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*Insurance Regulation: History, Background, and Recent
Congressional Oversight*

Baird Webel, Government and Finance Division

February 11, 2005

Abstract. States are now the primary regulator of insurers. Some insurers joined by some banks with insurance affiliates believe that current state insurance regulation hinders their effective competition with other financial intermediaries. Congress has several interests in any examination of state insurance regulation. In the 1945 McCarran-Ferguson Act it ceded that insurance regulatory authority to the states, but it also committed to assessing the effectiveness of this regulation. Another is to assess the marketplace after the Gramm-Leach-Bliley Act, which dramatically revised regulation for most of the financial services industry, but left insurance regulation essentially unchanged. The objective of this report is to frame these issues in their historical and substantive contexts. The frame will have several parts. One is that insurance regulation developed at the state level largely because most companies were local. A second is that, until 1945, the courts said that Congress did not have the constitutional authority to regulate insurance. Third, since the 1950s, Congress and the National Association of Insurance Commissioners (NAIC) have been engaged in a ongoing dialogue about the nature and quality of state regulation, which has led both to the substantial growth of the NAIC and to increasing federal legislative involvement in insurance regulation. Fourth, insurance is now regulated at both the state and national level.

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CRS Report for Congress

Insurance Regulation: History, Background, and Recent Congressional Oversight

Updated February 11, 2005

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Prepared for Members and
Committees of Congress

Insurance Regulation: History, Background, and Recent Congressional Oversight

Summary

Since the current insurance regulatory framework was established by Congress in the McCarran-Ferguson Act of 1945, various proposals have been advanced to revise this system. In the past few years, Members of Congress and various interest groups have put forward ideas including a full-scale federal insurance regulator, an optional federal charter, and a federally mandated, but state controlled, harmonization of state regulation. Proponents of federal involvement have argued that the current system puts insurers at a significant disadvantage in competing with other financial institutions, both nationally and internationally, who have more streamlined regulatory systems. Opponents have argued that the federal option is unnecessary and would weaken consumer protection. Congressional committees have held numerous hearings examining the arguments and evidence put forth by the various sides in the debate.

Insurance regulation began in the states in the early 19th century. In the mid-19th century, the Supreme Court decided *Paul v. Virginia*, which foreclosed federal regulation of insurance. State regulation of insurance grew in scope and scale during the next 80 years.

The Court reversed itself in 1945 in *South-Eastern Underwriters v. U.S.*, establishing that Congress did have authority to regulate insurance and insurers. At the time, many worried that *South-Eastern Underwriters* vitiated state authority to tax and regulate insurers, so Congress enacted the McCarran-Ferguson Act. The act ceded to states the authority to regulate insurance and exempted insurers from most federal antitrust laws.

Since 1945, several trends have emerged. Courts have circumscribed the antitrust exemption substantially, congressional involvement in and oversight of insurance has increased, and the National Association of Insurance Commissioners (NAIC) has adopted a national role in establishing standards for states' regulation of insurers' financial solvency. The NAIC has also become involved in establishing international standards for insurance regulation.

This report provides the historical background for examining the arguments in this debate. It shows that state regulation of insurance is largely a historical artifact, that Congress has become increasingly involved in both regulating insurance and overseeing states' regulation of insurance, and that the National Association of Insurance Commissioners has assumed a national role. It will be updated only following major legislative action.

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Insurance Regulation: History, Background, and Recent Congressional Oversight

Overview

States are now the primary regulator of insurers. Some insurers — joined by some banks with insurance affiliates — believe that current state insurance regulation hinders their effective competition with other financial intermediaries. They want a more uniform system and many have called for the option of obtaining a federal charter and subjecting themselves to a single, federal regulator. State insurance regulators and other insurers disagree, believing that state regulation can provide more uniform and efficient regulation and does provide better consumer protection.

Congress has several interests in any examination of state insurance regulation. In the 1945 McCarran-Ferguson Act it ceded that insurance regulatory authority to the states, but it also committed to assessing the effectiveness of this regulation. Another is to assess the marketplace after the Gramm-Leach-Bliley Act, which dramatically revised regulation for most of the financial services industry, but left insurance regulation essentially unchanged.

The objective of this report is to frame these issues in their historical and substantive contexts. The frame will have several parts. One is that insurance regulation developed at the state level largely because most companies were local. A second is that, until 1945, the courts said that Congress did not have the constitutional authority to regulate insurance. Third, since the 1950s, Congress and the National Association of Insurance Commissioners (NAIC) have been engaged in an ongoing dialogue about the nature and quality of state regulation, which has led both to the substantial growth of the NAIC and to increasing federal legislative involvement in insurance regulation. Fourth, insurance is now regulated at both the state and national level.

Basics of Insurance Regulation

Only a state may charter an insurer. Once chartered by a state, an insurer must obtain a license in each state where it plans to sell policies. Its external business practices — such as its marketing, advertising, and policyholder services — are regulated separately in each state where it sells policies, under laws and rules that often vary state to state. In theory, only the state that charters the insurer regulates its internal business practices. This principle is generally observed in the breach, however, as the largest states (such as New York and California) regulate the solvency and internal business practices of each insurer doing business in their states, under laws and rules that also vary state to state. Some observers would say that an

insurer selling policies in 50 states and the District of Columbia has 51 regulators, each with slightly different or very different requirements. The National Association of Insurance Commissioners sets standards for both market practices and solvency, though individual states may modify or ignore any NAIC standard.¹

Why Regulate Insurers?

The purpose of insurance regulation, stated classically, is to protect consumers by monitoring the solvency of insurers and their business practices. The idea was that consumers were not in an equal bargaining position with insurers, so it was necessary for the government to regulate the terms of insurance contracts. Likewise, it was necessary, since the consumer was purchasing a promise that the insurer would perform in the future, for the government to regulate prices in order to prevent insurers from charging either too little — which would endanger the insurer's solvency and render the promise illusory — or too much — which would be unfair.

Insurance has also been regulated for economic, social, and political purposes. Since the 1960s, Congress has stepped in when markets have actually failed or when its constituencies have perceived that the market has failed.² In some cases Congress has created new programs, such as Medicare, or has revised insurance regulation to expand availability, such as authorizing risk retention groups. In other cases Congress has created new standards for insurance, such as those for Medigap insurance. State legislators have responded to market failures, or the perception of market failures, by mandating certain benefits in health insurance policies or by creating special programs, such as California's earthquake pool and Florida's windstorm pool.³ These decisions represent regulation to make insurance available and affordable to anyone who wants its benefits — federal and state efforts to make health insurance both available and affordable is the classic example.

Insurance has also been regulated to protect the insurance franchise. State insurance regulators have litigated for many years to maintain exclusive jurisdiction over federal banks' insurance activities, for example. Historically, insurers wanted regulation to protect their franchise — that is, to exclude other entities from the risk financing market. As alternative markets for financing risk have expanded, however, large insurers have found that current state insurance regulation is not a barrier-to-entry against their competitors not organized as insurers.

Some are now suggesting that insurance should be regulated, as are banks and capital markets, for macroeconomic purposes. After the terrorist attacks in New

¹ See Emmett J. Vaughan and Therese M. Vaughan, *Fundamentals of Risk and Insurance* (New York: John Wiley & Sons, Inc., 1996), pp. 103-110.

² A classic market failure is a lack of equilibrium in supply and demand. That disequilibrium can be caused by market structure, imperfect information, or externalities (e.g., terrorism). A perception of market failure can include a lack of equity, which is subjective. Robert S. Pindyck and Daniel L. Rubinfeld, *Microeconomics*, (Macmillan Publishing Co.: New York, 1989), pp. 617-644. See also Vaughan and Vaughan, *supra* note 2, pp. 97-98.

³ Vaughan and Vaughan, *supra* note 2, pp. 96-100.

York City on September 11, 2001, for example, global financial regulators — such as the Financial Stability Forum⁴ — have insisted on regulating international insurers for financial soundness and transparency. Other macroeconomic purposes would be to avoid regulatory arbitrage among financial sectors and to maximize efficiency of capital allocation.

Much of the debate about whether chartering of insurance companies should continue as solely a state function arises from the absence of a consensus on the purpose(s) of regulating insurance or types of insurance.

How Does State Regulation Work?

The solvency of each insurer is regulated primarily but not exclusively by its domiciliary commissioner. Each state requires the insurer to prepare its quarterly and annual financial statements in a very conservative format unique to insurance, known as “statutory accounting.”⁵ The NAIC as an organization sets the rules for statutory accounting and determines the content of the statements. Each insurer must file its statement with its domiciliary commissioner, with the commissioner in each state in which it is licensed or does business, and with the NAIC corporate office. Though the formats are usually similar to the NAIC’s, they are not identical, particularly among the larger states. Each state may make its own assessment of the solvency of insurers; in practice, many states rely heavily on the NAIC corporate office’s extensive financial database analysis in making that assessment.

Each state regulates the terms of each insurance contract sold to consumers in that state. Every insurer, as a condition of retaining its license to operate in that state, must obtain the insurance department’s prior approval of insurance policies to be marketed there. In many states, property-casualty companies selling personal lines coverage — such as automobile and homeowners insurance — must obtain prior approval of the rates they plan to charge as well as of the terms of the policies they plan to market. States’ regulation of commercial coverages is also extensive, though not all require prior approval of both rates and forms. All states regulate advertising; many require prior approval of advertising. In an attempt to reduce the regulatory burden on individual states and on insurers, the NAIC has recently established an online system for electronic rate and form filing (SERFF) and an online coordinated rate and form review authority (CAFRA).⁶ Observers disagree on whether these on-line filing and approval systems are providing or can provide regulatory uniformity and efficiency.⁷

⁴ The Financial Stability Forum ([<http://www.fsforum.org>]) is the group of central bankers, national financial authorities, and international regulatory and supervisory groups that cooperates in monitoring and promoting international financial stability.

⁵ Vaughan and Vaughan, *supra* note 2, pp. 140-156.

⁶ Further information is available at [<http://www.serff.org/>] and [<http://www.carfra.org/>]. These systems incorporate current state requirements.

⁷ See Lynna Goch, “Switching gears: Electronic rate and form filing can hasten product approvals, but adaptation is hampered by technological incompatibility and administrative (continued...)”

Each state regulates the internal and external business practices of insurers domiciled in that state, and many also regulate those licensed in their states as well. Often the NAIC has established standards for those business practices; most — but not all — states enact or promulgate those standards.⁸ These standards are known as the NAIC model laws and regulations. In the late 1980s and early 1990s, states' ability and commitment to regulate insurers for solvency was in question, subject to substantial criticism during the 103rd Congress. In response the NAIC began a voluntary program to encourage states to adopt those standards. States that adopted certain standards that the NAIC considered to be fundamental to solvency regulation were said to be "NAIC-accredited." Currently all states but New York are NAIC-accredited.⁹

What Is the NAIC?

The National Association of Insurance Commissioners (NAIC) is a private, voluntary association of the chief insurance regulatory officials of the 50 states, the District of Columbia, and the territories of American Samoa, Guam, Puerto Rico, and the Virgin Islands. Its "overriding objective is to protect consumers and help maintain the financial stability of the insurance industry by offering financial, actuarial, legal, computer, market conduct, and economic expertise [to insurance regulators]."¹⁰ It began in 1871 — and continued for nearly a century — as a cooperative effort by the appointed or elected regulators to share information and knowledge among themselves. The regulators were supported in their collective efforts by their own staffs, employed by the various states.¹¹

In 1968, a former regulator founded a support-and-services office to augment the regulators' state staffs. The office grew slowly; in 1978, for example, it had a budget of \$842,790.¹² It has now grown to 422 authorized staff positions and a budget of \$54 million, as of 2003. It is organized as a Delaware corporation and is headquartered in Kansas City, Missouri, with offices in New York City and Washington, DC. The term "NAIC" now also refers not only to the voluntary association of state regulatory officials but also to its professional and support staff, as well as their activities. The term "corporate NAIC" is used here to include the collective actions of the state insurance regulators, their own staffs of state

⁷ (...continued)

procedures," in *Best's Review*, vol. 102, Apr. 2002, p. 101.

⁸ See NAIC, *Model Laws, Regulations, and Guidelines*, vols. 1-5, (Kansas City, MO: 2003).

⁹ See NAIC, "Accredited States," updated June 2004, available at [<http://www.naic.org/frs/accreditation/map.htm>].

¹⁰ NAIC News Release, "NAIC Members Approve 2003 Budget," Dec. 8, 2002, available at [http://www.naic.org/pressroom/releases/rel02/120802_budget.htm].

¹¹ Eric C. Nordman, "The Early History of the NAIC," *Journal of Insurance Regulation*, vol. 19, Winter 2000, pp. 164-178.

¹² Comptroller General of the United States, *Issues and Needed Improvements in State Regulation of the Insurance Business*, PAD-79-72 (Washington: GPO, 1979), p. 174.

employees, and to their private, non-state staff employed by the corporation organized in Delaware.¹³

How is NAIC Funded?

The NAIC funds its corporate and collective activities by assessing fees for its services and publications. States require insurers to file their annual financial statements with the corporate NAIC for its analysis, and it charges each insurer a filing fee based on its premium volume. In 2003, those filing fees were 42% of the total corporate NAIC's revenue, which was \$58,234,435. Another 23% of its revenue came from sales of its publications, such as its guides on statutory accounting, examiners' handbooks, meeting reports, its model laws and regulations, and data compilations.¹⁴ Another 15% came from fees charged insurers for rating securities held in their portfolios and for admitting non-U.S. insurers into the U.S. market.¹⁵ In 2003, about 3% of the budget of NAIC's corporate activities — or \$1,815,610 — was funded by the states.¹⁶

How State Regulation Evolved

States Begin Chartering Insurers in 1795

States first created corporate insurers in the late 18th century by enacting individual statutes or charters for each insurer. These charters created rules that applied to that particular insurer. Successive charters developed a pattern, which became the rudiments of state insurance regulation. Massachusetts was the first state to require its insurers to submit annual informational reports, in 1818, and New Hampshire was the first state to set up an agency to regulate insurance, in 1851.¹⁷

Fire insurance and marine insurance were critical to early 19th century American businesses.¹⁸ They bought most marine insurance from European insurers and most

¹³ Some observers view as an anomaly a private, non-governmental entity having a “central and national role in insurance regulation, acting in many ways as a federal agency [but without power to] sanction regulators or insurers” Susan Randall, “Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners,” 26 *Florida State U. L. Rev.* 625, 639 (Spring 1999).

¹⁴ NAIC, Insurance Products and Services Division, available at [<http://www.naic.org/insprod/index.htm>].

¹⁵ NAIC, “Statement of Financial Position,” in *Annual Report 2002*, available at [http://www.naic.org/about/docs/03_annual_report.pdf], p. 24.

¹⁶ *Ibid.*

¹⁷ Spencer L. Kimball and Barbara P. Heaney, *Federalism and Insurance Regulation: Basic Source Materials* (Kansas City, MO: National Association of Insurance Commissioners, 1995), pp. 1-7.

¹⁸ Kenneth J. Meier, *The Political Economy of Regulation: The Case of Insurance*, (Albany: (continued...))

fire insurance from the growing number of American insurers. State governments taxed those policies for revenue, and in an effort to protect their local insurers, they taxed policies bought from out-of-state insurers at a much higher rate.¹⁹ In years with few large fires, fire insurers profited; after large fires, many local fire insurers became insolvent. The fire insurers addressed the insolvencies — what they perceived to be “destructive competition” — by establishing cartels to keep rates high enough to provide adequate reserves to cover future fires. State legislatures responded to the insolvencies by establishing administrative agencies to set reserve requirements and to collect information about company solvency.²⁰

Court Says Insurance Is Not “Interstate Commerce”

Insurers objected to the discriminatory taxes and to regulation, and in 1866 they challenged — in Congress and in the courts — the states’ authority to impose them. They were unsuccessful in persuading Congress to enact legislation²¹ and unsuccessful in a test case charging that states were depriving them of equal protection under the law and impeding interstate commerce.

In that test case, the U.S. Supreme Court disagreed with the insurers, holding in *Paul v. Virginia*²² in 1868 that a corporation was not entitled to the protections accorded a citizen under the Constitution and that an insurance contract was not an article of commerce within the meaning of its Commerce Clause. Therefore, the Court reasoned, the Commerce Clause did not deprive states of the power to tax and regulate out-of-state corporate insurers. Some analysts believe the Court may have reached this conclusion to curtail the growing power of corporations generally and to avoid “upset[ting] a host of state regulatory and taxing laws [which] would have left the insurance companies free for the time being from all control.”²³ The decision in *Paul v. Virginia* meant not only that states could continue to subject insurers from other states to requirements not imposed on local insurers but also that Congress arguably had no authority to regulate insurance policies. *Paul v. Virginia* was upheld in later challenges.

¹⁸ (...continued)

State Univ. of New York Press, 1988), pp. 50-56. Life and health insurance did not begin to grow until much later in the century. Ibid.

¹⁹ Paul R. Nehemkis, Jr., “Paul v. Virginia: The Need for Re-Examination,” 27 *Georgetown L. J.* 519, 524 (March 1939). This practice continued until the U.S. Supreme Court decided, in *Metropolitan v. Ward*, 470 U.S. 869 (1985), that it violated the Equal Protection Clause of the Constitution.

²⁰ Meier, *supra* note 20, p. 51-53.

²¹ Nehemkis, *supra* note 21, pp. 524-527. Later Congresses also declined to create a national insurance regulator or to endorse a constitutional amendment defining insurance as interstate commerce. Michael Rose, “State Regulation of Property and Casualty Insurance Rates, 28 *Ohio State L. J.* 669, 673-674 (1967); Sen. Walter, remarks in the House, *Congressional Record*, vol. 90, June 22, 1944, p. 6524.

²² 75 U.S. (8 Wall.) 168 (1868).

²³ Nehemkis, *supra* note 21, p. 534.

The National Association of Insurance Commissioners (NAIC) met for the first time in 1871, as the National Insurance Convention, to discuss how to harmonize regulation among the states. They agreed to adopt a uniform annual financial statement for life insurers.²⁴ States themselves began mandating policy forms for fire insurance. In New York, the Armstrong Committee scrutinized the growing life insurers, found serious abuses, and in 1906 recommended sweeping new laws to govern their internal operations. Some states followed New York's lead in enacting governance laws for insurers. The 1906 San Francisco earthquake bankrupted many fire insurers, and New York's Merritt Committee recommended collaborative rate setting for fire insurers to prevent future insolvencies. Most states followed New York's example in encouraging collaborative rate setting boards or bureaus.²⁵

Court Reverses; Says Insurance Is “Interstate Commerce”

Missouri did not follow New York's lead in allowing collaborative rate setting. Instead in 1922 it attempted to curtail fire insurance rate increases, but the fire insurers bribed the Pendergast political machine to maintain them. When the Missouri Attorney General discovered that in 1939, he and the U.S. Attorney General obtained a criminal indictment against the largest rate-setting bureau, the South-Eastern Underwriters Association, for violations of federal antitrust laws. The fire insurers challenged the charges on the ground that insurance was not commerce, based on *Paul v. Virginia*, and that therefore the federal court had no jurisdiction over them.

A divided Supreme Court disagreed with the insurers once more. It found, in *U.S. v. South-Eastern Underwriters Association*,²⁶ that the federal court did indeed have jurisdiction over them because insurance was clearly interstate commerce and Congress had authority under the Constitution to regulate interstate commerce. Congress had not acted to regulate insurance specifically, said the Court, but it certainly had the power to include insurers within the scope of the antitrust law, which four of the seven Justices voting determined Congress had done.²⁷ The Court's decision, though it did not do so expressly, effectively overruled *Paul v. Virginia*.

Because *South-Eastern Underwriters* held that insurance was interstate commerce, it caused consternation among insurers, regulators, and state legislators. The decision created uncertainty about whether and to what extent states could tax or regulate and about whether insurers could continue to use rating bureaus. Insurers, regulators, and the states asked Congress to clarify these issues quickly, and in March

²⁴ Randall, supra note 15, pp. 630-631.

²⁵ Meier, supra note 20, pp. 54-61.

²⁶ 322 U.S. 533 (1944); two justices took no part in the consideration of the case.

²⁷ Ibid. at 533-562. A fifth justice agreed that the challenged conduct violated the antitrust laws but did not think it necessary to determine whether insurance was commerce. He thought that if the conduct in question adversely affected commerce, then precedent allowed Congress to regulate it. Ibid. at 584-585 (opinion of Justice Jackson). See Rep. Hancock, remarks in the House, *Congressional Record*, vol. 91, Feb. 14, 1945, p. 1087.

1945 — nine months after *South-Eastern Underwriters* — Congress enacted the McCarran-Ferguson Act.²⁸

McCarran-Ferguson Act: Congress Cedes Regulation to the States and Exempts Insurers from Most Antitrust Laws

To many, *South-Eastern Underwriters* “threatened state jobs and state revenue.”²⁹ Seeking to preserve both, the NAIC drafted a bill to nullify the decision, and Senators McCarran of Nevada and Ferguson of Michigan introduced it. Though each house passed a slightly different bill, the conference committee’s version followed the NAIC’s draft closely.³⁰ The new law — known as the McCarran-Ferguson Act — emphasized congressional deference to the states’ taxation and regulation of the business of insurance and imposed a moratorium on enforcement of the federal antitrust laws.

In the act, Congress declared, as a matter of policy, “that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.”³¹ Congress implemented this policy in the act in three ways:

- It clarified that the states did have the power to tax insurance policies,³² which was vitally important to state coffers.³³ Though

²⁸ P.L. 79-15, 59 Stat. 33 (codified at 15 U.S.C. §§1011 et seq.).

²⁹ Kimball and Heaney, *supra* note 19, p. 35. See also Sen. Homer Ferguson, remarks in the Senate, *Congressional Record*, vol. 91, Jan. 25, 1945, pp. 478-479.

³⁰ Meier, *supra* note 20, pp. 68-69. Sen. Hatch, extension of remarks in the Senate, *Congressional Record*, vol. 90, Nov. 16, 1944, pp. A4403-A4408 (containing the NAIC’s draft, its cover letter, and its memorandum of explanation).

³¹ P.L. 79-15, sec. 1 (codified at 15 U.S.C. §1011). Both the House and Senate versions contained this declaration, which had been drafted by the NAIC. The NAIC, in transmitting the draft, had said to Congress:

The National Association of Insurance Commissioners sincerely believes that the States can adequately regulate the insurance business, and because of legal considerations and the close proximity of State supervisory officials to the people affected, are in a better position to regulate that business than the Federal Government. In that regard it has regulatory machinery available, including regulatory statutes and trained personnel.

Sen. Hancock, remarks in the Senate, *Congressional Record*, vol. 91, Feb. 14, 1945, p. 1087.

³² *Ibid.*, sec. 2(a) (codified at 15 U.S.C. §1012(a)).

³³ See, for example, remarks of Sen. Ferguson, *Congressional Record*, vol. 91, Jan. 25, 1945, p. 484 (noting that the state of North Carolina paid its pensions with revenue from insurance company premium taxes), and remarks of Rep. Gwynne, *ibid.*, Feb. 14, 1945, p. 1090 (noting that premium taxes paid to the states totaled about \$120 million annually).

the act’s legislative record is not extensive, it appears that cession of this authority to the states was not controversial.³⁴

- It limited the short-term application of the federal antitrust laws to the business of insurance by granting an immediate moratorium on their enforcement.³⁵ The purpose was to allow states to decide, during the period of the moratorium, whether to allow insurers to set rates collectively.³⁶ The breadth of the three-year moratorium was debated intensely on the House and Senate floors.³⁷ In both bodies, the majority agreed that the act would allow states — for the period of the temporary moratorium — to enact laws to regulate insurance that otherwise would not be allowed under federal antitrust laws, limited only by the act’s prohibition on boycotts, coercion, and intimidation.³⁸ They felt this time-limited exemption was necessary to give the insurance industry time “to make necessary adjustments” to the *South-Eastern Underwriters* decision.³⁹
- It also limited the long-term application of the antitrust laws to the business of insurance. In an amendment drafted in conference, the conference committee proposed extending the exemption from federal antitrust laws indefinitely, as long as and “to the extent” that state law regulated “the business of insurance.”⁴⁰ The amendment

³⁴ See, for example, President Roosevelt’s letter to Senator Radcliffe averring that “this administration is not sponsoring Federal legislation to regulate insurance or to interfere with the continued regulation and taxation by the States of the business of insurance.” Sen. Radcliffe, remarks in the Senate, *ibid.*, Jan. 25, 1945, p. 482.

³⁵ P.L. 79-15, sec. 3(a) (codified at 15 U.S.C. §1013(a)) (“Until June 30, 1948, the ... Sherman Act, ... the Clayton Act, ... the Federal Trade Commission Act, [and] the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.”).

³⁶ Sen. Ferguson, remarks in the Senate, *Congressional Record*, vol. 91, Jan. 25, 1945, p. 479.

³⁷ Sen. O’Mahoney, remarks in the Senate, *Congressional Record*, vol. 91, Jan. 25, 1945, p. 483; Rep. Bailey, *ibid.*, Feb. 14, 1945, p. 1091; Sen. Pepper, *ibid.*, Feb. 27, 1945, pp. 1477-1478.

³⁸ P.L. 79-15, sec. 3(b) (codified at 15 U.S.C. §1013(b)) (“Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.”).

³⁹ Sen. O’Mahoney, remarks in the Senate, *Congressional Record*, vol. 91, Jan. 25, 1945, p. 480 (quoting the unanimous report of the Senate Committee on the Judiciary (U.S. Congress, Senate Committee on the Judiciary, *Expressing the Intent of the Congress with Reference to the Regulation of the Business of Insurance*, report to accompany S. 340, 79th Cong., 1st sess., S.Rept. 20 (Washington: GPO, 1945))).

⁴⁰ The conference report amendment was that “after June 30, 1948 ... the Sherman Act, and ... the Clayton Act, and ... the Federal Trade Commission Act ... shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.” P.L.

(continued...)

engendered debate between Senator Pepper — who agreed with the moratorium but wanted insurers to conform their subsequent behavior to the federal antitrust laws — and Senator Ferguson. Senator Ferguson agreed with Senator Pepper that the amendment would give states the authority to enact laws permitting insurers to take action forbidden by federal antitrust laws.⁴¹ Unlike Senator Pepper, he thought that was an appropriate cession, since the act also said that no agreement to boycott, coerce, or intimidate, nor any act of boycott, coercion, or intimidation would be legal — whatever the states did⁴² — and since Congress could override any state law it found not in the public interest.⁴³ The majority of the Senate favored Senator Ferguson’s view, by a vote of 68 to 8.⁴⁴ The McCarran-Ferguson Act became effective March 9, 1945.

State Regulation Occupies the Field

By March 10, 1945, the NAIC had completed a model law on insurance rating in order to implement the preemption in McCarran-Ferguson. The model allowed cooperative rate-making, though it prohibited rates that were “excessive, inadequate, or unfairly discriminatory.”⁴⁵ It required rating bureaus to be licensed and to allow nondiscriminatory access to bureau rates, and it permitted any insurer that deviated from bureau rates to file and defend each deviation separately. No rate could be used

⁴⁰ (...continued)

79-15, sec. 2(b) (codified at 15 U.S.C. §1012(b)). This is often referred to as “reverse preemption,” meaning that Congress ceded its legislative authority over insurance to the states, absent any subsequent, specific, and express declaration from Congress to the contrary.

The exemption in the conference report amendment was more limited than the blanket exemption from the Sherman Act and the Clayton Act that Congress had considered in the industry-sponsored Walter-Hancock bill (H.R. 3270, introduced in the 78th Congress). Though the House had passed the Walter-Hancock bill, the Senate had not — under threat of veto. See Rose, *supra* note 23, pp. 693-694; Meier, *supra* note 20, pp. 68-69. See also Rep. Walter, remarks in the House, *Congressional Record*, vol. 90, June 22, 1944, p. 6524 (“The purpose of [H.R. 3270] is ... to reassert the intention which Congress had when it adopted the Sherman Act and the Clayton Act, and from which it has never deviated, that those acts shall not be applicable to the insurance business”).

⁴¹ “What we saw as wrong was the fixing of rates without statutory authority in the States; but we believe that State rights should permit a State to say that it believes in a rating bureau [as] all the wisdom is not here in Congress.” Sen. Ferguson, remarks in the Senate, *Congressional Record*, vol. 91, Feb. 27, 1945, p. 1481.

⁴² *Ibid.*, citing Sec. 3(b) of the act.

⁴³ “[T]here is no attempt here to have Congress throttled in the future in acting upon insurance legislation.” *Ibid.*, p. 1487.

⁴⁴ *Ibid.*, p. 1489.

⁴⁵ Kimball and Heaney, *supra* note 19, pp. 78-79.

without the insurance commissioner's prior approval.⁴⁶ Within a year, 37 states had enacted statutes similar to the NAIC's model. By 1951, all states had enacted laws to regulate property-casualty insurance rates.⁴⁷

In 1946, the NAIC drafted a model law to preempt the application of the Federal Trade Commission Act to the business of insurance.⁴⁸ The model — known as an Act Relating to Unfair Methods of Competition and Unfair and Deceptive Practices in the Business of Insurance — prohibited certain marketing and sales practices and gave the enacting state's insurance commissioner broad powers to investigate insurers.⁴⁹ All states enacted the model, though not as quickly as they had the rating laws.

NAIC intended to “occupy the field” of insurance regulation and thereby preempt federal law pursuant to the McCarran-Ferguson Act that it had advocated.⁵⁰ The relevant section of the act, however, granted the reverse preemption only “to the extent” that the “business of insurance” was regulated by state law.⁵¹ The scope of the reverse preemption depended, therefore, on several factors. One was the definition of “insurance:” Was “insurance” any contract issued by an entity chartered as an insurer? And who should decide that — state insurance regulators? A second was the breadth of the term “the business of insurance:” Did the “business of insurance” include any and all activities of insurers, or only some subset of them? The third factor was the meaning of the phrase “to the extent:” Could states gain preemption merely by enacting a statute, or did preemption depend on some level of enforcement of that statute? These were questions for the courts.

Courts Narrow Scope of McCarran-Ferguson Act

In the years since the passage of the McCarran-Ferguson Act, courts have substantially narrowed its scope. The important cases have arisen when insurers or the NAIC have asserted that the act exempts some activity or product from federal

⁴⁶ Meier, *supra* note 20, pp. 74-75.

⁴⁷ Meier, *supra* note 20, p. 76. Life insurance rates are not regulated, since historically life insurers did not set rates collectively or use rating bureaus.

⁴⁸ Randall, *supra* note 15, p. 634.

⁴⁹ Scott E. Harrington, “The History of Federal Involvement in Insurance Regulation,” in *Optional Federal Chartering and Regulation of Insurance*, Peter J. Wallison, ed. (Washington, DC: AEI Press, 2000), p. 26.

⁵⁰ Kimball and Heaney, *supra* note 19, pp. 62-62, 84.

⁵¹ P.L. 79-15, sec. 2(b) (codified at 15 U.S.C. §1012(b) (“No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the *business of insurance* ... unless such Act specifically relates to the *business of insurance*: Provided that after June 30, 1948, [the federal antitrust laws] shall be applicable to the *business of insurance to the extent* that such business is not regulated by State Law.”) (all emphasis added).

antitrust law or federal regulation or interference.⁵² The cases have, in effect, increasingly circumscribed the reverse preemption granted to state legislatures by the McCarran-Ferguson Act — or, as is sometimes said, they have led to “increasing federal involvement in insurance regulation.”⁵³

The courts have established that interpretation of McCarran-Ferguson is a federal question, not a state one. They have narrowed the definition of insurance — and therefore state insurance regulators’ jurisdiction — by subjecting some contracts issued by insurers to federal securities laws. They have narrowed the scope of the antitrust exemption by narrowing the definition of “the business of insurance” and by broadening the exemption’s exception for boycott.⁵⁴ In general, judicial interpretation of McCarran-Ferguson has substantially limited the antitrust exemption and circumscribed state authority exercised under the act. Courts have declined, however, to assess the quality or extent of state regulation.⁵⁵

Congress Reoccupies Major Parts of the Field

In the years since the 79th Congress ceded authority to regulate insurance, subsequent Congresses have reclaimed major parts of that authority from the states. Congress has intervened most often when the private insurance market has failed or its constituencies have perceived it was failing. The most notable example is, of course, health insurance — which many Congresses have addressed.

Past Congresses have been active in health insurance regulation. The 89th Congress passed the comprehensive health insurance plans known as Medicare⁵⁶ and Medicaid in 1965.⁵⁷ The 93rd Congress passed the Employee Retirement Income Security Act of 1974,⁵⁸ which placed employee benefit plans — including health plans — primarily under federal jurisdiction. That Congress also passed the HMO Act,⁵⁹ which set standards for health maintenance organizations wanting to become federally qualified. In 1980, the 96th Congress enacted minimum standards for

⁵² Kimball and Heaney, *supra* note 19, pp. 63-78.

⁵³ *Ibid.*, p. 170. See also *Dep’t of the Treasury v. Fabe*, 508 U.S. 491, 507-508 (1993) (“The McCarran-Ferguson Act did not simply overrule *South-Eastern Underwriters* and restore the status quo. To the contrary, it transformed the legal landscape by overturning the normal rules of preemption [It is therefore] impossible to compare our present world to the one that existed at a time when the business of insurance was believed to be beyond the reach of Congress’ power under the Commerce Clause.”)

⁵⁴ Harrington, *supra* note 51, pp. 26-27.

⁵⁵ See the appendix to this report for a review of the major historical cases.

⁵⁶ P.L. 89-97, 79 Stat. 290.

⁵⁷ P.L. 89-97, 79 Stat. 343.

⁵⁸ P.L. 93-406, 88 Stat. 829.

⁵⁹ P.L. 93-222, 87 Stat. 914.

Medigap insurance⁶⁰ to be enforced in cooperation with the National Association of Insurance Commissioners. In 1986, the 99th Congress enacted Title X of the Consolidated Omnibus Budget Reconciliation Act [COBRA],⁶¹ which required employers to make temporary health insurance available to employees that lose their jobs. In 1996, the 104th Congress passed the Health Insurance Portability and Accountability Act,⁶² which established minimum federal standards of availability and renewability for health insurance. Most of these measures have required extensive coordination among the states, the NAIC, and the federal government — subject to federal standards. Some observers have praised the resulting federalism,⁶³ others have criticized it.⁶⁴

In the 1980s — in reaction to the lack of availability of liability insurance — Congress enacted legislation to expand its availability.⁶⁵ The Product Liability Risk Retention Act of 1981 allowed businesses to self-insure their product liability risks collectively, and it exempted such special-purpose insurers from most state insurance regulation. Each special-purpose insurer — known as a risk retention group — was to be subject to limited regulation only in the state that chartered it. The act also allowed groups of businesses — known as purchasing groups — to purchase product liability insurance collectively. The 99th Congress expanded the scope of the preemption to allow risk retention groups to provide all types of liability insurance. Purchasing groups were similarly authorized.⁶⁶ As of February 2005, about 177 risk retention groups and 654 purchasing groups were operating in the United States, providing coverage for professionals, manufacturers, and property developers. Total premiums written by risk retention groups grew from \$250 million in 1988 to \$2.1 billion in 2004, and total premiums paid by purchasing groups grew from \$575 million in 1988 to an estimated \$4.6 billion in 2004.⁶⁷

⁶⁰ P.L. 96-265, 94 Stat. 476.

⁶¹ P.L. 99-272, 100 Stat. 222.

⁶² P.L. 104-191, 110 Stat. 1936.

⁶³ Len M. Nichols and Linda J. Blumberg, “A Different Kind of ‘New Federalism’? The Health Insurance and Portability and Accountability Act of 1996,” in *Health Affairs*, May/June 1998, pp. 39-40. See also Earl R. Pomery and Carole Olson Gates, “State and Federal Regulation of the Business of Insurance,” *Journal of Insurance Regulation*, vol. 19, Winter 2000, pp. 179-188.

⁶⁴ Randall, *supra* note 15, pp. 667-684, 699 (arguing that the NAIC’s central role — as a private, non-governmental organization “closely identified with the insurance industry” — erodes federalism).

⁶⁵ The Product Liability Risk Retention Act of 1981, P.L. 97-45, 95 Stat. 45, which was amended by P.L. 98-193, 97 Stat. 1344, and by the Risk Retention Amendments of 1986, P.L. 99-563, 100 Stat. 3170 (all codified at 15 U.S.C. §3901 et seq.). For additional information see CRS Report RL32176: The Risk Retention Acts: Background and Issues, by Baird Webel.

⁶⁶ P.L. 99-563, 100 Stat. 3170.

⁶⁷ Statistics from *The Risk Retention Reporter*, available at [http://www.rrr.com/education/growth.cfm].

Other examples of Congress acting to address actual or perceived failures in the private insurance market are flood insurance and crop insurance, which subsidize both the availability and affordability of coverage. A more recent example is the Terrorism Risk Insurance Act of 2002,⁶⁸ in which Congress provided a temporary backstop for insurers issuing property-casualty coverages of acts of international terrorism.

Congress Oversees State Regulation

Continuing congressional oversight has affected states' insurance regulation substantially. Since the early 1950s, Congress and state insurance regulators have engaged in a dialectic: Congress investigates the effectiveness or efficiency of state regulation, state regulators change regulation in response, and then interest and attention wane — until the cycle begins again.⁶⁹ The cycle has occurred several times since 1945.

McCarran-Ferguson Act to Representative Dingell's Reports

Congress began investigating the effectiveness of state insurance regulation in 1958 under the oversight of Senator O'Mahoney, who had been a principal architect of the McCarran-Ferguson Act.⁷⁰ The purpose was to assess "whether the States have faithfully honored the mandate of the McCarran-Ferguson Act ... by regulating the insurance industry in the public interest."⁷¹ The majority reports found state regulation lacking, incapable of dealing with interstate and international issues, and unwilling or unable to "bring the blessings of competition"⁷² to insurance rate-making. The state insurance regulators responded by holding their own hearings to address the rate-making issues noted in the Senate hearings and by recommending changes to their model rating law to increase competition.⁷³

⁶⁸ P.L. 107-297, 116 Stat. 2322. See CRS Report RS21444, *The Terrorism Risk Insurance Act of 2002: A Summary of Provisions*, and CRS Report RS21979, *Terrorism Insurance: An Overview*, both by Baird Webel.

⁶⁹ Harrington, *supra* note 51, pp. 21-22 and pp. 36-37; Randall, *supra* note 15, p. 640.

⁷⁰ U.S. Congress, Senate Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, *The Insurance Industry: Aviation, Ocean Marine, and State Regulation*, report pursuant to S.Res. 238, 86th Cong., 2nd sess., S.Rept. 1834, (Washington: GPO, 1960), p. III (letter of transmittal from Senator Joseph C. O'Mahoney to Senator James Eastland, June 27, 1960); U.S. Congress, Senate Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, *The Insurance Industry: Insurance: Rates, Rating Organizations and State Rate Regulation*, report pursuant to S.Res. 52, 87th Cong., 1st sess., S.Rept. 831, (Washington: GPO, 1961), p. III (letter of transmittal from Senator Estes Kefauver to Senator James Eastland, dated July 28, 1961).

⁷¹ S.Rept. 1834, p. 2.

⁷² S.Rept. 831, p. 7.

⁷³ Rose, *supra* note 23, p. 726. See also Meier, *supra* note 20, pp. 77-82.

In the late 1960s, insolvencies among insurers writing automobile coverage prompted a proposal to create a federal guaranty system for insurers, modeled on federal bank deposit insurance.⁷⁴ In response, state regulators drafted laws establishing state-run guaranty funds; and many states enacted them during the 1970s.⁷⁵ State regulators also established the first centralized early warning system to enable regulators to detect financially unstable insurers.⁷⁶ The NAIC commissioned a study by McKinsey & Co., which was presented in 1974. The report recommended specific improvements in financial regulatory practices and creation of market conduct supervision.⁷⁷ These efforts forestalled congressional action on a bill (S. 3884) introduced by Senator Brooke to create a federal guaranty fund and an optional federal charter for insurers.⁷⁸

NAIC's efforts did not, however, forestall congressional interest. Senator Metzenbaum, then chairman of the Subcommittee on Antitrust, Monopoly and Business Rights, held several hearings in the late 1970s on unfair discrimination in insurance rating.⁷⁹ The GAO issued a contemporaneous report criticizing states' failure to protect insurance consumers from, among other things, unfair discrimination by age and sex in automobile insurance.⁸⁰ A number of states responded by refusing to allow insurers to raise automobile insurance rates or by trying to eliminate sex as a rating factor.

In 1979, the Federal Trade Commission issued a staff report on life insurance cost disclosure, concluding that life insurers should disclose rates of return on policies.⁸¹ The FTC chairman testified in the Senate that the life insurance industry

⁷⁴ Sen. Thomas J. Dodd, remarks in the Senate, *Congressional Record*, vol. 112, Feb. 17, 1966, pp. 3373-3374.

⁷⁵ Harrington, *supra* note 51, pp. 27-28. All states now have these statutes, known as guaranty fund laws, which assess insurers to fulfill promises of their insolvent competitors and allow them to offset those assessments against their state premium taxes. A detailed history is Spencer L. Kimball and Noreen J. Parrett, "Creation of the Guaranty Association System," *Journal of Insurance Regulation*, vol. 19, Winter 2000, pp. 259-272.

⁷⁶ Harrington, *supra* note 51, p. 28.

⁷⁷ McKinsey & Co., Inc., *Final Report on Strengthening the Surveillance System*, (New York: McKinsey & Co., 1974). Also printed in 1974 *NAIC Proceedings*, vol. II, pp. 225-346.

⁷⁸ Harrington, *supra* note 51, p. 28. Senator Brooke introduced S. 3884, Federal Insurance Act, in the 94th Congress (1975-76).

⁷⁹ See, for example, U.S. Congress, Committee on the Judiciary, Subcommittee on Antitrust, Monopoly and Business Rights, 96th Cong., 1st sess., hearing on state insurance regulation, Oct. 9, 1979 (Washington: GPO, 1979).

⁸⁰ Comptroller General of the United States, *Issues and Needed Improvements in State Regulation of the Insurance Business*, PAD-79-72, (Washington: GPO, 1979), included cover transmittal letter from the Comptroller General to the President of the Senate and the Speaker of the House of Representatives (undated letter and page not numbered).

⁸¹ Bureau of Consumer Protection and Bureau of Economics, U.S. Federal Trade Commission, *Life Insurance Cost Disclosure: Staff Report to the Federal Trade Commission* (continued...)

was not competitive because consumers lacked that information.⁸² Both industry and regulators protested, and by May 1980 Congress had curtailed the FTC's authority to investigate the business of insurance.⁸³

Rates for commercial liability coverage spiked in the mid-1980s,⁸⁴ and calls for repeal of the insurance industry's antitrust exemption rose in tandem. In response, state insurance regulators persuaded the rating bureaus to stop promulgating rates that included profit and expense loadings; only data on the historical development and trends in pure losses were published thereafter.⁸⁵ Individual states tried to control rates, and insurers began to withdraw from states that legislated rate-control.⁸⁶ Congress considered, but did not enact, a bill to revise McCarran-Ferguson to apply the federal antitrust laws to the insurance industry.⁸⁷

Representative Dingell's Reports

In 1990, Representative John Dingell, who was then chair of the House Energy and Commerce Committee, released a report entitled "*Failed Promises: Insurance Company Insolvencies*."⁸⁸ It described the huge property-casualty insolvencies of the late 1980s,⁸⁹ detailed the "scandalous mismanagement and rascality"⁹⁰ that caused them, and determined that state insurance regulation was "seriously deficient."⁹¹ It found "an appalling lack of regulatory controls to detect, prevent, and punish ...

⁸¹ (...continued)

Commission, July 1979 (Washington: GPO, 1979).

⁸² U.S. Congress, Committee on Commerce, Science, and Transportation, *Federal Trade Commission's Study of Life Insurance Cost Disclosure*, hearings, 96th Cong., 1st sess., July 10 and Oct. 17, 1979 (Washington: GPO, 1980), pp. 6-7.

⁸³ Federal Trade Commission Improvement Act of 1980, P.L. 96-252, 94 Stat. 374, 375-376 (codified at 15 U.S.C. §46, last paragraph).

⁸⁴ Meier, *supra* note 20, pp. 90-93, details the causes, which included an explosion of asbestos litigation and a contraction in the reinsurance market.

⁸⁵ Harrington, *supra* note 51, p. 30.

⁸⁶ Meier, *supra* note 20, pp. 98-99.

⁸⁷ *Ibid.*, p. 101. Sen. Simon introduced S. 2458, Insurance Competition Act of 1986, in the 99th Congress.

⁸⁸ U.S. Congress, Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, *Failed Promises: Insurance Company Insolvencies*, 101st Congress, 2nd sess., Committee Print 101-P (Washington: GPO, 1990) (hereinafter *Failed Promises*).

⁸⁹ The California receiver of Mission Insurance Company estimated its insolvency would cost the public \$1.6 billion. *Ibid.*, p. 12. The Missouri receiver of Transit Casualty Company estimated its losses at \$3 billion to \$4 billion. *Ibid.*, p. 31.

⁹⁰ *Ibid.*, p. III (letter of transmittal).

⁹¹ *Ibid.*

[wrongdoers].”⁹² It criticized state insurance regulation for allowing insurers to hand over management authority to agents and for failing to prevent holding company affiliates from “milking” insurers. It said that “[s]olvency regulation in the United States suffers from inadequate resources, lack of coordination, infrequent regulatory examinations, poor information and communications, and uneven implementation.”⁹³ It deplored how little state regulators actually knew about non-U.S. reinsurers and about insurers’ estimates of their own future losses. Finally, it admonished state insurance regulators for not pursuing and punishing persons responsible for insurance company insolvencies, stating that their efforts were “hampered by resource deficiencies, procedural and jurisdictional problems, limited penalties, and unwillingness to pursue wrongdoers.”⁹⁴ Not only did the report substantively criticize the effectiveness of state insurance regulation, it also discussed imposing federal solutions.⁹⁵

The report — together with contemporaneous GAO reports⁹⁶ — galvanized state regulators and the insurance industry. State insurance regulators agreed to endorse a set of financial regulation standards, which it recommended that each state adopt and implement. These included critical NAIC model laws and regulations, staff qualifications, funding and resource requirements, as well as essential departmental practices and procedures.⁹⁷ Teams of knowledgeable regulators would assess each state insurance department’s implementation of them; any state that met the standards would then be accredited by the NAIC.⁹⁸ State regulators felt this process would not only assure effective solvency regulation but also stave off federal regulation.⁹⁹ By 1992 year-end, 10 states were accredited. That did not stop the insolvencies — among them Executive Life, Inter-American, and Mutual Benefit.

⁹² Ibid.

⁹³ Ibid., p. 4.

⁹⁴ Ibid., p. 5.

⁹⁵ Ibid., pp. 75-76.

⁹⁶ The General Accounting Office also criticized state insurance regulation. U.S. General Accounting Office, *Insurance Regulation: State Reinsurance Oversight Increased, but Problems Remain*, GAO Report GGD-90-82 (Washington: May 1990); U.S. Congress, Senate Committee on Commerce, Science and Transportation, statement of Johnny C. Finch, Director for Planning and Reporting, General Government Division, GAO, *Insurance Industry: Questions and Concerns about Solvency Regulation*, GAO Testimony T-GGD-91-10 (Washington: Feb. 27, 1991)

⁹⁷ See 1989 *NAIC Proceedings*, vol. II, June 4-8, 1989, pp. 33-37.

⁹⁸ A full description of the NAIC’s accreditation process, as it has evolved, is available at [http://www.naic.org/frs/accreditation/docs/frsa_6-04.pdf].

⁹⁹ 1992 *NAIC Proceedings*, vol. I, Dec. 9-12, 1991, at 6 (remarks of Commissioner Harold Duryee).

Congress scrutinized the accreditation process¹⁰⁰ and the major life insurer insolvencies that were occurring.¹⁰¹ In 1994 Representative Dingell issued another major report entitled “*Wishful Thinking: A World View of Insurance Solvency Regulation*.”¹⁰² The majority report warned that “solvency regulation in the United States is based in many ways on wishful thinking.”¹⁰³ It found that, although the NAIC had expended massive efforts and resources, it lacked the national and international authority to “achieve the promises made to its members and the public.”¹⁰⁴ According to the chairman, the subcommittee reached these conclusions:

- “Rascality, speculative excess,” and incompetence will always chase the money in insurance.
- “Insurance regulation ... is a supervisory Babel “
- Insurance company operations reach around the globe and “form a closely interwoven network that responds to money and markets, rather than political boundaries.”
- As the world’s largest market, the U.S. relies heavily on foreign insurance capacity, “and the responsibility for protecting its citizens is spread among 50 States and a passel of foreign governments.”
- NAIC must have federal assistance because it lacks “the necessary authority and resources.”

¹⁰⁰ U.S. Congress, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, statement of Richard L. Fogel, Assistant Comptroller General, General Government Programs, GAO, *Insurance Regulation: Assessment of the National Association of Insurance Commissioners*, GAO Testimony T-GGD-91-37 (Washington: May 22, 1991); U.S. Congress, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, statement of Richard L. Fogel, Assistant Comptroller General, General Government Programs, GAO, *Insurance Regulation: The Financial Regulation Standards and Accreditation Program of the National Association of Insurance Commissioners*, GAO Testimony T-GGD-92-27 (Washington: Apr. 9, 1992); U.S. Congress, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, statement of Richard L. Fogel, Assistant Comptroller General, GAO, *Insurance Regulation: The National Association of Insurance Commissioners’ Accreditation Program Continues to Exhibit Fundamental Problems*, GAO Testimony T-GGD-93-26 (Washington: June 9, 1993).

¹⁰¹ U.S. Congress, Senate Committee on the Judiciary, Subcommittee on Antitrust, Monopolies and Business Rights, statement of Richard L. Fogel, Assistant Comptroller General, General Government Programs, GAO, *Life/Health Insurer Insolvencies and Limitations of State Guaranty Funds*, GAO Testimony T-GGD-92-15 (Washington: April 28, 1992); U.S. Congress, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, report to the Chairman, *Insurance Regulation: Weak Oversight Allowed Executive Life to Report Inflated Bond Values*, GAO Report GGD-93-35 (Washington: Dec. 1992); U.S. Congress, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, report, *Insurance Regulation: Shortcomings in Statutory Asset Reserving Methods for Life Insurers*, GAO Report GGD-94-124 (Washington: June 3, 1994).

¹⁰² U.S. Congress, Committee on Energy and Commerce, Subcommittee on Oversight and Investigations,., *Wishful Thinking: A World View of Insurance Solvency Regulation*, 103rd Cong., 2nd sess., Committee Print 103-R (Washington: GPO, 1994).

¹⁰³ *Ibid.*, p. 1.

¹⁰⁴ *Ibid.*, p. 10.

- Insurance regulators should focus on solvency regulation and actively search for rule-breakers.¹⁰⁵

Wishful Thinking's minority report made significant observations as well. It agreed with the majority's goals of "(1) uniform national minimum solvency standards, (2) meaningful enforcement, and, (3) controlling alien insurers and reinsurers."¹⁰⁶ It objected, however, to the majority's implication that only a federal regulator could accomplish these goals, favoring instead "strengthening, not dismantling, the current State regulatory system."¹⁰⁷ It proposed three possible models for improving solvency regulation:

- Congress might grant the NAIC authority to register foreign insurers and reinsurers.
- Congress could consent to a compact among states to regulate an aspect of insurance regulation.
- Congress could enact federal minimum standards or could direct that minimum standards be developed, subject to oversight by the Secretary of Commerce.¹⁰⁸

In response, the NAIC continued to expand its accreditation program, and it assisted in creating the International Association of Insurance Supervisors.¹⁰⁹ Congressional pressure receded in 1995, as the majority and minority reversed in the House.

Congress Draws New Lines

In 1999 — after decades of litigation over who regulated the insurance activities of banks — Congress enacted the Gramm-Leach-Bliley Act (GLBA)¹¹⁰ to modernize the regulation of financial services. GLBA permitted banking, insurance, and securities firms to affiliate, subject to regulation-by-activity — now known as "functional regulation."¹¹¹ The act expressly reaffirmed the McCarran-Ferguson

¹⁰⁵ Ibid., p. IV (transmittal letter from Representative John Dingell to the Committee on Energy and Commerce, dated Oct. 19, 1994).

¹⁰⁶ Ibid., p. 128.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid., pp. 128-130.

¹⁰⁹ The IAIS is now headquartered in Basel, Switzerland, and works to establish internationally applicable standards for insurance supervision. The text of principles, standards, and guidance papers that the IAIS has endorsed is available at [http://www.iaisweb.org/133_ENU_HTML.asp].

¹¹⁰ P.L. 106-102, 113 Stat. 1338.

¹¹¹ CRS Report RL30375, *Major Financial Services Legislation, the Gramm-Leach-Bliley Act (P.L. 106-102): An Overview*, by F. Jean Wells and William D. Jackson.

Act,¹¹² reserved for state insurance regulators areas of authority over banks' insurance sales,¹¹³ and required state and federal regulators to share information.¹¹⁴ It also expedited legal review of any regulatory conflict between a state insurance regulator and a federal regulator, under an unusual standard: The reviewing court must show equal deference to both state and federal regulators.¹¹⁵ This standard has put state insurance regulators and federal regulators on an equal footing in federal court in disputes about insurance activities of federal banks.¹¹⁶

GLBA did have a conditional preemption. It would have created a new organization called the National Association of Registered Agents and Brokers (NARAB) to implement national uniformity of insurance agent licensing requirements unless a majority of the states enacted either uniform or reciprocal laws within three years.¹¹⁷ To prevent creation of NARAB, the NAIC drafted a model law implementing reciprocity and urged state legislatures to enact it. The NAIC certified 38 states as meeting GLBA's reciprocity standard by the deadline, which forestalled NARAB's creation.¹¹⁸

GLBA's Title V imposed comprehensive, minimum federal privacy standards on all financial institutions, both federal and state.¹¹⁹ It delegated rule-making to the functional regulators,¹²⁰ and required state and federal regulators to consult and coordinate with each other to make their privacy regulations as consistent and comparable as possible.¹²¹ The NAIC drafted a model regulation on consumer financial and health information in 2001, amended it in 2002, and in 2003 reported

¹¹² P.L. 106-102, sec. 104(a), 113 Stat. 1352 (codified at 15 U.S.C. §6701(a)) (stating that the McCarran-Ferguson Act “remains the law of the United States.”).

¹¹³ *Ibid.*, sec. 301, 113 Stat. 1407 (codified at 15 U.S.C. §6712) (stating that the “insurance activities of any person (including a national bank ...) shall be functionally regulated by the states ...”).

¹¹⁴ *Ibid.*, sec. 307, 113 Stat. 1415-1417, (codified at 15 U.S.C. §6716). See National Association of Insurance Commissioners, “Coordinating with Federal Regulators,” available at [http://www.naic.org/GLBA/coordinating_fed.htm].

¹¹⁵ *Ibid.*, sec. 304(e), 113 Stat. 1410, (codified at 15 U.S.C. §6714(e)) (“The court shall decide a petition filed under this section based on its review on the merits of all questions presented under State and Federal law, including the nature of the product and activity and the history and purpose of its regulation under State and Federal law, *without unequal deference.*”) (emphasis added).

¹¹⁶ This is known as the “jump ball” provision. See Martin E. Lybecker, “Bank Insurance Provisions of the Gramm-Leach-Bliley Act,” in *Financial Services Modernization 2003: Implementation of the Gramm-Leach-Bliley Act* (Philadelphia: The American Law Institute, 2003), p. 235.

¹¹⁷ P.L. 106-102, secs. 321-340, 113 Stat. 1422-1434 (codified at 15 U.S.C. §§6751-6766).

¹¹⁸ National Association of Insurance Commissioners, “Responding to the NARAB Requirements,” available at [<http://www.naic.org/GLBA/narab.htm>].

¹¹⁹ P.L. 106-102, secs. 501-527, 113 Stat. 1436-1451 (codified at 15 U.S.C. §§6801-6827).

¹²⁰ P.L. 106-102, sec. 504(a)(1), 113 Stat. 1439 (codified at 15 U.S.C. §6804(a)(1)).

¹²¹ *Ibid.*, sec. 504(a)(2), 113 Stat. 1439-1440 (codified at 15 U.S.C. §6804(a)(2)).

that 50 states and the District of Columbia have privacy standards meeting GLBA requirements.¹²²

The NAIC also pledged “to modernize insurance regulation to meet the realities of the new financial services marketplace” and “to work cooperatively with all our partners — governors, state legislators, federal officials, consumers, companies, agents and other interested parties — to facilitate and enhance this new and evolving market place as we begin the 21st Century.”¹²³ At about that time, it became apparent that insurers controlled by Martin Frankel had been swindled out of some \$200 million, allegedly by Mr. Frankel himself. Some said that showed state insurance regulation to be ineffective.¹²⁴

The NAIC continued with its accreditation program.¹²⁵ It also followed up on its pledge to modernize state regulation by undertaking significant efforts to streamline agent licensing, company licensing, and policy form approval by centralizing the function in its corporate office.¹²⁶ Since the NAIC cannot impose uniformity or standards on states, it has proposed to state legislatures an interstate compact to set uniform standards for life insurance and annuity products, to receive filings for them, and to give regulatory approval.¹²⁷

Oversight Continued in Recent Congresses

In the 107th Congress, Senator Schumer and Representative LaFalce each offered legislation to create an optional federal charter for insurers. There were no hearings or markups on these bills, though there were four hearings, including one over three separate days, in the House Financial Services Committee on insurance regulatory issues. Senator Schumer’s proposal,¹²⁸ which was never assigned a

¹²² National Association of Insurance Commissioners, “Implementing Privacy Protections,” available at [<http://www.naic.org/GLBA/privacy.htm>].

¹²³ Text of the pledge is available at [<http://www.ins.state.ny.us/naicsoi.htm>].

¹²⁴ U.S. Congress, House Committee on Commerce, Subcommittee on Finance and Hazardous Materials, statement of Richard J. Hillman, Associate Director, Financial Institutions and Market Issues, General Government Division, GAO, *Insurance Regulation: Scandal Highlights Need for States to Strengthen Regulatory Oversight*, GAO Testimony T-GGD-00-209 (Washington: Sept. 19, 2001).

¹²⁵ U.S. General Accounting Office, *Regulatory Initiatives of the National Association of Insurance Commissioners*, GAO Report GAO-01-885R (Washington: July 6, 2001); U.S. General Accounting Office, *Insurance Regulation: The NAIC Accreditation Program Can Be Improved*, GAO Report GAO-01-948 (Washington: Aug. 2001).

¹²⁶ The NAIC’s description of their efforts to modernize insurance regulation is available at [<http://www.naic.org/GLBA>].

¹²⁷ For additional information about the compact, see [<http://www.naic.org/compact/>].

¹²⁸ Mark A. Hoffman, “Chartering Bill Introduced,” *Business Insurance*, Jan. 7, 2002, p. 1. Text of the National Insurance Chartering and Supervision Act is available at (continued...)

number, would have created a new federal agency but would not have given that agency authority to regulate rates or policy forms. All federally chartered insurers would have been required to participate in either state guaranty associations or a backup federal one. It would not have exempted federally chartered insurers from federal antitrust laws. Representative LaFalce's bill — H.R. 3766 — would have allowed a federally chartered insurer to underwrite both life and property-casualty insurance in the same company, encouraged community investment, retained state insurance regulators' authority over rates, and imposed federal standards on state-licensed insurance agents.

In the 108th Congress, both the House and the Senate held hearings on insurance regulation and one bill on the topic, S. 1373, was introduced by Senator Ernest Hollings. S. 1373 would have created a federal commission within the Department of Commerce to regulate the interstate business of property/casualty and life insurance and would have required federal regulation of all interstate insurers. It thus would have preempted most current state regulation of insurance. Single state insurance companies would have continued to be regulated by the state where the company is domiciled and operates. The federal commission would have had full regulatory powers, including licensure, rate and form approval, regulation of solvency, and regulation of market conduct. S. 1373 also would have repealed the antitrust exemptions in the McCarran-Ferguson Act and created a federal guaranty fund. S. 1373 was referred to the Commerce Committee; no hearings or markups on the bill were scheduled, although the committee did hold a hearing on insurance regulation as discussed below.

The House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held its first hearing on insurance issues during the 108th Congress on April 10, 2003, entitled: *The Effectiveness of State Regulation: Why Some Consumers Can't Get Insurance*. Witnesses at the hearing addressed the general financial challenges facing the insurance industry as well as specific states' market experiences. A particular focus was on various states' regulatory policies. Positive experiences were highlighted in states, such as Illinois and South Carolina, which have less regulation, especially less direct regulation of rates. Negative experiences were highlighted in states, such as Louisiana and New Jersey, which have a greater amount of regulation and generally require prior approval for insurance rates. Much of the questioning revolved around what sort of role the federal government might play in this area that has traditionally been left to the states. General support was expressed for continuing a state role in regulation of insurance, but various ideas for federal intervention were mentioned, including an optional federal charter, direct federal preemption of some state regulation, and a NARAB-like approach where threatened federal preemption might lead to changes by the states themselves.

The House Financial Services Subcommittee on Oversight and Investigations also held a hearing addressing insurance issues. The May 6, 2003 hearing was entitled *Increasing the Effectiveness of State Consumer Protections*. This hearing

¹²⁸ (...continued)

[http://www.aba.com/ABIA/ABIA_Reg_Mod_Page.htm].

focused on market conduct examinations, which are exhaustive reviews by state insurance regulators of individual insurance companies' business practices and policies. The Government Accountability Office (GAO; formerly named the General Accounting Office) and the National Council of Insurance Legislators (NCOIL) separately have been studying issues relating to market conduct regulation and both presented preliminary findings of their studies at this hearing. There was general agreement among the witnesses that the current system of market conduct regulation needs improvement. Of particular concern was the lack of uniform standards and coordination between the states in how and when the examinations are conducted. Both NCOIL and NAIC are undertaking efforts to improve the current system. Questions were raised by GAO, however, as to the effectiveness and speed of these efforts; even when NCOIL or NAIC produce model legislation or practices, these must be then adopted by each state individually. Continued state regulation was strongly defended, but it was suggested that continuing congressional pressure might be necessary to encourage adoption of suggested changes.

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises returned to the question of insurance regulation on November 5, 2003, with a hearing entitled: *Reforming Insurance Regulation — Making the Marketplace More Competitive for Consumers*. This hearing focused particularly on the NAIC's recently released "Insurance Regulatory Modernization Action Plan," and other efforts to modernize the state regulatory system. In addition to testimony from the NAIC, the subcommittee heard from NCOIL and a number of insurers on the modernization effort and the costs and benefits of the current system. General support for the NAIC reform efforts was expressed; however, concerns about the length of time that these efforts would take and whether or not they would result in effective uniformity of regulation were also voiced.

On March 31, 2004, the Subcommittee on Capital Markets held what was described as the committee's 14th meeting of some kind on the question of insurance regulation in the past three years. Entitled *Working with State Regulators to Increase Insurance Choices for Consumers*, this hearing focused on a "road map" for insurance legislation developed by full committee Chairman Oxley and subcommittee Chairman Baker and publicly proposed by Chairman Oxley at the NAIC spring meeting on March 14, 2004.¹²⁹ While not a fully formed legislative proposal at the hearing, the concept calls for allowing states to continue regulating insurance while enacting some federal requirements on what the state regulation should look like. The model seems to be the NARAB provisions that were in GLBA, but expanded to other areas such as commercial form preapproval, company licensing, market conduct examinations, and general rate regulation. Both industry groups and representatives of the states expressed general support for the concept, although some noted that it falls short of the federal charter that parts of the industry have sought. A letter from a number of consumer groups, presented at the hearing by Robert Hunter of the Consumer Federation of America, expressed concern that the road map would override what they see as critical consumer protections enacted by the states,

¹²⁹ Full text of Chairman Oxley's speech was included in the March 15, 2004 press release entitled "Oxley Outlines Road Map to State-Based Insurance Regulatory Reform" and can be found at [<http://financialservices.house.gov/news.asp>].

particularly regulation of insurance rates. Mr. Hunter indicated his support of greater uniformity, but stressed that this uniformity should not come at the expense of such consumer protections.

The Senate Committee on Commerce, Science and Transportation signaled its interest in insurance issues with a hearing on October 22, 2003, entitled *Federal Involvement in Regulation of The Insurance Industry*. Although the hearing was not specifically called to examine S. 1373, discussion of the bill was prominent during the hearing. Senator Hollings expressed the rationale behind the bill, namely his conviction that state regulation of insurers has failed to oversee the industry and protect consumers sufficiently, and that it is time to federalize the system in order to do so. Reaction to this proposal was mixed, with, for example, one of the two consumer advocates on the panel, Robert Hunter of the Consumer Federation of America, supporting federalization. The other, Douglas Heller of the Foundation for Taxpayer and Consumer Rights, expressed his belief that, if done properly, state regulation is sufficient to protect consumers as demonstrated in California's Proposition 103. The witnesses from the insurance industry generally supported either a federal charter that is optional, not mandatory, or continued state regulation of insurance.

The Senate Committee on Banking, Housing, and Urban Affairs held the last hearing focusing on insurance regulatory issues in the 108th Congress on September 22, 2004. Entitled *Examination and Oversight of the Condition and Regulation of the Insurance Industry*, this hearing covered a wide range of issues relating to federal intervention in the insurance regulatory system. Particularly distinguishing this hearing compared to earlier ones was the discussion of the draft legislation that had been circulated in the House the month before. Some skepticism was expressed over lack of enforcement provisions in the House draft and Mr. Hunter's testimony included another letter criticizing the draft for lack of consumer protection, particularly the preemption of state rate regulation.

Appendix

How Federal Courts Narrowed the McCarran-Ferguson Act's "Reverse Preemption": Major Historical Cases

Congress passed the McCarran-Ferguson Act in 1945 as a compromise after the Walter-Hancock bill — which would have imposed an absolute preemption of federal law — failed in 1944.¹³⁰ Not only did the compromise leave many unanswered questions but also — as time passed and the industry changed — new ones arose. Supreme Court decisions on those questions have narrowed the scope of the McCarran-Ferguson “reverse preemption,” as this review of the historically important cases shows.

This analysis omits the long line of cases interpreting the preemption in the Employees Retirement Income Security Act (ERISA) of state insurance laws, such as mandated benefits. In those cases, employers and insurers argued that ERISA excluded completely any and all state insurance regulation of employee health plans, notwithstanding the McCarran-Ferguson Act. The line ended — in theory, at least — in the recent Supreme Court decision in *Kentucky Association of Health Plans v. Miller*,¹³¹ which separated the ERISA analysis from reference to McCarran-Ferguson.¹³²

What Is “Insurance”

*SEC v. VALIC*¹³³ established that the definition of “insurance” under McCarran-Ferguson is a federal question, not a state one. In this case, the Securities and Exchange Commission wanted insurers issuing variable annuity contracts to register them as securities under the federal securities laws.¹³⁴ The insurers refused, asserting both that the McCarran-Ferguson Act shielded them from federal regulation and that even if it did not, they qualified for the insurance exemptions from the federal securities laws. The Court held that neither state regulation of variable annuities nor their issuance by insurers qualified them as insurance. This meant both that insurers and regulators could not prevent federal regulation using McCarran-Ferguson nor avail themselves of the exclusion for “insurance” from the federal securities laws.

¹³⁰ See note 42 supra.

¹³¹ *Ky. Ass’n of Health Plans, Inc. v. Miller*, 538 U.S. —, 1238 S.Ct. 1471 (Docket No. 00-1471)(Apr. 2. 2003), available at [<http://www.supremecourtus.gov/opinions/02pdf/00-1471.pdf>].

¹³² See CRS Report RS21497, *Reconciling McCarran-Ferguson (Insurance) Case Law and ERISA Preemption: Kentucky Ass’n of Health Plans, Inc. v. Miller*, by Janice E. Rubin.

¹³³ *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65(1959).

¹³⁴ Under a variable annuity contract, annuity payments are not fixed but vary according to the performance of an underlying investment portfolio; these contracts did not exist in 1933 and 1934 when the federal securities laws were enacted. *Ibid.* at 67-69.

*NationsBank v. VALIC*¹³⁵ established that — for purposes of federal banking law — selling fixed annuities is the business of banking and is not exclusive to insurers. In this case the Comptroller of the Currency had by letter ruling determined that fixed annuities were not insurance but rather were “financial investment instruments of the kind congressional authorization permits [banks] to broker.”¹³⁶ An insurer issuing and selling annuities challenged the Comptroller’s authority to allow banks to sell insurance. The Court agreed with the Comptroller that the presence of mortality risk does not qualify an investment as “insurance” and that “federal banking law does not plainly require automatic reference to state [insurance] law”¹³⁷ This decision affirmed that the definition of “insurance” is a federal question — and that neither insurers nor state regulators can use McCarran-Ferguson’s reverse preemption to exclude federal regulation.

What Is the “Business of Insurance”

*National Securities*¹³⁸ established that McCarran-Ferguson’s reverse preemption of federal law did not extend beyond regulation to protect policyholders.¹³⁹ It did not extend to all insurers’ activities regulated by state insurance commissioners under state laws.¹⁴⁰ In this case, the Securities and Exchange Commission wanted to unwind a merger between insurance companies that had been approved by the domestic insurance commissioner pursuant to state law, as the SEC thought that the insurers’ shareholders had not been given correct or appropriate information about the terms of the merger. The insurers had objected to the SEC’s assertion of jurisdiction, arguing successfully in the lower courts that McCarran-Ferguson barred it. The Supreme Court disagreed with the lower courts and with the insurers, holding “that a state statute aimed at protecting the interests of those who own stock in insurance companies [did not come] within the sweep of the McCarran-Ferguson Act [since it] is not a state attempt to regulate the “business of insurance”¹⁴¹ The Court went on to say that “the McCarran-Ferguson Act furnishes no reason for refusing the remedies the [SEC] is seeking.”¹⁴² This meant the scope of the reverse preemption was much narrower than its supporters had hoped.¹⁴³

¹³⁵ *NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995).

¹³⁶ *Ibid.* at 260.

¹³⁷ *Ibid.* at 262.

¹³⁸ *SEC v. National Sec.*, 393 U.S. 453 (1969). At issue was the scope of the exemption granted by Section 2(b) of the act; see note 42 *supra*.

¹³⁹ *Ibid.* at 463 (“The paramount federal interest in protecting shareholders is in this situation perfectly compatible with the paramount state interest of protecting policyholders.”).

¹⁴⁰ *Ibid.* at 459 (“The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation.”).

¹⁴¹ *Ibid.* at 457.

¹⁴² *Ibid.* at 461-463.

¹⁴³ Kimball and Heaney, *supra* note 19, at 104-105.

*Royal Drug*¹⁴⁴ established that insurers' exemption from antitrust laws under McCarran-Ferguson likewise did not extend to all their business activities.¹⁴⁵ It extended instead only to those practices that spread or transfer a policyholder's risk, are integral to the relationship between the insurer and the insured, and are limited to entities within the insurance industry.¹⁴⁶ In this case, pharmacies that had declined to contract with Blue Shield to limit drug costs for its policyholders brought an antitrust action against Blue Shield, alleging an unlawful boycott. After analyzing in detail McCarran-Ferguson and its legislative history, the Court concluded that the contracts between Blue Shield and the pharmacies could not be considered the business of insurance since they did not transfer risk but merely arranged for purchase of goods and services,¹⁴⁷ since they did not directly affect the contract between the insured and the insured,¹⁴⁸ and since Congress had intended to exempt only collective rate-making from the antitrust laws.¹⁴⁹ This meant that most insurers' business practices — other than collective rate-making — were subject to the federal antitrust laws.

*U.S. v. Fabe*¹⁵⁰ established that states' laws for liquidating insurers do constitute the "business of insurance" — and therefore preempt a conflicting federal statute — but only to the extent necessary to protect the insolvent's policyholders.¹⁵¹ In this case the United States had claims on the assets of an insolvent insurer, which it asserted had priority under federal bankruptcy law over all other claimants, including policyholders. The state insurance commissioner administering the insolvency objected, asserting that the state's priority scheme — under which all government claims ranked last — preempted the federal law.¹⁵² The Court analyzed Section 2 of the McCarran-Ferguson Act and its legislative history closely. It concluded that "federal law must yield to the extent the [state liquidation] statute furthers the interests of policyholders."¹⁵³ The federal law need not yield, said the Court, "to the extent that [the state liquidation statute] is designed to further interests of other creditors"¹⁵⁴ This meant that McCarran-Ferguson could subordinate the federal

¹⁴⁴ *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979).

¹⁴⁵ *Ibid.* at 211 ("The exemption is for the 'business of insurance,' not the 'business of insurers.'").

¹⁴⁶ *Ibid.* at 211, 215-216, 226-230.

¹⁴⁷ *Ibid.* at 211-215.

¹⁴⁸ *Ibid.* at 215-217 (citing *National Securities*).

¹⁴⁹ *Ibid.* at 217-27.

¹⁵⁰ *United States Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993).

¹⁵¹ *Ibid.* at 493-494, 508.

¹⁵² *Ibid.* at 494-497.

¹⁵³ *Ibid.* at 502 (citing *National Securities*).

¹⁵⁴ *Ibid.* at 508. Four justices dissented, arguing that the majority's decision was not a logical extension of the *National Securities* decision and erroneously confined the *Royal Drug* indices to antitrust issues. *Ibid.* at 512-518.

government as a creditor only with respect to policyholders but not with respect to general creditors.¹⁵⁵

Must State Regulation Be Effective to Preempt Federal Law?

*FTC v. National Casualty*¹⁵⁶ established that McCarran-Ferguson’s reverse preemption did not depend on the quality of state regulation.¹⁵⁷ In this case the Federal Trade Commission ordered two multistate insurers to stop using advertising that it found violated the Federal Trade Commission Act as false, deceptive, and misleading.¹⁵⁸ The Court agreed that the McCarran-Ferguson Act “withdrew from the [FTC] the authority to regulate [the defendant insurers’] advertising practices in those States which are regulating those practices under their own laws.”¹⁵⁹ The Court expressly declined to examine whether the states’ laws had been effectively applied.¹⁶⁰

What Is “Boycott, Coercion, or Intimidation”?

*St. Paul v. Barry*¹⁶¹ established that federal antitrust laws may be applied to certain disputes between insurers and their policyholders.¹⁶² In this case only four insurers offered medical malpractice insurance in a state. One of them — St. Paul — stopped selling it with terms most favorable to the insureds, offering only coverage with less favorable terms. The three other insurers in the market also refused to sell the more favorable coverage to any of St. Paul’s policyholders. Those policyholders sued, alleging that the insurers had engaged in an unlawful boycott. The insurers asked for the case to be dismissed as barred by McCarran-Ferguson. The U.S. Supreme Court held that the suit should not be dismissed, since the insurers’ alleged concerted refusal-to-deal came within the statutory exception in the McCarran-Ferguson Act.¹⁶³ It did not matter, said the Court, that the floor debates

¹⁵⁵ Kimball and Heaney, *supra* note 19, at 128.

¹⁵⁶ *FTC v. Nat’l Cas. Co.*, 357 U.S. 560 (1958).

¹⁵⁷ *Ibid.* at 564. See also Kimball and Heaney, *supra* note 19, at 84.

¹⁵⁸ *FTC v. Nat’l Cas. Co.*, *supra* note 178, pp. 561-562.

¹⁵⁹ *Ibid.* at 563 (footnote omitted).

¹⁶⁰ *Ibid.* at 564. The scope of federal antitrust preemption of a federal statute under the “state action” doctrine established in *Parker v. Brown*, 317 U.S. 341 (1943), is beyond the scope of this Report. See Kimball and Heaney, *supra* note 19, at 87-88.

¹⁶¹ *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978).

¹⁶² *Ibid.* at 552-555.

¹⁶³ The Section 2(b) antitrust exemption, codified at 15 U.S.C. §1012(b), is: “No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance, unless such Act specifically relates to the business of insurance “ The statutory exception to that exemption is Section 3(b) (codified at 15 U.S.C. §1013(b)): “Nothing contained in this [Act] shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidation, or act of (continued...) ”

during the act's passage expressed intent to proscribe concerted activity by insurers against other insurers or against agents. The Court reasoned that Congress could not have meant to offer the shelter of the antitrust laws only to competitors and agents and not to consumers as well.¹⁶⁴ This case meant that mere regulation by the states could not shield insurers from all attempts to apply federal antitrust law.¹⁶⁵

*Hartford Fire v. California*¹⁶⁶ established that refusal to sell contracts with certain terms did not constitute a boycott, absent proof that the insurers also refused to deal on collateral or unrelated matters.¹⁶⁷ In this case, nineteen states had sued U.S. and foreign insurers, alleging they had violated the antitrust laws by acting to force other insurers to sell only policies with terms similar to those in the defendants' policies. A bare majority of the Court defined a boycott as a collective use of *unrelated* commercial transactions as leverage to achieve the desired terms.¹⁶⁸ The majority distinguished between concerted refusals to deal on unrelated matters, on the one hand, and concerted refusals to deal on particular transactions until the terms of those transactions are satisfactory, on the other. A concerted refusal to deal on certain contract terms was not a boycott within the meaning of McCarran-Ferguson, said the majority, because the terms were central to the insurance contract.¹⁶⁹ This decision had the effect of narrowing the boycott exception to McCarran-Ferguson's antitrust immunity.¹⁷⁰

¹⁶³ (...continued)

boycott, coercion, or intimidation.” The insurers were arguing that the act's Section 2(b) exemption trumped the Section 3(b) exception to the exemption.

¹⁶⁴ *St. Paul v. Barry*, supra note 183, at 551-552 (note 24). See also *ibid.* at 547 (“The debates make clear that the ‘boycott’ exception was viewed by the act's proponents as an important safeguard against the danger that insurance companies might take advantage of purely permissive state regulation to establish monopolies and enter into restrictive agreements falling outside of the realm of state-supervised cooperative action.”).

¹⁶⁵ The case came before the Supreme Court on a motion to dismiss, so the Court's decision meant that McCarran-Ferguson provided no shield against the mere allegation of a boycott. *Ibid.* at 533-534. See also *Kimball v. Heaney*, supra note 19, at 157.

¹⁶⁶ *Hartford Fire Ins. Co. v. California*, 509 U.S. 763 (1993).

¹⁶⁷ *Ibid.* at 800-811.

¹⁶⁸ *Ibid.* at 803.

¹⁶⁹ *Ibid.* at 805-809. “Of course as far as the Sherman Act (outside the exempted insurance field) is concerned, concerted agreements on contract terms are unlawful The McCarran-Ferguson Act, however, makes that conspiracy lawful unless the refusal to deal is a ‘boycott.’” *Ibid.* at 803 and 810-811.

¹⁷⁰ Courts have since held that defendant insurers concertedly refusing to deal on terms satisfactory to plaintiffs have not engaged in illegal boycotts within the meaning of Section 3(b) of McCarran-Ferguson. See *Slagle v. ITT Hartford*, 102 F.3d 494 (11th Cir. 1996); *N. J. Auto. Ins. Plan v. Sciarra*, 103 F.Supp. 2d 388 (D.N.J. 1998).