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COMPETITION AND RELATED REGULATION ISSUES IN THE INSURANCE INDUSTRY

-- United States --

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COMPETITION AND RELATED REGULATION ISSUES IN THE INSURANCE INDUSTRY

United States

The McCarran-Ferguson Act

1. In 1945, Congress passed the McCarran-Ferguson Act, which reserved to the states the power to regulate and tax the business of insurance. Under the Act, the Sherman, Clayton, and Federal Trade Commission Acts apply "to the extent that such business is not regulated by State Law," except that agreements or acts of boycott, coercion, or intimidation remain subject to the Sherman Act.

2. Litigation regarding the scope of the federal antitrust exemption has involved the meaning of the terms "business of insurance" and "regulated by state law," and the question of what constitutes a "boycott." Supreme Court decisions regarding the scope of the phrase "the business of insurance" focus on three elements: the "spreading and underwriting of a policyholder's risk," the direct connection of the activity to the contractual relationship between the insurer and insured, and whether the allegedly anticompetitive practice is "limited to entities within the insurance industry." Regulation by the state has been held to mean regulation of the relationship between the insurance company and the policy-holder, and not regulation of other aspects of the insurer's business. The degree of regulation required is less than the "active supervision" with "intent to displace competition" required for the state action[1] doctrine to apply. The Supreme Court has held that general prohibitions against unfair practices, combined with authorized enforcement, constituted sufficient regulation under the Act.[2] A "boycott" need not be an absolute refusal to deal on any terms, but can "be conditional, offering its target the incentive of renewed dealing if and when he mends his ways;" the boycott must extend beyond the targeted transaction, so that "unrelated transactions are used as leverage to achieve the terms desired."[3]

3. The FTC has ruled, and two lower courts have held,[4] that the McCarran-Ferguson Act does not exempt mergers from antitrust review. The business of insurance also remains subject to state antitrust laws. In addition, as noted in ¶210.1 of P. Areeda and H. Hovenkamp, Antitrust Law (1997 Supp.),

> Even repeal of the McCarran-Ferguson Act need have no enormous impact on insurance practices, for three reasons. First, many of those practices are already subject to the antitrust laws because insufficiently regulated by the states, too 'interstate' in character to be subject to regulation by any one state, or an undoubted boycott. Second, many recently challenged practices need no immunity because they do not violate the antitrust laws. Third, to the extent that the insurer's practices are actively supervised by state regulators pursuant to a state policy to substitute regulation for market competition, the insurer would enjoy a 'state action' immunity under the *Parker* doctrine.

Reform of McCarran-Ferguson Act

4. The need for regulation to ensure the trustworthiness, solvency, and character of an insurance company, and the fairness of its practices, marketing, and disclosure, is well recognized. The need for broad exemption of the sector from the federal antitrust laws has been questioned over the years, however. There has been enormous development and increased sophistication of legal and economic analysis under the antitrust laws in the half century since the Act was passed. Consideration of procompetitive effects and careful economic and competitive analysis is now deeply ingrained in the relevant jurisprudence. Not

only do the cases provide guidance that joint ventures can be procompetitive, such as when they involve, for example, risk sharing or activities that cannot be undertaken as efficiently separately, but similar guidance is also reflected in business review letters issued by the DOJ and in DOJ/FTC antitrust guidelines relating to the health care sector.

5. The DOJ has been on record in support of narrowing the McCarran-Ferguson antitrust exemption for a number of years. Indeed, in 1977 the DOJ issued a report which concluded that "the insurance industry should be able to conduct its business within the federal antitrust laws without any special exemption. Antitrust precedent indicates that insurance companies could pool their loss experience consistent with federal antitrust standards. Moreover, the federal antitrust laws would not prohibit the trending of future losses on a composite basis by advisory organizations that were independent of the companies they were serving. Likewise the antitrust laws would not prohibit those voluntary risk-sharing arrangements, such as insurance pools and reinsurance agreements, that were either necessary to the conduct of business or served some other legitimate business purpose without substantially lessening competition." Over the past twenty years, Congress has considered numerous proposals to repeal or narrow the exemption.

FTC Enforcement in the Insurance Sector

6. The FTC has brought cases in the insurance sector to halt anticompetitive conduct that is not exempted by McCarran-Ferguson Act. In 1986, the FTC charged the Independent Insurance Agents of America, Inc. and two of its affiliate organizations with urging their members to boycott insurance companies that sold low-cost policies directly to consumers. The charges were settled by consent orders that prohibited the anticompetitive conduct.[5]

7. Commission enforcement also has helped to clarify the scope of the McCarran-Ferguson exemption. Two cases narrowed the definition of what constitutes "the business of insurance." In *American General Insurance Co. v. FTC*, a federal district court declined to enjoin the FTC's challenge of a merger of two companies engaged in the business of insurance and to declare that the McCarran-Ferguson Act barred the FTC's exercise of subject matter jurisdiction. The court agreed with the FTC position that the "business of insurance" does not include mergers since it does not concern the regulation or protection of the relationship between the insurance company and the policyholder. In *Ticor Title Insurance*, the FTC successfully established that the services provided by title insurance companies do not qualify as the "business of insurance" under the "three-prong test" established by the Supreme Court[6] and prohibited six title insurance companies from collectively establishing through private rating bureaus uniform rates for title search and examination services and settlement services.[7]

NOTES

1 Under the state action doctrine, private action taken pursuant to a clearly articulated policy of one of the U.S. states to displace competition and subject to the active supervision of the state is immunized from antitrust liability.

2 The Court has said that the Act's requirement is satisfied as long as the state statute is not a "mere pretense" at regulation. However, regulation by a state of the activities of its domiciliary