •                         |                                        | •                                |                                              |
| 4. Experience prolonged period of stagnation in the development of new products and services - concerns with legal uncertainties - interpretations. |                                    | •                         |                                        | •                                | •                                            |
| 5. Increase in the size of state workers' compensation residential market possibly leading to more state-run plans.                                 |                                    |                           |                                        | •                                | •                                            |



- 3 -

Impact of Repeal of McCarran-Ferguson Act on Competition, Prices, Concentration,  
Entry and Regulation in the Insurance Industry  
(cont'd.)

|                                                                                                                                                                                                                                         | Increased<br>Insurance<br>Premiums | Constricts<br>Competition | Increased<br>Industry<br>Concentration | Impairs<br>Entry of<br>New Firms | Leading to More<br>Government<br>Regulation |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------------------|----------------------------------------|----------------------------------|---------------------------------------------|
| 6. Withdrawal from insurance markets<br>- In territories where market penetration is light<br>- Where insurance coverages are sold as an accommodation (i.e., miscellaneous, small lines)<br>- For certain types of specialty coverages | o                                  | •                         | •                                      |                                  | •                                           |
|                                                                                                                                                                                                                                         | o                                  | •                         | •                                      |                                  | •                                           |
|                                                                                                                                                                                                                                         | •                                  | •                         | •                                      |                                  | •                                           |
| 7. Withdrawal of some companies from existing insurance pools due to anti-trust concerns                                                                                                                                                |                                    | •                         | •                                      |                                  | o                                           |
| 8. Increase in non-renewal of policyholders and agents as markets contract and change                                                                                                                                                   | o                                  | •                         | •                                      |                                  | o                                           |
| 9. Increase in number of mergers and acquisitions, insurer insolvencies                                                                                                                                                                 | •                                  | •                         | •                                      |                                  | •                                           |
| 10. Increase in state regulatory activities<br>- Stepped up monitoring of general industry solvency conditions                                                                                                                          |                                    |                           |                                        |                                  | •                                           |



- 4 -

Impact of Repeal of McCarran-Ferguson Act on Competition, Prices, Concentration,  
Entry and Regulation in the Insurance Industry  
(cont'd.)

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | <u>Increased<br/>Insurance<br/>Premiums</u> | <u>Constricts<br/>Competition</u>                                         | <u>Increased<br/>Industry<br/>Concentration</u>                           | <u>Impairs<br/>Entry of<br/>New Firms</u> | <u>Leading to More<br/>Government<br/>Regulation</u>                                                                                        |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------|-------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>- Handling increasing number of insolvencies</li> <li>- Increased staff to assess rate adequacy, via a vis, carrier reserves, solvency</li> <li>- Withdrawal from insurance markets, non-renewals, agency cancellations</li> <li>- Increased filing of policy forms</li> <li>- Increased number of carrier mergers/acquisitions</li> <li>- Increased number of carrier retirements</li> <li>- Revision/restructuring of state residual market programs</li> <li>-- auto</li> <li>-- workers compensation</li> <li>-- FAIR, beach, windstorm</li> <li>- Continued expansion of state made rates</li> <li>- More self-insurance</li> </ul> |                                             | <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul> | <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul> |                                           | <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> </ul> |
| 11. Escalating federal government involvement in overview of rate affordability and coverage availability                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                             |                                                                           |                                                                           |                                           | •                                                                                                                                           |



Impact of Repeal of McCarran-Ferguson Act on Competition, Prices, Concentration,  
Entry and Regulation in the Insurance Industry  
(cont'd.)

|                                                                                                                     | <u>Increased<br/>Insurance<br/>Premiums</u> | <u>Constricts<br/>Competition</u> | <u>Increased<br/>Industry<br/>Concentration</u> | <u>Impairs<br/>Entry of<br/>New Firms</u> | <u>Leading to More<br/>Government<br/>Regulation</u> |
|---------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-----------------------------------|-------------------------------------------------|-------------------------------------------|------------------------------------------------------|
| 12. Development by federal government of data base on loss information                                              |                                             |                                   |                                                 |                                           | •                                                    |
| 13. Questionable continuation of pooling activities among insurers - with pools subject to anti-trust               |                                             | •                                 |                                                 |                                           | •                                                    |
| - aircraft                                                                                                          |                                             | •                                 |                                                 |                                           | •                                                    |
| - energy                                                                                                            |                                             | •                                 |                                                 |                                           | •                                                    |
| - nuclear                                                                                                           |                                             | •                                 |                                                 |                                           | •                                                    |
| - FAIR                                                                                                              |                                             | •                                 |                                                 |                                           | •                                                    |
| - other JUA's                                                                                                       |                                             | •                                 |                                                 |                                           | •                                                    |
| - etc.                                                                                                              |                                             | •                                 |                                                 |                                           | •                                                    |
| 14. Expect price leadership to be established by major carriers (i.e. those with adequate loss and experience data) | •                                           | •                                 |                                                 |                                           | •                                                    |



APPENDIX CEntries and Retirements - Property-Casualty Insurance Companies

| <u>Years</u> | <u>Entries</u> | <u>Retirements</u> |
|--------------|----------------|--------------------|
| 1960-1969    | 270            | 604                |
| 1970-1977    | 331            | 281                |
| 1968         | 21             | 40                 |
| 1969         | 15             | 31                 |
| 1970         | 32             | 46                 |
| 1971         | 34             | 39                 |
| 1972         | 63             | 37                 |
| 1973         | 58             | 25                 |
| 1974         | 35             | 35                 |
| 1975         | 25             | 54                 |
| 1976         | 46             | 27                 |
| 1977         | 38             | 18                 |

As one would expect, entries exceed retirements in those years when industry has had profitable experience. In reverse, in poor experience years, retirements have exceeded entries.



THE ROLE OF RATING BUREAUS IN  
PROPERTY-LIABILITY INSURANCE MARKETS

prepared on behalf of the  
ALLIANCE OF AMERICAN INSURERS

by

PATRICIA MUNCH, Ph.D.

January 1980



## SUMMARY AND CONCLUSIONS

Under the McCarran Ferguson Act (1945) insurance is exempt from federal anti-trust law, provided it is subject to state regulation. This immunity has recently come under attack from several sources and repeal has been advocated by the Department of Justice, the National Commission for the Review of Antitrust Laws and Procedures (National Commission ) and is embodied in the proposed Insurance Competition Improvement Act of 1979 distributed by Senator Metzenbaum. The attack on the antitrust immunity is premised on the belief that competition is the most efficient regulator of resource use and the accumulation of evidence from other industries that substitution of regulation for competition has reduced rather than enhanced efficiency, contributed to higher prices and wasteful "service" competition.

There have been no studies that directly estimate the cost of the insurance exemption. However it is observed that the industry engages in certain collective activities that are potentially non-competitive, in particular, the use of rating bureaus to pool loss and expense data and publish recommended rates. Prior approval rate regulation is said to discourage departure from these rates. The National Commission states the problem:

"Essentially under McCarran-Ferguson, competing insurers are able to collectively publish industry rates for future periods based on industry average costs, often without effective governmental supervision and under regulatory mechanisms that, in many states, discourage independent pricing behavior. Our study of the trucking industry, for example, demonstrates that such an environment creates a strong upward pressure on rates. There is no evidence that insurance premiums are not similarly affected."<sup>1</sup>

---

<sup>1</sup> National Commission, ch. 11, p. 12



Thus, critics of the McCarran-Ferguson anti-trust exemption view the purpose and result of the rating bureaus as cartelization.<sup>1</sup> An alternative view is that because the industry is structurally competitive, an attempt to cartelize would be unrealistic in most states and lines of insurance. Although these concerted activities may have been used for non-competitive purposes historically, they continue to survive only to the extent they are efficient, i.e., they reduce the cost of performing certain functions for certain types of firms. The purpose of this paper is to attempt to apply empirical evidence to discriminate between these two views of the role of rating bureaus in the insurance industry, which will be referred to as the cartel model and the service model respectively. To do this we use both direct and indirect evidence. The direct evidence is drawn from the pattern of adherence to bureau rates and the behavior of the leading bureau, ISO.<sup>2</sup> The indirect evidence applies tests suggested by Commissioner Kahn for detecting the existence of cartelization due to antitrust immunities or regulatory controls.

Section I of this paper first briefly reviews the cartel and service models of rating bureaus, to generate implications which enable us to discriminate between these alternative views on the basis of evidence. The cartel model of a rating bureau yields the following testable predictions:

- large firms are more likely to adhere to bureau rates than small firms;
- the bureau will seek to enforce use of bureau rates;
- the bureau will only survive if a sufficient fraction of the market is written at bureau rates to convey significant market power;

---

<sup>1</sup> "Cartelization" is used loosely to denote collusion to raise prices, restrict output and hence increase profits above competitive levels.

<sup>2</sup> The data available refer primarily to the influence of the leading bureau, ISO, in the private passenger automobile market. The conclusions therefore refer primarily to this market but can be generalized to the role of ISO and other bureaus in other lines to the extent the pattern of adherence is similar. Data were not available to test this.



- above competitive profits and hence willingness of new entrants to incur costs of entry will be positively related to the fraction of the market written at bureau rates;

- deviations from bureau rates will be downward;

- adherence to bureau rates will be greater in prior approval states.

On the other hand, the service model of the role of a bureau yields the following testable predictions:

- small firms are more likely to use the bureau rates than large firms; large firms only use bureau rates in those lines and states where they write relatively small premium volume;

- no attempt will be made to enforce adherence to bureau rates;

- the bureaus will survive to the extent they can perform services more efficiently than individual firms, i.e., their survival is not contingent on controlling a significant fraction of the market;

- average industry profits and hence willingness of new entrants to incur entry costs will be unrelated to the fraction of the market written at bureau rates.

- deviation from bureau rates may be upward or downward;

- adherence to bureau rates will be greater in prior approval states, because interaction with regulators is one of the functions performed efficiently by bureaus.

In order to use these predictions to discriminate between the cartel and service models of bureaus one needs data on the fraction of the market written at bureau rates and the relative size of firm using bureau rates, by line and state. Such data are not routinely available. The data available are confined to three prior studies which compiled limited data on the use



of ISO rates for private passenger automobile insurance. In addition, data on the fraction of the auto market reported to ISO is used as a crude indicator of ISO influence. The evidence from these various sources consistently supports the service model but is inconsistent with the cartel model. Small firms are much more likely than large firms to adhere to ISO rates; of the top ten companies writing auto liability in 1976, the average number using ISO rates countrywide was 0.8. The mean fraction of the auto market premium reported to ISO is under 30%. This probably overstates the fraction of the market written at ISO rates. Adherence to ISO rates is greater under prior approval than open competition rating laws, but prior approval is neither a necessary nor sufficient condition for use of ISO rates. Deviations from ISO rates are both upward and downward; in fact the fraction of deviations above ISO rates was higher in two prior approval states than the one open competition state for which data are available.<sup>1</sup> There is no evidence that the costs of entry (and by implication excess profits) are positively correlated with the fraction of the market reported to ISO (used as a crude indicator of use of ISO rates). No attempt is made to enforce adherence to ISO rates. ISO services are made available to purchasers on a piecemeal basis, i.e., access to other services is not conditional on use or even purchase of ISO rates. Thus there is no evidence that ISO exerts a significant cartelising influence in the auto insurance market. One must conclude that it survives only to the extent it provides valuable services.

In the second section of the paper four tests for the existence of

---

<sup>1</sup> As discussed below, this may reflect product differences and rate control.



excess profits due to antitrust immunity and/or regulation are applied to the insurance industry. There is no single unambiguous test for competitive conditions in an industry. The four tests applied here are proposed by Commissioner Kahn in the Report of the National Commission on Antitrust Immunities, but they are not the only tests suggested by economic theory. The traditional structure and performance tests used in the NAIC program to monitor competition are reviewed elsewhere.<sup>1</sup> The basic conclusion there is that the low concentration and easy entry probably suffice to ensure competition, provided that concerted action, protected by antitrust immunity and regulation, does not undermine this competitive structure. It is therefore appropriate to examine the effects of concerted action here.

The first test looks for evidence of capitalization of excess profits into a high cost of entry. Application of this test to the insurance industry poses theoretical and empirical difficulties. At the theoretical level, it is argued that some control of entry may be justified in terms of efficient control of fiduciary risk. Only costs in excess of this hypothetically efficient level are potential evidence of pure monopoly profits. At the empirical level, measurement of the cost of entry due to regulation requires data on dollar outlay (including the opportunity cost of minimum capital requirements) and cost of delay, which are generally not available. The limited data available for two companies indicates trivial dollar outlay and delay of less than a year in most states. However in a few states delay of over a year is suggestive of entry barriers which cannot be rationalised in terms of efficient solvency regulation. However there is no evidence that abnormally long delay is positively correlated with the share of the market

---

<sup>1</sup> Comments on the Program to Monitor Competition, Munch 1979.



reported to ISO. Thus by this test there is no support for the hypothesis that ISO operates an effective cartel.

The second test looks for inflated input prices, in particular, above competitive returns to capital. Several major studies of profits in the insurance industry were reviewed. These are of two types. The first uses loss ratios as a measure of profitability. This approach has the advantage that the data are available on a by line and by state basis which is essential because it is generally agreed that to the extent excess profits exist in insurance they are likely to be concentrated in specific lines and regulatory environments. Moreover the practical problem of rate regulation is state and line specific. However this approach has the defect that the profit margin on sales (premium) is no indication of the rate of return on capital which is the measure of profits relevant for testing the cartelisation hypothesis.

Loss ratio studies generally examine whether loss ratios are higher or lower under prior approval than open competition. Although not the central issue here, this question is highly relevant because any cartelising influence ISO may exert is likely to be greater under prior approval. Thus if profitability is not higher under prior approval than open competition, it is reasonable to conclude that the cartelizing power of ISO is negligible in general. Of the three studies reviewed, Saba (1978) concluded that loss ratios are lower under prior approval; Ippolito (1979) finds no systematic difference; the Department of Justice finds loss ratios higher under prior approval. Of these three the Ippolito study carries by far the greatest weight because it covers a representative group of states, uses a three-year average loss ratio (which provides some control for transitory fluctuations) and includes both the voluntary and assigned risk sections of the market.



Thus, on balance, the evidence suggests no difference in loss ratios under prior approval. For the reasons given above (rate of return on sales does not translate directly into rate of return on capital, prior approval is only an indirect measure of potential cartelizing influence of the bureau) this is at best weak evidence against the hypothesis that the bureau acts as an effective cartel.

The second approach to measuring profits departs from the correct assumption that the relevant measure of profits is the rate of return on net worth. In practice this approach encounters two major obstacles: attribution of the overall rate of return on net worth of multiline and multistate firms to specific lines and states; definition of a benchmark or competitive rate of return against which to evaluate actual rates, which entails determining what is a fair return for the risk born by insurance shareholders. Two studies are reviewed which use the capital asset pricing model as a framework for determining a fair rate of return, adjusting for risk, in terms of the profit margin on sales, by line of insurance. The capital asset pricing model describes an equilibrium trade-off between risk and return on the basis of a stringent set of assumptions. To the extent these assumptions are violated in practice in the insurance context, the relevance of the model and hence of the target profit margins derived from it may be questioned. Furthermore, the data necessary to apply the model are not readily available. As a result of differences in the choice of key parameters, the two studies reviewed come to very different conclusions as to what constitutes a fair rate of return and hence as to whether historically observed rates of return have been excessive or not. Because the estimate of the benchmark competitive rate of return is very sensitive to the specific values chosen



for empirical magnitudes which cannot be known with accuracy, the credibility of these studies is low. We conclude that direct measurement of profits is not a fruitful test of cartelization, despite its theoretical appeal. This is a conclusion that has been reached by a large number of students of industrial organization, for a wide variety of reasons, in a wide variety of areas.

The question of above competitive returns to agents is discussed only to note that although agents might benefit from any excess profits in insurance that might be created by the anti-trust exemption since agents themselves are subject to considerable other regulations, including entry restrictions, these alone might suffice to create above competitive returns. Since McCarran-Ferguson is neither a necessary nor sufficient condition for excessive returns for agents, this is not a useful test of the effects of the anti-trust immunity for insurance.

The third test, evidence of customers attempting to circumvent the allegedly cartelized section of the market, is implicitly covered by the first section of the paper, which shows that the bureau share is typically less than 30% of the market. However the existence of a large non-bureau share of the market is equally consistent with the service model. Firms which can perform the functions performed by ISO at lower cost in-house or by purchasing close substitutes from other sources will not use ISO. Thus the growth of a non-bureau section of the market does not indicate cartelization. This test cannot discriminate between the cartel and the service view of rating bureaus.

The fourth test, exclusion of innovators and innovations, is also implicitly covered by the first section of the paper. Innovation in the



insurance market consists of development of new forms of coverage, new classification criteria, (unobservable) new underwriting techniques, etc. Firms are free to develop their own forms and classification systems or use those provided by ISO just as they are free to develop their own rates or use those available through ISO. Some of the evidence of dispersion of prices which was presented in the first section no doubt reflects differences in the various dimensions of product quality. Thus in the absence of data on the extent of use of ISO forms and classification systems, etc. it seems reasonable to conclude that firms will deviate on these product dimensions when it serves their interest, just as they do on price.

In summary, although all the evidence on the influence of ISO is of necessity indirect, we find no evidence that ISO exerts a significant cartelizing influence, considerable evidence that it does not and considerable evidence for the alternative hypothesis that ISO provides valuable services. The evidence on which these conclusions are based is derived almost entirely from private passenger automobile. To the extent the pattern is similar in other lines -- small ISO market share, primarily composed of small firms, significant deviations by large firms above and below the ISO rate -- the conclusions may be generalized to other lines but we lack the data to prove this.

To the extent the bureaus increase information in the market and provide other useful services, but lack the means to enforce adherence to their rates and lack the market power to significantly raise the mean level of rates, their continued existence is justified on grounds of economic efficiency.

Posner (1979) has argued that the exchange of price information which narrows the dispersion of prices without raising the mean price level should be allowed since it promotes rather than reduces social welfare. Unfortunately



this test is hard to apply in the case of insurance rating bureaus, because of the nature of the insurance product. The claims cost and therefore the competitive price of even a standardized policy varies by state, making it difficult to distinguish the effect of ISO from the effect of other territorial variables.

One must therefore look to indirect evidence of the effect of ISO on price levels. The simplest indirect test is derived from the survivorship principle. If ISO systematically set prices above competitive levels, but enforcement and barriers to entry were imperfect, then one would expect the market share of ISO firms to diminish over time, which it has. This finding is not inconsistent, however, with the alternative view that ISO performs services at lower cost. One of the costly functions undertaken by ISO is the filing of rates and other dealings with regulators. The costs of independent filing have diminished over time (DOJ Report) which has reduced the relative cost advantage of filing ISO rates. Thus even if ISO rates were set at competitive levels, one would expect the share of the market written at ISO rates to have diminished over time. However, we do not wish to argue that ISO did not originally have significant power as a cartelising force. The current policy issue is whether that power remains.

Bork (1978) argues that concerted action, including horizontal price fixing, may be socially efficient if it is ancillary to some other purpose (in this case, cost reduction). He points out that it is inconsistent for antitrust policy to outlaw limited action in concert by two or more firms if the same activities would be legal if the firms were to merge totally: the same principles should apply to concerted action among separate firms as apply to horizontal mergers. The test should be one of market power. Bork suggests 30-40% as a market share below which market power is negligible. The evidence suggests that the market share of ISO firms is typically less



than 30%. (The market share of the largest writer is typically over 20%.)

Thus the potential for significant cartelization due to the operation of ISO is surely trivial.



## INTRODUCTION

Under the McCarran-Ferguson Act (1945) insurance is exempt from federal anti-trust law, provided that it is subject to state regulation. This immunity has recently come under attack from several sources and repeal has been advocated by the Department of Justice, the National Commission for the Review of Antitrust Laws and Procedures (National Commission) and is embodied in the proposed Insurance Competition Improvement Act of 1979 distributed by Senator Metzenbaum. The attack on the antitrust immunity is premised on the belief that competition is the most efficient regulator of resource use and the accumulation of evidence from other industries that substitution of regulation for competition has reduced rather than enhanced efficiency, contributed to higher prices and wasteful "service" competition.

There have been no studies that directly estimate the cost of the insurance exemption. However it is observed that the industry engages in certain collective activities that are potentially non-competitive, in particular, the use of rating bureaus to pool loss and expense data and publish recommended rates. Prior approval rate regulation is said to discourage departure from these rates. The National Commission states the problem:

"Essentially under McCarran-Ferguson, competing insurers are able to collectively publish industry rates for future periods based on industry average costs, often without effective governmental supervision and under regulatory mechanisms that, in many states, discourage independent pricing behavior. Our study of the trucking industry, for example, demonstrates that such an environment creates a strong upward pressure on rates. There is no evidence that insurance premiums are not similarly affected."<sup>1</sup>

Critics of McCarran-Ferguson thus view the purpose and result of the rating bureaus as cartelization.<sup>2</sup> An alternative view is that because the industry is structurally competitive, an attempt to cartelize would be

---

1. National Commission, ch. 11, p. 12.

2. "Cartelization" is used loosely to denote collusion to raise prices, restrict output and hence increase profits above competitive levels.



unrealistic in most states and lines of insurance.<sup>1</sup> Although these concerted activities may have been used for non-competitive purposes historically, they continue to survive only to the extent they are efficient, i.e., they reduce the cost of performing certain functions for certain types of firms. The purpose of this paper is to attempt to apply empirical evidence to discriminate between these two views of the role of rating bureaus, which will be referred to as the cartel model and the service model respectively. To do this we will use both direct and indirect evidence. The direct evidence is drawn from the pattern of adherence to bureau rates and the behavior of the leading bureau, ISO. The indirect evidence applies tests suggested by Commissioner Kahn<sup>2</sup> for detecting the existence of cartelization due to anti-trust immunities or regulatory controls. The suggested tests are:<sup>3</sup>

1. Capitalization of the monopoly value of anti-trust immunity or regulatory restraints into a high cost of entry licenses.
2. Inflation of input prices.
3. Attempts by customers of the industry to circumvent the regulation.
4. Exclusion of innovators and innovations.
5. Superior performance in a comparable unregulated or more competitive market.

In Part I of this paper we first briefly review the cartel and service views of the rating bureaus, to generate implications which enable us to discriminate between them on the basis of evidence. We then reexamine the evidence reported in earlier studies by Joskow, the Department of Justice and others, and update it with more recent evidence. The final section examines the behavior of ISO to see if it is consistent with how a cartel would operate. In Part II Kahn's tests for cartelization are applied. Section 1 discusses evidence of entry restrictions (Kahn test 1). Section 2 reviews the evidence on profits and discusses the question of above competitive returns to labor (Kahn test 2). Sections 3 and 4 briefly address the questions of attempts by customers to circumvent the allegedly cartelized section of the market and

---

1. Because of availability of data, this study follows most previous studies in focusing on private passenger automobile.

2. National Commission.

3. As all students of industrial organization and anti-trust know, there are no simple, unambiguous tests for the existence of competition. The traditional structure and performance tests applied by the NAIC in their program to monitor competition have been discussed elsewhere (Munch 1979) and will not



obstacles to innovation. The fifth test, comparison between the allegedly cartelized market to a comparable, more competitive market cannot be applied to the McCarran Ferguson exemption which applies across the board to all lines of insurance and all states. However the extent of rate regulation does vary across states. Throughout the paper we attempt to distinguish any non-competitive effects due to regulation as opposed to the anti-trust immunity per se.

# I. CARTEL VS. SERVICE MODELS OF INSURANCE RATING BUREAUS

## 1. Theoretical Models

### A. The Cartel Model

Standard economic theory implies that the firms in any industry maximize their joint profits if they collude and act as would a monopolist. This implies setting price above the competitive level and restricting output below the competitive level. For any single firm, however, its individual profits are maximized if it cuts price unilaterally while the other firms adhere to the joint profit maximizing, monopoly price.<sup>1</sup>

Because of this conflict of interest between the individual firm and the group as a whole, cartels are inherently unstable. Stigler (1968) has developed a theory of oligopoly or collusive pricing which enables us to identify the characteristics of an industry which are likely to facilitate collusion. The underlying premise of the theory is that the firm's decision to collude is made by balancing the potential gains of collusion to the firm against costs. Circumstances which tend to imply large gains from

---

3. be repeated here. There it is argued that the industry is structurally competitive, by traditional standards of concentration. It follows that collusion to protect above competitive profits could only persist if enforced by some institutionalized framework. It has been argued (for example, Joskow 1973, Ippolito 1979) that the McCarran-Ferguson exemption, combined with prior approval rate regulation provide the institutional framework necessary to support collusive pricing. The competitive structure of the industry can therefore not be relied upon to ensure competitive pricing. The purpose of this study is to address the issue of whether the McCarran Ferguson exemption and resulting bureau practices in fact significantly reduce competition.

1. If only the single firms cuts price, it can achieve a given increase in output by means of a smaller reduction in price than if all firms in the industry simultaneously cut price. This is because the firm



collusion relative to independent pricing are more likely to result in attempts to cartelize. Circumstances which are likely to facilitate collusion include the following:

- Inelastic demand for the output of the colluding sellers. This is promoted by inelastic market demand for the product (which depends on the availability of close substitutes) and a relatively large market share of the colluding sellers.
- Inelastic supply from alternative sources. This is promoted by increasing costs (diseconomies of scale) of firms outside the cartel and barriers to entry of new firms. If firms remaining outside the cartel can increase their output without incurring increasing costs, they can rapidly expand their output to replace the output restrictions of the cartel and hence nullify the effect of the cartel on market price.
- Easy detection of "cheating." If detection is prompt, the optimum strategy for other firms is to match the cheater's price reduction which nullifies his advantage and hence the incentive to cheat.
- A homogeneous product. This facilitates agreement as to the joint profit maximizing price.
- Limited potential for competition on dimensions of the product other than price, such as services, quality, etc. Since non-price competition is typically more difficult to monitor, restrictions on price competition are only worthwhile if the expected gains will not

1. that cuts price unilaterally increases its output in two ways: it obtains the full increase in market demand at the lower price and it may attract customers from its rivals that continue to charge the lower price. Thus a given increase in sales can be achieved by a smaller price cut if other firms adhere to the (higher) cartel price than if all firms cut price simultaneously. Formally, the elasticity of demand facing the  $i^{\text{th}}$  firm,  $\epsilon_i$ , if all firms change price simultaneously, is equal to the elasticity of market demand,  $\epsilon$ , whereas if the price cut is unilateral  $\epsilon_i = \epsilon \frac{Q}{q_i}$  where  $Q$  is total market output,  $q_i$  is the output of the  $i^{\text{th}}$  firm. Thus incentive to cut price unilaterally relative to adherence to the cartel, increases as the inverse of the firm's market share.



simply be competed away by non-price competition.<sup>1</sup>

In light of this list of conditions favorable to collusion, successful collusion by insurance rating bureaus seems unlikely, in the absence of some institutionalized framework for enforcing adherence. Although the market demand for insurance may be inelastic, the market share of firms reporting statistics to ISO is typically less than 30%. Many firms that report statistics to ISO do not use ISO rates so the mean market share of firms actually using ISO rates is probably less than 30%, i.e., insufficient to convey substantial market power.<sup>2</sup> There is no evidence of serious diseconomies of scale or barriers to entry. Thus the elasticity of supply from sources outside the cartel is likely to be high. Cheating is immediately detectable since all states,<sup>3</sup> including those with open competition rating laws, require filing of rates with the insurance department. Although the insurance contract is itself fairly homogeneous, the actual product varies with the expected claims cost of each individual policyholder. There is room for competition on other product dimensions, including dividends and rebates; whether the premium is increased and for how long if a claim is filed; speed and generosity of claims handling, etc.

It has been argued (Joskow 1973, Ippolito 1979) that although the basic characteristics of the insurance industry do not themselves facilitate collusion, prior approval rate regulation provides a legal mechanism for enforcing adherence to bureau rates. While it is true that in many states the original prior approval laws placed severe obstacles to deviating from bureau rates, these obstacles have been reduced over time and the evidence is that deviations are now less the exception than the rule. Moreover, the cost of deviating tends to be a fixed cost that does not vary with premium volume. For firms that have incurred this cost, regulation does not impose obvious barriers to their expansion. In the absence of impediments to the growth of firms that do not adhere to the cartel rates, the elasticity of demand of firms that do adhere must surely be too high to offer large profits from attempts at cartelization.

The cartel model of the bureaus yields the following testable predictions:

- (i) Large firms are less likely to deviate from the cartel rate than

---

1. The theory and evidence of cartels is discussed in Scherer, 1970.

2. These data are for private passenger auto liability, and are discussed more fully below.

3. Except California.



small firms, assuming common supply elasticities. This follows from the fact that the gains from deviating, relative to adhering to the cartel price are less, the larger the firm's market share.

- (ii) The bureau will seek to enforce bureau rates.
- (iii) Deviations from the bureau rate will be downward. The unilateral profit maximizing price is always below the joint profit maximizing price. This assumes a uniform product, uniform expectations of future claims and uniform cost conditions in general. To the extent these uniformity assumptions do not hold, the conclusion with respect to the direction of deviations from bureau rates does not hold.
- (iv) Adherence to bureau rates is greater in prior approval states, since prior approval raises the cost of deviating.<sup>1</sup>
- (v) Bureaus will only survive if a sufficient fraction of the market is written at bureau rates to convey market power.

#### B. Service Model

The service model of the rating bureaus acknowledges the original cartelizing power of the bureaus. However the hypothesis is that this power has been eroded to negligible levels over time, such that now the bureaus continue to survive only to the extent they perform useful services for their members. The insurance firm performs diverse operations. These include estimating expected claims cost and formulating rates; publishing rates and policy forms and distributing them to sales personnel and agents; selection of policyholders; claims handling; filing rates and meeting other requirements of regulation. The optimum scale for performing these several functions varies. In particular there are significant economies of scale in rate making, production of rate manuals and forms, and dealing with regulators. On the other hand the optimum scale for dealing with policyholders may be quite small. Moreover the firm that is large in absolute size may nevertheless write relatively small premium volume in many lines and states, in order to be able to offer policyholder complete coverage of their various needs. Such diversification across lines and states also reduces the total risk borne by the firm.

---

<sup>1</sup>. The dichotomy made here and throughout this paper between prior approval and competitive rating laws ignores the variation that exists among states within these two broad categories.



Because the optimum scale for different functions varies, it is efficient for firms to pool those functions which are subject to economies of scale while retaining individual autonomy over the other functions, and to diversify across lines and states. Bureaus provide those services which are performed at lower unit cost if pooled. These include ratemaking, design and reproduction of policy forms and dealing with regulators, since for many functions the bureau may act on behalf of all the firms it represents, which eliminates duplication. In addition, the availability of bureau rates is of value to firms entering a particular market for the first time, before they accumulate experience on which to base rates.

The service model does not deny that in setting recommended rates the bureau will set those rates that maximize the expected profits of its members. However, the profit maximizing price does not significantly differ from the competitive price because the demand facing bureau firms is highly elastic, for the reasons discussed above.

The service model of bureaus yields the following testable predictions:  
 (i) Users of bureau rates are typically small firms. Large firms use bureau rates only in lines or states where they have relatively small premium volume.

(ii) No effort will be made to enforce bureau rates. Competing bureaus may co-exist.

(iii) Deviations from bureau rates may be upward or downward.

(iv) Adherence to bureau rates will be greater in prior approval states because one of the functions performed efficiently by bureaus is dealing with regulators.

(v) Bureaus survive even though their market share is insufficient to convey market power.

Thus the primary distinguishing features of the cartel and the service models of the role of bureaus are with respect to the size of the firm that will choose to belong, the attempts to enforce adherence of bureau rates and the market share necessary for survival. Both models predict greater adherence to bureau rates in prior approval states. The cartel model predicts only downward deviations, but only under rather unrealistic assumptions of uniform product, costs and expectations. Let us now examine the evidence to see which of these two alternative models better fits the data.



## 2. EVIDENCE OF ADHERENCE TO ISO RATES

### A. Joskow (1973)

Joskow reports two sets of evidence which show greater adherence to bureau rates under prior approval than open competition rating laws. Comparing the percentage of premiums written at bureau rates in California, with open competition, and New York, with prior approval in 1967, the percentage written at bureau is higher in New York in all four lines compared (See Table 1). Second, using data confined to the top 30 firms, the number writing off bureau and the percentage of premiums written off bureau in New York increased following the introduction of open competition in January (See Table 2).

Joskow argues that since the structure of the industry is competitive and barriers to entry minimal (at least for agency firms), prior approval regulation is necessary to enforce adherence to the cartel rates. This cartel view of the bureau cannot account for the fact that in California, even absent this enforcement mechanism, only 32% of fire, 50% of auto liability, 46% auto physical damage and 68% of homeowners premium were written off bureau in 1967. Similarly in New York in 1972 49% of the auto liability premiums written by the top 30 firms were still written at bureau. Thus prior approval is neither a necessary nor a sufficient condition for adherence to bureau rates, contrary to the simple view of the bureau as a cartel enforced by regulation. On the other hand the evidence that something less than 100% of the market is written at bureau in both prior approval and open competition states is consistent with the service model.

### 2. The Department of Justice (DOJ) Report

The DOJ Report examines the dispersion of prices quoted by 25 companies for 9 standardized automobile policies in four territories in one open competition state (California) and two prior approval states (Pennsylvania and New Jersey) in January 1976. The Report concludes:

"A substantially larger share of the automobile insurance market is priced independent of the bureau in California than in New Jersey or Pennsylvania..... There appear to be meaningful price differentials between bureau and off-bureau companies in all three states....California appears to have a more consistent pattern of substantial price differentials (10% or more) below the bureau rates than exists in either New Jersey or Pennsylvania."



Table 1

Percentage of Direct Premiums Written at Off-Bureau Rates

|                      | New York (1967) | California (1966 or 1967) |
|----------------------|-----------------|---------------------------|
| Fire                 | 8.9             | 32.0                      |
| Homeowners           | 22.5            | 67.7                      |
| Auto Liability       | 22.6            | 49.9                      |
| Auto Property Damage | 24.7            | 45.9                      |

Source: New York State Insurance Department.



Table 2

Deviations from Bureau Rates by the Top 30 Insurers  
in New York under Prior Approval (pre 1970) and Open  
Competition (post 1970). Includes Assigned Risk Plan

|                | % of Premiums<br>Off Bureau |      | No. of Companies<br>Off Bureau |
|----------------|-----------------------------|------|--------------------------------|
| Auto Liability | 1967                        | 38.2 | 8                              |
|                | 1968                        | 38.7 | 8                              |
|                | 1969                        | 38.3 | 7                              |
|                | 1970                        | 33.2 | 7                              |
|                | 1971                        | 33.3 | 6                              |
|                | 1972                        | 50.6 | 12                             |
| Homeowners     | 1967                        | 22.8 | 6                              |
|                | 1968                        | 22.1 | 6                              |
|                | 1969                        | 24.7 | 6                              |
|                | 1970                        | 30.9 | 7                              |
|                | 1971                        | 57.2 | 10                             |
|                | 1972                        | 78.9 | 17                             |



First it must be noted that the DOJ definition of deviation from bureau rates leads to an underestimate of economically relevant deviation and possibly a bias in the comparison of prior approval and open competition states. "A company that simply deviates from the bureau rates by a fixed or varying percentage is not considered an independent insurer for the purpose of this study." (DOJ, p. 40).

This is a misclassification for purposes of testing the cartel hypothesis. A cartel will be undermined by any pricing below the cartel price, regardless of whether the price cutter develops a totally independent pricing structure or follows the basic structure set by the cartel. If filing a percentage deviation is cheaper than filing an independent rate structure then the price cutter can offer a larger average percentage price cut if it does not incur the cost of developing and filing an independent structure. Furthermore, if the relative cost of filing a totally independent structure is higher in prior approval states, then this misclassification biases upward the measures difference between adherence to bureau rates under open competition and prior approval.

Bearing in mind this downward bias in the classification of firms as writing off bureau, the data do suggest that prior approval encourages adherence to bureau rates. Counting each territory/coverage as a separate observation, 98% of the price quotes are off bureau in California, compared to 55% in New Jersey and 62% in Pennsylvania.

However, both the extent and pattern of deviations (See Table 3) are inconsistent with the simple cartel hypothesis. First, in every territory/coverage market, over 50% of the firms in the sample are writing off bureau but they account for over 75% of the premium written. Thus larger firms are more likely to deviate, contrary to the necessary conditions for a successful cartel. Second, even if all other firms in the industry wrote at bureau rates less than 50% of total premium volume is written at bureau even in the prior approval states. Less than 50% of the market does not constitute a viable cartel (unless there are obstacles to the expansion of the deviating firms). Third, a substantial fraction of the deviations from the bureau rates are upward, in both open competition and prior approval states (34% in California 40% in New Jersey and 41% in Pennsylvania). Since the profit maximizing price for a cartel exceeds the individual profit maximizing price for a price



Table 3

Dispersion of Price Quotations for Automobile Liability  
and Physical Damage Policies. January 1976.

|       | Total | # Off<br>Bureau | #Above<br>Bureau | # Below<br>Bureau | % Off<br>Bureau | % of Devia-<br>tions above<br>Bureau | % of Devia-<br>tions below<br>Bureau |
|-------|-------|-----------------|------------------|-------------------|-----------------|--------------------------------------|--------------------------------------|
| Cal.  | 864   | 848             | 290              | 558               | .98             | .34                                  | .66                                  |
| NJ    | 900   | 497             | 197              | 300               | .55             | .40                                  | .60                                  |
| Penn. | 898   | 555             | 226              | 327               | .62             | .41                                  | .59                                  |

Source: DOJ Report, p. 39ff.



cutter, the substantial percentage (over 40%) of deviations above the cartel price is inconsistent with the cartel hypothesis.

Some of the observed dispersion of prices charged by different firms for a standard ISO territory/coverage no doubt reflects product differences. Firms select different types of policyholders within the broadly-defined ISO class on the basis of underwriting judgment. They may also differ on other dimensions of the policy such as the degree to which the policyholder's premium is increased in the event of a claim. Thus the dispersion of prices for an ISO class is an overestimate of the dispersion of prices for a homogenous product: some unobservable amount of the price difference is due to product difference. Far from invalidating the conclusion that price dispersion indicates competition, price differences that reflect product differences indicate competition on other dimensions in addition to price. This is evidence of the enforcement problems that would confront a cartel attempting to eliminate competition in a multidimensional product such as insurance.<sup>1</sup>

It is interesting to note that the percentage of deviations which are above bureau is higher in prior approval states (40% in New Jersey, 41% in Pennsylvania) than under open competition (34% in California). One hypothesis to account for this difference is that prior approval regulation may be used to hold the ISO rates below the level desired by the bureau and possibly below the competitive level.<sup>2</sup> This hypothesis is supported by the evidence cited elsewhere in the DOJ Report that average loss ratios for the period 1966-75 were higher in New Jersey and Pennsylvania than in California.<sup>3</sup>

<sup>3</sup> See Part II below.

<sup>1</sup> Note that there is no presumption that competition on quality dimensions of a product is inefficient if it is accompanied by price differences. By contrast there is a presumption that competition on dimensions other than price is inefficient if it is a substitute for price competition.

<sup>2</sup> The rates finally approved by regulators are frequently below the level initially filed by ISO. Rates can be held consistently below cost in one line, provided they exceed costs in other lines and entry to profitable lines is made conditional on writing the unprofitable lines.



### 3. Independent Insurance Agents of America (IIAA) Study<sup>1</sup>

The data from Joskow and the DOJ Report are the only readily available evidence on the percentage of the market actual written at bureau rates. Their disadvantage is that they are confined to a total of four, possibly atypical states. The IIAA study covers all states in 1974, 1975 and 1976 but does not report the fraction of the market actually written at ISO rates. The data reported for both homeowners and automobile insurance include:

- percentage of total market premiums written by the top ten companies
- percentage of total market volume reported to ISO
- percentage of top ten volume reported to ISO
- number of top ten companies writing at, above and below ISO rates.

These data are summarized in Table 4.

The patterns that emerge are similar to those found in the sample of four states: the majority of firms, particularly large firms, do not use ISO rates, even in prior approval states and deviations above ISO rates are not uncommon. In the case of automobile, of the top ten firms in each state, the mean number using ISO rates is only .8, the minimum is zero and the maximum is 3. These top ten firms account for over 50% of the total premium volume in all states (66% on average). Although most deviations are below ISO rates on average .5 of the top ten firms in each state charge above ISO rates, with a maximum of 5.

In the case of homeowners, the top ten firms account for a slightly smaller fraction of the market on average (58.3%) and there is more adherence to ISO rates. The average number of firms using ISO rates is 1.5, with a minimum of zero and a maximum of 9. Deviation above ISO rates is less common than in automobile (mean .6, maximum 4 firms).

The IIAA also reports the percentage of premium reported to ISO by the top ten firms and the total market. It must be emphasized that reporting statistics to ISO is neither a necessary nor a sufficient condition for using ISO rates. It is widely believed that the percentage reported to ISO overstates the percentage written at ISO rates, but data are not readily available to substantiate this. Assuming that the percentage of premium reported

---

<sup>1</sup> Report of the Committee to study ISO's role in the personal lines marketplace, IIAA 6/20/78.



Table 4

Mean, Minimum and Maximum Use of ISO Rates, by State, 1974-76

|                                                | <u>Automobile</u> |      |      | <u>Homeowners</u> |      |      |
|------------------------------------------------|-------------------|------|------|-------------------|------|------|
|                                                | Mean              | Min  | Max. | Mean              | Min  | Max  |
| % of Total Premium<br>Written by Top Ten Firms | 65.9              | 54.3 | 83.3 | 58.3              | 54.3 | 88.3 |
| # of Top Ten Firms<br>Using ISO Rates          | .8                | 0    | 3    | 1.3               | 0    | 9    |
| # of Top Ten Firms<br>Over ISO Rates           | 1.5               | 0    | 5    | .6                | 0    | 4    |
| % of To 10 Premium<br>Reported to ISO          | 22.1              | 0    | 61.5 | 34.7              | 0    | 75.7 |
| % of Total Premium<br>Reported to ISO          | 34.3              | 4.8  | 67.9 | 44.1              | 14.8 | 74.4 |

Source: Independent Insurance Agents of America.



to and written at ISO rates are positively correlated, with the former an upper bound on the latter, the IIAA data may provide a rough indicator of the influence of ISO countrywide. The pattern is consistent. For both homeowners and automobile, the large firms are less likely to report to ISO than small firms and the percentage of premium reported by both small and large firms is greater for homeowners and automobile. Thus the pattern by size of firm within lines and across lines is consistent with the view of ISO as a service organization providing services the value of which is greater, the smaller the premium volume of the firm.

The percentage of the market written at ISO rates is significantly higher in prior approval states (35.3) than in open competition states (24.9). As noted above, this is consistent with both the cartel and the service models of the role of ISO.

#### 4. NIC Data

All companies are required by law to report premium and loss data to a statistical agent. Of the three major statistical agents, NAII and NISS only make pure loss data available to their member companies, whereas ISO also furnishes recommended rates.<sup>1</sup>

The National Industry Committee (NIC) reports the distribution of private passenger auto liability voluntary car years, by statistical agent, for 1975 and 1977 (See Table 5). It must be emphasized that these data are at best crude proxies for the extent of the market written at ISO rates because many firms reporting statistics to ISO do not use ISO rates and conversely some non-members may use ISO rates in some territories. On balance the ISO share probably overstates the percentage actually written at ISO rates. The mean ISO share countrywide decreased from 32.76 in 1975 to 29.75 in 1977 while the NAII shares increased from 50.1% in 1975 to 52.5% in 1977. In only 17 states in 1977 did the ISO share exceed 30%.

---

<sup>1</sup> Companies using NAII include the largest direct writers, State Farm and Allstate, as well as many smaller "specialty" companies, that write atypical policyholders.



| State                | ISO      |            |    | RAIL       |           |           | MISS     |            |           | Other      |           |       | State Total |           |   | Other |
|----------------------|----------|------------|----|------------|-----------|-----------|----------|------------|-----------|------------|-----------|-------|-------------|-----------|---|-------|
|                      | Cys. No. | Car Years  | %  | Cys. No.   | Car Years | %         | Cys. No. | Car Years  | %         | Cys. No.   | Car Years | %     | Cys. No.    | Car Years | % |       |
| Alabama              | 121      | 929,699    | 29 | 2,613,629  | 25        | 736,704   | 10       | 530,406    | 257       | 4,810,315  | 19.33     | 54.73 | 15.12       | 11.03     |   |       |
| Alaska               | 116      | 418,071    | 98 | 1,647,698  | 25        | 345,732   | 2        | 8,810      | 233       | 2,460,299  | 16.99     | 66.97 | 15.68       | 13.36     |   |       |
| Arizona              | 108      | 226,040    | 95 | 1,108,928  | 22        | 214,309   | 2        | 11,223     | 221       | 1,558,501  | 14.38     | 71.15 | 13.75       | 17.72     |   |       |
| Arkansas             | 107      | 807,584    | 64 | 3,028,137  | 18        | 342,863   | 3        | 191,218    | 196       | 4,388,184  | 18.40     | 69.01 | 7.81        | 4.40      |   |       |
| California           | 105      | 428,219    | 90 | 1,099,475  | 15        | 489,167   | 1        | 32,774     | 212       | 2,089,952  | 13.09     | 52.61 | 23.41       | 1.57      |   |       |
| Colorado             | 86       | 51,330     | 14 | 233,701    | 14        | 85,480    | 1        | 22,657     | 165       | 392,187    | 23.09     | 59.59 | 21.80       | 3.78      |   |       |
| Connecticut          | 90       | 52,611     | 65 | 215,187    | 19        | 87,647    | 3        | 22,591     | 177       | 277,768    | 13.73     | 59.96 | 23.20       | 5.98      |   |       |
| Delaware             | 106      | 385,378    | 82 | 1,493,053  | 20        | 235,233   | 3        | 4,774      | 211       | 2,118,441  | 18.19     | 70.48 | 11.10       | 2.23      |   |       |
| District of Columbia |          | 3,245,594  |    | 11,439,808 |           | 2,577,135 |          | 826,473    |           | 18,193,652 | 17.84     | 62.87 | 14.16       | 4.34      |   |       |
| Florida              | 99       | 205,502    | 67 | 664,177    | 4         | 2,536     | 0        | 0          | 170       | 874,266    | 23.51     | 75.07 | 2.9         | 0         |   |       |
| Georgia              | 113      | 296,941    | 80 | 837,650    | 10        | 290,265   | 0        | 0          | 203       | 1,420,570  | 20.20     | 58.97 | 20.73       | 0         |   |       |
| Idaho                | 105      | 271,917    | 14 | 245,728    | 0         | 245,728   | 0        | 192        | 1,310,490 | 20.75      | 61.13     | 18.65 | 0           | 0         |   |       |
| Illinois             | 98       | 114,860    | 72 | 612,174    | 17        | 123,381   | 0        | 185        | 850,417   | 11.51      | 71.99     | 14.51 | 0           | 0         |   |       |
| Indiana              | 96       | 119,478    | 62 | 366,471    | 1         | 1,888     | 0        | 0          | 164       | 487,799    | 24.69     | 75.13 | 3.9         | 0         |   |       |
| Iowa                 | 99       | 102,400    | 71 | 1,091,142  | 4         | 6,080     | 4        | 50,019     | 178       | 1,451,739  | 20.83     | 75.10 | 4.2         | 3.45      |   |       |
| Kansas               | 118      | 2,012,020  | 73 | 2,694,189  | 4         | 0         | 0        | 0          | 191       | 4,706,209  | 42.75     | 57.25 | 0           | 0         |   |       |
| Kentucky             | 81       | 39,070     | 49 | 120,102    | 10        | 53,096    | 1        | 20,649     | 141       | 232,925    | 16.77     | 51.56 | 22.80       | 8.85      |   |       |
| Louisiana            |          | 3,362,208  |    | 7,233,421  |           | 722,974   |          | 70,668     |           | 11,334,399 | 29.66     | 63.82 | 6.38        | 1.62      |   |       |
| Maine                | 62       | 38,793     | 28 | 71,934     | 1         | 0         | 0        | 0          | 91        | 117,288    | 34.55     | 65.84 | 0           | 0         |   |       |
| Maryland             | 105      | 236,441    | 66 | 760,476    | 3         | 2,159     | 1        | 10,047     | 175       | 1,008,646  | 23.44     | 75.40 | 21          | 1,100     |   |       |
| Massachusetts        | 117      | 1,295,582  | 58 | 795,528    | 6         | 1,321,030 | 17       | 5,734,759  | 78        | 9,540,039  | 18.82     | 8.34  | 13.85       | 40.11     |   |       |
| Michigan             | 98       | 78,698     | 62 | 279,081    | 4         | 16,167    | 4        | 0          | 96        | 405,127    | 61.59     | 38.41 | 0           | 0         |   |       |
| Minnesota            | 80       | 78,015     | 54 | 183,468    | 5         | 27,279    | 3        | 137,728    | 168       | 483,656    | 16.27     | 57.70 | 3.34        | 28.48     |   |       |
| Mississippi          | 83       | 47,440     | 52 | 247,639    | 3         | 1,067     | 3        | 36,953     | 142       | 399,542    | 19.53     | 45.92 | 6.83        | 2.73      |   |       |
| Missouri             | 102      | 249,467    | 68 | 975,891    | 4         | 27,845    | 3        | 68,092     | 177       | 1,385,174  | 14.15     | 73.88 | 32          | 11.43     |   |       |
| Montana              | 85       | 114,942    | 60 | 456,422    | 4         | 15,562    | 1        | 16,810     | 155       | 1,615,919  | 19.40     | 75.91 | 2.17        | 3.59      |   |       |
| Nebraska             | 105      | 389,331    | 64 | 1,145,639  | 4         | 49,049    | 5        | 291,900    | 178       | 1,874,752  | 18.66     | 74.10 | 2.53        | 4.68      |   |       |
| Nevada               |          | 3,277,815  |    | 5,073,694  |           | 1,460,158 |          | 6,398,967  |           | 16,060,804 | 20.41     | 31.59 | 9.09        | 39.84     |   |       |
| New Hampshire        | 106      | 26,867,009 |    | 47,439,956 |           | 5,573,850 |          | 10,555,095 |           | 90,321,201 | 29.75     | 52.52 | 6.17        | 11.69     |   |       |
| New Jersey           |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| New Mexico           |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| New York             |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| North Carolina       |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| North Dakota         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Ohio                 |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Oklahoma             |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Oregon               |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Pennsylvania         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Rhode Island         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| South Carolina       |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| South Dakota         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Tennessee            |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Texas                |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Utah                 |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Vermont              |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Virginia             |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Washington           |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| West Virginia        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Wisconsin            |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Wyoming              |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone A         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone B         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone C         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone D         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone E         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone F         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone G         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone H         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone I         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone J         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone K         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone L         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone M         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone N         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone O         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone P         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone Q         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone R         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone S         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone T         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone U         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone V         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone W         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone X         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone Y         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone Z         |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AA        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AB        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AC        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AD        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AE        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AF        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AG        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AH        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AI        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AJ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AK        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AL        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AM        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AN        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AO        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AP        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AQ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AR        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AS        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AT        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AU        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AV        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AW        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AX        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AY        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone AZ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BA        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BB        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BC        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BD        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BE        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BF        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BG        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BH        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BI        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BJ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BK        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BL        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BM        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BN        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BO        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BP        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BQ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BR        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BS        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BT        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BU        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BV        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BW        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BX        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BY        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone BZ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CA        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CB        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CC        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CD        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CE        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CF        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CG        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CH        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CI        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CJ        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CK        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CL        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CM        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |
| Total Zone CN        |          |            |    |            |           |           |          |            |           |            |           |       |             |           |   |       |



TABLE 5 ISO MARKET SHARE, BY REGION (NIC)  
PRIVATE PASSENGER AUTOMOBILE LIABILITY INSURANCE  
PENETRATION OF VOLUNTARY MARKET BY STATE AND STATISTICAL AGENT  
BY ZONE - CALENDAR YEAR 1977

Exhibit I  
Page 1  
Compiled: 5/9/79

| State                | ISO       |           |           | NAII      |           |           | MISS      |           |           | Other     |           |           | State Total |            |           | ISO       |           |           | NAII      |           |           | Other     |  |  |
|----------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-------------|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|--|--|
|                      | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No.   | Car Years  | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years | Cons. No. | Car Years |  |  |
| Connecticut          | 106       | 965,486   | 29        | 423,270   | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 135         | 1,388,755  | 69.52     | 30.48     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Maine                | 93        | 334,342   | 34        | 96,562    | 1         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 128         | 430,905    | 77.59     | 22.41     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Massachusetts        | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 89          | 1,895,931  | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 100.00    |  |  |
| New Hampshire        | 04        | 287,839   | 21        | 113,563   | 1         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 116         | 401,402    | 71.71     | 28.29     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| New Jersey           | 121       | 1,563,863 | 33        | 1,033,310 | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 154         | 2,598,941  | 60.17     | 39.76     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| New York             | 133       | 1,063,741 | 27        | 2,049,128 | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 160         | 5,112,918  | 59.52     | 40.08     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Rhode Island         | 71        | 231,769   | 26        | 120,981   | 1         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 98          | 352,755    | 63.70     | 36.30     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Vermont              | 92        | 131,326   | 24        | 74,492    | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 116         | 205,816    | 63.81     | 26.19     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Total Zone 1         |           | 6,578,366 |           | 3,911,306 |           | 0         |           | 0         |           | 1,495,931 |           |           |             | 12,387,425 | 53.11     | 31.57     | 0         | 0         | 0         | 0         | 0         | 15.31     |  |  |
| Delaware             | 92        | 97,642    | 34        | 177,801   | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 126         | 275,447    | 35.45     | 64.55     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| District of Columbia | 84        | 34,372    | 31        | 106,002   | 1         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 118         | 140,377    | 24.49     | 75.51     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Maryland             |           |           |           |           |           |           |           |           |           |           |           |           |             |            |           |           |           |           |           |           |           |           |  |  |
| North Carolina       | 115       | 1,553,897 | 38        | 1,409,242 | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 153         | 2,961,139  | 52.46     | 47.56     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Ohio                 | 122       | 1,572,468 | 76        | 3,085,045 | 18        | 333,138   | 1         | 1,639     | 217       | 4,992,294 | 0         | 0         | 179         | 5,092,617  | 71.50     | 61.40     | 6.57      | 0         | 0         | 0         | 0         | 0         |  |  |
| Pennsylvania         | 124       | 2,086,650 | 50        | 2,968,435 | 5         | 37,482    | 0         | 0         | 0         | 0         | 0         | 0         | 212         | 1,358,436  | 40.97     | 58.29     | 7.74      | 0         | 0         | 0         | 0         | 0         |  |  |
| South Carolina       | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 168         | 2,264,006  | 34.61     | 65.39     | 0         | 0         | 0         | 0         | 0         | 100.00    |  |  |
| Virginia             | 119       | 783,541   | 49        | 1,480,456 | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 134         | 780,881    | 20.43     | 28.90     | 6.68      | 0         | 0         | 0         | 0         | 0         |  |  |
| West Virginia        | 86        | 159,498   | 66        | 616,083   | 4         | 5,300     | 0         | 0         | 0         | 0         | 0         | 0         |             |            |           |           |           |           |           |           |           |           |  |  |
| Total Zone 2         |           | 6,288,068 |           | 9,843,064 |           | 375,920   |           | 1,360,075 |           |           |           |           |             | 17,867,197 | 35.19     | 55.09     | 2.10      | 7.61      | 0         | 0         | 0         | 0         |  |  |
| Alabama              | 118       | 311,698   | 72        | 1,059,569 | 4         | 319       | 0         | 0         | 0         | 0         | 0         | 0         | 194         | 1,371,648  | 22.72     | 77.28     | .02       | 0         | 0         | 0         | 0         | 0         |  |  |
| Florida              | 129       | 974,561   | 62        | 2,283,277 | 5         | 27,587    | 0         | 0         | 0         | 0         | 0         | 0         | 196         | 3,285,479  | 29.66     | 69.50     | .84       | 0         | 0         | 0         | 0         | 0         |  |  |
| Georgia              | 128       | 661,572   | 68        | 1,620,534 | 4         | 4,657     | 0         | 0         | 0         | 0         | 0         | 0         | 200         | 2,280,347  | 29.01     | 71.07     | .20       | 0         | 0         | 0         | 0         | 0         |  |  |
| Kentucky             | 112       | 524,334   | 68        | 1,006,294 | 10        | 46,069    | 1         | 2,608     | 184       | 1,564,745 | 13.51     | 64.31     | 2.82        | 0          | 0         | 0         | 0         | 0         | 0         | 0         | 0         |           |  |  |
| Louisiana            | 99        | 514,727   | 51        | 703,507   | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 151         | 1,238,467  | 42.24     | 57.74     | 0         | 0         | 0         | 0         | 0         |           |  |  |
| Mississippi          | 101       | 241,535   | 59        | 545,950   | 2         | 0         | 0         | 0         | 0         | 0         | 0         | 0         | 121         | 1,238,467  | 42.24     | 57.74     | 0         | 0         | 0         | 0         | 0         | 0         |  |  |
| Missouri             | 112       | 301,637   | 87        | 1,528,057 | 17        | 356,535   | 1         | 373       | 217       | 2,186,876 | 13.79     | 69.88     | 16.10       | 0          | 0         | 0         | 0         | 0         | 0         | 0         | 0         |           |  |  |
| Tennessee            | 123       | 584,904   | 76        | 1,191,475 | 4         | 4,486     | 0         | 0         | 0         | 0         | 0         | 0         | 203         | 1,780,886  | 32.84     | 66.90     | .25       | 0         | 0         | 0         | 0         | 0         |  |  |
| Total Zone 3         |           | 4,114,958 |           | 9,938,663 |           | 437,663   |           | 2,981     |           |           |           |           |             | 14,475,724 | 28.43     | 68.66     | 1.02      | 0         | 0         | 0         | 0         | 0         |  |  |

127B



These data reveal interesting regional patterns. Of the states with ISO shares above 30%, twelve are in the northeast (Zones 1 and 2). This suggests that studies such as Joskow (1973) or the DOJ Report which derive conclusions on adherence to ISO rates under prior approval from a small sample of northeastern states yield an upward biased estimate of the situation nationwide. Furthermore, it suggests that regional factors may be at least as important as prior approval in determining the extent of adherence to ISO rates. One factor already discussed is more stringent rate control in the northeast, due possibly to the influence of urban consumer groups. Another factor is that the two largest independent writers State Farm and Allstate originated in Illinois and have grown most rapidly in the midwest. An analysis of the causes of regional differences in use of ISO is beyond the scope of this paper. We merely note that because of such differences, studies based on a small number of states are likely to be seriously biased.

#### Conclusions on the Adherence to ISO Rates

Evidence from different lines and different time periods and states consistently shows that the percentage of firms and premium volume written at ISO rates is larger in prior approval states. However, this is consistent with both the cartel and the service model of ISO. Other evidence is more consistent with the service model. Even in prior approval states, less than 50% of the market is written at ISO rates. Thus the ISO share is insufficient to convey substantial market power. The fact that small rather than large firms are more likely to use ISO rates is inconsistent with the cartel view but consistent with the view that ISO provides services which exhibit economies of scale beyond the scale of many small firms in the industry. Finally, the fact that even in prior approval states deviations from ISO rates are often in an upward direction is inconsistent with the view that ISO attempts to establish a cartel price.



### 3. ISO SERVICES AND CHARGES

This section reviews the services performed by ISO and the means of charging for them. ISO performs two types of services:

(a) information gathering that would be of value to insurers even in the absence of regulation;

(b) interaction with regulators.

Specifically, the services available include the following:

Actuarial: - ratemaking data by line and territory;

- studies of specific issues, such as loss development, expense review, excess limits, territorial relativities.

Rates: In most states: - review of statewide and territory rate levels

- annually in each line;
- advisory rates or loss costs;
- comparison of competitors rate levels;

In addition, in prior approval states:

- act as filing agent.

Forms: - development and filing of policy forms;

- copyright permission to adapt ISO forms for company use;
- availability of ISO printing and mailing capability to supply company with forms.

Statistical service: - filing of statistical plan and aggregate company data to insurance department.

Many of these services are almost pure public goods, i.e., having performed them for one company, the marginal cost of making them available to other companies is very low. Thus there are sound efficiency reasons for pooling and sharing the cost. This does not preclude the possibility of using the services to induce adherence to bureau rates which may be set above competitive levels.

The cartel model would predict that the conditions under which these services are made available to subscribers would be designed to encourage adherence to the ISO rates. IF the services were to be used to maximize the incentive to adhere to ISO rates, access to the valuable actuarial and filing services would likely be conditional on use of ISO rates. In fact insurers are free to purchase as many or as few services as they wish and may purchase for a subset of lines or states or for all. If the statistical filing



Table 6 CHARGES FOR ISO SERVICES - 1980 #

| Type of Service   | LINE OF INSURANCE                      |                                                        |                                        |                                                        |
|-------------------|----------------------------------------|--------------------------------------------------------|----------------------------------------|--------------------------------------------------------|
|                   | Private Passenger                      |                                                        | Homeowners                             |                                                        |
|                   | Flat                                   | Variable Per Million                                   | Flat                                   | Variable Per Million                                   |
| Rates             | \$200 per state*                       | \$300-500 per state premium volume                     | \$150 per state*                       | \$300-500 per state premium volume                     |
| Rules             | \$150 per state*                       | \$200-250 per company/group countrywide premium volume | \$100 per state*                       | \$250-350 per company/group countrywide premium volume |
| Forms             | \$50 per state*                        | \$100-150 per company/group countrywide premium volume | \$50 per state*                        | \$200-250 per company/group countrywide premium volume |
| Actuarial         | \$20,000** per company/gp. countrywide | \$400-500 per countrywide premium volume               | \$10,000** per company/gp. countrywide | \$700-800 per countrywide premium volume               |
| Statistical Agent | \$50 per state                         | \$50-100 per state premium volume                      | \$50 per state                         | \$100-150 per state premium volume                     |

#Assessment rates are tentative, based upon 1978 ISO budget and 1976 company premium volume.

\*Flat Charge applied to a maximum of 40 states.

\*\*These charges are countrywide, subject to the following adjustments:

PP Auto \$10,000 - if not writing in more than 10 states;  
 \$ 5,000 - if not writing in more than 5 states;  
 Homeowners \$ 5,000 - if not writing in more than 10 states.

\*\*\*\*\*

BASIC CHARGE  
 (per company group)

\$2,000 plus \$125 per \$1,000,000 of all lines premium volume countrywide (excluding states and lines for which ISO is not licensed as a rating or advisory organization).

Volume Discount on  
 Basic Charge:

20% on amount greater than \$100,000,000 all lines volume  
 40% " " " " \$200,000,000 " " "  
 50% " " " " \$500,000,000 " " "  
 70% " " " " \$1,000,000,000 " " "  
 90% " " " " \$2,000,000,000 " " "

Maximum Charge: \$125,000



## ASSESSMENT CREDITS

1. Members and Subscribers Credit  
5% credit applied to assessments in recognition of involvement in the management of ISO.
2. Full Affiliation Credit  
20% credit applied to assessment for Rates, Rules, Forms and Actuarial Services when company is affiliated for all these services in all the states where it writes the line of insurance.
3. Statistical Credit

| Line of Insurance           | Service   | Amount of Credit |              |
|-----------------------------|-----------|------------------|--------------|
|                             |           | Full Plan        | Minimum Plan |
| Pvt. Pass. Auto             | Rates &   | 60%              | 20%          |
| Homeowners                  | Actuarial |                  | --           |
| Dwelling Fire               | Rules     | 30%              |              |
| Personal Inland Marine, PIC | Rates     | 33.3%            |              |

4. Volume Credits

These Volume Credits are applied to variable charges for Rules, Forms and Actuarial Services:

P.P. Auto: 50% on amount above \$100 million up to \$200 million.  
70% on amount above \$200 million up to \$400 million.  
90% on amount above \$400 million up to \$1 billion.  
98% on amount above \$1 billion.

Homeowners: 50% on amount above \$50 million up to \$100 million.  
70% on amount above \$100 million up to \$200 million.  
90% on amount above \$200 million up to \$500 million.  
98% on amount above \$500 million.

Volume Credits do not apply to any other line of insurance, but they do apply to Basic Service for both commercial and personal lines.

COMMERCIAL LINES  
ASSESSMENTS

The application of the Basic Charge will have the effect of reducing the 1980 Commercial Lines Assessments; however, the amount will vary according to line of insurance.

COMPUTATION OF  
ESTIMATED COST OF  
LINE SERVICES

In order to roughly estimate the charge for selected services (in addition to the Basic Charge) the following procedures should be followed for each line of insurance:

- (1) Adjust premium volume for Volume Discount.
- (2) Variable Charges equals rate X adjusted premium X statistical reporting factor (if applicable).  
(Statistical discount factor is not applicable to Variable Charge for Statistical Service.)



service is purchased, the charge is the same whether ISO rates or deviated company rates are filed. The basic pricing structure is shown in Table 6. The price for each service involves a flat rate per state and a variable charge based on premium volume, with credits for full affiliation and volume beyond a certain size. Full affiliation discounts are consistent with inducements to adhere. However charges based on volume are not consistent with maximizing market share of the bureau which requires providing special inducements to large firms to adhere.

In order to determine whether the pricing structure for different services is designed to encourage adherence (for example, by selling rates service below cost and actuarial service above cost) one would need much more information on the costs of providing the various services.<sup>1</sup> However, it seems clear from this brief review of ISO services and membership conditions that there is no attempt to enforce adherence to ISO rates, punish deviations, restrict output, share territories or profits, which are common features of successful cartels. The only penalty for deviating from ISO rates is the additional cost of making an independent filing. Thus if regulation is designed to keep this cost low, ISO rates will only be used where it is cost-effective to do so.

## II. TESTS FOR THE EXISTENCE OF A CARTEL

### 1. BARRIERS TO ENTRY (KAHN TEST 1)

#### A. Regulation

The first proposed test for cartelization by means of regulation and/or anti-trust immunity is evidence of the capitalization of the resulting excess profits into a high cost of entry. The logic for this test runs as follows: if above competitive returns can be earned in an industry, in the absence of restrictions on entry, new firms will enter, supply will increase

---

<sup>1</sup> Because some of the services are joint products and many have public good attributes, the efficient pricing schedule may also depend on demand conditions.



and prices will fall until excess profits are eliminated. Above competitive returns can only persist if there are restrictions on entry, unless the industry is a "natural monopoly," i.e., exhibits increasing returns to scale throughout the relevant range. Restrictions on entry to an industry that is structurally competitive and willingness of would-be entrants to pay for the right of entry are therefore suggestive of above competitive returns.

Measurement of excess profits is simplest if the right of entry is marketed, as in the case of taxi medallions in some cities or seats on the New York Exchange. The price a would-be entrant is willing to pay for the license to enter a restricted occupation is his expected income in that occupation over and above what he could earn in his next best alternative employment. Thus the price of the license is a measure of the (discounted present value of) excess returns on operating costs after entry.<sup>1</sup>

If the right of entry to the restricted occupation is not freely marketed but rationed by some other means, e.g., queues, the existence of an entry restriction and hence of above competitive returns may still be inferred but the precise value is harder to quantify. If the right of entry is rationed solely by waiting, then the length of the waiting list is an indicator of the value of the excess profits. The precise value can be computed if one knows the cost per period of time spent waiting.<sup>2</sup> With competition for entry, the number of applicants would be such that the cost of the wait (for the marginal applicant) would be equal to the discounted present value of excess profits, as in the case of the marketed entry license.

Measurement of excess profits is more difficult in the case of mixed rationing devices, where entry can be achieved by some combination of dollar outlay and waiting. If the length of the wait can be reduced by increased dollar outlay, e.g., hiring more or better quality lawyers, then measurement of the total cost of entry (and hence the value of excess profits) requires information on both the dollar outlay and the implicit cost of delay. If only one of the two components is observable it may provide a biased and misleading indicator of the value of excess profits. Insurance falls into this mixed category, with both dollar and delay costs of entry, and some

<sup>1</sup> Return on total costs, gross of the cost of obtaining the license are normal.

<sup>2</sup> For example, if filing an entry application requires outlay of \$100, and the opportunity cost of capital is 1% per month, then the cost of waiting is \$10 per month. The rational entrant would be willing to wait one year if the discounted present value of excess profits is at least \$1200.



possibility of substitution between the two. Measurement is therefore hazardous.<sup>1</sup>

Even if the cost of entry could be measured, there is an ambiguity of interpretation, in the case of insurance. In most industries the sole purpose of entry costs is to ration access to monopoly profits. Such barriers to entry are necessarily inefficient. However, in the case of insurance and other financial institutions, some control over entry may be efficient. Because of the nature of the insurance product, that the premium is collected before the services (payment of claims) are provided, the potential for fraud is greater than in most service or manufacturing industries where the product can be inspected prior to purchase. A consumer protection case can be made for the imposition of some controls on entry, such as minimum capitalization requirements<sup>2</sup>. Furthermore, in those lines of insurance where the liabilities of an insolvent firm are transferred to other firms through the intermediation of a guaranty fund, an efficiency case can be made for solvency regulation to protect the interests of other firms. Any form of entry control tends to imply dollar costs and delay between the application for a license and granting of authority to operate. Thus the existence of both dollar costs and delay in obtaining an insurance license is not necessarily indicative of an inefficient level of operating profits. The efficient level of operating profit is just sufficient to yield a competitive return on operating costs plus the efficient level of entry costs. What constitutes an efficient level of entry costs is extremely hard to determine in practice. With these caveats on the interpretation of entry costs, let us turn to the evidence.

Entry is restricted by licensure requirements in all states. Licensure

---

<sup>1</sup> This paper is concerned solely with regulatory or 'artificial' barriers to entry. In practice the rate of growth of new entrants may be slow because of the need to establish agent and consumer confidence. This source of delay, common to industries where consumer confidence is important, is for the most part intrinsic to the nature of the insurance product and is in no sense evidence of cartelization or excess profits. However, to the extent growth is delayed by laws such as regulation of agents' commissions the barrier is artificial.

<sup>2</sup> See Munch and Smallwood, 1979. There it is shown that minimum capital requirements do reduce entry. It is argued that such restrictions are efficient only if the value to consumers of insolvencies deterred exceeds any cost in terms of reduced competition.



requirements include fairly trivial filing fees (typically \$500) and more substantial minimum capital requirements, which vary by line and range (for a multiple lines license) from \$150,000 in Washington, D.C. to \$5,000,000 in New York. It would be erroneous to interpret capital requirements as an indicator of the value of monopoly profits. The capital deposits are not an out-of-pocket expense, since the depositor retains ownership. The only cost involved is any difference between the returns on the funds in this use and the most valuable alternative.<sup>1</sup>

Even more difficult to quantify are the other costs of entry, such as filing requirements, interviews, etc., which entail personnel and other direct costs, and costs due to delay between filing and issuance of a certificate of authority. The only data available to us on filing costs is from one company X, which filed licensure applications in 48 states over the space of three years. A rough estimate of the total personnel cost involved (at 1975-78 wage rates) is as follows:

|                     |               |
|---------------------|---------------|
| 3 attorney years    | 72,000        |
| 2.5 secretary years | 20,000        |
| 0.5 law clerk years | 8,000         |
|                     | <hr/> 100,000 |

The implied average personnel cost per state is trivial.

Data on delay between filing and issuance of the Certificate are available for two companies. One subsequently changed its state of domicile and had to refile in some states. The mean delay (in months) and standard deviations are as follows:

|                           | Mean | Standard<br>Deviation | States |
|---------------------------|------|-----------------------|--------|
| Company X                 | 9.7  | 14.9                  | 50     |
| Company Y                 | 5.8  | 5.1                   | 48     |
| Company Y<br>(Redomicile) | 2.4  | 1.2                   | 49     |

<sup>1</sup> Since the deposits are usually required to be held in some widely marketable security, the cost of minimum capital requirements is probably trivial for established firms with low borrowing costs but may be significant for new entrants which are not established credit risks.



The mean delay of less than a year for both companies does not suggest large costs on average. However, delays of up to two years in 12 states and over two years in 5 states (for company X) can surely not be rationalized in terms of efficient solvency regulation. To test the hypothesis that entry restrictions are designed to protect excess profits, at least in states with abnormally long delay, and to identify the source of these excess profits, we estimated the relation between entry delay and three possible indicators of excess profits: (i) some measure of the ISO share of the market; (ii) prior approval regulation; (iii) the four firm concentration ratio.

For Company X, the following regression was estimated:

$$\text{DELAY} (\ln_e) = 1.58 + .72 \text{ PRIOR} - .009 \text{ ISOBIG} - .012 \text{ ISOSMALL} + .013 \text{ C4}$$

(2.55)            (1.17)            (1.95)            (.6)

$$R^2 = .216$$

$$n = 48$$

t statistic in parentheses.

where

DELAY = months from filing to issuance of certificate,  $\log_e$

PRIOR = 1 if prior approval regulation (NAIC)

0 otherwise

ISOBIG = % of automobile premium of top ten companies, which is reported to ISO.

ISOSMALL = % of automobile premium of remainder of companies which is reported to ISO. (IIAA)

C4 = 4-firm concentration ratio, automobile, 1971.

These estimates imply that delay is significantly greater in prior approval states -- 72% longer on average than in open competition states. Delay is negatively related to share of the market reported to ISO, which is a crude upper bound on the fraction of the market written at ISO rates. Delay is unrelated to the four firm concentration ratio. Thus if delay is an indicator of the relative profitability of writing in different states, these estimates imply that profits are higher in prior approval states but are negatively related to the ISO share of the market and are unrelated



to the market share of the top four firms.<sup>1</sup>

The same equation was estimated for company Y, for both the delay in first licensure and delay at relicensure after changing state of domicile. All coefficients were statistically insignificant, in both cases. This does not necessarily indicate that this company perceived no difference in expected profits among states. As discussed above, if a firm can accelerate entry by increasing its dollar outlay, then delay is only one component of the total cost of entry and may be a misleading indicator of the total cost. Specifically if dollar outlay is negatively correlated with delay (i.e., delay is shorter in precisely those states where more was spent to accelerate entry) then conclusions based on the delay component alone will be wrong. Thus the limited evidence available only supports the weak conclusion that there is no evidence to support the hypothesis that ISO has a significant effect on the level of profits.

Conclusion: Identification of excess profits capitalized into a high cost of entry is not a simple matter, in the case of insurance. At the theoretical level, some control of entry may be justified in terms of efficient control of fiduciary risk. Only costs in excess of this efficient level are potential evidence of pure monopoly profits. Accurate measurement of the cost of entry due to regulation requires data on dollar outlay (including the opportunity cost of capitalization requirements) and cost of delay, which are not generally available. The limited data available from two companies indicates trivial dollar outlay and delay of less than a year in most states. However in a few states delay of over a year is suggestive of entry barriers which cannot be rationalized in terms of efficient solvency regulation. To the extent abnormally long delay is indicative of excess profits, there is no evidence that excess profits are correlated with the share of the market reported to the ISO or the degree of concentration. Thus there is no support

<sup>1</sup> The simple correlation between DELAY(log) and ISOBIG is -.25, ISOSMALL is -.28, PRIOR is .22. The measures of the shares of the market reported to ISO certainly contain reporting error, in addition to error as proxies for the fraction of the market written at ISO rates. However, provided these errors are not systematically correlated with profits, the coefficient estimates are unbiased.



for the hypothesis that ISO operates an effective cartel.

#### B. Capital Requirements

Joskow (1973) concludes that although regulatory barriers to entry are low, persistent above competitive profits are earned by direct writers due to another form of entry 'barrier' -- the cost of obtaining consumer recognition and establishing a marketing network. He argues that because agents perform these functions for agency firms, barriers to entry for agency firms are 'low to moderate', whereas barriers to entry for direct writers are 'moderate to high'.<sup>1</sup>

"The high level of concentration among direct writers, as well as apparently consistent profit performance above the industry average, indicate that barriers to entry may be quite high. Substantial initial funding may be necessary to get a direct writer set up in the market."

These conclusions are unfounded, both empirically and theoretically. As Joskow acknowledges, the "available evidence is quite ambiguous" on whether the expenditure necessary to establish product identification and contact consumers is an important barrier or not. Allstate and State Farm are cited as examples of firms using existing contacts to market a new insurance product, Geico as a firm that was able to enter and grow to a large size without such a base. Since then several life insurers have entered the property/casualty market, using established contacts to overcome initial product recognition and marketing costs. Thus there is ample evidence that these costs are in no sense prohibitive. Moreover, if the argument is one of barriers to entry, rather than barriers to growth, it presupposes that entry at a large scale is necessary. Yet in California in 1972 there were 41 direct writers of automobile liability; 99% of their premium volume was written by the largest 22 firms, the remaining 1% was written by 19 firms.<sup>2</sup> To the extent entry at a small scale is possible the capital requirements of entry are correspondingly reduced. If earnings as a direct writer are above competitive levels, there is no reason why lenders would not be willing to lend to would-be entrants. For a strong statement of the view that initial capital requirements

---

<sup>1</sup>These terms are not quantified.

<sup>2</sup> A.M. Best Co., cited in Ippolito, 1979.



should not be viewed as a barrier to entry and therefore do not protect monopoly profits see Stigler (1965) and Bork (1978).

Assuming that above average profits are indeed earned by large direct writers, an alternative explanation is required if the argument of high capital costs as a barrier to entry is rejected. The obvious one is that they are more efficient, as Joskow recognizes. In any market if there is some heterogeneity of efficiency, the more efficient firms will grow to be relatively large and earn above average returns in the long run, since prices are determined by the marginal, less efficient firms. These returns constitute a competitive return to scarce factors of production and do not imply non-competitive behavior by either the direct writers or the agency firms.

Joskow is led to the conclusion of monopolistic restriction of output by the direct writers by his assumption of constant returns to scale. Economic theory of the profit maximizing firm predicts that if one firm is more efficient than others and enjoys constant or increasing returns to scale, then it will drive out other, less efficient firms.

"Since direct writers have much lower costs than agency companies, even after small deviations below bureau rates (to attract customers) it would seem that any risk class which is profitable for an agency company to write would be at least as profitable for the direct writers. They should therefore be willing to accept all risks that agency companies accept (and perhaps more) and rather quickly take over the entire market." (Joskow, 1973, p. 421)

However, if there are diminishing returns to scale, then the large direct writers may be earning only normal returns at the margin, despite higher returns on average. Expansion is limited by rising marginal cost, not an inefficient restriction of output to exploit monopoly power. There are serious problems with Joskow's estimates of both the average cost advantage of the direct writers and of the (lack of) the economies of scale in the industry. Once diminishing returns are recognized, it is not necessary to invoke monopolistic restrictions of output and barriers to entry to explain why the largest firms persistently earn above normal profits and yet have not taken over the entire market.<sup>1</sup>

---

<sup>1</sup>. Note that logically Joskow's position also requires barriers to growth by the smaller direct writers. He ignores this problem.



## 2. INFLATED INPUT PRICES (KAHN TEST 2)

The objective of a cartel is to maintain prices above competitive levels in order to raise above competitive levels the returns to (one or more) factors of production. Thus inflated input prices (rents) is one test of successful cartelization. Rents will accrue to those factors whose supply is less than perfectly elastic. In the case of insurance, capital and agents are potential candidates, because of entry controls in both cases. Returns to capital (profits) and returns to agents are discussed in turn.

### A. Profits

Measuring profitability in the insurance industry is even more problematic than in other industries for several reasons. First, it is generally agreed that to the extent profits exist, they are concentrated in particular lines and states. The regulatory problem of setting profit margins also occurs on a by line, by state basis. However, most firms are multi-line, multi-state firms. Thus even if the true rate of return on capital could be observed, it would be an average return over lines and states, making attribution of any observed excess profits to regulatory or bureau activities that are state or line specific very difficult. If operation in certain profitable lines is tied to operation (through regulatory fiat) in other unprofitable lines, then the average return may be normal, concealing the existence of excess profits in some areas.

Second, the great majority of insurance firms are not the prototypical publicly traded stock firm, with an observable market value. Many stock insurance firms are members of holding companies with other non-insurance interests and over half the firms in the industry are either mutuals or reciprocal exchanges and hence have no observable market price. Thus there is only a relatively small sample of firms with observable market data on profits derived exclusively from insurance operations.<sup>1,2</sup>

<sup>1</sup> Studies based on different samples of publicly traded firms have come to quite different conclusions, in part no doubt due to small sample problems. This is discussed below.

<sup>2</sup> The fact that a market valuation of profitability cannot be observed for the large, non-traded segment of the industry does not mean that conclusions based on the observed sector cannot be generalized to the unobserved sector, provided that the observed sector is representative of the industry as a whole in terms of size of firm, lines and types of product written. If profits in the observed sector could be shown to be competitive, competition would insure that prices are not excessive in the unobserved sector.



There have been two main types of analysis of insurance industry profits. The first (for example, Saba 1978, Ippolito, 1979) analyses loss ratios, on the assumption that the difference between claims and other costs and premiums is some indicator of underwriting profits. The second approach recognizes that the underwriting profit margin is only one component of the rate of return on capital and attempts a more complete measure of the latter, using accounting data on both underwriting and investment income, relative to some measure of net worth. This approach is exemplified by Arthur D. Little (1970), Joskow (1973), Fairley (1979), Hill (1979). A third approach (Walters 1979) compares market to book value as a measure of excess profits.

Before reviewing the evidence from these different approaches the limitations of each must be emphasized. Underwriting loss ratios bear no necessary relation to the rate of return on capital since they are only one component of that return. Other necessary inputs are expenses, investment income, taxes and the premium-capital ratio. These defects are avoided in principle by studies that measure the net rate of return on capital directly but this approach has other limitations. First there is the problem of attribution of any observed excess profits to particular lines or states, which is the level at which bureau or regulatory restrictions operate. Second, even if the actual rate of return is accurately measured, the question remains whether the observed rate is "normal" or "excessive" relative to comparable industries. Third, even if it could be shown that only competitive returns to capital were being earned, it does not follow that premium rates are at competitive levels. It has been argued (Joskow 1973) that rates are set above competitive levels in states with prior approval regulation but the potential excess profits are competed away either by non-price competition or by excessive capitalization.

Most of these studies have focused on the question of whether profits are higher in states with prior approval rating laws, not directly on the question of whether anti-trust immunity and the operation of rating bureaus permit excess profits in the industry overall. However, they are relevant to the latter question, which is the focus of our inquiry here. There is general consensus that any cartelizing intentions of the rating bureaus depend on implementation by prior approval regulations, because of the competitive



structure of the industry. Thus, if profits are not higher in prior approval than in competitive states, there is little basis for concern over the anti-competitive potential of the rating bureaus. With these caveats, let us turn to the evidence.

(a) Loss Ratio Studies

Of the many loss ratio studies that have been undertaken, the three reviewed here are selected in part to demonstrate the lack of consensus and dependence of the conclusion reached upon the sample and methodology used. Saba (1978) regresses earned premium per car in 1970 on incurred loss per car in 1969, using ISO data for all territories for 46 states. In order to test whether prior approval regulation leads to a larger mark-up of premium over losses (which he takes as indicative of profits) he includes a dummy variable for open competition states, both alone and interacted with loss per car. The data are limited to property damage. The following equation is estimated:

$$\text{Premium}_{70} = 17.93 + 6.95 \text{ OC} + .58 \text{ Loss}_{69} - .39(\text{Loss}_{69} \times \text{OC}) - 8.26 \text{ Rural}$$

(1.27)    (4.28)    (.046)    (.18)    (1.88)

where OC = 1 if state is competitive

= 0 if state is regulated.

Rural = % of non-farm rural + farm population

N = 602

R<sup>2</sup> = .27

Standard errors in parentheses.

Saba concludes that "the average rate per level of incurred losses is greater in the regulated states."<sup>1</sup> This conclusion is based on the significant negative coefficient of the interaction between loss and the dummy variable for open competition. However, it is erroneous to infer from this study that

<sup>1</sup> Curiously, he does state explicitly that regulation permits a higher underwriting profit margin but concludes: "regulation...forces the firms away from the competitive equilibrium toward a constrained equilibrium manifesting some of the characteristics of a monopoly solution." However, his diagrammatic illustration of the effects of regulation implies excess profits, as well as excess capacity.



regulation permits higher underwriting profits for several reasons. First, as noted above, net underwriting profit depends on expenses as well as losses, for both the voluntary and the assigned risk markets. These data include only the voluntary market. Since the assigned risk market tends to be larger in prior approval states and is typically operated at a loss (Ippolito, 1979), profit margins in the voluntary market must be higher to permit the same overall margin. Second, it is highly likely that both the coefficient and its standard error are biased. The sample consists of a single year of data from 46 states, which include only 4 perhaps atypical open competition states: Montana, Missouri, Idaho and Georgia. If residuals on territories in the same state are correlated this leads to a downward biased estimate of the standard error of the coefficient and hence an upward bias in the estimate of statistical significance.<sup>1</sup> The coefficient itself may be biased due to omission of variables which are correlated with the regulation dummy. Thus the effect attributed to regulation may in fact be due to other unmeasured characteristics. Third, evidence from the DOJ report suggests that loss ratios show greater variance under prior approval, due to regulatory lag. A single year of data is therefore insufficient to measure long run effects.

Ippolito (1979) performs a similar analysis but corrects for these potential sources of bias. His sample of 49 states includes a larger, more representative group of competitive states. To reduce the effect of transitory fluctuations, he used two samples of the average loss ratio over two three-year periods, 1971-73 and 1973-75. His measure of the loss ratio, from Best's, is the statewide average, aggregated over the voluntary and assigned risk segments over the market. Separate regressions are run for auto liability and property damage, using a slightly different functional form from that used by Saba and including several other variables.<sup>2</sup> Ippolito concludes:

"The effect of regulation is insignificant in the liability and property damage equations for the periods 1971-73 and 1973-75. While regulatory lag may affect levels of loss ratios in any particular state

---

<sup>1</sup> Theil, 1971

<sup>2</sup> Other explanatory variables are a cost of living index, the size of the assigned risk pool, income per capita and a measure of traffic density. Presumably the theoretical justification for including these variables is that they may affect the expense ratio, although it is not clear why.



over short periods of time, our findings suggest that it has no impact when several years are combined."

Recognising that underwriting profits depend on expenses as well as claim costs, Ippolito performs the same analysis with expense ratios and combined ratios. Due to lack of state-specific expense data for multi-state firms, the sample is confined to firms that operate exclusively in one state, which is a very atypical sample. For what it is worth, the evidence supports the conclusion of no effect of regulation on underwriting profit margins.

The Department of Justice (DOJ) Report (1977) presents data on mean loss ratios over the period 1966-75 for eleven large insurers in two prior approval states (Pennsylvania and New Jersey) and one open competition state (California). The average (unweighted) loss ratio of the eleven companies was 13% higher in New Jersey than in California, 9% higher in Pennsylvania than in California. For the three firms that reported state-specific expense data, the combined ratio was 11% higher in New Jersey, 7% higher in Pennsylvania than in California. Year to year volatility of both the loss ratios and combined ratios was also higher in the two prior approval states. Thus this evidence tends to refute the hypothesis that regulation is used to enforce a bureau cartel.

The Report notes that any conclusion from these data must be tentative because of the small sample involved. Furthermore,

"the higher average combined ratios do not necessarily indicate that consumers pay lower prices in the regulated states for the same services received in the deregulated states...While it is conceivable that consumers pay somewhat lower prices for similar insurance coverage, it may also be true that they receive less service or that the service is less available to a larger proportion of drivers in the regulated states."

Logical consistency requires that the same reasoning be applied if combined ratios are found to be lower in prior approval states. On the contrary, studies that have purported to find such evidence have not considered any explanation other than the enforcement-of-the-cartel hypothesis.

#### (b) Studies of the Rate of Return on Capital

The studies by Hill (1979) and Fairley (1979) are similar in intent and methodology. Both depart from the observation that the traditional statutory



profit margins built into the rate making process are arbitrary, both conceptually and in the actual margins selected. There is no theoretical reason why a 5% underwriting profit<sup>1</sup> for automobile liability or 2.5% for workers compensation should yield a competitive return on capital, since the rate of return on capital depends additionally on investment income, taxes and the premium/capital ratio. The purpose of both studies is to determine "target" underwriting profit margins by line of insurance, necessary to ensure a competitive return on capital, taking into account these other factors. These target or competitive profit margins are then compared with traditional regulatory margins (Fairley) and actual realised margins. Although conceptually similar, these two studies come to significantly different conclusions as to appropriate target margins and hence of whether actual margins have been excessive.

One major issue in determining what constitutes a competitive rate of return for any industry is to determine the appropriate premium for risk. Hill and Fairley both adopt the capital asset pricing model. The capital asset pricing model (CAPM) developed by Sharpe (1964), Lintner (1965) and Mossin (1966) is a model of capital market equilibrium that quantifies the trade-off between risk and return required by risk averse investors. The central conclusion is that prices of securities adjust such that expected returns are equalized except to the extent of systematic or non-diversifiable risk. In other words, the only risk which commands a positive (negative) premium is that which is positively (negatively) correlated with returns on the "market" portfolio<sup>2</sup> and hence cannot be eliminated by diversification. The "beta" or nondiversifiable risk of a security is determined by the correlation between its returns and returns on the market portfolio.<sup>3</sup>

<sup>1</sup> Or equivalently, a 95% combined ratio.

<sup>2</sup> The "market" portfolio holds all securities in proportion to their market value.

<sup>3</sup> Formally,

$$\bar{R}_i = R + \beta_i (\bar{R}_m - R) \quad \text{and}$$

$$\beta_i = \frac{\text{cov}(R_m, R_i)}{\text{var}(R_m)}$$

where  $\bar{R}_i$  is the expected return on the  $i$ th security,  $R$  is the riskless rate of interest, and  $\bar{R}_m$  is the expected return on the market portfolio. All returns have the dimension  $1 + r$ .



The logic underlying this conclusion is that investors are concerned with the risk on their total portfolio. Hence, assets must yield a premium in proportion to their contribution to total market risk.

Although this model has considerable theoretical appeal, there are serious objections to its use for judging whether past returns have been excessive and, even more so, for computing "fair" margins for future rates. Empirical evidence on the structure of security returns from several studies is inconsistent with the simple version of the model. Some of the assumptions on which the model is premised are clearly violated in practice. In particular, transactions are costly; borrowing and lending are risky and liability is not unlimited; expectations among investors as to the mean, variance and covariance of security returns are not homogenous.<sup>1</sup> Application of the CAPM in the insurance context to obtain estimates of competitive underwriting profit margins is undermined by data deficiencies and logical circularity.<sup>2</sup> The target, competitive margin depends on the underwriting beta, the riskless rate of interest, the premium/capital ratio and the effective tax rate. Calculation of these target margins, given the formula, requires empirical estimates of specific values for these parameters. However, none of the necessary data is readily available and the actual values chosen are at best rough estimates. Specifically, effective tax rate and premium/capital ratios vary across companies and over time. There is no obvious riskless rate of interest: the return on government bonds is certainly not riskless in real terms and varies over time. Most problematic is estimating a value of the underwriting betas, i.e., the correlation between expected claims costs and the expected return on the market, by line of insurance. Note that the theory implies that the requisite  $\beta$  is not the  $\beta$  for the firm's equity as a whole, which is easily observable, but the  $\beta$  of loss costs, by individual line of insurance.

There are two possible approaches to estimating underwriting betas. The first, adopted by Hill, computes the covariance between accounting data on losses incurred and returns on the market. However, as Hill recognizes

<sup>1</sup> The empirical evidence on the validity of the model and the implications of modifying the basic assumptions are reviewed in Jensen (1973).

<sup>2</sup> To the extent the variability of past returns depends on past regulatory action, there is circularity in using it as a guide to future regulatory action.



accounting losses incurred are likely to be a poor measure of the underwriting losses expected by the market. The results are not convincing if judged by their statistical significance and internal consistency. The second approach, used by Hill and Fairley, computes an underwriting return as the difference between the total return on the firm's equity and the return on its investment portfolio. Using this technique, Hill computes an alternate underwriting beta based on the average results over all lines for a sample of six companies for the period 1951-65. The fact that the estimated underwriting betas for the individual companies range from -1.03 to .85 for companies writing a similar mix of lines underscores the potential error in these estimates. Hill takes the mean (-.2) over these companies and applies it uniformly to all lines to obtain his second set of estimates of target profit margins by line. Fairley obtains a similar estimate from a sample of nine companies for the period 1971-75. Walker reports a regression of market betas ( $\beta_m$ ) for total equity on book betas ( $\beta_B$ ) for a sample of 25 companies with the following result:

$$\beta_m = .88 + .41\beta_B, \quad R^2 = .13$$

(5.60) (2.15)

(t-statistic in parentheses).

Only 13% of the variation in market betas is "explained" by variation in book betas. This implies that the choice between market and book betas materially affects the precise values.

Differences in estimates of beta and of other parameters significantly affect target margins and hence conclusions as to whether past profits have been excessive. Table 7 shows the sensitivity of target margins to the selection of particular parameter values. Note that a difference of .1 in the choice of beta implies a difference of approximately 1% in the target profit rate, which is large relative to the range of historic profits.

Hill's target and historic profit margins are shown in Table 8, for different types of company. Table 9 shows Fairley's estimates of target, historic and statutory margins. Because of the use of different parameter values for beta, tax rates and premium capital ratios, Hill and Fairley differ in their estimates of competitive profit margins for automobile



TABLE 7 SENSITIVITY OF TARGET PROFIT MARGINS TO CHOICE OF PARAMETERS

| q   | CAPITAL -<br>PREMIUMS | UNDERWRITING<br>TAX<br>RATE | p' (%)   |            |            |
|-----|-----------------------|-----------------------------|----------|------------|------------|
|     |                       |                             | BETA = 0 | BETA = 0.2 | BETA = 0.5 |
| 1.2 | 2.0                   | 5                           | 81       | -2.08      | 8.09       |
|     |                       | 3                           | --       | -1.47      | --         |
|     |                       | 0                           | --       | -1.02      | --         |
| 1.2 | 1.0                   | 5                           | 1.37     | 4.76       | 5.90       |
|     |                       | 3                           | .97      | 1.01       | --         |
|     |                       | 0                           | 0.7      | 2.19       | --         |
| 1.2 | 0.5                   | 5                           | 2.47     | 5.46       | 4.80       |
|     |                       | 3                           | 1.75     | 1.79       | --         |
|     |                       | 0                           | 1.21     | 2.63       | --         |
| 5   | 2.0                   | 5                           | 39       | -2.37      | 7.61       |
|     |                       | 3                           | --       | -1.62      | --         |
|     |                       | 0                           | --       | -1.13      | --         |
| 5   | 1.0                   | 5                           | 51       | -3.16      | 6.71       |
|     |                       | 3                           | 37       | -2.25      | --         |
|     |                       | 0                           | 25       | -1.57      | --         |
| 5   | 0.5                   | 5                           | -97      | -3.63      | 6.25       |
|     |                       | 3                           | -69      | -2.58      | --         |
|     |                       | 0                           | -48      | -1.80      | --         |

Source : Hill, 1979.



TABLE 8 : MEAN ACTUAL AND CAPM TARGET PROFIT MARGINS BY TYPES OF FIRM : 1955-1974

|                                                    | (1)<br>MEAN<br>PROFIT<br>RATE | (2)<br>$\rho^*$ | (3)<br>EXCESS<br>PROFIT<br>(1)-(2) | (4)<br>MEAN<br>(SURPLUS<br>+ PREMIUMS) | (5)<br>MEAN<br>(RESERVES<br>+ PREMIUMS) |
|----------------------------------------------------|-------------------------------|-----------------|------------------------------------|----------------------------------------|-----------------------------------------|
| <b>I BETA = .20</b>                                |                               |                 |                                    |                                        |                                         |
| ALL STOCK                                          | .005                          | .006            | .001                               | .88                                    | 1.19                                    |
| STOCK AUTO                                         | .045                          | .002            | .043                               | .52                                    | 1.06                                    |
| STOCK FIRE<br>(STANDARD RATE)                      | .004                          | .025            | .029                               | 1.78                                   | 1.20                                    |
| STOCK FIRE<br>(RATE DEVIATING)                     | .027                          | .018            | .009                               | 1.07                                   | 1.00                                    |
| STOCK CASUALTY<br>(STANDARD RATE)                  | .006                          | .002            | .004                               | .81                                    | 1.34                                    |
| STOCK CASUALTY<br>(RATE DEVIATING)                 | .027                          | .016            | .006                               | 1.02                                   | 1.36                                    |
| STOCK MARINE                                       | .006                          | .029            | .035                               | 1.94                                   | 1.16                                    |
| STOCK ACCIDENT & HEALTH                            | .063                          | .016            | .047                               | .86                                    | .52                                     |
| ALL MUTUALS                                        | .058                          | .001            | .059                               | .55                                    | 1.04                                    |
| MUTUAL AUTO                                        | .077                          | .005            | .072                               | .84                                    | 1.05                                    |
| MUTUAL STANDARD RATE                               | .053                          | .004            | .057                               | .47                                    | 1.22                                    |
| MUTUAL DIRECT WRITERS                              | .081                          | .016            | .097                               | .36                                    | 1.33                                    |
| <b>II PROFITS CALCULATED WITH ACCOUNTING BETAS</b> |                               |                 |                                    |                                        |                                         |
| STOCK FIRE (STANDARD RATE)                         | .004                          | .002            | .006                               |                                        |                                         |
| STOCK FIRE (RATE DEVIATING)                        | .027                          | .004            | .023                               |                                        |                                         |
| STOCK AUTO                                         | .045                          | .022            | .023                               |                                        |                                         |
| MUTUAL AUTO                                        | .058                          | .017            | .075                               |                                        |                                         |
| STOCK ACCIDENT & HEALTH                            | .063                          | .006            | .069                               |                                        |                                         |
| STOCK MARINE                                       | .006                          | .010            | .004                               |                                        |                                         |

Source: Hill, 1979

TABLE 9: MEAN ACTUAL, CAPM TARGET AND TRADITIONAL PROFIT MARGINS BY LINE

| LINE OF INSURANCE                                                                                                                                                                                                  | (1)<br>CAPM REQUIRED<br>MARGINS<br>(1977) | (2)<br>TRADITIONAL<br>"TARGET" MARGINS<br>(MASSACHUSETTS) | (3)<br>HISTORICAL*<br>MARGINS<br>(1956-1975) | (4)<br>HISTORICAL*<br>MARGINS<br>(1971-1975) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|-----------------------------------------------------------|----------------------------------------------|----------------------------------------------|
| AUTO BODILY INJURY                                                                                                                                                                                                 | 6.0                                       | 10**                                                      | 5.6                                          | -5.3                                         |
| AUTO PROPERTY DAMAGE                                                                                                                                                                                               | 0.1                                       | 5.0                                                       | -1.6                                         | -1.2                                         |
| HOMEOWNERS                                                                                                                                                                                                         | -0.3                                      | 6.0                                                       | -9.7                                         | -0.4                                         |
| WORKERS COMPENSATION***                                                                                                                                                                                            | 6.3                                       | 2.5                                                       | 2.3                                          | -6.4                                         |
| WEIGHTED AVERAGE                                                                                                                                                                                                   | 2.9                                       | 3.7                                                       | 4.0                                          | 3.2                                          |
| *SOURCE: BEST (1966) FOR YEARS 1966-1975; AUTO LINE'S MARGINS ADJUSTED TO MASSACHUSETTS CATEGORIES AND U.S. DEPARTMENT OF COMMERCE HISTORICAL STATISTICS OF THE UNITED STATES, 1975 FOR YEARS 1956-1965, ADJUSTED. |                                           |                                                           |                                              |                                              |
| **A 5 PERCENT MARGIN IS CUSTOMARY IN MOST STATES                                                                                                                                                                   |                                           |                                                           |                                              |                                              |
| ***PROFIT OR LOSS AS A PERCENT OF EARNED PREMIUMS IS LESS ESTIMATED DIVIDENDS OF PARTICIPATING COMPANIES                                                                                                           |                                           |                                                           |                                              |                                              |

Source: Fairley, 1979.



liability, the only line where even rough comparison is possible. The values they report for historical margins also differ, due to use of different samples. Not surprisingly, therefore, their measures of excess profits -- the differences between historical and target returns -- differ. Fairley concludes that profit margins have been roughly competitive for auto B.I., less than competitive for auto P.D. and homeowners, and above competitive for workers compensation. Hill, by contrast, concludes that excess profits have been positive for all types of company except stock fire, using standard rates, and stock marine. His tentative conclusion is that

"Although the evidence is weak, it suggests that historical profit rates have exceeded fair profit rates; the structure of profits by line and by type of firm suggests that regulation may be responsible for profits above the level which would be earned in a fully competitive market."

Even this tentative conclusion seems strong, given the flimsy nature of his evidence. The attribution of excess profits to regulation is based on the finding that stock marine companies, which show the largest negative excess profits using one set of estimates ( $\beta = .2$ ) are unregulated, whereas automobile and accident and health insurance, which are alleged to be relatively tightly regulated have relatively high excess profit rates, using his accounting beta estimates.

#### (c) Comparison of Market and Book Values

Walter (1979) undertakes a theoretical and empirical analysis of the ratio of stock price to book value per share for a sample of 25 property and liability insurance companies during the decade ending in 1976. He concludes:

"The model developed portrays the ratio of stock price to book value per share as a valid measure of the excess value (departure from the competitive norm) attributable to regulation, including the anti-trust exemption. The empirical analysis lends plausibility to the underlying model and suggests that, despite the ravages of inflation, state regulation of property and liability insurers has not been unduly restrictive."

These strong conclusions are based on one assumption:

"The relation between stock value in the marketplace and net asset book value reflects the net shareholder benefit attributable to the umbrella of regulations (including immunity from anti-trust, "



together with two pieces of empirical evidence:

(i) for his sample of companies the median ratio of stock price to book value for the decade was 1.36 and

(ii) stock value for the median company appreciated at 6.2% p.a., compared to 2% p.a. rate of change in the Standard & Poor's 500.

At one point Walter does recognize that factors other than above competitive profits protected by regulation and anti-trust immunity might contribute to a deviation between market and book value. However, no attempt is made in the empirical analysis to distinguish the effect of regulation from the effect of either anti-trust immunity or other factors and in the conclusion the possibility of other factors is simply dropped. Thus the conclusion that there is evidence from market/book ratios of above competitive profits in the insurance industry is an assertion for which neither theoretical nor empirical support is provided.

The paper does provide some analysis of the determinants of the variation among insurance firms in the ratio of market to book value. Explanatory variables include the rate of growth of book value, market or book beta, the dividend pay out ratio (percent of current earnings paid out as dividends) and a measure of leverage (net worth divided by total assets). No attempt is made to introduce the distribution of the firm's business between highly and less regulated lines or highly and less regulated states, although regulation is allegedly the major cause of inter-industry differences in market/book ratios, and his sample includes two predominantly reinsurance firms and five life-oriented firms which should be less "protected by the regulatory umbrella." If excess of market over book value is to be attributed solely to regulation, then by implication all firms within the insurance industry should have the same ratio of market to book value as a long run average. In fact the median values for individual firms in the sample over the decade range from 5.02 to .76 and in 1976 they range from 4.41 to .68. If the difference in the ratio of market to book value between firms within the insurance industry are to be attributed to factors other than regulation, then presumably these same factors might contribute to the difference between the average price to book ratio for the sample of insurance firms and firms in other industries. Thus there appears to be a logical inconsistency in



attributing all the inter-industry difference to regulation and all the intra-industry difference to non-regulatory variables.

There are several possible reasons for a discrepancy between market and book value, which undermine Walter's conclusion that it is evidence of non-competitive profits protected by regulation and anti-trust immunity. First Walter's reliance on competition to equate market and book value seems to rest on a confusion. He states "the capitalized value of the anticipated earnings stream (inherent in the market value of the company's stock) in excess of the current value of assets motivates the further injection of capital which -- under standard supply-demand assumptions -- tends to bring capitalized value into line with asset value."

This seems to state that anticipated earnings will be capitalized into book value, which is simply untrue. Book value of an insurance firm is the difference between book value of current assets and book value of current liabilities. If the book value of either differs from the valuation the market would place on them (e.g., bonds carried at face rather than market value) then book value of net worth will differ from the value the market would place on it. Market value of the firm reflects the present value of current and expected future net income streams, discounted at a rate which reflects the risk of the firm, relative to other assets. This market value will include the value of "intangible" capital, which reflects items such as an experienced agency force, a seasoned book of business, good will of consumers, which is likely to be understated in book value. The value of this intangible capital relative to measurable capital may be larger in insurance than in other industries because of the nature of the insurance product. On the firm's side, the cost of the product is not known before the price is set and that cost depends crucially on the underwriting experience of the firm and its agents. On the consumer's side, the product cannot be inspected prior to purchase, so the consumer relies heavily on the firm's reputation for good service. All these factors may tend to yield a higher average ratio of market to book value for insurance than other industries and, within the insurance industry, a higher ratio for large, well-established firms than small, new firms. All the firms in Walter's sample are relatively large and well-established. Thus the ratio of market to book value for this sample



may be atypical of the industry-wide average, which in any case may reasonably be expected to exceed that in other industries, in the absence of monopoly profits.

The magnitude of the effect Walter attributes to regulation is totally unrealistic. While it is conceivable that regulation and anti-trust immunity could protect a modest level of above competitive profits, 36% is surely absurd. Moreover the 46% reduction from the median for the decade to .9 in 1976 seems an equally implausible measure of decrease in regulatory protection.

Finally, although Walter claims that his evidence supports his model, it could be interpreted to support exactly the opposite conclusion, of no close correlation between market and book value. As noted above, his empirical analysis focuses on the determinants of price/book ratios and year to year changes in market values within his sample of insurance firms. He reports regressions of market relatives on book relatives for each firm. On average over 17 companies interperiod changes in book values "explain" only 21% of between-year variation in stock price. Even if we accept his thesis that regulation accounts for the discrepancy in price/book levels between insurance and other industries, if his underlying model is correct, changes in market and book values over time for firms within the industry should track each other very closely.<sup>1</sup> The evidence that on average only 21% of the year-to-year changes in market values are associated with contemporaneous changes in book values undermines his basic presumption of a very close association between market and book value.

Conclusion. We conclude from this review of 3 different approaches to measurement of profits that although theoretically appealing, this is not a useful test of monopolistic restrictions, due to the fundamental problems of measuring actual profits and defining a competitive standard of comparison. The lack of consensus among the studies reviewed supports this conclusion.

---

<sup>1</sup> The difference in levels would be picked up by the constant term in the regressions.



### B. Returns to Agents

Monopolistic restrictions may result in above competitive returns to any factor which is not in perfectly elastic supply. In the case of insurance the supply of agents may be less than perfectly elastic. There are licensure and other controls on entry which may protect non-competitive returns to agents. In fact barriers to entry of agents would be a sufficient condition for above-competitive prices for insurance, even if the market for the insurance product were perfectly competitive.<sup>1</sup> The question of above competitive returns to agents is not addressed further because to the extent they exist (and we have no evidence for or against) the necessary and sufficient condition is entry restrictions on agents, not the anti-trust immunity or regulation of the insurance industry. This does not mean that if there are restrictions on entry of agents, agents might not benefit from restrictions on entry in insurance. However, since the entry restrictions on agents are a necessary and sufficient condition for above-competitive returns for agents, it would be misleading to attribute any evidence of excess returns to the anti-trust immunity of insurance, which is the question at issue. In principle one should measure the marginal effect of the anti-trust immunity on agents returns, over and above the effect due to entry restrictions on agents. In practice that is surely a hopeless task.

### 3. ATTEMPTS BY CUSTOMERS TO CIRCUMVENT THE CARTEL

Part I of this paper has presented detailed evidence of the fact that the ISO share of automobile market (crudely measured by percent of premium volume reported to ISO) is typically less than one-third. Thus, customers have been very successful in circumventing what may once have been a cartel. Precisely because they have been so successful, the market share and market power of ISO have been reduced to a negligible degree.

---

<sup>1</sup> This assumes that licensed agents are an essential input.



#### 4. INNOVATION

The third test of monopolistic restrictions proposed by Kahn is evidence of obstacles to innovation. "Innovation" in insurance could include new types of coverage, new territorial or other classification criteria, new policy forms, new marketing techniques, etc. There is evidence that historically the bureaus have resisted innovation in all these areas. ISO continues to provide a standard with respect to type of coverage, classification, forms, etc. in addition to recommending rates. However, (obviously) these are dimensions of the product that must be defined before a price can be defined: they are an integral part of the price. Development of new product dimensions is a function which has attributes of a "public good" so is a function which may be efficiently performed by a bureau. Other firms are free to develop alternative products, just as they may choose to compete on price but use the ISO product, subject to the additional costs of obtaining regulatory approval. Thus the analysis of barriers to innovation, i.e., competition on dimensions other than price, is exactly analogous to the analysis of competition on price: ISO provides a standardized product but other firms are free to compete. The only obstacle to competition with the ISO product is the additional cost of development and of obtaining regulatory approval for a non-ISO product. Provided this additional cost is low, barriers to innovation are low.

To the extent there are restrictions on product innovation, they appear to be due to regulation, not to the anti-trust immunity and resulting operations of the bureaus. There is increasing regulatory intervention in classification criteria. Rating on the basis of sex, territory, marital status has been challenged in several states. Regulatory requirements on the provision of information to consumers will also raise the cost and hence reduce innovation. The case for and against these restrictions is not addressed here. They are mentioned only to point out that existing obstacles to innovation derive from regulation, not from the anti-trust immunity per se.



## APPENDIX

Changes in Market Shares

As noted above, the incentive to collude is inversely related to the speed with which firms outside the cartel can expand to nullify any restriction of output by firms in the cartel. Significant changes in market shares indicate the absence of effective obstacles to growth. Moreover since cartels often attempt to stabilize market shares, changes in market shares is suggestive of lack of effective collusion.

Table A1 provides some measures of changes in market shares of the top 20 firms in 13 states between 1973 and 1978. The data refer to Automobile and P.I.P. premium volume, for 4 states with open competition rating laws and 9 with some variant of prior approval. Statistics reported are rank correlation coefficients, the mean absolute change in rank and the number of companies whose rank changed 5 positions or more. Companies which were not among the top twenty in both years are omitted from the first two measures which imparts a downward bias to these measures of mobility.

Without some a priori standard of a competitive norm we cannot apply any precise statistical tests for presence or lack of competition. However it is clear that there is substantial mobility of firms.



TABLE AI CHANGES IN MARKET POSITIONS OF TOP TWENTY FIRMS, PRIVATE PASSENGER  
 AUTO, 1973-1978 AUTO, 1973-1978

|                    | Rank<br>Correlation | Mean Absolute<br>Change in Rank | #Firms Changing<br>5 Places |
|--------------------|---------------------|---------------------------------|-----------------------------|
| <u>Competitive</u> |                     |                                 |                             |
| California         | .148                | 6.3                             | 10.                         |
| Colorado           | .525                | 4.9                             | 7.                          |
| Illinois           | .258                | 10.6                            | 15                          |
| Wyoming            | .647                | 4.0                             | 8.                          |
| <u>Other</u>       |                     |                                 |                             |
| Arizona            | .412                | 7.2                             | 10.                         |
| Florida            | .281                | 8.6                             | 11                          |
| Louisiana          | .578                | 5.2                             | 8                           |
| Michigan           | .636                | 3.5                             | 4.                          |
| New Jersey         | .886                | 2.7                             | 5                           |
| New York           | .837                | 2.8                             | 2.                          |
| Pennsylvania       | .835                | 2.6                             | 4.                          |
| Tennessee          | .817                | 3.1                             | 5                           |
| Washington         | .440                | 3.7                             | 5                           |

Source: Best's Executive Data Service.



## Bibliography

-39-

1. Arthur D. Little, Inc., Price and Profits in the Property and Liability Insurance Industry - November 1967.
2. Bork, R., The Anti-Trust Paradox.
3. A. M. Best and Company, Executive Data Service.
4. Fairley, William B., "Investment Income and Profit Margin in Property-Liability Insurance: Theory and Empirical Results", Bell Journal - Spring 1979.
5. Hill, Raymond D., "Regulation in Property-Liability Insurance", Bell Journal - Spring 1979.
6. Independent Insurance Agents of America, Report of the Committee to Study ISO's Role in the Personal Lines Marketplace - June 1978.
7. Ippolito, R., "The Effects of Price Regulation in the Automobile Insurance Industry", Journal of Law and Economics - Spring 1979.
8. Jensen, Michael C., "Capital Markets", Bell Journal - Autumn 1972.
9. Joskow, "Cartels, Competition and Regulation in the Property-Liability Insurance Industry", Bell Journal - Autumn 1973.
10. Litzenberger, Robert, Ramaswamy, Krishna and Sosin, Howard, "On the CAPM Approach to the Estimation of a Public Utility's Cost of Equity Capital" - Mimeo 1979.
11. Munch, Patricia and Smallwood, Dennis E., "Solvency Regulation in the Property-Liability Insurance Industry: Empirical Evidence", Bell Journal - forthcoming.
12. Munch, Patricia, "Comments on the NAIC Program to Monitor Competition in the Property and Liability Insurance Industry" - December 1979.
13. NAIC, Monitoring Competition, Milwaukee - May 1974.
14. National Commission for the Review of Anti-Trust Laws and Procedures, Washington, D.C. - 1978.
15. National Industry Committee of Automobile Insurance Plans, 733 Third Avenue, N.Y., N.Y. 10017.
16. Posner, "Information and Anti-trust: Reflections on the Gypsum and Engineers Decisions" - Mimeo 1979.
17. Saba, Richard P., "An Alternative Theory of the Regulation of Automobile Insurance", Southern Economic Journal - October 1978.
18. Stigler, George J., The Organization of Industry.
19. U.S. Department of Justice, Report on Pricing and Marketing of Insurance, Washington D.C. - January 1977.
20. Walter, James E., "Regulated Firms Under Uncertain Price Change: The Case of Property and Liability Insurance Companies" - Journal of Risk and Insurance.



PATRICIA MUNCH

Dr. Munch received her B.A. degree (1st Class, with honors) in Politics, Philosophy, and Economics from Oxford University, England, in 1968, and her M.A. and Ph.D. degrees from the University of Chicago in 1969 and 1973, respectively.

Dr. Munch joined the staff of the Economics Department of The Rand Corporation in 1974 as a research economist. Her primary areas of research are professional liability (in particular, medical malpractice), and the economics of regulation. She is currently working on an analysis of the causes of the crisis in medical malpractice claims and insurance, sponsored by the Social Security Administration and has completed a study of professional liability for the California Commission on Tort Reform. She is currently spending a year as a National Fellow at the Hoover Institution where she is writing a book on medical malpractice.

Before joining Rand, she was a research associate at the Center for Health Administration Studies, University of Chicago. Dr. Munch was also an instructor in Economics at the University of Illinois Circle Campus during 1971, and a lecturer at the University of Chicago during 1972. During 1978 she taught courses on regulation and anti-trust at the Rand Graduate Institute and at the University of California, San Diego.

Dr. Munch is a referee for Journal of Political Economy, Journal of Economic Inquiry, Journal of Legal Studies, Journal of American Statistical Association, Bell Journal, Harvard University Press.

PUBLICATIONS

Solvency Regulation in the Property/Casualty Insurance Industry: Empirical Evidence, The Rand Corporation, June 1979 (P-6349, forthcoming in the Bell Journal) with Dennis Smallwood.

Contingent Fees for Personal Injury Litigation, The Rand Corporation (R-2458-HCFA, forthcoming).

Economic Factors in the Use of Laboratory Tests by Office-Based Physicians, The Rand Corporation (R-2525-HEW, forthcoming)

Civilian Earnings of Military Retirees, The Rand Corporation (R-2355-MRAL) - 1979.

"Solvency Regulation in the Property/Casualty Insurance Industry: A Theoretical Analysis", forthcoming in NBER Proceedings of Conference on Public Regulation, with Dennis Smallwood - 1978.

Professional Liability, California Citizens' Commission on Tort Reform - 1977.

Costs and Benefits of the Tort System if Viewed as a Compensation System, The Rand Corporation (P-5921) - June 1977.



- 2 -

Issues in Professional Liability: Multiple Defendants, The Rand Corporation  
(P-6157) - May 1977.

Issues in Professional Liability: Limits on Awards, The Rand Corporation  
(P-6156) - May 1977.

Issues in Professional Liability: The Statute of Limitations, The Rand  
Corporation (P-6155) - May 1977.

Professional Liability Insurance: The Case for Regulation, The Rand Corporation  
(P-6154) - May 1977 with Dennis Smallwood.

"Causes of the Medical Malpractice Insurance Crisis: Risk and Regulation," in  
The Economics of Medical Malpractice, American Enterprise Institute -  
December 1976.

"Comment" on Victor R. Fuchs, "From Bismarck to Woodcock: The Irrational  
Pursuit of National Health Insurance," Journal of Law and Economics -  
August 1976.

"An Economic Analysis of Eminent Domain," Journal of Political Economy -  
June 1976.



APPENDIX 4

GAO REPORT ON INSURANCE

A CRITIQUE

Alliance of American Insurers

November 28, 1979



GAO REPORT ON INSURANCE  
A CRITIQUE

The General Accounting Office recently released the final version of its report on state regulation of the insurance industry. The report had been prompted by Senator Metzenbaum (D.-Oh.) and Congressman Moss (D.-Cal.), who asked the GAO to conduct an evaluation of state regulation of insurance in March of 1978. The report "assesses the effectiveness of the regulation of insurance by state insurance departments and discusses a number of insurance regulatory issues." According to the Comptroller General, the report makes no specific recommendations with respect to a federal response to the cited shortcomings of state regulation. However, the information in the study will be available to Congress in evaluating the McCarran-Ferguson Act; its accuracy is therefore an important issue to the Congress and the people of the United States. After critically evaluating the GAO report on state regulation of insurance, the Alliance feels it is necessary to point out only the most obvious distortions and omissions in the report so that the study and its recommendations can be seen in the proper content. The GAO report may be used by some to advocate the end of state regulation of insurance and the assumption of such regulation by the federal government. As will be demonstrated by this analysis of the report, the conclusions it reaches do not support the imposition of



federal regulatory authority on the business of insurance.

Resources and Activities of State Insurance Departments

The first area of state regulation addressed by the GAO report pertains to the resources and activities of the state insurance departments. The GAO found that there had been a 202% real increase in department budgets since 1957, 16% more than the overall budget increases for the states themselves. Expenditures of departments were characterized as "not insignificant," and comparable on an aggregate basis to the combined budgets of the SEC and FTC, two somewhat parallel federal agencies. While the study showed that state insurance departments lack personnel resources this was seen as not a "crippling lack." It should be noted that the need for more personnel is a chronic governmental shortcoming in these days of inflation and citizen revolts against increased taxes, and so should not be considered peculiar to insurance departments. This complaint applies equally to both state and federal levels of government.

The GAO report also showed that the professional qualifications of department personnel have improved since the earlier Congressional study. Although specialized training of insurance department staffs was not as high as the GAO would have liked, the professional qualifications of staffs have improved. In particular the senior staffs, apart from most commissioners, had many years of experience in in-



insurance department work that may be equivalent to more formal training.

One of the GAO's major criticisms of the professional qualifications of staff was that the total number of certified actuaries in state insurance departments was extremely small. Insurance departments reported 64 staff members who are fellows or associates of the two professional societies, the Casualty Actuarial Society and the Society of Actuaries. Twelve states reported having no certified actuaries. However, considering the number of actuaries there are in the United States, and the number of insurance companies as compared to insurance departments, the insurance departments employ the percentage of actuaries that they would be expected to have.

According to the most recent figures from the Society of Actuaries and the Casualty Actuarial Society there are 4,370 fellows and 3,468 associate actuaries in the United States. The total number of insurance companies in America is at least 4,750, according to statistics put out by the Insurance Information Institute. If each company and insurance department is considered a potential employer, there is a total of 4,800 employers competing for these actuaries. In addition actuaries are employed in independent consulting, university work and miscellaneous employment. All these potential types of jobs are competing with the insurance departments. Taken in this context, given the scarcity of actuaries and the abundance



of potential employers, the state departments are not as understaffed by actuary fellows and associates as the GAO assumes.

Admittedly, there are personnel problems in all areas of government and business including insurance departments. However, according to the GAO itself, data on budgets, staff sizes and professionalism only represent the potential for effective regulatory activity. The effectiveness of state regulation cannot be inferred from that data alone. The fact is that improvement has occurred:

- more money is being spent by insurance departments;
- the personnel has become more highly qualified due to length of experience and other factors.

This, in itself, supports the state regulation of insurance.

#### Financial and Trade Practice Regulation

The second area scrutinized by the GAO in their report on insurance is financial and trade practice regulation. Throughout the Chapter the GAO distorted data and ignored facts which show the responsiveness of state regulation in this field. The GAO refers to the McKinsey & Co. report prepared for the NAIC in 1974 repeatedly in this chapter as a yardstick to measure insurance department progress in improving the financial examination system. An Alliance staff summary of the findings of the McKinsey study is attached to these remarks, for the reader's reference.



Before going into specific errors of the GAO in this chapter, it should be noted that the very fact that McKinsey & Co. was commissioned by the NAIC in 1973 to study the examination systems used by insurance departments, is strong evidence of the states' responsiveness to problems in the financial examination field and their interest in improving the system.

The first financial area discussed by the GAO is the use of the NAIC "early warning system" by states. The Alliance takes issue with the agency's statement that "about half of the states use the NAIC system, together with their own system, while at least 39% use the NAIC as their primary warning system." The NAIC early warning system actually applies on a much broader scale to the insurance industry.

Although the states may not universally use the NAIC early warning system in their own surveillance of companies, the NAIC system covers all companies except those which receive a special exemption from their domiciliary state (mostly county and farm mutuals). Almost all but the smallest companies, therefore, are required to file their annual statements and insurance expense exhibits with the NAIC office in Milwaukee. This information is fed through a computer, which applies the eleven early warning tests to the data. The computer rates the financial strength of each company, listing as "priority" companies any insurer which fails four or more of the tests. A team of financial examiners reviews the test results



and financial history of every insurer designated as a priority company to determine whether or not a company may be in a precarious financial position. A write up of the priority company is then sent to every insurance department and the priority company itself. These tests are used as an "alert" to focus attention on companies which are potential problems. The domiciliary state then has the primary obligation of following up on the problem companies. In addition, insurance departments in other states where the priority company does business may investigate. Thus, stating that only half of the states use the NAIC early warning tests severely underestimates the true effectiveness of that surveillance technique.

The GAO report also recommended that improvements are needed in the resources devoted to financial regulation, especially in the area of quality of examiners. The GAO failed to note that the NAIC is well down the road in conjunction with the Society of Financial Examiners and the Griffith Foundation in developing academic and salary guidelines for financial examiners. A nine-course program is being developed as prerequisite to recognition as a Certified Financial Examiner and one eligible to participate in zone examinations. This is another example of how the states through the NAIC are responding to perceived problems in regulation.

A third area of financial regulation criticized by the GAO was the lack of use of CPA audits by states. The GAO cited the



McKinsey study's recommendations of greater use of CPA audits as one way to cover more companies and stretch a state's examination staff. According to the GAO data, only Illinois and Wisconsin used an appreciable number of CPA audits. Presently, not only Illinois and Wisconsin, but Massachusetts, Michigan, Pennsylvania and West Virginia have adopted or are in the process of adopting a CPA audit rule. Although Illinois limits the scope of its rule to domestic companies, the other states have a rule that applies to all insurers of any size doing business in the state. Most insurers of any size do business in at least one of the above-mentioned jurisdictions and therefore are now covered by a CPA audit rule. The NAIC (A5) Subcommittee is currently drafting a model CPA audit requirement rule expected to be adopted in December 1979. Thus, more activity is going on in this area than the GAO report acknowledges.

The GAO also reviewed the trade regulation practices of insurance departments. The term "trade regulation" as used by insurance departments in this context, encompasses activities substantially similar to the activities prohibited by the FTC Act (15 U.S.C. §45). Therefore, "trade regulation," in its generic sense, is the process of preventing the use of unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce. Over the years the states have elaborated on this rather vague definition by enacting unfair trade practices acts. A majority of states have adopted verbatim, or essentially, the NAIC Unfair Trade Practices



Act. This Act contains definitions of unfair methods of competition and unfair or deceptive acts or practices, as well as a list of unfair claim settlement practices. It prohibits, in short, practices in restraint of trade or tending to foster monopoly. A copy of the NAIC Model Act is attached at the end of these comments.

#### Complaint Handling

Among other things, trade regulation includes the handling of complaints by consumers. The GAO report found that all departments they visited considered complaint handling an important function and had special procedures and staff to deal with consumer complaints. Based on their fieldwork sample, "it appears that consumers in nearly all states are assured of at least getting a response to their complaints and having their complaints pursued to the extent of an insurance department letter or phone call." The GAO found that the state insurance departments "do a good job of responding to individual complaints," although improvements were needed in utilization of data for regulatory purposes. Also, on a national basis, most states make complaint summaries available to the public in some form.

The GAO was critical of insurance departments which did not systematically use complaint data as a regulatory tool. Based on their fieldwork, the GAO concluded that most states have the pre-



requisites for systematic action in that they can identify complaint patterns, but they fail to use the complaint data in the examination process. This conclusion was based only upon fieldwork done in 17 states. In 6 of those 17 states complaints were systematically used to trigger market conduct examinations. In nearly all of the fieldwork states, complaints were used to trigger enforcement activity if an illegal practice by an insurer or agent was involved. Contrary to what the GAO's conclusions are, state insurance departments do make use of complaint statistics and have made great strides in this area in the last several years. In addition, the states appear to be doing a much better job of consumer complaint handling than the federal agency which is comparable in this area, the FTC.

According to a GAO report to the Congress done in October 1978, entitled "Victims of Unfair Business Practices Get Limited Help from the Federal Trade Commission," the FTC has not been handling cases involving potential consumer redress as expeditiously as possible, to maximize consumers prospects of receiving redress. In some cases consumers received no satisfaction for losses resulting from unfair or deceptive business practices. In others, the amount of redress was relatively small or available only to a few consumers. The Commission's ability to obtain consumer redress has been limited by several factors, said the GAO. These include:



- lengthy and time-consuming procedures,
- the weak financial position of many businesses it investigates,
- its internal management problems.

The GAO acknowledged the good job that the state insurance departments are doing in the field of individual complaints. The GAO was not able to say the same of the FTC in their study of that federal agency. However, it has not been suggested that such a shortcoming might be a good reason to leave this type of trade regulation to the individual states instead of the FTC. For the same reason, the fact that state regulators may have underutilized complaint data for regulatory purposes can not be cited as a reason to interject federal regulation over insurance.

#### Market Conduct Examinations

A final area of operations discussed in Chapter Four of the GAO report is that of market conduct examinations. The purpose of market conduct surveillance is to protect policyholders and claimants against unfair market practices. Market conduct surveillance focuses on those companies that are engaging in unfair business practices as opposed to those which infrequently and unintentionally treat policyholders unfairly.



One of the biggest criticisms of state market conduct examinations by the GAO is that there are no consistent quantitative and qualitative standards used by the examiners. This conclusion was based on the fact that none of the market conduct reports the GAO received explained what the minimum qualitative standards were and that in two fieldwork states the GAO was told that assessment of company performance was based totally on the professional judgment of the on-site examiner. On the basis of this small amount of data, the GAO determined that there is an absence of consistent quantitative and qualitative standards.

As has been noted earlier, a majority of the states have adopted unfair trade practices acts which contain explicit minimum standards applying not only to the form and content of the insurance policy and the accompanying promotional materials, but also to most other acts and practices which the insurance company may employ in its dealings with the consumer.

The scope of a market conduct examination covers four key areas:

1. Sales and Advertising,
2. Underwriting,
3. Rating,
4. Claims.

The NAIC Market Conduct Examination Handbook, which has served as a resource book for the states since its publication in 1976 (and is



presently being revised), contains very particular guidelines for conducting an examination. For example, the Handbook states on page 5 that the examination recommended by the NAIC relies primarily on:

- financial examiners;
- information developed by staff who:
  - handle complaints,
  - review rate and policy form filings,
  - regulate agents and brokers;
- complaint analysis;
- information from other states,
- other indicators.

On page 7, the NAIC Handbook states that:

"to be effective in examining market conduct practices, we need to know, in depth, the statutes, rules and regulations affecting market conduct. They provide the legal background for any action ...and, in some instances, define what constitutes an unfair practice."

This chapter is then devoted to an inventory of the state's pertinent statutes, rules and regulations, including:

- A. Statutes, Rules and Regulations that Cover Market Conduct Practices in a General Way.
- B. Statutes, Rules and Regulations that Relate to Specific Market Conduct Areas:



1. Sales and Advertising
  2. Underwriting
  3. Rating
  4. Claims
- C. Statutes that give the Department the Right to Conduct Examinations.
- D. Other Relevant Statutes.

In addition, the NAIC Market Conduct Handbook contains Appendix D, "Qualitative Standards." A copy of these Standards are included in this critique to show their specificity.

(Please turn to next page for Appendix D - Attachment 1, Page 14)



## APPENDIX D

## QUALITATIVE STANDARDS

1. After determination and documentation of specific company practices which constitute errors, omissions or illegalities, qualitative minimum standards must be applied. Such errors, omissions or illegalities might be:
  - a. Failure to comply with statutes, rules, or regulations governing filings of rates, rules, policy forms, endorsements and riders.
  - b. Improper application or calculation of rates.
  - c. Failure to comply with statutes, rules, or regulations governing cancellations, nonrenewals and rejections and failure to return appropriate premium refund.
  - d. Improper settlement of first and third party claims. (*Reference should be made to applicable unfair claim practices statutes or regulations.*)
  - e. Failure to comply with statutes, rules, or regulations governing licensing of agents, agencies or brokers.
  - f. Violations pertaining to the company's certificate of authority.
2. Company performance in each and all of the above areas must be evaluated by a specific measure that is appropriate.
  - a. Improper application or calculation of rates should be stated as a ratio and considered an error, only if the percentage exceeds acceptable standards as determined by the commissioner.
  - b. Failure to comply with any individual statute, rule or regulation should be considered as one error per violation; or if it is determined by the commissioner to constitute a business practice, it may be treated as such.
  - c. Improper claims settlement practices should be considered on a case by case basis; such cases, if of sufficient frequency, may be determined by the commissioner to constitute a business practice to be treated as such.
  - d. Failure to make appropriate premium refunds should be considered on an individual basis and the commissioner shall make the determination as to whether such error/violation constitutes a business practice.
  - e. Violations pertaining to the company's charter shall be considered one error per violation.
3. If rating errors or claims handling procedures may be isolated and patterns indicated further follow-up may be required.
4. Each measure to be used as a qualitative standard must be ultimately developed not from an arbitrary standard but from the collection of data developed by the examination program. Such measures might have as their origin:
  - a. Statistical summary results of prior market conduct examinations (e.g., the "normal" median time to settle claims for all companies reviewed).
  - b. Information developed from the similar studies of other states.
  - c. Generally accepted business standards both within insurance and also within related industries such as finance.



The presence in all states of statutes, rules and regulations pertaining to Market Conduct, as well as the particular standards found in the NAIC Handbook, which serves as a model for the states, demonstrates that there is no lack of consistent qualitative and quantitative standards for market conduct examinations. Therefore, the conclusion of the GAO that the market conduct examination is a particularly weak link in company surveillance, and that there was no evidence in most states that there are qualitative and quantitative standards of what constitutes unacceptable behavior by insurance companies, is entirely unsubstantiated.

From the foregoing analysis of the GAO chapter on financial and trade regulation by state insurance departments, it is obvious that the GAO overlooked important additional facts which demonstrate the responsiveness of state regulation. The report evidently criticized the state insurance departments on the basis of incomplete information, which led to unsubstantiated generalizations about state behavior. In light of this, federal involvement in the area of solvency and market conduct due to alleged state deficiencies appears unwarranted.

#### Automobile Risk Classification and Insurance Availability

In Chapters 6 and 7, the GAO addressed the issues of automobile risk classification and insurance availability. In their summary and conclusions pertaining to availability, the GAO was critical of insurance departments for not investigating the problem nor collect-



ing the necessary data to monitor insurance availability.

However, no recommendations of federal activity in this area of insurance were made. Instead, the GAO asserted that state insurance departments should protect consumer interests by monitoring the reasons that the consumers are denied coverage in the voluntary market, and ensuring that customers are informed of their options in the assigned risk plan. It should be noted, in response, that the Alliance supports the notion that customers be informed of their options in the assigned risk plan. In addition, the NAIC is now readying for adoption a Model Property Disclosure and Cancellation Law which would provide the information to consumers that the GAO thinks important. A similar Model law in the field of auto insurance is also under consideration by the NAIC.

The GAO made a strong call for federal activity in the final version of the chapter on automobile risk classification. Interestingly, the first draft of this report came out with the exact opposite conclusion, based on the identical data. Not a word was changed in the body of the chapter, only the conclusion was altered.

Although the reasons for such an about-face are not relevant to this analysis, the fact that the same facts can support both an affirmation of state regulation, and call for federal activity, two diametrically opposing views, indicates analytical problems on the part of the GAO. Obviously, they are confused as to where the data takes them. The Alliance wishes to emphasize that the GAO inter-



pretation of this data on auto classifications is therefore very subjective, not objective, and deserves little credence unless substantiated further.

The major GAO criticism of state insurance departments in the field of auto classification was that the departments have not studied the current classification plans with sufficient rigor to assure that they are not unfairly discriminatory. This is almost identical to their criticism of state action regarding availability. In the case of risk classification, federal legislation is called for, yet in the case of availability, it is not. The GAO does not explain this internal inconsistency.

#### Personal Classifications Issues

In regards to "personal" classification issues, the GAO admitted that state insurance departments, "...may be justified in awaiting the results of further study before acting on the issues raised by personal classification...". The study also stated that "the accuracy of the classification system is an open question that needs further analysis...".

Despite these two admissions that the issue of risk classification is one that is in a state of flux presently, the GAO inconsistently condemns state insurance departments for "not yet (having) examined the current classification plans with sufficient rigor...". Because of this failure to have solved a problem that the GAO admits



has no solution yet, the report recommends that "continued federal consideration of risk classification is necessary." The logic of this argument escapes us.

The GAO seems very critical of the fact that exceedingly complex issues which have only become problems in the last few years, such as risk classification, have not been completely resolved by the state regulatory system. The GAO contends that the regulators should have anticipated these problems and corrected them before they became an "issue." In this, they are being critical of a phenomenon that pervades the entire political and governmental process in America. To say that state government is slow to face some problems does not lead to the deduction that the federal government would have addressed these same problems any earlier or more efficiently. Has Congress solved the "energy crisis" in this country yet? If not, does this mean that handling of that issue should go to the states? Of course not -- it means that certain social, governmental, political and economic factors have made it difficult to find an easy solution.

Likewise, although the states have not all addressed and solved problems associated with risk classifications, many states have treated the problem either by legislation or regulation. Several states, including California, Rhode Island, New York, Louisiana and Florida are struggling with the issue now. Wherever a state's poli-



tical system identifies risk classification as a top priority, it will be addressed. Where risk classification has not become a local issue, because of individual state characteristics, the legislatures and insurance departments will be expending their limited resources on other, more pressing problems. That is a judgment that should be left up to the governmental representatives of each state's citizens, under our federal system.

#### Independence of State Regulators

The last subject discussed by the GAO report was the independence of insurance regulators. GAO found that insurance is not characterized by an "arms-length relationship" between the regulators and the regulated. The GAO supported this finding by asserting that a "revolving door" problem did exist, although it may have been overstated by critics, and that the meetings of the NAIC are numerically dominated by insurance industry representatives.

As for the numerical dominance of the industry at NAIC meetings, it should be pointed out that there are over 4,750 insurance companies in America, and only 50 insurance departments. It would be difficult to include some companies and exclude others from the meetings. Therefore, the "numerical dominance" of industry is inevitable due to the ratio of companies to departments.



The GAO's conclusion that the regulators are "captured" by the industry is an articulation of the "Stiglerian hypothesis." George J. Stigler, an economist, has postulated the theory that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."

However, Richard A. Ippolito, another economist who has done work in the insurance field, has tested the Stiglerian hypothesis and found it erroneous in the case of insurance regulation.<sup>1/</sup> According to the Stigler theory, if regulation is acquired by an industry, that industry would use price regulation to collude on a non-competitive price. That is, for any given category of coverage, prices should generally be higher and less widely dispersed in regulated states than in competitive ones. Ippolito compared the price dispersion between price regulated and open competition states, and found that the general effect of regulation on the measure of price dispersion is positive, not negative as the Stigler theory suggests.

The comparisons Ippolito computed as to price level also rejected the Stigler theory. He found that the net effect of regulation was "insignificantly different from zero... These results are largely inconsistent with the notion that regulation is a means of increasing the general level of price above the competitive norm." <sup>2/</sup>

- 
1. Richard A. Ippolito, "The Effects of Price Regulation in the Automobile Insurance Industry." The Journal of Law and Economics, 55, April 1979.



After doing several other tests, Ippolito concluded that no evidence was uncovered in his study which supports the Stiglerian notion of regulation in the automobile insurance industry. <sup>3/</sup>

Thus, the Stiglerian hypothesis that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit," has been refuted by at least one economist after extensive research.

In addition, the GAO itself, in chapter 5 of the report, contradicts its assertion of regulatory "capture" by the industry. The report states that "...there is little difference in the price of insurance, as measured by loss ratios, between states that regulate rates directly and those that have open competition systems." This finding is also inconsistent with the Stigler theory.

Therefore, the Alliance maintains that the economic data disproves the "capture" theory and supports our belief that state insurance departments do operate independently of the industry.

### Conclusion

The GAO admits that its analysis of insurance issues and regulation is static, not dynamic, and that the report's evaluation relates only to whether particular problems were addressed at the time of their research. It has not put these issues into an historical

-----  
3. Ibid., p. 86



timeframe, nor measured progress toward solutions of these problems by the states. Can an accurate evaluation of the effectiveness of state government versus the effectiveness of federal regulation be made on such a static basis? We think not.

State regulators have not abdicated their responsibilities in the insurance field, despite the fact that some problems which have recently surfaced have not yet been addressed universally by the states. State regulation has its shortcomings, to be sure, but on a relative basis, are they any worse than comparable federal regulatory shortcomings? At least, if one insurance department is deficient in any way, only that one state is adversely affected. If a federal regulatory body has weaknesses, however, the entire country suffers. For the regulation of insurance to be removed from the states and transferred to the federal government, it would seem that a case would have to be made that the federal government would serve the insurance consumer better and more efficiently than the states. This case has not been made by anyone, least of all by this GAO report on insurance regulation.

Alliance of American Insurers  
November 28, 1979



## PREPARED STATEMENT OF EDWARD CIRLIN

Mr. Chairman and Members of the Sub-Committee, I am Edward Cirlin, Executive Vice-President of the N.Y. Metropolitan Brokers and Agents Association, Inc., in New York City. I am a practicing insurance broker, operating my own business, for more than thirty-two years. I have a degree in Economics, and am a licensed Public and Auto Insurance Adjustor. I thank you for the opportunity to appear before you today. Before going further I must advise you that the views I express here are those of the brokers who are encumbered and decimated by the insurance pricing and distribution system. There are a few, in the minority, who are still fearful of losing whatever limited market capacity they have.

I intend to focus on two topics today. First, I will talk about the severe market constrictions that are forced by nearly all of the carriers through their discriminatory underwriting practices, and then I will describe the magnitude of the unaffordability problem that causes so much economic distress.

-1-

LIMITED ACCESS TO BETTER PRICE MARKETS

Essential coverage for auto and homeowners is a matter of paramount concern for millions of American consumers. Probably more than 80% of the entire adult population of the United States carries some form of property and casualty insurance. Each year Americans spend over 90 billion dollars for property and casualty premium payments.

Our whole social conscience reveres individuality and individual freedom. Wars have been fought and millions of lives have been spent, or "invested" to affirm this principle, and yet, these two principles have been violated by the insurance carriers, within the insurance mechanism, with huge urban territories threatened with extinction. Invisible empire devastates and consume the individual and the small business entrepreneur.

Life insurance companies, like Prudential, John Hancock, and now Metropolitan, have huge capital and surplus, albeit, owned by



policyholders, and yet by no one, have seized upon a new and subtle tie-in sales scheme. It requires their agents to constantly deliver life premiums, in order to "enjoy" their property casualty franchise. This reeks of anti-trust violation, tie-in sales and restraint of trade. These life companies should not be allowed to operate both businesses under one roof or with dual licensees.

What good, is there, if an insurance company is licensed and regulated by the State, if the carrier will not accept business from the public or their broker? or at their rates filed?

Why have the semblance of regulation by Insurance Departments who are unable to open the marketplace, and who are not regulating monopoly pricing and distribution abuses in the marketplace.

Most certainly the companies talk about competition in rate-making, but it matters not whether price prior approval, or file and use. This is only the death knell of competition. What matter how the rates are manufactured, if every form of redlining is engaged in, and primarily in the urban areas.

The magnitude of the economic violence is unimaginable, and the double standards of justice and redlining is everywhere.

Redlining is insidious. Redlining is not accepting business even for the good guys. Overcharges and life insurance tie-in sweetening abound. Carriers prey on everyone alike. They should instead pray for everyone.

How much is "enough profit"? Excess profit laws abound, but what amount is permitted and over what amount is a profit excessive? 15 - 18 - 20% ? I don't know! Will someone please tell me? Is 24% on Net Worth and an increase of 10% in Surplus (7 - 9 Billions) excessive? and for each of the last three years in a row?

Discrimination of every sort imaginable is foisted on a helpless and unsuspecting public.



Racial and Ethnic discrimination hardly exist, because nearly all urban policyholders are rebuked and sold in a network of fear. Boycott, coercion and intimidation is not clearly spelled out, but it exists and in its most insidious form! Like carbon monoxide, it is odorless, tasteless and invisible! IT IS DEADLY, because it takes food and economic security from the poor and the working masses. It feeds on the greed of the majority and totally destroys the minority of 30 to 40%.

Commissions are below cost with broker costs climbing on a daily basis. Can insurance companies file or contract for 15 - 22%, and be allowed to pay half? I think this is morally and economically indefensible! and is one of the two reasons for redlining!

What better marketing scheme than cause the insured and his broker to beg for the product, pay overcharges and cut commissions? And yet, that's the name of the game.

The Supreme Court said three times, in St. Paul vs. Barry, Proktor Case, and Royal Drug, that the business of insurance is different than the insurance business exemption, of McCarran-Ferguson. Clearly - boycott, coercion and intimidation are not immunized by this law. Does the Justice Department do anything about this? I did write to John Schenenfeld. I never got an answer in two years.

#### THE TRAGEDY IN INSURANCE

You do not have to be black to seethe with outrage about the overcharging in the urban areas. You do not have to be white to see poor service and "cream risk writing" by direct writers. You don't even have to be smart to see the decay in the cities, and the despair of the prudent workingclass. Using lower than normal rates by direct writers is not competition, because that is the primary cause of the chaos, the locomotive, if you will, that causes overcharging and results in super profits, to the detriment of the rest of the market share.



SPEAKING OF FAT CATS

This business of closing brokers and agents accounts forces

- 1- lower commissions than filed
- 2- inaccessability to companies of the insured or broker's choice
- 3- artificial residual market class and build-up
- 4- super profits than filed for

by carriers, all and alike.

SUPER AND EXCESS PROFITS

It is no longer a secret that the American Insurance Carriers continue to make enormous profits. They blame it all on premium overcharges, high interest rates and lowered auto use. Very few will admit that subdued brokers, uninformed buyers, masterful public relations campaigns, divide and conquer nearly everyone.

It won't work! I don't mean to be presumptuous and tell a 900 billion dollar industry to be patriotic or even to ask for fair play in the marketplace. Without Open Markets available to all, there is NO COMPETITION. If brokers, who only represent the buyer, cannot select a carrier of the insured's or broker's choice, the present crisis will persist.

Only Senator Metzenbaums' Competition Bill addresses the problem of unbridled and raw non-competition.

Only Stew. Kemp's draftsmanship and stewardship will cause the glare of public opinion to force corporate responsibility into the area of insurance pricing and distribution.

If McCarran-Ferguson can permit redlining in all its forms, then it failed. If McCarran-Ferguson repeals Sherman Anti-Trust Laws, then let it say so, with the approval and stated policy of Congress.

Last weeks explosion in Miami is just the tip of an iceberg in Urban Areas. How much longer will it take before insureds, who are so long abused, and disenfranchised, by such an insensitive distribution system, remain silent? Rate differentials of 10:1 are no longer acceptable.



"Shared responsibility" is a concept not only for individuals, but for Corporations. Fair Play to all is justifiable.

We can no longer afford to sit idly by observing the cynical position of insurance companies remaining first among equals.

The U.S. Supreme Court has spoken out for free competition in the marketplace.

We are at the lowest point ever, and can readily observe the shackles on:

- 1- the helpless, urban American policyholder and their brokers in a limited marketplace, with overcharging by age, sex, marital status, territory and super bonuses for the many, and discounts for the "protected preferential".
- 2- brokers are unable to represent the policyholder because of the companies' boycott, coercion and intimidation. Residual market mechanisms, unadmitted carriers, redlining schemes and the accounting abuses go unchecked by any system of checks or balances.

Only the Federal Government is the inactive player in this drama.

No other authority can counter this overreaching by the Insurance Industry, except for the Congress.

You are our voice, our only countervailing power.

Senator Metzenbaum's Bill on Competition totally states and remedies the abuses that are readily apparent, if one just has the willingness to fight injustice wherever it might be.



As I look back over the years, I find myself without markets, and so too, do most of my Insurance Broker friends. No companies or no General Agents are available, in the New York City area.

I'd like to tell you about problems I can easily document.

Doctor S.L. Auto- has Jaguar and 20 year old son- rate system with higher limits adds \$1,000 to A.R. policy. I lost account.

Attorney S.W. Auto- three sons under 25- three Cadillacs- each car carries class2 rate. \$3,000 in overcharges. I lost account.

Insurance Broker M.R.- Only handles Auto. No Market. Fair Plan for Fire, not enough profit. Too much paperwork.

Insurance Broker S.G.- Lost Aetna C & S. Can't place his own Auto., 30 year.veteran broker. Good driver.

Client L.A.- Employs 100 people. Has fire-proof sprinkler building. Can't get enough fire at a decent normal rate. Risks insolvency.

Insurance Broker P.P. - Has to sue Home Insurance Company because of unilateral commission cut from 15% to 10%. This is below cost.

Insurance Broker-Agent B.P. - Same problems. Commissions cut, and constant replacement problems with market trimming. He is here today to testify.

Insurance Broker-Agent M.B. - has a problem with Hartford, they will not take Auto.

Policyholder L.B. - Auto - has three sons under 25 - 2 cars and 5 drivers. Pays highest rate in Brooklyn, by age,sex, and marital status. Is subject to all marketing turbulence. He is here today.

Policyholder J.G. Auto- male, 23, Brooklyn. Could'nt buy new car, Chev., and insurance rate of \$3400 with higher limits and collision. Instead bought 1976, with low limits and no collision. When he married he had to sell car because even \$1500 was too high, and he preferred to stay married. His letter enclosed.



I would like the Committee to allow these memos and evidence, and to hear the cries of pain from the others who are here, inflicted by the economic tyranny of the carriers.

Many others who would like to be heard could be added to the roles, but are either inarticulate, scurrying to earn a living or have such a sense of hopelessness, against all the opposition or fear retribution by the carriers or of losing their agency representation.

My association strongly endorses the Bill under discussion. It is the only ray of hope on the horizon. Massachusetts and Michigan have come a long way forward, but there are 50 other States, in a \$90 Billion Dollar yearly market.

WE URGE FULL SUPPORT AND CO-SPONSORSHIP BY ALL THE SENATORS, AND ALL IN THE CONGRESS.

Brokers are literally forced to

- 1- guarantee loss ratios-or they are dumped
- 2- guarantee collection of all earned premium
- 3- required to balance personal lines with commercial
- 4- tied in sales with life companies

Auto and Fair Plan bonus rates subsidize the up-state drivers, who are paying less than normal rates. That's the fact, not the other way around.

#### CONCLUSION

Submitted with this statement is a rate chart showing auto rates that are at least 50% lower than deliverable, by the New York Senate Insurance Committee, in order to justify the present discrimination by age, sex, marital status, territory and surcharging some of the people for moving violations. Closed Market conditions cause all forms of redlining and discrimination. There is no earthly reason why 95% of the people cannot pay a uniform, fair price, with market accessibility to all carriers, made readily available, even if it takes the Congress to do it.

I hope this general discussion about monopoly pricing and distribution problems will be of help in your on-going investigation and will give you an idea of the parameters of the present levels



With which we are grappling.

Mr. Chairman, that concludes my remarks. I would be delighted to respond to any questions the Sub-Committee may have

1977 CHEVROLET IMPALA OR FORD GALAXY 500 - COMPREHENSIVE INSURANCE RATES (FIRE & THEFT)

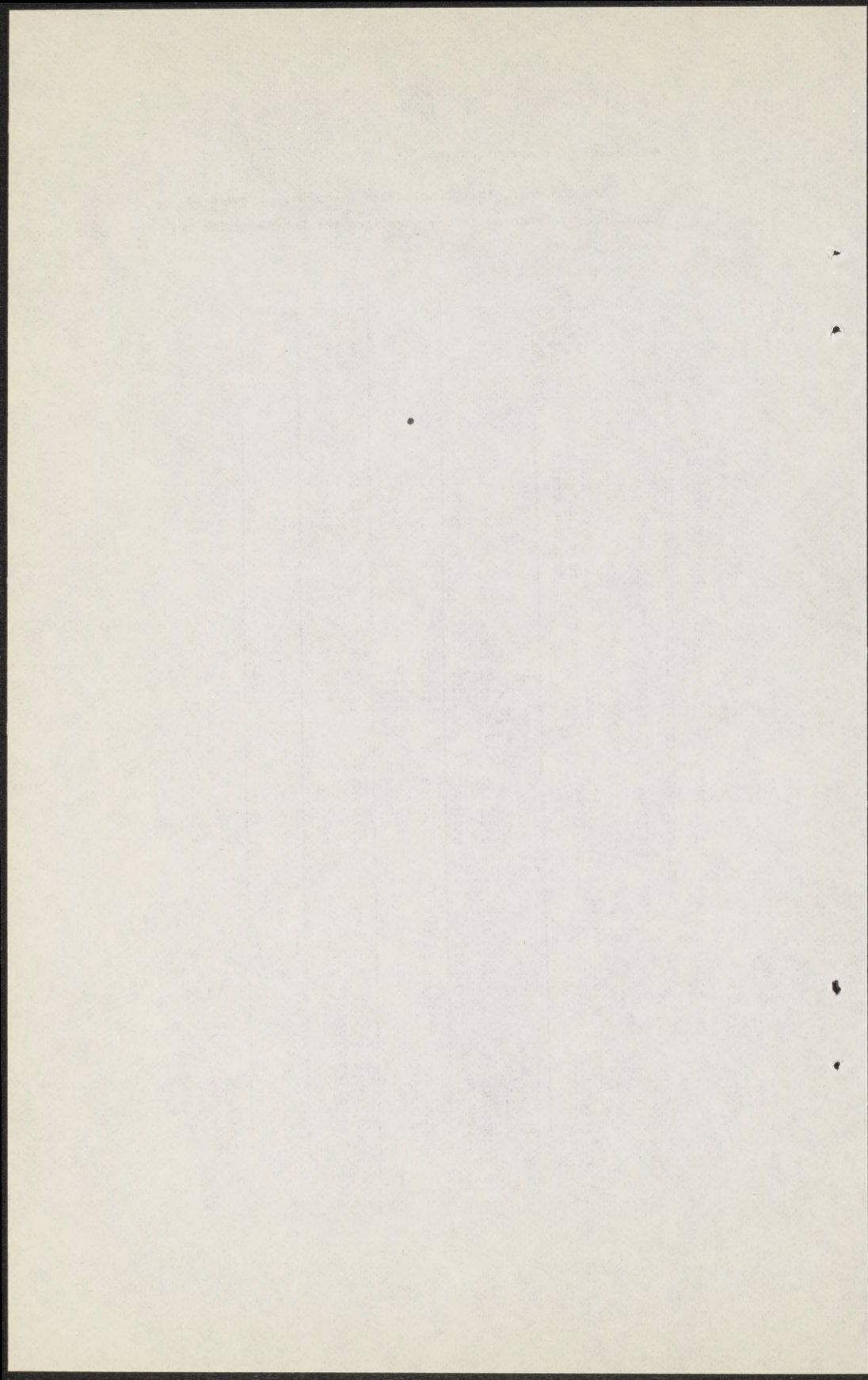
\$50 DEDUCTIBLE WITH FULL GLASS COVERAGE, PLEASURE USE

(ISO) INSURANCE SERVICES OFFICE - ADVISORY RATES

(\*) RATES IN USE BY MAJOR INSURER

| PRINCIPAL DRIVER                  | 32 yr. old married male or female | 21 yr. old single male | 21 yr. old single female | 17 yr. old single male without driver training credit | 17 yr. old single female w/o driver training credit |
|-----------------------------------|-----------------------------------|------------------------|--------------------------|-------------------------------------------------------|-----------------------------------------------------|
| AREA                              |                                   |                        |                          |                                                       |                                                     |
| KINGS CO.<br>(Brooklyn)           | \$256 ISO                         | \$525 ISO              | \$282 ISO                | \$858 ISO                                             | \$410 ISO                                           |
|                                   | \$271 *                           | \$556*                 | \$298*                   | \$907*                                                | \$434*                                              |
| QUEENS CO.<br>(Suburban Queens)   | \$150 ISO                         | \$368 ISO              | \$165 ISO                | \$593 ISO                                             | \$240 ISO                                           |
|                                   | \$194*                            | \$475*                 | \$213*                   | \$766*                                                | \$310*                                              |
| NASSAU CO.<br>(Town of Hempstead) | \$ 70 ISO                         | \$172 ISO              | \$ 77 ISO                | \$277 ISO                                             | \$112 ISO                                           |
|                                   | \$ 56*                            | \$137*                 | \$ 62*                   | \$221*                                                | \$ 90*                                              |
| COLUMBIA CO.                      | \$ 50 ISO                         | \$123 ISO              | \$ 55 ISO                | \$198 ISO                                             | \$ 80 ISO                                           |
|                                   | \$ 43*                            | \$105*                 | \$ 47*                   | \$170*                                                | \$ 69*                                              |
| ALBANY CO.<br>(City of Albany)    | \$ 39 ISO                         | \$ 96 ISO              | \$ 43 ISO                | \$154 ISO                                             | \$ 62 ISO                                           |
|                                   | \$ 33*                            | \$ 81*                 | \$ 36*                   | \$130*                                                | \$ 53*                                              |







96TH CONGRESS  
2D SESSION

# S. 2474

To amend the McCarran-Ferguson Act to limit the antitrust immunity of insurance companies, to improve the operation of competition in the business of insurance, and for other purposes.

---

## IN THE SENATE OF THE UNITED STATES

MARCH 25 (legislative day, JANUARY 3), 1980

Mr. METZENBAUM introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

## A BILL

To amend the McCarran-Ferguson Act to limit the antitrust immunity of insurance companies, to improve the operation of competition in the business of insurance, and for other purposes.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*  
3       That this Act may be cited as the "Insurance Competition  
4       Improvement Act".

5               FINDINGS AND DECLARATION OF PURPOSE

6       SEC. 2. (a) The Congress finds and declares that—



1           (1) the Federal antitrust laws comprise an essen-  
2           tial component of congressional policy in favor of com-  
3           petition and consumer protection, and the current  
4           broad immunity from the antitrust laws afforded the in-  
5           surance industry has weakened competition and ad-  
6           versely affected consumers of insurance; and

7           (2) although the continued regulation and taxation  
8           by the several States of the business of insurance is in  
9           the public interest, regulation by most States with re-  
10          spect to certain lines of insurance does not adequately  
11          protect the vital interests of consumers of insurance in  
12          fair and equitable pricing and full availability of essen-  
13          tial coverages, or sufficiently promote price competition  
14          among insurers.

15          (b) It is the purpose of this Act to achieve, without  
16          delay, improvements in State regulation of insurance in order  
17          to guarantee fair and equitable competitive pricing, to elimi-  
18          nate unfairly discriminatory classifications and rate differen-  
19          tials, and to ensure full availability of essential coverages,  
20          and to encourage and assist the States in meeting this re-  
21          sponsibility by—

22                (1) modifying the current antitrust immunity of  
23                the business of insurance, and

24                (2) establishing Federal minimum standards gov-  
25                erning competition in the business of insurance while



1 maintaining the primary responsibility and authority for  
2 insurance regulation in the States.

3 AMENDMENTS TO THE M'CARRAN-FERGUSON ACT

4 SEC. 3. (a) Section 1 of the Act entitled "An Act to  
5 express the intent of the Congress with reference to the regu-  
6 lation of the business of insurance", approved March 9, 1945  
7 (15 U.S.C. 1011; known as the McCarran-Ferguson Act), is  
8 amended by striking out the period and inserting in lieu  
9 thereof the following: ", provided that the several States reg-  
10 ulate the business of insurance in accordance with the provi-  
11 sions of this Act."

12 (b) Section 2(b) of that Act is amended to read as  
13 follows:

14 "(b)(1) The antitrust laws shall not be construed to pro-  
15 hibit the joint gathering by insurers, or the gathering by asso-  
16 ciations of insurers or rating bureaus, of information on losses  
17 incurred by insurers, except that no insurer shall make use of  
18 such joint loss data in setting the price of any insurance cov-  
19 erage unless such use is essential to the operation of that  
20 insurer's business and the data generated by its own experi-  
21 ence for such coverage are so sparse that a reasonable degree  
22 of actuarial credibility is lacking.

23 "(2) The antitrust laws shall be construed to prohibit—

24 "(A) the joint gathering by insurers, or gathering  
25 by associations of insurers or rating bureaus, of infor-







1 amended by striking out sections 5 and 6 and the heading  
2 thereto, and by adding after section 4 the following:

3 "SEC. 5. As used in this Act, the term—

4 "(1) 'antitrust laws' means the Sherman Act (15  
5 U.S.C. 1 et seq.), the Clayton Act (15 U.S.C. 12 et  
6 seq.), and the Federal Trade Commission Act (15  
7 U.S.C. 41 et seq.);

8 "(2) 'Commissioner' means the commissioner, su-  
9 perintendent, or director of insurance of a State, or, in  
10 a State in which the business of insurance is regulated  
11 by a board or commission composed of two or more  
12 members, such board or commission;

13 "(3) 'homeowners insurance' means insurance  
14 against loss, damage, or liability arising in connection  
15 with the ownership, occupancy, or use of an owner-  
16 occupied house, including the contents thereof and ad-  
17 jacent property, and including but not limited to such  
18 perils as fire, theft, wind, rain, hail, and riot, and lia-  
19 bility for personal injury or property damage;

20 "(4) 'included coverage' means property, home-  
21 owners, tenants, and private passenger motor vehicle  
22 insurance (except commercial property insurance for  
23 which the annual policy premium exceeds \$5,000);

24 "(5) 'insurable risk' means any risk other than a  
25 risk that creates a potential for loss so great in relation



1 to a normal premium for a risk similarly classified, on  
2 the basis of characteristics particular to that risk deter-  
3 mined on an individual, nonaggregated basis, that no  
4 prudent insurer would voluntarily underwrite it;

5 “(6) ‘overcharge’ means the difference between  
6 the expected losses of an individual insured under a  
7 policy providing any included coverage, combined with  
8 a reasonable allowance for insurer expenses and profit,  
9 and the premium charged such individual for coverage  
10 under a rating plan applicable to such policy, where  
11 the premium exceeds the sum of such expected losses  
12 and allowance;

13 “(7) ‘private passenger motor vehicle insurance’  
14 means insurance against loss, damage, or liability aris-  
15 ing in connection with the ownership or operation, for  
16 personal but not commercial purposes, of an auto-  
17 mobile, truck, motorcycle, or other motor vehicle, and  
18 including but not limited to such perils as collision,  
19 fire, theft, vandalism, and flood and liability for person-  
20 al injury or property damage;

21 “(8) ‘property insurance’ means insurance against  
22 loss or damage arising in connection with the owner-  
23 ship, occupancy, or use of real and tangible personal  
24 property at fixed locations, whether for personal or



1 commercial purposes, and including but not limited to  
2 such perils as fire, theft, wind, rain, hail, and riot;

3 “(9) ‘residual market mechanism’ means an ar-  
4 rangement among insurers for the equitable allocation  
5 of the premiums, losses, and expenses of insuring per-  
6 sons who are unable to obtain coverage in a voluntary  
7 contract with an insurer, other than as a result of the  
8 requirements of this Act or similar provisions;

9 “(10) ‘State’ means each of the several States,  
10 the District of Columbia, Puerto Rico, American  
11 Samoa, Guam, and the Virgin Islands; and

12 “(11) ‘tenants insurance’ means insurance against  
13 loss, damage, or liability arising in connection with the  
14 occupancy or use of leased or rented residential real  
15 property, including the contents thereof and adjacent  
16 property, and including but not limited to such perils  
17 as fire, theft, wind, rain, hail, and riot, and liability for  
18 personal injury or property damage.

19 “SEC. 6. No policy of property, homeowners, tenants,  
20 or private passenger motor vehicle insurance may be issued,  
21 sold, or delivered unless it is in conformance with the follow-  
22 ing standards:

23 “(a) DISCRIMINATION.—

24 “(1) No insurer may discriminate in the sale, issu-  
25 ance, underwriting, or rating of any policy providing



1       any included coverage, or processing of an application  
2       therefor, on the basis of sex, marital status, race, color,  
3       religion, national origin, occupation, personal living  
4       habits, appearance, marital history, or political activi-  
5       ties, except that insurers may vary rates on the basis  
6       of occupational duties if their discharge directly and  
7       demonstrably causes increased exposure to loss.

8       “(2) Except in the case of occupational duties, no  
9       insurer may use statistics showing losses of groups of  
10      insureds compiled on the basis of any classification or  
11      characteristic specified in paragraph (1) as a basis for  
12      any action which is contrary to this subsection.

13      “(3) Nothing in this section shall be construed to  
14      prevent an insurer who regularly provides insurance  
15      coverage solely to persons of a single religious affili-  
16      ation from continuing to provide insurance solely to  
17      persons of that religious affiliation.

18      “(b) AVAILABILITY, CANCELLATION, AND RE-  
19      NEWAL.—

20      “(1) No insurer may cancel, fail to renew (at the  
21      policyholder's option), or refuse to make available to  
22      any applicant, in conformance with the same rates,  
23      rules, and terms applied to its other policyholders in-  
24      sured with comparable coverage, any included cover-



1 age which it generally provides, except for any of the  
2 following reasons or conditions:

3 "(A) Nonpayment of premiums after reason-  
4 able notice.

5 "(B) Fraud or material misrepresentation in  
6 the application for insurance or renewal thereof or  
7 in the filing of a claim.

8 "(C) In the case of private passenger motor  
9 vehicle insurance, if the operator's license or  
10 motor vehicle registration of the applicant, named  
11 insured, or any other person covered under the  
12 application or policy is under suspension or revo-  
13 cation at the time of cancellation, nonrenewal, or  
14 application.

15 "(D) If the applicant or insured is not an in-  
16 surable risk.

17 "(E) If the insurer which refuses coverage  
18 has been found by the commissioner of the State  
19 in which such refusal occurs to have exhausted its  
20 capital capacity to write any new policies provid-  
21 ing included coverages and has been ordered not  
22 to write any such policies.

23 "(2) Any cancellation or nonrenewal notice issued  
24 by an insurer shall state specifically and fully the  
25 reason or reasons for such cancellation or nonrenewal.



1           “(3) Any insurer which refuses to issue a policy  
2       providing any included coverage shall provide any ap-  
3       plicant therefor with timely notice of the refusal to  
4       insure, including a specific and full statement of the  
5       reason or reasons for such refusal.

6           “(4) Any insured or applicant who receives notice  
7       of a refusal to insure, cancellation, or nonrenewal shall  
8       be entitled to review thereof by an appropriate State  
9       official.

10       “(c) CLASSIFICATIONS AND TERRITORIES.—

11           “(1) No classification category, territorial or other  
12       geographic distinction, or other grouping of risks may  
13       be used by any insurer to establish rate differentials  
14       unless it has been approved by the appropriate com-  
15       missioner as fair, just, reasonable, and not unfairly  
16       discriminatory.

17           “(2) In reviewing any classification category, geo-  
18       graphic distinction, or other grouping of risks proposed  
19       for use, the commissioner shall give substantial weight  
20       to—

21           “(A) the compatibility of the use of the char-  
22       acteristic by which the grouping is defined with  
23       widely held social values;



1           “(B) the degree of incentive created by the  
2           use of such characteristic for the reduction and re-  
3           tention of losses by individual insureds;

4           “(C) the degree to which such characteristic  
5           is causally linked to likelihood of loss and control-  
6           lable by individual insureds;

7           “(D) the accuracy of pricing which results  
8           for each individual insured so grouped;

9           “(E) the homogeneity with respect to poten-  
10          tial for loss which results from the use of the  
11          grouping; and

12          “(F) the degree of statistical separation of  
13          the grouping of insureds from the remainder of  
14          the insured population which results from the use  
15          of the category.

16          “(3) With respect to private passenger motor ve-  
17          hicle insurance, any classification plan which varies  
18          rates and premium charges on the basis of characteris-  
19          tics of insured drivers shall include a merit rating plan  
20          which establishes differentials in premium charges to  
21          insureds whose policies cover drivers found to have  
22          been at fault in a motor vehicle accident or convicted  
23          of a moving traffic violation during the three-year  
24          period preceding the period for which coverage is to be  
25          in effect. The differentials imposed under any such



1 merit rating plan shall be reasonable, fair, and nonpu-  
2 nitive and shall bear a reasonable relationship to the in-  
3 creased likelihood of loss under such a policy.

4 “(d) RATE DIFFERENTIALS BY CLASSIFICATION AND  
5 TERRITORY.—No rate differential between insureds which is  
6 based solely on differences in classification grouping or geo-  
7 graphic location may be used unless it has been approved by  
8 the appropriate commissioner as meeting the following  
9 criteria:

10 “(1) Rate differentials based solely on classifica-  
11 tion grouping or geographic location shall be reason-  
12 able, fair, and just.

13 “(2) Such differentials shall be neither unfairly  
14 discriminatory nor excessive.

15 “(3) In the determination of such differentials—

16 “(A) allocation of general and acquisition ex-  
17 penses by classification and territory shall reason-  
18 ably reflect actual differences in the costs of serv-  
19 icing different classes of insureds;

20 “(B) no actuarial method of computation may  
21 be used which systematically overcharges individ-  
22 uals in the highest rated combinations of classifi-  
23 cation and territory; and

24 “(C) primary weight shall be given to the ac-  
25 curacy of rating of each individual member within



1           any classification or territorial grouping, the  
2           avoidance of large overcharges of individual in-  
3           sureds, and a broad distribution among insureds of  
4           the costs of environmental hazards over which in-  
5           sureds have little or no control.

6           “(4) In the rating of private passenger motor ve-  
7           hicle insurance within a State, the maximum allowable  
8           rate differential based on differences in the principal  
9           place of garaging of an insured vehicle or any other  
10          rating factor based on geographic distinctions among  
11          insureds shall be a factor of 2. The ratio of the highest  
12          rate to the lowest rate in a State for two insureds sim-  
13          ilarly situated in all respects other than geographic lo-  
14          cation shall not exceed 2 to 1. An insurer shall not  
15          employ a territorial base rate in a territory for private  
16          passenger motor vehicle insurance that is less than 90  
17          percentum of the territorial base rate employed in any  
18          adjacent territory for the same coverage. The maxi-  
19          mum allowable rate differential based on all differences  
20          in classification (other than merit rating, mileage  
21          driven, geographic location, and make, model, age,  
22          value, or damageability of an insured motor vehicle)  
23          shall be a factor of 2.

24          “(5) In the rating of property, homeowners, and  
25          tenants insurance within a State, the maximum allow-



1       able rate differential based on geographic distinctions  
2       among insureds shall be a factor of 1.5. The ratio of  
3       the highest rate to the lowest rate in a State for two  
4       insureds similarly situated in all respects other than  
5       geographic location shall not exceed 1.5 to 1. The  
6       maximum allowable rate differential based on all differ-  
7       ences in classification other than geographic location  
8       and physical condition and characteristics of the in-  
9       sured property shall be a factor of 1.5.

10       “(6) No insured, whether insured through a resid-  
11       ual market mechanism or not, may be charged by an  
12       insurer at rates other than those generally charged by  
13       such insurer to insureds similarly classified.

14       “(7) Any person insured through a residual  
15       market mechanism shall receive coverage under the  
16       same terms, rates, conditions, and rules as apply to  
17       similarly situated insureds not insured through such  
18       mechanism.

19       “SEC. 7. No policy form providing any included cover-  
20       age may be issued, sold, or delivered unless it is written in  
21       clear, readable language, is printed in type sufficiently large  
22       to be easily read by a person of average eyesight, is orga-  
23       nized in a readily understandable manner, and is easily com-  
24       parable on the basis of scope of coverage and price with  
25       policy forms providing similar coverage.



1       “SEC. 8. (a) Except as provided in subsection (b), with  
2 respect to any included coverage neither the commissioner  
3 nor any other governmental or public authority of a State  
4 shall have the right to disapprove or otherwise challenge the  
5 statewide average rates charged by an insurer as excessive  
6 as applied, in the aggregate, to all such insurer's policy-  
7 holders within a State. Nothing in this subsection shall be  
8 construed to prohibit the commissioner of any State from ex-  
9 ercising full regulatory authority in all other respects, includ-  
10 ing the power to disapprove, over rating classifications,  
11 rating territories, and applicable differentials.

12       “(b)(1) Any State may by statute restore to the commis-  
13 sioner full regulatory authority over any included coverage,  
14 including the authority to disapprove or to fix and establish  
15 rates, except that no State may take such action within  
16 eighteen months of enactment of this section.

17       “(2) Any State may grant authority to the commissioner  
18 to make a determination, for any included coverage, that  
19 competition is insufficient to assure that rates will not be  
20 excessive or so conducted as to be destructive of competition  
21 or detrimental to the solvency of insurers, and, on the basis  
22 of such determination, to disapprove or to fix and establish  
23 rates for any included coverage. Any such determination  
24 shall be made after a public hearing, on the basis of findings  
25 of fact, and subject to review by an appropriate State court.



1 No commissioner may make such a determination within  
2 eighteen months of enactment of this section.

3 "SEC. 9. (a) The commissioner of each State shall pre-  
4 pare, update, and cause to be distributed to all prospective  
5 and current insureds, consumer shopping guides for each in-  
6 cluded coverage at least once a year. Each guide shall con-  
7 tain summaries of the scope of the coverage and specific rela-  
8 tive price information, including rankings on a statewide rate  
9 level basis and percentage differentials, for all writers of the  
10 coverage with a significant share of the market in the State.

11 "(b) All insurers writing any included coverage, and  
12 agents of such insurers, shall provide, no later than the time  
13 of application, a copy of the appropriate guide to all appli-  
14 cants for any included coverage, and shall promptly give spe-  
15 cific quotations of the premium for any included coverage to  
16 persons who make reasonable inquiries therefor, either orally  
17 or in writing, as requested.

18 "SEC. 10. (a) No insurer may cancel an agent's contract  
19 or otherwise terminate an agent's authority to represent the  
20 insurer with respect to any included coverage on the basis of  
21 either the geographic location of the agent's business or the  
22 actual or expected loss experience of the agent's business.

23 "(b) No insurer may cancel an agent's contract or other-  
24 wise terminate an agent's authority to represent the insurer  
25 with respect to any included coverage unless the insurer noti-



1 files in writing, not less than ninety days before such cancella-  
2 tion or termination, the agent and the appropriate commis-  
3 sioner. Such notice shall provide the reason or reasons for the  
4 cancellation or termination, including supporting evidence.  
5 Any agent receiving such notice shall be entitled to review  
6 by the appropriate commissioner.

7       “(c) Compensation of agents and brokers paid in connec-  
8 tion with the sale or issuance of any policy providing any  
9 included coverage through a residual market mechanism shall  
10 be determined in accordance with the same terms, rates, con-  
11 ditions, and rules as apply for similar policies not insured  
12 through a residual market mechanism.

13       “SEC. 11. Each insurer writing any included coverage  
14 within a State shall file with the appropriate commissioner,  
15 on or before the effective date of rates for any included cover-  
16 age, every applicable manual of rules and rates, rating plan,  
17 and manual of classification, and all applicable underwriting  
18 rules, manuals and guidelines, and every modification there-  
19 of. Each filing shall include full and complete supporting in-  
20 formation, including statistical data. Each insurer shall con-  
21 currently file data showing a geographical breakdown by  
22 rating territory of the insurer's new and renewal business,  
23 cancellations, nonrenewals, and applications. All filings and  
24 supporting information shall be open to public inspection.



1       “SEC. 12. (a) REMEDIES.—(1) Except as limited by  
2 subsection (c) hereof, any person who is aggrieved by any  
3 violation of this Act may maintain a civil action in an appro-  
4 priate State or Federal court, if a reasonable effort has been  
5 made to exhaust available administrative remedies. In any  
6 such action, the court may continue the case for a period not  
7 to exceed ninety days in order to require exhaustion of such  
8 speedy and effective administrative remedies as are available.  
9 The district courts of the United States shall have jurisdiction  
10 over any such action without regard to the amount in contro-  
11 versy or the citizenship of the parties.

12       “(2) If a violation is established in a civil action brought  
13 under paragraph (1), the plaintiff shall be entitled to receive  
14 for each violation the greater of three times the actual dam-  
15 ages sustained or \$1,000, and reasonable attorney’s fees.

16       “(b) ENFORCEMENT.—Both the commissioner and the  
17 attorney general of each State shall have authority to enforce  
18 all provisions of sections 5 through 11 of this Act. The com-  
19 missioner shall have authority to order any insurer or other  
20 person to cease and desist from any violation of such provi-  
21 sions. The attorney general of each State shall have the au-  
22 thority to intervene in administrative proceedings brought to  
23 consider any alleged violation or to petition a court of compe-  
24 tent jurisdiction to enjoin the continuation of any act or prac-  
25 tice contrary to the provisions of sections 5 through 11 of this



1 Act, order restitution of any moneys paid by any person pur-  
2 suant to any act or practice determined to be a violation, and  
3 impose fines of no less than \$1,000 for each violation.

4 “(c) STATE ACTION.—In any State which has enacted  
5 into law the provisions of sections 5 through 12 of this Act,  
6 no action for any violation of these standards may be main-  
7 tained in a Federal court.

8 “SEC. 13. The Federal Insurance Administrator shall  
9 conduct a study to assess the implementation and enforce-  
10 ment of the provisions of this Act. The commissioner of each  
11 State shall submit such information concerning implementa-  
12 tion and enforcement of these standards as the Administrator  
13 requires. No later than three years subsequent to the effec-  
14 tive date of this section, the Administrator shall submit to  
15 Congress a detailed report documenting the extent of compli-  
16 ance by insurers with the standards and the actions taken by  
17 each State to implement and enforce them.

18 “SEC. 14. Any provision of State law that is inconsis-  
19 ent with the provisions of this Act is preempted by this  
20 Act.”.

21

#### EFFECTIVE DATE

22 SEC. 5. This Act and the amendments made by this Act  
23 are effective six months after the date of enactment of this  
24 Act.



## LETTERS



Andre Maisonnier  
Vice President

1" 1

Alliance of American Insurers

1776 F Street, N.W.  
Washington, D.C. 20006

202-331-0313

May 30, 1980

The Honorable Howard M. Metzenbaum  
Chairman  
Subcommittee on Antitrust Monopoly and Business Rights  
Senate Committee on the Judiciary  
Room 347  
Russell Senate Office Building  
Washington, DC 20510

Dear Mr. Chairman:

In the course of my recent testimony on S.2474, the Insurance Competition Improvement Act, twice, the accuracy of my responses to questions were challenged, once from the audience and once by your staff. I have since checked into the accuracy of my responses and both times I find I was correct. The challenges were inappropriate.

The first challenge, this one articulated by attorney Ashley Brown, a prior witness, related to the price differentials between Ohio FAIR Plan insurance and voluntary property insurance. I stated that there is no surcharge in Ohio for FAIR Plan coverage and, I stand on that statement. FAIR Plan coverage in Ohio is priced at the ISO's advisory rate -- the same rate used by companies that have adopted the ISO advisory rate structure for private business. This, of course, does not mean that every company in Ohio uses the ISO advisory rate for property insurance. Contrary to the impression you obviously have, there is stiff price competition in Ohio for property as well as other insurance coverages and the different competing companies will charge different rates -- some below the ISO advisory and some in excess of the ISO advisory.

Accordingly, Mr. Brown's interjectory comment was incorrect.

The second challenge deals with the insurance coverage available under the Illinois FAIR Plan. In answer to one of your questions I stated that the Illinois FAIR Plan provides for homeowners coverage as well as fire and extended coverage for those policyholders desiring to purchase such coverage. Your staff indicated that this was not so. I have rechecked the accuracy of my answer and would be glad to provide you, for the record, a copy of the Illinois FAIR Plan Rules and Procedures which clearly identify the availability of homeowner coverage if so desired by a policyholder.

I would appreciate it if this letter could be made part of the record.

Sincerely,

A handwritten signature in dark ink, appearing to read "Andre Maisonnier", written over a horizontal line.

AM:lbd

cc: All members of the Subcommittee on Antitrust, Monopoly and Business Rights





Washington Office

Alliance of American Insurers  
1776 F Street, N.W.  
Washington, D.C. 20006  
202-331-0313

July 3, 1980

The Honorable Howard M. Metzenbaum  
Chairman  
Subcommittee on Antitrust, Monopoly and Business Rights  
Senate Committee on the Judiciary  
Room 347  
Russell Senate Office Building  
Washington, DC 20510

Dear Mr. Chairman:

During the recent hearing held May 29, 1980, by the Subcommittee on Antitrust, Monopoly and Business Rights concerning your legislation S.2474, the Insurance Competition Improvement Act, I was most surprised to understand you to say that an Insurance Commissioner of the Ohio Insurance Department had informed you that the Ohio Department did not have control over rate filings made to the Ohio Insurance Department by insurance companies. I perceived you to mean the Ohio Department of Insurance does not have authority or the means to regulate rates filed in Ohio by insurers.

Being part of Ohio's voting constituency and having an insurance background, I was quite concerned about your statement. I am familiar with the statutory authority granted to the Ohio Department of Insurance by the Ohio Legislature. A brief description of the law is set forth below.

"The property and casualty division of the Ohio Insurance Department has been charged by the Ohio General Assembly to review all rating rules, rates and policy forms filed by the 573 property and casualty insurers licensed in Ohio. These filings deal with the areas of title, homeowners, liability, auto and surety insurance. Homeowners insurance, rating rules, rates and policy forms are filed by the insurers under Chapter 3935, of the Ohio Revised Code. Chapter 3935 as enacted by the legislature requires filings to be processed on a prior approval basis, with a 15-day 'deemer' clause. This means that filings are not effective until 15 days after they are filed with the department, unless the department gives approval during this period."

This means that Ohio Insurance Laws require consideration be given to: "Past and prospective loss experience, countrywide and in Ohio; catastrophe hazards; dividends returned to policyholders; a reasonable margin for underwriting profit and contingencies; and past and prospective expenses, in Ohio and countrywide."



"The Ohio General Assembly has authorized liability and automobile rates to be filed with the Department under Chapter 3937 on a 'file and use' basis. This means that, by statute, each filing becomes effective on the filing date or on the date requested by the insurer. The Department has no authority to disapprove a rating rule or rate before it is effective." Here again, Ohio Insurance Laws require each filing to take into consideration: "Past and prospective loss experience, in Ohio and countrywide; the experience or judgement of the insurer making the filing; physical and catastrophe hazards; the experience of other insurers; a reasonable margin for underwriting profit; dividends to be returned to policyholders and past and prospective expenses, in Ohio and countrywide. All rates filed under Chapters 3935 and 3937 are required not to be inadequate, excessive or unfairly discriminatory."

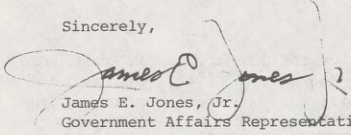
It is clear from the above that the Department has been granted the authority by the Ohio General Assembly to review insurance rates, either prior to their being put in effect by the companies or immediately thereafter.

We trust this information will be beneficial to you and your staff and may help to clear up some facts regarding the authority of the Ohio Department of Insurance in regulating rates.

I would appreciate this letter being made part of the record.

If you have questions, I would be happy to respond.

Sincerely,



James E. Jones, Jr.  
Government Affairs Representative

JEJ:lbd



DALMA GRANDJEAN, Executive Director  
Attorney at Law

SANDRA K. HOBSON  
ASHLEY C. BROWN  
DIANNE M. ADKINSON  
Managing Attorneys

JOHN ALLEN WILMES  
ROBERT A. OAKLEY  
Senior Attorneys

VICTORIA E. ULLMANN  
JOHN D. POLEY  
VIRGINIA M. PLATT  
PAUL D. HARMON  
JERI J. SIMMONS  
JACK LONGERT  
Attorneys



# LEGAL AID SOCIETY OF DAYTON

REIBOLD BUILDING, SUITE 525  
117 SOUTH MAIN STREET  
DAYTON, OHIO 45402

(513) 228-8104

NANCY E. POLLITT  
Office Manager

BOYSE L. BOSLEY  
STEVE E. CHAFFIN  
Law Clerks

BETTY J. STIDHAM  
DONNA T. HALL  
KIM N. BEASLEY  
Paralegals

PATRICIA EADY RAINNEY  
Intake Coordinator

THOMAS GLASPER  
Community Education  
Specialist

February 19, 1981

Honorable Howard M. Metzenbaum  
United States Senate  
Washington, D.C. 20510

Attention: Stuart Kemp

Dear Senator Metzenbaum:

I am writing as a follow-up to my testimony before your subcommittee on Anti-Trust on May 29, 1980. As you recall, during the testimony of Mr. Maisonnier, I objected to his allegation that the coverage available from the Ohio Fair Plan, at that time, was comparable to that obtainable in the voluntary market. I would like to take this opportunity to elaborate on the reasons for my objections to Mr. Maisonnier's statement.

By law, the rates for the Ohio Fair Plan coverage are set by the major rating organization of our state, I.S.O. Standard practice in the industry, however, is not to follow in blind obedience to I.S.O.'s rates. Rather, it is to utilize I.S.O. as a frame of reference in making their own rates. Thus, those companies seriously interested in providing adequate coverage at affordable rates, usually deviate downward from the rates set by I.S.O. Any policy-holder or prospective policy-holder who has been relegated to the Fair Plan for coverage, however, does not have the opportunity to shop around for rates in the voluntary market which are usually significantly less than I.S.O. Rather, the Fair Plan policy-holders must pay the I.S.O. rate which is higher than most voluntary companies charge their customers.

Another serious concern as of May 29, 1980 was that the only coverage available from the Fair Plan was fire insurance. Thus, a Fair Plan policy-holder was not only stuck with higher rates, but was also limited in the amount of coverage he or she could obtain. Since my testimony, Ohio has authorized the Fair Plan to offer homeowners' coverage. However, while the first year's rates will be set by I.S.O., the Fair Plan Board which is dominated by the insurance industry, will have the discretion to set whatever rates it desires in subsequent years. Thus, it would appear that Fair Plan rates will move significantly upward for those who seek Fair Plan homeowners' coverage and the difference between voluntary rates and residual market rates will become greater.

## AN AFFIRMATIVE ACTION EMPLOYER

DAVID L. HALL  
PRESIDENT

EUGENE ROBINSON  
VICE PRESIDENT

BONNI BRANDON  
SECRETARY

KURT R. PORTMANN  
TREASURER



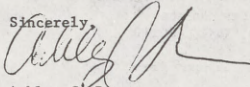
Honorable Howard M. Metzenbaum  
February 19, 1981  
Page 2

For the reasons that I have set forth in this letter, I stand on my objections to Mr. Maisonnier's representation that Ohio Fair Plan rates were substantially equivalent to those found in the voluntary market. Indeed, I was disappointed by Mr. Maisonnier's efforts to mislead this Committee into believing what he must have known to have been inaccurate.

I would very much appreciate that this letter be incorporated into my testimony at the May 29, 1980 hearing. I would appreciate your cooperation in doing same.

Thank you very much.

Sincerely,



Ashley C. Brown  
Attorney at Law

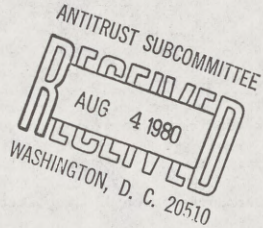
ACB:s



PROFESSIONAL  
INSURANCE  
AGENTS  
OF NEW YORK STATE, INC.

P.O. Box 196  
Glenmont, New York 12077  
518-434-3111

Donald K. Gardiner, CAE, Executive Director



July 30, 1980

The Honorable Howard M. Metzenbaum  
United States Senate  
Washington, D.C. 20510

Dear Senator Metzenbaum:

We have noted with a great degree of interest the evolution and filing of your "Insurance Competition Improvement ACT" (H.R. 2474).

Enclosed with this letter is a statement dealing with the bill by our association President, Mr. Norman R. Cohen. Please enter this statement in the record of your present round of hearings on the measure.

If you desire additional copies of the document or any further input from us, please let us know.

Sincerely,

A handwritten signature in cursive script that reads "Irving B. Mickey".

Irving B. Mickey  
Director of Governmental Relations

IBM/amb  
Enclosure



PREPARED STATEMENT OF PROFESSIONAL INSURANCE AGENTS OF  
NEW YORK

STATEMENT RE: HR 2474, THE "INSURANCE COMPETITION IMPROVEMENT ACT"  
FROM: PROFESSIONAL INSURANCE AGENTS OF NEW YORK STATE, INC.,  
P.O. BOX 196, GLENMONT, NEW YORK 12077  
TO: SENATOR HOWARD M. METZENBAUM, CHAIRMAN, SENATE JUDICIARY  
ANTITRUST SUBCOMMITTEE, WASHINGTON, D.C.



Mr. Chairman, according to your statement as printed in the Congressional Record of March 25, 1980, the primary purposes of this measure are "to amend the McCarran-Ferguson Act to limit the antitrust immunity of insurance companies (and) to improve the operation of competition in the business of insurance . . ."

Among other objections to the bill, the approximately 11,000 independent insurance agents and their employees who comprise the membership of the Professional Insurance Agents of New York State, Inc., strongly oppose the first objective outlined in this statement, and we seriously question the approach to the second objective.

Specifically, the antitrust immunity granted by the McCarran-Ferguson Act was indeed the real basis for the subsequent state regulation of the business of insurance. Without this immunity, which would be eliminated by Section 3 of HR 2474, state regulation would at best be a hollow shell, always subject to federal intervention.

Furthermore, despite the fact that it professes to leave regulation of the business to the states, HR 2474 actually almost totally emasculates existing state insurance laws and substitutes for them a rigid set of new federal standards.

We simply cannot accept either the elimination of the antitrust immunity or the new standards as spelled out in the present bill. We'll have more to say about several of the individual standards in a moment.

We certainly agree with any attempt to eliminate the politics-prone prior approval rating system, which has already created an insurance disaster area in our neighboring state of New Jersey. However, we feel that HR 2474 falls far short of achieving this goal.



For example, by a simple legislative action permitted under Section 8 of the bill, a state could delegate to its insurance commissioner the full power to return to a system of prior approval rating, if he finds that "competition is insufficient. . ." In other words, far from being assured by the passage of HR 2474, the perpetuation of open competitive rating will still ultimately rest upon the whim of the state insurance commissioner and, directly or indirectly, upon the political pressures brought to bear against him to hold the line on insurance rates.

Our third major objection is to the rigid restrictions which Section 3(b) of the measure would place upon rating bureaus. For example, it would prohibit: (1) use by any one company of bureau-compiled loss data, except where the company's own experience is too sparse to provide a reasonable degree of actuarial credibility; (2) gathering of expense data by bureaus; and (3) joint determination of loss development factors, claim frequency trends, claim adjustment expense factors and profit allowances.

We do, of course, recognize the relationship between bureau operations and the concerns held by some over possible misuse of the present antitrust immunity of the insurance industry. However, we feel that this bill has gone completely overboard in its restrictions on rating bureaus and would seriously decrease their effectiveness as statistical gathering organizations. Perhaps some of the larger insurance companies might be able to live with this situation, but for many of our smaller insurance carriers, which rely heavily on bureau acquired statistical data, this could lead to disaster.

We also object to five of the new standards set forth in Section 6 of the bill, as follows:

1. Section 6(a) would prohibit discrimination in underwriting or rating of a policy based upon age, sex, marital status, race, color, religion, national origin, occupation, personal living habits, appearance, marital history or political activities. In short, the measure throws out virtually all of



the presently-used, long-proven rating criteria -- particularly age, sex and marital status -- and offers absolutely no substitutes for them. In conjunction with this point, we invite your attention to the recent administrative hearing decision in Florida which struck down the state insurance commissioner's self-imposed ban upon use of age, sex and scholastic standing as factors in automobile rating.

2. Section 6(b) prohibits refusal to issue, cancellation or non-renewal of included coverages, except for: non-payment of premium; fraud or misrepresentation in the application for coverage; in case of auto insurance, suspension or revocation of the driver's license or registration of anyone who normally operates the vehicle; the case where the applicant or the insured is not an insurable risk; or the case where the insurer has exhausted its writing capacity. We object to this subdivision, because, depending entirely upon state-by-state interpretation of the term "insurable risk", the provision could seriously impair the marketing and/or underwriting prerogatives of our insurance companies. In other words, it goes a very long way toward establishing an iron-clad system of full insurance availability which would ultimately have a depressing effect upon availability of the insurance products covered by the act.
3. Section 6(d) requires residual market plans to charge voluntary market rates. This flies directly in the face of abundant proof that losses in the residual markets consistently and substantially exceed those in the voluntary marketplace. For further substantiation of this statement, we invite your attention to a study released early in June of 1980 by the Alliance of American Insurers which reveals that, in the year 1978 alone, residual market underwriting losses and insolvency assessments totalled about \$738 million. Of this, nearly \$450 million or 61% of the industry's shared market losses occurred in the auto residual market.



4. Section 6(c) severely restricts development of rating territories and classifications and requires their approval by the commissioner of insurance in a given state. In this case, the bill, by its apparent intent and its actual wording appears to lay off onto the insurance industry the solution of very real social problems associated with geographical location by restricting the industry's ratemaking prerogatives. Again, as in the case of discrimination outlined in item 1 above, the bill offers absolutely no substitutes for these rating mechanisms, and it leaves the enforcement of these territorial provisions up to the discretion of the state insurance commissioner.
5. Section 6(d) caps auto rate differentials based upon geographical location at a maximum ratio of 2 to 1 (i.e., the ratio of the highest territorial rate in a state to the lowest). It similarly caps property rate differentials at a ratio of 1.5 to 1. This might be practical in some western states with very small populations and no really major urban centers. However, it could prove to be unfairly out of line in a heavily populated state such as New York, where the difference in loss potential between New York City and a rural upstate area are enormous. Furthermore, this kind of rate capping directly refutes the basic concept of open competitive rating supposedly espoused by this measure.

Finally, we object to two additional provisions of HR 2474, as follows:

1. Section 9 of the bill requires a state commissioner of insurance to prepare, update and cause to be distributed to all prospective and current insureds consumer shopping guides for each included coverage at least once a year. We have four specific objections to this proposal: (a) the cost of preparation of these guides can become exorbitant, and that cost will ultimately wind up being paid by the consumer; (b) the guides are based entirely upon a comparison of price and ignore other benefits which may be



offered by one company as opposed to another company; (c) the price statistics included in such publications almost invariably favor a handful of relatively large companies against the many smaller companies; and (d) because of the time involved in the gathering of statistical data and publication of the guides, they are almost always completely out of date by the time they reach the consumer's hands.

2. Section 12 provides for triple damage awards to insureds in certain cases. This would seem to encourage still further litigation in this already overly litigious age -- i.e., it would encourage every disgruntled insurance consumer to sue his insurance company for additional amounts of money purely on the basis of technicalities of law.

In short, this measure represents just about the ultimate in federal intervention in the regulation of the private insurance business. When seen in that light, its passage would be very much contrary to the best interests of the insurance consumer. It should not be allowed to pass.

Respectfully submitted,

NORMAN R. COHEN, PRESIDENT

July 30, 1980

○



