Order Code RS22639
April 6, 2007

CRS Report for Congress

Impact of the Abolition of McCarran-Ferguson Antitrust Exemption for the "Business of Insurance"

Janice E. Rubin
Legislative Attorney
American Law Division

Baird Webel
Analyst in Economics
Government and Finance Division

Summary

Identical, bipartisan bills, S. 618 and H.R. 1081, that would eliminate the current McCarran-Ferguson Act[1] antitrust exemption for the "business of insurance," in force since 1945, have been introduced in the 110th Congress. Their impact, if enacted, is unclear. They would each amend 15 U.S.C. § 1012(b) to make the antitrust laws and the Federal Trade Commission Act (FCTA) "as it relates to unfair methods of competition" specifically applicable to such business. The FCTA, "as it relates to areas *other* than unfair competition"(emphasis added) *would*, however, continue to apply to the "business of insurance" "to the extent that [it] is not regulated by State law." Due largely to the importance of information sharing to insurers, the insurance industry in the past has cooperated in a variety of ways, including sharing loss information, jointly developing policy forms and rates, operating residual market mechanisms, and participating in state guaranty funds. Some forms of cooperation, particularly joint rate making and mandatory advisory rates, have already been curtailed because of antitrust concerns. Other forms of industry cooperation, however, might be considered illegal under federal antitrust laws if S. 618 or H.R. 1081 were to become law. The precise impact of these bills on the insurance industry would depend critically on future court decisions. In particular, the cooperation that insurance companies currently undertake might be judged legally permissible under the "state action" doctrine.[2] Before this area of law would be settled, however, it would arguably involve numerous lawsuits. This report will be updated as events warrant.

---

[1] 15 U.S.C. §§ 1011-1015.

[2] *See* footnote 13, below, for an explanation of the state action doctrine.

When Senator Leahy introduced S. 618 on February 15, 2007, with the co-sponsorship of Senators Specter, Lott, Reid, and Landrieu, he did so by first noting that the insurance industry "has operated largely beyond the reach of federal antitrust laws for more than six decades." Concerned by the manner in which insurers operating in the Gulf Coast region have been interpreting their policy-related responsibilities, he stated that "[i]f there ever was, there is no longer any justification to exempt the insurance industry from federal government oversight."[3] H.R. 1081, an identical bill, was introduced on the same day by Representative DeFazio, with similar, bi-partisan co-sponsorship (Representatives Taylor, Melancon, Alexander, and Jones of North Carolina). The bills have been referred to their respective Judiciary Committees, with the House bill also being referred to the Committees on Energy and Commerce and Financial Services, "for consideration of such provisions as fall within the jurisdiction of the committee concerned."

Currently, 15 U.S.C. § 1012(b) declares that the antitrust laws "shall be applicable to the business of insurance to the extent that such business is not regulated by State law." Since virtually all states regulate the insurance industry, the effect is to immunize "the business of insurance" from application of the federal antitrust laws. Both bills would remove the "to the extent ..." language so that the federal antitrust laws *would* be applicable to the "business of insurance."[4]

The single exception to the blanket application of federal antitrust law to the "business of insurance," is, however, that both bills would specify that the Federal Trade Commission (FTC) Act,[5] "as it relates to areas *other* than unfair methods of competition"[6] *would* continue to be applicable to the "business of insurance to the extent that such business is not regulated by State law."[7]

---

[3] 153 CONG. REC. S2045 (Feb. 15, 2007).

[4] Although, as is discussed in CRS Report RL33683, *Courts Narrow McCarran-Ferguson Antitrust Exemption for 'Business of Insurance': Viability of 'State Action' Doctrine as an Alternative*, by Janice E. Rubin, removal might not be fatal to the industry. It is also noted here that the Antitrust Modernization Commission (AMC), created by Congress in the AMC Act of 2002 (P.L. 107-233, amended by P.L. 110-6), while not specifically recommending the repeal of McCarran-Ferguson, did, however, in its final, April 2007 Report to Congress, characterize the exemption as "questionable" (at 351). The Commission recommended, with respect to *all* immunities, that Congress [c]onsult with the [FTC] and the Antitrust Division of the Department of Justice about whether the conduct at issue could subject the actors to antitrust liability and the likely competitive effects of the existing or proposed immunity"; and that Congress "[r]equire proponents of an immunity to submit evidence showing that consumer welfare, achieved through competition, has less value than the goal promoted by the immunity, and the immunity is the least restrictive means to achieve that goal" (at 21). The AMC website, which includes the entire Report, can be found at [http//:www.amc.gov].

[5] The FTC Act is codified at 15 U.S.C. §§ 41 *et. seq.* Section 5 (15 U.S.C. § 45) contains the Commission's "unfairness" jurisdiction.

[6] Section 2(a)(1)(B) of each bill (emphasis added).

[7] It is noted that the bills' insertions, as prescribed, would result in a run-on sentence, as there is no punctuation specified between the first insertion ("as it relates to unfair methods of competition," presumably ending with "the business of insurance"), and the second, which makes the FTC Act, "as it relates to areas other than unfair methods of competition" applicable to the
(continued...)

Both measures would delete 15 U.S.C. § 1013, in which the 79th Congress (1) made the antitrust laws inapplicable to the "business of insurance" until June 30, 1948; but (2) specified, at the same time, that the antitrust laws *would* nevertheless be applicable to boycotts, coercion, or intimidation, or agreements to create or further those activities.[8] In addition, they would each restore the authority of the Federal Trade Commission, pursuant to its 15 U.S.C. § 46(a) powers, to investigate the insurance industry;[9] that authority was removed in 1980 by Section 5 of P.L. 96-252, "Federal Trade Commission Antitrust Improvements Act of 1980," except to the extent that such studies were specifically requested by Congress. Lastly, each would permit the Department of Justice and the FTC to "issue joint statements of their antitrust enforcement policies regarding joint activities in the business of insurance."[10]

The Senate Judiciary Committee held a hearing on the issue entitled "The McCarran-Ferguson Act and Antitrust Immunity: Good for Consumers?" on March 7, 2007. Hearings before the House Judiciary Committee have not yet been scheduled.

---

[7] (...continued)
business of insurance "to the extent that such business is not regulated by State law." It is further noted that it might be preferable to not retain the phrase, "That after June 30, 1948": as the bills' are currently drafted, the new provision would read, "[t]hat after June 30, 1948, the [antitrust laws] and ... the Federal Trade Commission Act ... as it relates to unfair methods of competition shall be applicable to the business of insurance." From that date to the date of enactment of any proposed change, the antitrust laws were, in fact, *not* applicable to the "business of insurance."

[8] Section 2(a)(2) of each bill. If the antitrust laws are fully applicable to the "business of insurance," there would be no need for a "boycott exception."

[9] Section 2(b) of each bill. 15 U.S.C. § 46(a) allows the Commission:

> [t]o gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any person, partnership, or corporation engaged in or whose business affects commerce [except with respect to banks, savings and loans, credit unions, or common carriers, each of which is regulated by an independent agency].

[10] Section 3 of each bill. Other examples of policy statements or guidance jointly issued by the FTC and the Antitrust Division of the Department of Justice include "Antitrust Guidance — Hurricanes Katrina and Rita" (issued September 27, 2005); "Statements of Antitrust Enforcement Policy in Health Care" (first promulgated in 1993 and revised in 1996); and "Antitrust Guidelines for Collaborations Among Competitors" (issued in April 2000):

> To provide guidance to business people, the Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") (collectively, "the Agencies") previously issued guidelines addressing several special circumstances in which antitrust issues related to competitor collaborations may arise. None of these Guidelines represents a general statement of the Agencies' analytical approach to competitor collaborations, however, the increasing varieties and use of competitor collaborations have yielded requests for improved clarity regarding their treatment under the antitrust laws.
> The new Antitrust Guidelines for Collaborations among Competitors ("Competitor Collaboration Guidelines") are intended to explain how the Agencies analyze certain antitrust issues raised by collaborations among competitors. Preamble to Guidelines, at 1.

All Guidelines are online at [http://www.usdoj.gov/atr/public/guidelines/guidelin.htm].

Insurance Industry Cooperation

Competitors in many industries have an economic incentive to cooperate in ways, such as creating cartels or price-fixing, that could result in general inefficiency and, ultimately, harm to the consumer. This possible consumer harm is one of the underlying reasons for the antitrust laws. Due to the specific economics of the insurance industry, however, cooperation among insurers may very well result in greater efficiencies and, possibly, lower prices for consumers.

Insurance depends critically on insurers possessing a large quantity of information to allow them to judge and price risks accurately. In a theoretical world of perfect information and competition, every consumer would pay a premium that covered his risk, and the resulting overall amount paid by consumers would be the lowest possible amount that would cover the aggregate losses to the group as a whole. If insurers can pool their information, the resulting rates can more accurately reflect risk and thus be lower for consumers as a whole, although some individual consumers may pay higher rates. Small insurers particularly benefit from information sharing, as they do not have a large volume of information of their own to analyze. The theoretically perfect world, however, assumes competition between insurers that would serve to reduce premium rates; too much cooperation between insurers could dampen this competition, reducing the consumer benefit that comes from allowing insurers to share information.

Insurer cooperation and information sharing revolves around advisory organizations, also known as ratings bureaus.[11] Some form of these organizations has existed for nearly as long as insurance has existed in the United States. At their most basic form, they gather data from the various insurers, aggregate and analyze this data, and provide the aggregated data back to the insurers for use in setting future rates. In practice, they have done, and continue to do, a good deal more than this. Historically, rating bureaus formulated final rates that insurers might charge for particular policies and in some cases required participating insurers to use the bureau's suggested rates. Having a central organization create insurance rates, whether mandatory or not, raised serious antitrust concerns. By the early 1990s, the main advisory organizations had ceased publishing fully formed rates. Advisory organizations continue, however, to collect, aggregate, and analyze data, providing not only historical loss data but also estimates of future loss data and future insurer expense data. Some maintain that this estimation of future data, known as "trending" raises similar antitrust concerns as the creation of final rates.[12]

Another primary activity of advisory organizations is the creation and filing of insurance policy forms. Insurance policy forms are complex legal documents, and, as

---

[11] The largest of these advisory organizations today are the Insurance Services Office (ISO) and the American Association of Insurance Services (AAIS) for general property/casualty insurance and the National Council on Compensation Insurance (NCCI) for workers compensation insurance.

[12] See the Testimony of Robert Hunter before the Senate Judiciary Committee [http://judiciary.senate.gov/pdf/03-07-07McCarran-FergusonHearing-HunterTestimony.pdf] for an argument regarding the creation of trended data by advisory organizations. A counter argument by NCCI on the importance of trending can be found at [http://www.amc.gov/public_studies_fr28902/immunities_exemptions_pdf/061101_NCCI-McCarran.pdf].

controversies over insurance coverage for New York's World Trade Center and for buildings damaged in Katrina have shown, many millions of dollars may ride on the interpretation of a handful of words. Joint creation of these forms allows for the sharing of the legal talent needed to create the forms, and, some would argue, promotes comparison shopping by consumers by reducing the confusion that could result from multiple policy forms being offered by different companies. Since the states generally require the filing of policy forms for state approval, using a jointly created form that has already been filed with the states significantly reduces the regulatory burden on a single insurer. The uniformity of policy forms, however, also may reduce consumer choice. If one were shopping for a particular policy feature that was not a part of the standard form, it might be impossible, or very costly, to find an insurance policy that would meet this particular need.

Further industry cooperation, both through the advisory organizations and other state-created mechanisms, occurs in state residual market mechanisms and state guaranty funds. Residual market mechanisms are often created to insure availability of insurance that is legally mandated, such as workers compensation or auto insurance. While such mechanisms differ significantly between states, they may have advisory organizations administering them or require some other joint action by insurers, such as splitting up high-risk insureds who are unable to find insurance in the regular market, which might be considered market allocation. State guaranty funds are intended to protect the policyholders in the case of insurer insolvency. In general, states require insurers to join these associations, which may open the possibility of challenges on grounds of unfair collaboration or collusion.

If McCarran-Ferguson antitrust protection for "the business of insurance" is, in fact, curtailed or abolished, many lawsuits challenging some of these insurer practices as violations of the federal antitrust laws are likely. If all of the cited examples of cooperation were found to be in violation, it would necessitate major changes in the operation of insurers, particularly small insurers which do not have large pools of information from their own experience. Should additional data be unavailable to small insurers in some way, it would likely drive consolidation in the insurance industry as small insurers merge in order to gain the competitive advantage of additional information. This outcome, however, is only one of a range of possibilities. It is also possible that many of the cooperative activities that insurers engage in would be found to be permissible under the "state action" doctrine.[13]

---

[13] The state action doctrine was first enunciated by the Supreme Court in1943 (Parker v. Brown, 317 U.S. 341). It is based on the concept of federalism, and is the reason the federal antitrust laws are not applicable to the states. The doctrine has, over the years, been interpreted, clarified and expanded to the point that it now confers antitrust immunity not only on the states *qua* states (including state agencies and officials who act in furtherance of state-directed activity, but also on those who act pursuant to state-sanctioned, but not necessarily mandated, courses of action). Its essence is captured in the two-part test set out in California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc. (445 U.S. 97 (1980)): first, the challenged restraint must be "clearly articulated and affirmatively expressed as state policy" (*e.g.*, in a legislatively enacted statute); second, the policy must be "actively supervised" and subject to enforcement by the state itself.

Some Possibilities for Resolution of Problems

Given the possibility of numerous, perhaps lengthy, lawsuits to clarify which practices of insurers are antitrust violations, and of significant upheaval in the insurance industry, Congress might take note of its solution to another litigation-related problem that arose more than 20 years ago.

Congress was confronted then with the concerns of municipalities facing antitrust suits on account of certain activities. The prospect of treble-damage antitrust liability in suits brought against municipalities — challenging, *e.g.*, municipal designation of an "authorized" taxicab company, operation of an airport, or the awarding of cable television franchises — was unsettling to municipalities even though defendants were often found not liable. Many municipalities voiced concerns about expenditures of both time and tax dollars (read, in the insurance context, "costs often translated into increased insurance premiums") during hearings or in other communications to Congress. In response, Congress enacted the "Local Government Antitrust Act of 1984,"[14] which, *inter alia,* prescribes that

> No damages, interest on damages, costs or attorney's fees may be recovered under ... (15 U.S.C. 15, 15a, or 15c) in any claim against a person based on any official action directed by a local government, or official or employee thereof acting in an official capacity.[15]

Subsequent to the enactment of the Local Government Act, the number of challenges to municipal activity significantly abated. While inserting a similar provision into a bill such as S. 618 or H.R. 1081 would reduce the financial incentive to file suit for insurer antitrust violations, the absence of private damages does not remove the authority of the courts to issue injunctive relief when an antitrust violation by insurers is found. In fact, inasmuch as courts also retain jurisdiction over an injunction, oversight to insure that an injunction is followed, and contempt-of-court citations if it is not, would remain possibilities.

Another possible solution that has been part of past legislation is inclusion of some form of "safe harbor" provisions specifically protecting cooperation that might be pro-consumer, *e.g.*, the sharing of historical loss information that is essential to the viability of small companies. A "*Provided that*" clause could be inserted in the provision making the antitrust laws applicable to the "business of insurance" to clarify that information sharing is permitted — at least under certain circumstances and conditions. Similar provisions were included in, for example, S. 84, introduced by Senator Metzenbaum in the 103rd Congress to repeal McCarran-Ferguson's antitrust exemption. The clause might also include a limitation to single damages for successful challenges to certain kinds of conduct deemed necessary.

---

[14] P.L. 98-544, 15 U.S.C. §§ 34-36.

[15] 15 U.S.C. § 36(a).