decisions surveyed in the 1977-1978 period are more in line with the Iowa Supreme Court's interpretation of industrial disability.

Robert N. Hendershot II

Just before publication, the Iowa Supreme Court rendered decisions in *Blacksmith v. All-American, Inc.*, No. 63557 (filed Mar. 19, 1980) and *McSpadden v. Big Ben Coal Co.*, 288 N.W.2d 181 (Iowa 1980). These decisions appear to open a new area for industrial disability in Iowa and a careful examination of these decisions is recommended. —*Ed.*

POTENTIAL FEDERAL INTERVENTION IN THE INSURANCE INDUSTRY: THE PENDING UNITED STATES SENATE SUBCOMMITTEE DRAFT TO AMEND THE McCARRAN-FERGUSON ACT

I. INTRODUCTION

Since the enactment of the McCarran-Ferguson Act[1] (hereinafter McCarran Act) in 1945, the business of insurance has nearly exclusively been subject to the laws of the several states.[2] The McCarran Act also renders the Sherman,[3] Clayton,[4] and Federal Trade Commission Acts[5] applicable to the business of insurance only to the extent that such business is not regulated by state law.[6] However, the Sherman Act[7] remains applicable to the business of insurance with respect to agreements to boycott, coerce or intimidate and

---

1. 15 U.S.C. §§ 1011-15 (1976).

2. *See* Section 2(a) of the McCarran Act (15 U.S.C. § 1012(a)(1976)) which provides: "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." *See also* Group Life & Health Ins. Co. v. Royal Drug Co., 99 S. Ct. 1067, 1076 n.18 (1979)(there is no question that the primary purpose of the McCarran Act was to preserve state regulation of the activities of insurance companies); St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531, 539 (1978)(obviously the congressional purpose in enacting the McCarran Act was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance)(citing Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 429 (1946)).

3. Sherman Antitrust Act, 26 Stat. 269 (1890), *as amended by* 15 U.S.C. § 1 (1976).

4. Clayton Act, 38 Stat. 730 (1914), *as amended by* 15 U.S.C. § 12 (1976).

5. Federal Trade Commission Act, 38 Stat. 717 (1914), *as amended by* 15 U.S.C. § 41 (1976).

For two decisions which consider the business of insurance and the applicability of the Federal Trade Commission Act, *see* FTC v. Travelers Health Ass'n, 362 U.S. 293 (1960) and FTC v. National Cas. Co., 357 U.S. 560 (1958).

6. Section 2(b) of the McCarran Act (15 U.S.C. § 1012(b) (1976)) states:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

See also Group Life & Health Ins. Co. v. Royal Drug Co., 99 S. Ct. 1067, 1077 (1977)(in section 2(b) of the McCarran Act (15 U.S.C. § 1012(b)) Congress provided that the federal antitrust laws shall be applicable unless the activities of the insurance companies are the business of insurance and regulated by state law); St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531, 539 (1978)(section 2(b) limits the general applicability of the federal antitrust laws "to the business of insurance to the extent that such business is not regulated by State Law")(citing S.E.C. v. National Sec. Inc., 393 U.S. 453, 460 (1969) and F.T.C. v. National Cas. Co., 357 U.S. 560 (1958)).

7. 15 U.S.C. § 1 (1976).

also to acts of boycott, coercion or intimidation.[8]

Cases decided upon McCarran Act grounds often turn on whether a particular activity falls within the definition of the phrase "business of insurance."[9] If an activity falls within the "business of insurance," the general rule is that state law governs and federal regulatory measures are excluded.[10] The leading case defining the "business of insurance" for purposes of the McCarran Act is *S.E.C. v. National Securities, Inc.*[11] In *National Securities,* the Supreme Court held that the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation and enforcement were the core of the "business of insurance."[12] Although other activities of insurance companies may relate so closely to their status as reliable insurers that such activities must be considered as falling within the "business of insurance," it was held that the focus of the phrase as used in the McCarran Act was on the relationship between the insurance company and the policyholder.[13] The Court concluded by stating: "Statutes aimed at protecting or regulating this relationship [between the insurer and insured], directly or indirectly are laws regulating the 'business of insurance.'"[14]

More recently, the Supreme Court held that "business of insurance" within the McCarran Act primarily involves underwriting or spreading of risk.[15] The Court further stated that this phrase relates to "the contract between the insurer and the insured."[16]

However, recent subcommittee activity in the Congress of the United

---

8. *See* Section 3(b) of the McCarran Act (15 U.S.C. § 1013(b) (1976)) which states: "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."

For an interpretation of the "boycott" exception in section 3(b), *see* St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531 (1978), noted in 27 DRAKE L. REV. 722 (1978).

In addition, the McCarran-Ferguson Act renders federal antitrust laws inapplicable when State legislation generally proscribes, permits or otherwise regulates the conduct in question. *See generally* FTC v. National Cas. Co., 357 U.S. 560 (1958); Lawyers Title Co. of Mo. v. St. Paul Title Ins. Corp., 526 F.2d 795, 797 (8th Cir. 1975)(general regulations by state statute sufficient to exempt the insurance carriers so regulated from federal antitrust suits); Crawford v. American Title Ins. Co., 518 F.2d 217, 218 (5th Cir. 1975); McIlhenny v. American Title Ins. Co., 418 F.Supp. 364, 370 (E.D. Pa. 1976)(a general state regulatory scheme is sufficient to preempt).

9. The phrase "business of insurance" is contained in sections 1 (15 U.S.C. § 1011 (1976)), 2(a) (15 U.S.C. § 1012(a) (1976)), 2(b) (15 U.S.C. § 1012(b) (1976)), 3(a) (15 U.S.C. § 1013(a) (1976)) and 4 (15 U.S.C. § 1014 (1976)) of the McCarran Act.

10. *See* 15 U.S.C. §§ 1011, 1012, 1013(a) (1976). *See also* S.E.C. v. National Sec. Inc., 393 U.S. 453, 459-60 (1969), where the Court stated: "[i]nsurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the 'business of insurance' does the [McCarran Act] apply."

11. 393 U.S. 453 (1969).

12. *Id.* at 460.

13. *Id.*

14. *Id.*

15. Group Life & Health Ins. Co. v. Royal Drug Co., 99 S. Ct. 1067, 1073, 1078 (1979), noted in 28 DRAKE L. REV. 977 (1979).

16. 99 S. Ct. at 1075.

States may result in changes to the McCarran Act as it presently exists. A recently completed subcommittee staff draft proposal contains provisions which would significantly alter the business of insurance in the United States.

II. The Pending Subcommittee Staff Draft Proposal to Amend the Act

Staff members of the United States Senate Subcommittee on Antitrust, Monopoly and Business Rights[17] have prepared a preliminary draft of a bill which would significantly amend the McCarran Act. It is entitled the "Insurance Competition Improvement Act of 1979" (hereinafter, ICIA - Staff Draft) and does not have official Subcommittee approval at this time.[18] However, even if the ICIA - Staff Draft is not approved by the Subcommittee and presented to the Congress this year, it has far-reaching implications as the first federal legislative proposal to deal with problems raised by the operation of competition in insurance and the impact of state regulation.[19]

It is possible, and perhaps likely, that the ICIA - Staff Draft will be significantly changed or diluted by the Subcommittee.[20] However, the obvious importance of this congressional activity requires some attention in the *Drake Law Review Insurance Symposium* at this time regardless of the ICIA - Staff Draft's future disposition.

The purpose of this short commentary is to generally describe the ICIA - Staff Draft and highlight its major provisions. In addition, industry response to the proposal will be set forth, as will the results of a recent General Accounting Office report concerning present state regulation of the business of insurance. Finally, this commentary will contain a conclusion reflecting the author's view of the ICIA - Staff Draft and the underlying issue of whether the present state insurance system is in need of significant improvement.

Interested readers may obtain additional information and offer comments to the Subcommittee at the following address:

> United States Senate Subcommittee on Antitrust, Monopoly and Business Rights, Washington, D.C. 20510.[21]

---

17. The Senators comprising the Subcommittee on Antitrust, Monopoly and Business Rights as of publication are Howard M. Metzenbaum (Ohio), Chairman; Edward M. Kennedy, (Mass.); Birch Bayh (Ind.); John C. Culver, (Iowa); Patrick J. Lehy (Vt.); Max Baucus (Mont.); Strom Thurmond (S.C.); Charles McC. Mathias, Jr. (Md.); Paul Laxalt (Nev.); and Orrin G. Hatch (Utah). Chief Counsel to the Subcommittee is Herman Schwartz.

18. Letter from Herman Schwartz, Chief Counsel to the United States Senate Subcommittee on Antitrust, Monopoly and Business Rights (Sept. 4, 1979).

19. Letter from Stewart W. Kemp, Special Counsel to the Senate Subcommittee (August 2, 1979). Mr. Kemp authored the ICIA - Staff Draft.

20. Letter from Herman Schwartz, Chief Counsel to the Senate Subcommittee on Antitrust, Monopoly and Business Rights (Sept. 4, 1979). In his letter, Mr. Schwartz indicates that substantial changes to the ICIA - Staff Draft are very likely.

21. The names of the Senators comprising the Subcommittee are set forth in note 17 *supra*.

A. *The Insurance Competition Improvement Act of 1979*

1. *Introduction*

Before proceeding to a detailed explanation of the ICIA - Staff Draft, it may be helpful to set forth the general confines of that proposal. In essence, the ICIA - Staff Draft establishes substantive and procedural standards for the business of insurance which each state would be required to implement. The vehicle for the implementation of the standards embodied in the proposal is termed a "regulatory plan." Each state would be required to establish a regulatory plan in compliance with federal standards. The ICIA - Staff Draft also creates a federal review panel which would scrutinize each state's regulatory plan to determine whether it is in compliance with federal standards. There would be no federal involvement, as such, beyond this review of the state regulatory plan if that plan is found in compliance with federal standards. However, if the federal review panel concluded that a regulatory plan was in noncompliance, the panel would then be authorized to implement an "alternative regulatory plan" in that state which does comply with federal standards. In such a case, the nonconforming state would regulate the alternative regulatory plan if it agreed to do so. If a nonconforming state refused to regulate the alternative regulatory plan, the United States Department of Justice would undertake that responsibility as a last resort.

The ICIA - Staff Draft is an attempt to keep actual federal involvement at a minimum; nevertheless, federal intervention remains a distinct possibility. As will be noted *infra,* opponents of the proposal contend that the ICIA - Staff Draft constitutes direct federal intervention into state domain under the guise of its professed purpose to intervene indirectly via its imposition of standards on the insurance industry. It is clear that the Subcommittee staff attempted to blunt industry opposition by choosing a middle ground: imposition of federal standards upon the states without stripping them of their primacy in insurance operation and regulation. Although federal involvement is professed to be minimal, it can hardly be asserted that the federal government maintains a low profile under the ICIA - Staff Draft. The proposal is considered in more detail below.

2. *Primary Purposes*

The ICIA - Staff Draft professes three primary purposes: (1) to limit the "sweeping antitrust immunity" granted to the insurance industry by the McCarran Act;[22] (2) to establish competition in the pricing of automobile and homeowner's insurance on an average rate level basis[23] and (3) to provide minimum standards to insure non-discrimination in insurance pricing, full availability of property/casualty coverage and the elimination of unfair and

22. ICIA - Staff Draft, *Summary and Section-by-Section Analysis* 1 (hereinafter, Analysis).

23. *Id.*

excessive rate differentials between insureds.[24]

However, the ICIA - Staff Draft also professes *not* to impose federal regulation on the insurance industry.[25] Rather, its stated purpose "is to ensure that state regulation meets basic standards of fairness and competitive rating."[26]

3. *Antitrust Immunity*

A major provision in the ICIA - Staff Draft would amend the McCarran Act by making the federal antitrust laws[27] *fully applicable* to the business of insurance.[28]

This amendment is deemed essential in order to promote open price competition in the business of insurance.[29] The apparent target of the provision is collective rate setting by industry-controlled rating bureaus, which is characterized as being "tantamount to cartel pricing."[30] However, the ICIA - Staff Draft provides for an exception: "essential collective activities" such as joint gathering by insurers or rating bureaus of loss data is permitted, but only where "it is essential to an insurer's business and the insurer's own data is not sufficient to establish a reasonable degree of actuarial credibility."[31] Thus, in order to enhance competitive pricing, the ICIA - Staff Draft would permit the use of joint data, but only where essential.[32]

In addition, joint ventures among insurers for purposes of reinsurance or pooling of risks are permitted if: (1) required by state regulatory action or (2)

---

24. *Id.*

25. *Id.* However, the federal government may become involved in actual regulation of the insurance industry in the event a particular state fails to comply with the provisions of the ICIA - Staff Draft. *See* notes 71-80 and accompanying text *infra*.

26. Analysis, *supra* note 22, at 1. *See also* ICIA - Staff Draft § 2(b)(statement of purpose).

27. Sherman Act, 15 U.S.C. § 1 (1976); Clayton Act, 15 U.S.C. § 12 (1976); and Federal Trade Commission Act, 15 U.S.C. § 41 (1976).

28. ICIA - Staff Draft § 3 (emphasis added). This provision is in accordance with the position of the National Commission for the Review of Antitrust Laws and Procedures. *See* Analysis, *supra* note 22, at 2.

29. Analysis, *supra* note 22, at 3.

30. *Id.*

31. *Id.*; ICIA - Staff Draft § 3(c)(1). Section 3(c)(2) details three major categories of specific practices which are prohibited: (1) the joint gathering by insurers, or gathering by associations of insurers or rating bureaus, of information on any expenses incurred in the sale or underwriting of insurance; (2) the joint determination by insurers, or the determination by associations of insurers or rating bureaus, of loss development factors, average claim cost trend and projection factors, claim adjustment expense factors, profit allowances, cost estimates of the impact of changes in the scope of insurance coverage, whether or not mandated by law, or other actuarial components (excepting reported losses and units of exposure to risk) used in the calculation of insurance rates; and (3) agreements among insurers involving the reinsurance or pooling of risks, unless any such agreement is (a) required by state regulatory action, or (b) necessary to establish the availability of the insurance coverage forming the subject of the agreement or to maintain competition in the market for such coverage, and instituted in the least anticompetitive manner possible.

32. Analysis, *supra* note 22, at 3.

necessary to establish the availability of coverage or to maintain competition in the market for such coverage.[33] However, in order to be permissible, such joint activity must be instituted in the least anticompetitive manner possible.[34] The stated purpose of this provision is to apply the Sherman Act[35] "Rule of Reason" to protect joint activities by insurers which serve valid business purposes that are not anticompetitive.[36]

4. *Minimum Federal Standards to be Implemented by the States*

Section 4 of the ICIA - Staff Draft provides that minimum federal standards with respect to insurance regulation shall be implemented by the states.[37] These standards are set forth in two broad categories: (1) those limiting discrimination, surcharging and refusals to insure[38] and (2) those

33. *Id.* at 5; ICIA - Staff Draft § 3(c)(2)(C).

34. *Id.*

35. Sherman Antitrust Act, 15 U.S.C. § 1 (1976).

36. Analysis, *supra* note 22, at 5.

The Sherman Act "Rule of Reason" was recently explained in National Soc. of Professional Engineers v. United States, 435 U.S. 679 (1978). Section 1 of the Sherman Act states that "every" contract that restrains trade is unlawful. *Id.* at 687. This provision of the Sherman Act cannot be read literally because its terms would outlaw the entire body of private contract law. *Id.* at 688. The "Rule of Reason" has therefore been formulated by the courts to temper the broad scope of this statutory language. *Id.* The Court stated: "Contrary to its name, the Rule [of Reason] does not open the field of antitrust inquiry to any argument in favor of a challenged restraint that may fall within the realm of reason. Instead, it focuses directly on the challenged restraint's impact on competitive conditions." *Id.*

The application of the Rule of Reason involves a process whereby the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977)(citing Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)).

The Rule of Reason permits case by case flexibility in determining whether particular restraints on trade should be prohibited as violative of the Sherman Act. The inquiry mandated by this rule is whether the challenged agreement is one that promotes competition or one that suppresses competition. National Soc. of Professional Engineers, *supra*, at 691. The Supreme Court further described the Rule of Reason test as follows:

> The test . . . is whether the challenged contracts or acts "were unreasonably restrictive of competitive conditions." Unreasonableness under that test could be based either (1) on the nature or character of the contracts, or (2) on surrounding circumstances giving rise to the inference or presumption that they were intended to restrain trade and enhance prices. Under either branch of the test, the inquiry is confined to a consideration of impact on competitive conditions.

Id. at 690.

For a further explanation of the Rule of Reason and its application, *see generally* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pt. 2), 75 YALE L. J. 373 (1966).

37. Analysis, *supra* note 22, at 6; ICIA - Staff Draft § 4. Section 4 would amend the McCarran Act by striking a portion of that Act (15 U.S.C. § 1015 (1976)) and add requirements which would be mandatory for each state regulatory insurance plan in order to be in compliance with the Insurance Competition Improvement Act of 1979.

38. ICIA - Staff Draft § 4 (proposed McCarran amendments §§ 5(a), 5(b)).

requiring competitive rating on an average rate level basis.[39]

a. *Discrimination*

Under the ICIA - Staff Draft, property/casualty insurers would be prohibied from discriminating on the basis of race, religion, national origin, color, age, sex or marital status.[40] This anti-discrimination provision may be readily contrasted to the classifications generally utilized by insurers today. According to the author of the ICIA - Staff Draft, in property/casualty insurance, the classifications of age, sex and marital status are used only for motor vehicle insurance rating.[41] Further, the marital status distinction is generally applied only to males under age twenty-five,[42] and distinctions based on sex are generally used to differentiate only drivers under the age of twenty-five.[43] In contrast, the age classification is "widely used" to separate youthful operators from the adult population for purposes of premium charges.[44] However, the author of the ICIA - Staff Draft states that the age classification is not used to subdivide adults for rating purposes, except for certain senior citizen discounts.[45]

The ICIA - Staff Draft would therefore significantly alter the rating systems presently used by insurers in this country. The emphasis of this section is to allow insurance policyholders a "presumption of being considered ordinary risks unless they demonstrate otherwise by their own actions."[46] The current system, in which broad groupings are based upon general classifications, "forces great numbers of persons with exemplary driving records to pay double or more the normal [premium] rate for auto insurance."[47] As an

39. *Id.* (proposed McCarran amendments §§ 5(d), 5(e) and 5(f)).

40. *Id.* (proposed McCarran amendment § 5(a)(1)). The accompanying Analysis, written by the author of the ICIA - Staff Draft, presents a well-reasoned argument that these classifications are impermissibly overbroad and result in a cost detriment to the majority of individuals within the classification. Analysis, *supra* note 22, at 6-8.

The alternative presented by the ICIA - Staff Draft is an individual merit system whereby premiums would be based as much as possible upon *individual* risks. Using such a system, individuals would be rewarded for favorable risk records with lower premium demands from insurers.

The ICIA - Staff Draft's goal of individual merit ratings, in place of the overinclusive groupings utilized today, is a fairer system and should be included in whatever bill is ultimately presented to the Congress. The Michigan State Senate recognized the advantage of the individual merit rating system. That legislative body passed Michigan Senate Bill 428 which requires objective and individual rating factors, such as age and miles driven, to be utilized in setting automobile insurance rates. *See* notes 183-204 and accompanying text *infra.*

41. Analysis, *supra* note 22, at 6.

42. *Id.* Males under age twenty-five comprise about ten percent of all drivers. *Id.*

43. *Id.* All drivers under the age of twenty-five comprise about twenty percent of all drivers. *Id.*

44. *Id.* at 7.

45. *Id.*

46. *Id.*

47. *Id.*

alternative to the presently used scheme of classifications, the ICIA - Staff Draft author advocates a "merit rating" scheme which bases premium charges on individual driving records rather than broad groupings.[48]

Under this proposed merit rating system, incentives are created to reduce losses because the individual would be rewarded for a good driving record in the form of lower premium payments.[49] Individualized merit rating, substituted for overly broad classifications, is perhaps the most commendable feature of the ICIA - Staff Draft's effort to eliminate stereotyping in insurance premium ratesetting.[50]

b. *Availability*

Another provision of the ICIA - Staff Draft would preclude any insurer from refusing to make available, cancel or fail to renew (at the policyholder's option) property/casualty coverage which it *generally provides,* except in cases where a risk is objectively uninsurable.[51]

This provision, which provides standards for insurance availability, is deemed essential because it is beyond reasonable dispute that individuals simply *need* insurance in modern life.[52] Such a provision is necessary because individuals may presently be unable to secure needed coverage through their own efforts. The author of the ICIA - Staff Draft states that insurance unavailability often results from insurers' refusals to write policies in certain geographic areas.[53] For example, inner city residents presently may be required to maintain essential insurance coverage only at prohibitive prices.[54] Thus, needed coverage may presently be restricted or prohibitively priced because of common insurance company practice; this provision would amend such industry practice.

While full insurance availability is theoretically mandated by this provision, "reasonable exceptions" are permitted.[55] For example, insurers are *not* required to: (1) insure objectively uninsurable risks such as unoccupied firetraps or unlicensed drivers;[56] (2) insure persons who have made material misrepresentations or filed fraudulent claims[57] or (3) insure additional in-

48. *Id.* at 7, 8.

49. *See id.* at 8.

50. The insurance industry disfavors individual merit rating. *See* notes 143-47, 161-63 and accompanying text *infra.*

51. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(b))(emphasis added). The "generally provides" phrase is important because the insurer is required, under the ICIA - Staff Draft, to take on only those risks which it generally assumes in its normal business. This would prevent an insurer from being required to underwrite a type of risk it is incapable of insuring. Analysis, *supra* note 22, at 9.

52. Analysis, *supra* note 22, at 8.

53. *Id.*

54. *Id.* at 9.

55. *Id.*

56. *Id.* (referring to ICIA - Staff Draft § 4)(proposed McCarran amendment § 5(b)(1)(D)).

57. *Id.* (referring to ICIA - Staff Draft § 4)(proposed McCarran amendment § 5(b)(1)(B)).

sureds if they (the insurers) have been found by state regulators to have exhausted their capital capacity.[58]

In addition, the ICIA - Staff Draft would prohibit insurers from charging insureds at rates other than those generally charged by such insurers to insureds similarly classified.[59] Very simply, this provision would prevent insurers from surcharging their insureds.

Finally, discrimination in rating and otherwise on the basis of personal living habits, appearance, occupation, personality, marital history, or involvement in sports, hobbies or other recreational activities would also be prohibited.[60] In short, insurers would no longer be able to increase premium charges upon the basis of these factors. Instead, general rating schemes which do not take these factors into account would be binding upon insurance companies.

c. *Establishment of Residual Market Mechanisms*

Where persons are unable to secure insurance coverage on a voluntary basis, "residual market mechanisms" would be established. Under the proposal, a residual market mechanism is a pooling system whereby such risks would be allocated equitably among insurers.[61]

d. *Classifications and Territories*

In another provision, the ICIA - Staff Draft would allow insurers to continue to use any rating territories and classifications they desire,[62] on the condition that they first be approved by the appropriate state commissioner of insurance.[63] Under this provision, each state insurance commissioner must give primary weight to several factors in determining whether to approve certain rating territories and classifications. These factors are: (1) the social acceptability of the characteristic by which the particular classification is

58. *Id.* (referring to ICIA - Staff Draft § 4)(proposed McCarran amendment § 5(b)(1)(F)).

59. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(b)(4)).

60. *Id.* (proposed McCarran amendment § 5(b)(5)).

61. *Id.* (proposed McCarran amendment § 5(c)).

"Residual Market Mechanisms" would guarantee the availability of property/casualty insurance to all persons unable to secure coverage voluntarily. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(c)). Insurance coverage via Residual Market Mechanisms would equitably allocate the premiums, losses and expenses of insuring such risks among the insurance companies. Analysis, *supra* note 22, at 10.

This provision is a thoughtful solution to the problem of persons unable to obtain coverage from insurers on a voluntary basis because it recognizes that individuals need insurance and takes steps to make coverage available by spreading the costs and the risks among insurers. Under the Residual Market Mechanisms system, the liability exposure of insurers is minimal, yet necessary coverage is provided to persons needing the special protection of this provision.

62. However, this freedom is limited by the ICIA - Staff Draft's discrimination proscriptions. For the discrimination proscriptions in the ICIA - Staff Draft, *see* part II A.(3)(a) in text, *supra*.

63. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(d)).

defined; (2) the degree of incentive the use of such a category creates for the reduction and retention of losses by insureds; (3) the accuracy of pricing which results for each individual or insured grouped in a classification category; (4) the homogeneity with respect to potential for loss of the groupings of insureds which results from the use of a classification category and (5) the degree of statistical separation of the grouping of insureds from the remainder of the insured population which results from the use of a classification territory.[64]

However, a state insurance commissioner may not approve a particular classification category, territory or other geographical distinction unless it is "fair, just, reasonable, and not unfairly discriminatory."[65] Importantly, this section also requires that insurers' automobile insurance rating schemes utilize merit rating plans which would establish premium differentials based upon individual driving records.[66]

e. *Rate Differentials by Classification and Territory*

Closely related to the concept of classifications and territories noted above is another section of the ICIA - Staff Draft which more specifically governs and limits rate differentials.[67] Two parallel standards are provided. First, certain criteria are established which must be considered in the determination of allowable differentials.[68] The section's prescribed criteria emphasize the importance of these factors: individual rating; general fairness; avoidance of discrimination; avoidance of large overcharges to certain individuals; actual cost differences to insurers and minimizing the cost effect environmental hazards place on insureds.[69] Second, maximum rate differentials for use in connection with particular rating variables are established.[70]

64. *Id.* (proposed McCarran amendment § 5(d)(2)).

65. *Id.* (proposed McCarran amendment § 5(d)(1)).

66. *Id.* (proposed McCarran amendment § 5(d)(3)). Premium charge differentials would still be permitted for drivers (1) found to be at fault in a motor vehicle accident or (2) convicted of a moving traffic violation during the three year period preceeding the period for which coverage is to be in effect. In addition, any such premium differentials would be required to be reasonable, fair, non-punitive and reasonably related to the increased likelihood of loss under the particular motor vehicle insurance policy.

67. *Id.* (proposed McCarran amendment § 5(e)).

68. *Id.* (proposed McCarran amendment §§ 5(e)(1)-(6)).

69. *Id.*

70. *Id.* (proposed McCarran amendment §§ 5(e)(7)-(10)). Specific ratios are established in this section which limit the maximum differential that can be based upon certain rating classifications. For motor vehicle insurance, the maximum rate differential specified by this provision is two to one (2 to 1) for differences based solely on geography and two to one (2 to 1) for all differences based on all other classifications (except merit rating, annual mileage driven, and make, model, age or value of an insured vehicle). Ratios of one point five to one (1.5 to 1) would apply to property and homeowners' insurance on the same basis.

Within these sections of the ICIA - Staff Draft, automobile, property, homeowners and tenants' insurance are separated into categories for purposes of establishing maximum rate differentials attributable to certain bases such as geography, physical place of garaging an

It is contended by the ICIA - Staff Draft's author that current actuarial techniques "systematically" overcharge individuals on the basis of overinclusive classifications.[71] It is further stated that although it is obviously impossible to predict the future and therefore impossible to charge each individual for precisely his expected loss,[72] this section of the ICIA - Staff Draft is intended to strike a reasonable balance between the use of class-territorial distinctions and the tempering of large premium overcharges.[73] The ratios established by this section are intended to strike this balance by precisely limiting premium charge differentials based upon these factors.

A helpful explanation of this provision is the following statement: "Merit rating creates positive incentives to reduce losses in the system. Class-mean pricing, on the other hand, often exacerbates tendencies toward inflated and fraudulent claims."[74]

f. *Regulatory Review of Statewide Rate Levels*

In order to insure independent, competitive pricing, another proposed section specifies that each approved state regulatory plan shall provide that rate level and rate level charges set by insurers for property/casualty insurance shall be reviewed by each state insurance commissioner.[75] Although each state insurance commissioner retains authority to disapprove rate classifications, territories and differentials, he may not disapprove statewide average rates charged solely on the basis that they are excessive in the aggregate.[76]

The section further provides that in the event insurance competition "is insufficient to assure that rates will not be excessive or otherwise contrary to public policy, such State may restore to the Commissioner of Insurance regulatory control."[77] It seems apparent that this provision of the ICIA - Staff Draft is a "safety valve" to invoke in the event open competition fails to result in satisfactory premium rates. Although the idea seems sound in theory, the section may be criticized as being vague and lacking in standards for application. This provision of the ICIA - Staff Draft is in particular need of review by the Subcommittee.

---

insured motor vehicle, and physical condition of insured property. Importantly, however, individual merit rating systems are permitted in motor vehicle insurance rating. Permissible factors in motor vehicle insurance rating by individual merit include: annual mileage driven; geographical territory; and make, model, age or value of an insured motor vehicle.

71. Analysis, *supra* note 22, at 12-17.

72. *Id.* at 15.

73. *Id.*

74. *Id.* at 16.

75. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(f)).

76. *Id.* (proposed McCarran amendment § 5(f)(1)).

77. *Id.* (proposed McCarran amendment § 5(f)(2)). The state insurance commissioner is not allowed to resume regulatory control within one year after an approved state regulatory plan has gone into effect for that state. *Id.* This means that insurers will have sufficient opportunity to conform to the legislation before the commissioner reassumes regulatory enforcement.

g. *Price Information Availability*

Competition is impossible if consumers are unable to readily compare the prices of similar goods. Another provision of the ICIA - Staff Draft would furnish extensive price information to consumers in two ways: (1) state insurance commissioners would be required to semi-annually rank the top thirty insurers in the state in order of statewide insurance rate levels[78] and (2) insurers and their agents would be required to provide specific rate quotations on request.[79]

It is clear that these provisions would greatly aid consumer price comparison and are therefore necessary to enable open competition. The need for better consumer information in the insurance industry is also stressed in the GAO report discussed in section IV.

h. *Policy Form Approval*

The ICIA - Staff Draft also requires that each state insurance commissioner approve only those policy forms which can be compared by consumers without unreasonable difficulty.[80] This provision would require a "substantial degree of standardization of coverage and policy terms" so that consumers could readily compare coverage offered by different insurers.[81]

Reasonable standardization of policy forms would allow consumers to "shop around" for the lowest prices and therefore allow meaningful insurance competition.[82]

i. *Policy Form Readability*

In order to further facilitate policy comparison and policyholder understanding of coverage, the ICIA - Staff Draft further provides for minimum readability standards for all policy forms.[83] This section sets forth technical

78. *Id.* (proposed McCarran amendment § 5(g)(1)(A)). This provision specifically provides that at least every six months, each state insurance commissioner must prepare, revise and update "consumer shopping guides" for motor vehicle, property, homeowners' and tenants' insurance. *Id.* These "consumer shopping guides" would include brief summaries of coverage provided under each line of insurance and describe relative pricing schemes used by no fewer than the thirty largest writers of insurance in the state. *Id.*

79. *Id.* (proposed McCarran amendment § 5(g)(2)). Under this provision, all persons who make "reasonable inquiries" for specific motor vehicle, property, homeowners' or tenants' insurance rating information would be entitled to receive that data from all insurers and their agents. *Id.* Requests for pricing information could be made in person, by telephone or in writing and would require insurers or their agents to provide that data "orally and without delay" if so requested. *Id.*

80. *Id.* (proposed McCarran amendment § 5(h)(2)).

81. *Id.*

82. Analysis, *supra* note 22, at 21-22. Interestingly, it is also stated that "motor vehicle and homeowners policies are already sufficiently standardized to allow price competitions." *Id.* at 22. Individual health policies and coverage are cited as being impossible to price-compare. *Id.* at 21.

83. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(i)).

standards of readability,[84] but basically requires that insurance policies contain only short words and sentences; fine print is also abolished.[85]

j. *Prompt and Fair Payment of Claims*

Another provision of the ICIA - Staff Draft requires insurers to pay valid claims fairly and promptly.[86] In the event an insurer refuses or substantially reduces a claim, it must specify its reasons for doing so.[87] If the insurer fails to make payment within fifteen days of receipt of a written claim notice, the claimant may sue in an appropriate state court for the amount claimed.[88] If the state court determines that the insurer did not pay the claim "promptly and fairly," the claimant would be entitled to recover three times the amount of damage, litigation costs and reasonable attorneys fees.[89] This provision also includes certain factors for the state court to consider in its "promptly and fairly" inquiry.[90] Relevant factors include a comparison of the insurer's settlement offer to the amount ultimately awarded; the insurer's reasonableness in its response to the claim and the insurer's promptness, completeness and comprehensibility in responding to the claim. This proposal also allows the court to consider any other factors which, in its discretion, it finds pertinent.[91]

Obviously, this provision is a coercive remedy which could operate harshly on insurers in certain instances. However, it would certainly increase the likelihood of prompt claim settlement.

k. *Remedies and Enforcement under the ICIA - Staff Draft*

In short, the ICIA - Staff Draft basically requires each respective state to establish a "state regulatory plan" which includes all the substantive provisions noted above. Although any person adversely affected by any action of an insurer of any other person which is contrary to the state regulatory plan may privately sue that insurer or other person for noncompliance with a particular state regulatory plan,[92] overall enforcement authority of the plan is vested in both the state insurance commissioner and state attorney general.[93]

---

84. *Id.* (proposed McCarran amendment §§ 5(i)(1)-(2)(which defines and imposes the Flesch readability test).

85. Analysis, *supra* note 22, at 22.

86. ICIA - Staff Draft § 4 (proposed McCarran amendment § 5(j)(1)).

87. *Id.* (proposed McCarran amendment § 5(j)(2)).

88. *Id.* (proposed McCarran amendment § 5(j)(3)).

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* (proposed McCarran amendment § 5(k)(1)). In addition, if a litigant under this provision is successful, he would be permitted to recover three times the actual damage sustained or $1,000 plus litigation costs including reasonable attorneys fees. *Id.* (proposed McCarran amendment § (5)(k)(2)).

93. *Id.* (proposed McCarran amendment § 5(1)). In this provision both the state insurance commissioner and state attorney general are granted authority to seek injunctions and restitution

The professed goal of the ICIA - Staff Draft is to vest the primary enforcement of its substantive provisions in state instrumentalities. However, and as a last resort, federal entities may compel a state to comply with the ICIA - Staff Draft's substantive standards.

1. *The Role of the Federal Government in the ICIA - Staff Draft — Big Brother Lurking in the Wings*

The ICIA - Staff Draft establishes an "Insurance Regulation Review Panel" (hereinafter Review Panel) to exist as an independent instrumentality within the federal Department of Justice.[94] Normally, the Review Panel would simply examine a state's regulatory plan to determine whether it is in compliance with the basic standards set out in the ICIA - Staff Draft.[95]

The overall substantive and procedural progression of the ICIA - Staff Draft may be summarized as follows:

1. Each state would establish a regulatory plan in compliance with the ICIA- Staff Draft standards;[96]
2. Every state governor must then certify that the state regulatory plan is in complaince with the ICIA - Staff Draft standards;[97]
3. Each governor would then submit the certified state regulatory plan[98] to the Review Panel for examination;[99]
4. If the Review Panel approves the state regulatory plan as being in compliance with the ICIA - Staff Draft standards, there would be no additional federal involvement except for a triennial review;[100]
5. Review Panel actions would be subject to judicial review in the United States Court of Appeals circuit in which the state is located or in the United States Court of Appeals for the District of Columbia Circuit;[101]
6. If the state regultory plan did not comply with ICIA - Staff Draft standards, the Review Panel would then be authorized to

---

as well as to levy fines of no less than $1,000 and no more than $5,000 for each violation of the state regulatory plan.

94. *Id.* at § 5 (proposed McCarran amendment § 7).

95. Analysis, *supra* note 22, at 23; ICIA - Staff Draft § 5 (proposed McCarran amendment § 8 (entitled "Review Process") (section 8 also provides that any state law which prevents the implementation of the ICIA - Staff Draft provisions is preempted)).

96. ICIA - Staff Draft § 5 (proposed McCarran amendment § 8(b)).

97. *Id.*

98. *Id.*

99. *Id.* at § 5 (proposed McCarran amendment § 8(d) (entitled "Review Panel Review")). Under this provision, the Review Panel is required to review the state regulatory plan within 90 days of receipt. *Id.*

100. Analysis, *supra* note 22, at 24.

101. *Id.;* ICIA - Staff Draft § 5. (proposed McCarran amendment § 8(f)).

implement an "Alternative State Regulatory Plan" which does comply;[102]

a. The noncomplying state would regulate this alternative plan if it agreed to do so;[103]

b. In the event a state refused to supervise and regulate the alternative plan, the United States Department of Justice would undertake the responsibility as a last resort.[104]

III. Response to the ICIA - Staff Draft

The August 3, 1979 issue of *The National Underwriter* reported that the ICIA - Staff Draft was released for comment to the insurance industry, state insurance regulators and certain federal government agencies.[105] This article stated that comments were requested by the staff of the United States Senate Judiciary Committee, Antitrust Subcommittee.[106] The article went on to generally describe the ICIA - Staff Draft.[107]

Two weeks later, *The National Underwriter* printed the explanatory Section-by-Section Analysis to the ICIA - Staff Draft.[108] That issue simply contained this section-by-section explanation of the ICIA - Staff Draft; no industry comment was included.

One week later, *The National Underwriter* included an article entitled: "Assns. Smell A Rat In Metzenbaum Draft."[109] This article reported that the Independent Insurance Agents of America "strongly oppose" the ICIA - Staff Draft.[110] It further stated that the Alliance of American Insurers believe that although the draft was "being postured as a minimum standards bill," it is actually federal regulation.[111] A representative of the American Insurance Association is quoted as saying that the ICIA - Staff Draft "would emasculate the state regulatory system and make that system the ward of the Federal

---

102. Analysis, *supra* note 22, at 24. *See generally* ICIA - Staff Draft § 5 (proposed McCarran amendment §§ 8, 9, 10). An "alternative State Regulatory Plan" would include all of the substantive and procedural provisions noted *supra*.

103. *Id.*

104. *Id.* If the United States Department of Justice assumed responsibility for the supervision of an "alternative State Regulatory Plan," it would be permitted to promulgate regulations necessary to implement, administer and enforce such a plan in the particular state. ICIA - Staff Draft § 5 (proposed McCarran amendment § 10(d)(2)).

105. The National Underwriter, Property & Casualty Insurance Edition, August 3, 1979, at 1.

106. For the members of the U.S. Senate's Subcommittee on Antitrust, Monopoly and Business Rights, *see* note 17, *supra*.

107. *See* The National Underwriter, Property & Casualty Insurance Edition, August 3, 1979, at 1, 51.

108. *See* The National Underwriter, Property and Casualty Insurance Edition, August 17, 1979, at 2, 57-61.The Section-by-Section Analysis to the ICIA - Staff Draft has been frequently cited in this commentary as Analysis. *See* note 22 *supra*.

109. The National Underwriter, Property & Casualty Edition, August 24, 1979, at 4.

110. *Id.*

111. *Id.*

government."[112] This same American Insurance Association representative is further quoted as saying that enactment of the ICIA - Staff Draft would represent a "long time Christmas present for the anti-trust lawyers and create legal problems for the next 100 years."[113] In addition, the President of the Independent Insurance Agents of America, Lee R. Meyer, is quoted as stating: "Our opposition [to the ICIA - Staff Draft] should be vigorous and unyielding."[114] After specifically criticizing the ICIA - Staff Draft, Mr. Meyer is further quoted as saying: "Sen. Metzenbaum's proposal is called the 'Insurance Competition Improvement Act of 1979'. In actuality, it would impose strict Federal regulation and control upon the insurance business and destroy the private insurance system as we know it today."[115]

In addition, an editorial comment in this issue strongly criticizes the ICIA - Staff Draft.[116] The editor stated that in establishing "minimum federal standards" rather than outright federal regulation, the ICIA - Staff Draft makes "a distinction without a difference."[117] The basic issue, according to the editorial, is whether the individual states or Washington is best equipped

---

112. *Id.*

113. *Id.*

114. *Id.* Mr. Meyer apparently concluded that the ICIA - Staff Draft is an attempt to federalize the insurance business, reduce the impact of state regulation and impede free and open competition. *Id.*

115. *Id.* at 4, 38. On these pages, the article lists fifteen changes which, according to Meyer, would result upon enactment of the ICIA - Staff Draft. Meyer's commentary follows each item. Although some items are accurately described (*i.e.*, items 1, 3, 5, 8 and 13), Meyer's impressions on several others are inaccurate. For example, item nine states that: "Commissioner [of state insurance] could control the allocation and amount of commissions paid to agents." *Id.* at 4. Nothing in the ICIA - Staff Draft or its Section-by-Section Analysis supports such a conclusion.

In addition, after noting that the ICIA - Staff Draft would require insurance agents to provide rate quotations upon request by telephone or in writing, Meyer concluded that such a burden upon the agent could be extremely onerous and ultimately inflate the cost of providing insurance. *Id.* Although the likelihood of a materialization of an "onerous burden" obviously cannot be predicted at this time, it is questionable that this requirement would be unreasonable or increase the cost of insurance as Meyer claims. When an agent sells an insurance policy to a consumer, he must certainly inform that consumer of the specific premium payments which will be due. It is submitted that an agent currently knows the specific premium rates of the policies he sells or can ascertain them when approached by a potential customer. Therefore, specific rate information is already available to, or ascertainable by, the agent and can therefore be communicated to interested persons with no real inconvenience.

Similarly, Meyer concluded that the ICIA - Staff Draft's provisions which require sufficient policy standardization in order to allow comparison shopping could discourage competition and inhibit the introduction of new coverages. *Id.* at 38. Contrary to Meyer's conclusion, it is submitted that reasonable standardization of policy forms to facilitate policy comparison shopping would encourage, and not discourage, competition. *See* Analysis, *supra* note 22, at 21, 22.

In conclusion, it is sufficient to state that an examination of this magazine article reveals that industry response to the ICIA - Staff Draft is clearly negative. Letter from Paul C. Blume, Vice-President and General Counsel, National Association of Independent Insurers (Nov. 20, 1979).

116. *See* THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, August 24, 1979, at 18. The title of this editorial is, "Control, By Any Other Name," *Id.*

117. *Id.*

to serve the needs of the public and of the insurance industry.[118] The editor concluded that the individual states are best equipped and asserted that the ICIA - Staff Draft, as presently written, would clearly impose federal regulation upon the insurance industry.[119]

H. Peter Hudson, Indiana Insurance Commissioner and President of the National Association of Insurance Commissioners described the ICIA - Staff Draft thus: "The mechanics of what the bill suggests are so elusive as to make it totally unworkable."[120]

Criticism of the ICIA - Staff Draft has also come from sources outside the insurance industry. Richard A. Posner, a University of Chicago law professor, expressed his views of the ICIA - Staff Draft via quotation in yet another issue of *The National Underwriter*.[121] Professor Posner stated that any federal attempt to delete any portion of the McCarran Act would have to be done with surgical precision.[122] However, Posner suggested that Congress does not have the competence to delete any portion of the McCarran Act with such precision.[123] Specifically commenting upon the ICIA - Staff Draft, Professor Posner stated that many lawyers consider it to be "irresponsible."[124] He further stated that the second part of the ICIA - Staff Draft proposes the creation of a vast superstructure of government regulation.[125]

A more general indication of insurance industry opinion was reported in a nationwide survey of 300 risk managers.[126] This survey did not specifically solicit opinion of the ICIA - Staff Draft, but several findings are nevertheless noteworthy. The survey revealed that the risk managers questioned oppose the repeal of the McCarran Act, fifty-four percent to twenty-six percent.[127] Fifty-four percent of the risk managers also stated that they favor the status quo regarding insurance regulation.[128] Significantly, however, twenty-nine

118. *Id.*

119. *Id.*

120. *See* THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, October 5, 1979, at 1. This article briefly described a panel discussion conducted at the annual meeting of the Society of Chartered Property and Casualty Underwriters. Included on that panel was Stewart W. Kemp, author of the ICIA - Staff Draft. Kemp defended the proposal, noting that its provisions, do *not* impose federal regulation on the insurance industry but instead insures that state regulation meets basic standards of fairness and competitive rating. THE NATIONAL UNDERWRITER, October 5, 1979, at 1, 110. In addition, Kemp stressed that federal involvement is limited. *Id.* at 110.

121. THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, October 22, 1979, at 19. Professor Posner is quoted in an article entitled "NAII Unites to Save McCarran Act." *Id.* at 1.

122. *Id.* at 19.

123. *Id.*

124. *Id.*

125. *Id.*

126. The results of this survey are reported in THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, June 22, 1979, at 1, 47, 48.

127. *Id.* at 1.

128. *Id.*

percent stated that they would favor some kind of dual state-federal mechanism.[129] Only six percent of the risk managers stated that they would favor replacing the current state regulatory system with a federal system.[130] The risk managers also rejected, by fifty-six percent to forty-one percent, a dual system whereby federal authorities would set standards and state regulatory authorities would regulate day-to-day activities.[131] The dual system which was the subject of this last survey question is apparently similar to the system envisioned by the ICIA - Staff Draft.

This survey, albeit general in scope, indicates that a dual state - federal system, such as that proposed by the ICIA - Staff Draft, is not completely beyond the pale of industry approval. Perhaps the survey is an indication that the vehement opposition to the ICIA - Staff Draft noted earlier is an overreaction. In any event, it is clear that the ICIA - Staff Draft as it is presently written faces significant industry opposition.

A. *The National Association of Independent Insurers' Position on Discrimination in Ratesetting*

In a notebook containing its 1980 Legislative Position Papers, the National Association of Independent Insurers (NAII) has specified its official views on several subjects related to the issues considered in this commentary.[132] This portion of *Trends* will briefly summarize the NAII position on "discrimination" in premium ratesetting.

In its "Discrimination" topical area, the NAII states that throughout the country much attention recently has been focused on insurers' use of certain rating factors to set premium rates.[133] Within this section, the NAII states that the use of risk classifications reflecting differences in loss potential primarily by geographic location, age, sex, and marital status is a practical method of distributing costs among insureds and is therefore "justified and equitable."[134]

The NAII position with respect to territorial classification states that there is a need to divide a state into rating territories to assure "equity, opportunity and market availability."[135] The NAII further states that the

---

129. *Id.*

130. *Id.*

131. *Id.* at 47.

132. For the information of interested readers, the National Association of Independent Insurers (NAII) has its headquarters at 2600 River Road, Des Plaines, Illinois 60018. The headquarters phone number is (312) 297-7800. As noted *supra*, the current president of the NAII is Arthur C. Mertz. Paul C. Blume serves as Vice-President and General Counsel.

The notebook containing the NAII position statements is divided into several issue sections. Citation to the notebook will be indicated by topical area. Unfortunately, the pages within the topical areas are unnumbered. Therefore, specific references will be indicated by page numbers determined by an unofficial count beginning from the first page within a particular topical area.

133. NAII 1980 Legislative Position Papers, Discrimination Section, at 1.

134. *Id.*

135. *Id.* at 3.

elimination of rating territories would violate state regulatory laws which require that rates shall not be excessive, inadequate or unfairly discriminatory.[136] In the Association's opinion, a violation of the law would occur where the absence of rating territories would "result in rates that are inadequate as to particular groupings of individuals."[137] "Inadequate" rates are apparently rates which are too low. The NAII asserts that rates which are inadequate for particular groupings of individuals would violate the state legislation noted above, which outlaws rates that are "excessive, inadequate or unfairly discriminatory."

It is submitted that the ICIA - Staff Draft presents a compelling argument that presently utilized rating territories result in rates that are "excessive" and "unfairly discriminatory."[138] If the reasoning of the NAII was truly accurate, there is an equally persuasive argument that the *present* system of rating territories violates the very provision of legislation upon which the NAII relies in its defense of currently used rating territories. This conclusion is equally compelling in light of the fact that the legislation cited by the NAII prohibits excessive and unfairly discriminatory rates, the precise evil which the ICIA - Staff Draft seeks to eliminate. In this respect, the argument of the NAII actually backfires and detracts from, rather than supports, its position.

The NAII also defends age, sex and marital classifications as being "justifiable and equitable as a mechanism for distributing costs among insureds."[139] It asserts that statistics reveal that losses of youthful drivers and unmarried young men are substantially greater than those of adult drivers and young married men and young women, respectively.[140] The NAII further asserts that statistics show that the losses of a single unmarried male are reduced when that male marries.[141] According to the NAII, elimination of these factors would result in: (1) an undesirable levy of additional costs on the majority of insured motorists; (2) serious problems with regard to insurance availability and market dislocation and (3) imposed restrictions on the current highly competitive market place.[142]

In addition, the NAII asserts that determining automobile insurance rates based upon a merit rating plan[143] is undesirable.[144] The NAII asserts that

---

136. *Id.* at 4.

137. *Id.*

138. *See* notes 62-74 and accompanying text *supra*. The words "excessive" and "unfairly discriminatory" are in quotation marks to refer to the rate regulatory law on which the NAII relies. The GAO report, discussed in section IV of this part of TRENDS, also supports this argument. *See generally* General Accounting Office Report, Issues and Needed Improvements in State Regulation of the Insurance Business 123-33 (Oct. 9, 1979).

139. NAII 1980 Legislative Position Papers, Discrimination Section, at 5.

140. *Id.*

141. *Id.*

142. *Id.* at 6.

143. A merit rating plan, as noted in the ICIA - Staff Draft section, *supra*, would base motor vehicle insurance premiums upon individual driving record. *See, e.g.*, Analysis, *supra* note 22, at 7, 8.

good drivers cannot be distinguished from bad drivers because many variables combine to make up a driving record.[145] It states that reliance upon individual accident and violation records is misleading because factors such as inconsistency with which accidents and violations are reported, varying degrees of traffic enforcement, varying road conditions and differences in traffic congestion make it impossible to separate good from bad risks.[146] The NAII concludes by stating: "[a]ny attempt, however, to establish artificial barriers on ratemaking which would preclude insurers from pursuing sound and legitimate business practices, will have the inevitable result of 'chilling' competition in the voluntary market."[147]

The NAII has also published a release entitled, "Classifications in Auto Insurance: Are They Really Fair?" (hereinafter, Release).[148] This Release states that the abolition of the presently utilized risk classification system based upon the factors of age, sex, marital status and geographical location would increase the cost of insurance for the great majority of motorists in the United States.[149]

Specifically, the Release states that if age were abolished as a classification criterion, eighty-three percent of the nation's motorists would be required to pay eighteen percent more for their automobile insurance in order to subsidize the losses of younger, higher risk drivers.[150] However, the remaining seventeen percent of the drivers, the younger drivers, would enjoy premiums lowered by an average of forty-two percent.[151]

The Release also states that among younger drivers, sex and marital status are important measures of loss potential.[152] According to NAII statistics, losses incurred by young male drivers are forty-one percent higher than losses of young female drivers.[153] NAII statistics also show that young single male drivers incur losses which are eighty-four percent greater than losses of young married drivers.[154] The Release further states that if sex and marital status were eliminated as rating classification criteria, rates for young female drivers would increase twenty-nine percent in order to subsidize the losses of young males.[155] In addition, the NAII concluded that rates for young married males would have to increase sixty-eight percent in order to subsidize the

144. NAII 1980 Legislative Position Papers, Discrimination Section, at 6-8.
145. *Id.* at 6, 7.
146. *Id.* at 7.
147. *Id.* at 8.
148. This release consists of ten numbered pages and four charts. It is located at the end of the NAII 1980 Legislative Position Papers' Discrimination Section.
149. NAII Release, *Classifications in Auto Insurance: Are They Really Fair?*, at 1. (hereinafter NAII Release). A copy of this release is on file in the *Drake Law Review* offices.
150. *Id.* at 3.
151. *Id.*
152. *Id.* at 4.
153. *Id.*
154. *Id.*
155. *Id.*

losses of young single males.[156]

The Release also defends presently utilized geographical location or territory rating classifications. The NAII states that higher premium rates for motorists living in metropolitan areas are justified because these motorists "experience much higher losses than motorists who live in less congested areas."[157] It is further stated that the rates developed for each territory are based on the loss experience of that territory relative to the state as a whole.[158] In general, stated the Release, the great majority of drivers would see substantial rate increases if the presently utilized territorial rating system were abolished.[159] In addition, it should be noted that territorial rating for automobile insurance is based upon the area where the automobile is primarily garaged, and not upon the location of the accident.[160]

The Release also rejected as unworkable any proposal to utilize individual merit plans for automobile insurance rating.[161] The reasons cited for rejecting merit plans were basically those noted earlier in this section.[162] The Release concluded by stating that a driver's accident and violation record must be supplemented with class and territory rating if insurers are to fairly and equitably determine significant differences among risks.[163]

Finally, the Release cited the results of an independent research study which concluded that the present rating system should not be altered.[164] This study, performed by the Stanford Research Institute, concluded "that risk assessment should not be restricted and that insurers should be free to make full use of classification information."[165]

IV. Conclusion

The ICIA - Staff Draft is a thought-provoking proposal. As previously indicated, changes in its provisions are likely and industry opposition is certain to be vehement. Nevertheless, the ICIA - Staff Draft is worthy of serious consideration.

Contrary to statements made by representatives of the insurance industry, the present system of state regulation over the business of insurance is subject to criticism. For example, a recently released report by the General Accounting Office concluded that "there are serious shortcomings in state

---

156. *Id.*

157. *Id.*

158. *Id.* at 5. This conclusion is *contra* to the General Accounting Office Report discussed in section IV. *See* notes 166-82 and accompanying text *infra.*

159. NAII Release, *supra* note 149, at 4. This conclusion is based upon data from three states: New Jersey, Michigan and Louisiana.

160. *Id.* at 5, 6.

161. *Id.* at 6-8.

162. *See* notes 143-47 and accompanying text *supra.*

163. NAII Release, *supra* note 149, at 8.

164. *Id.* at 9.

165. *Id.* The conclusion of this study is obviously contrary to the findings which formed the basis of the ICIA - Staff Draft.

laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States."[166] Entitled "Issues and Needed Improvements in State Regulation of the Insurance Business," the report was compiled by the General Accounting Office (hereinafter, GAO) at the request of Senator Howard M. Metzenbaum (D., Ohio) and former Representative John E. Moss (D., Cal.) who retired last year.[167] This report persuasively refutes most of the industry's contentions and supports the conclusion that the state insurance regulatory system, as it presently exists, is in need of improvement.

In a digest of the 275 page report, the GAO concluded that most state insurance departments do not have systematic procedures to determine whether insurance consumers are being treated properly with respect to such matters as claims payments, rate setting and protection from unfair discrimination.[168]

To gather data for the report, the GAO examined the resources and activities of state insurance departments by sending a questionnaire to all states.[169] In addition, the GAO conducted field work in a sample of seventeen states.[170] Although the GAO review covered certain state regulatory activities in every line of insurance, the primary focus of the inquiry was upon regulatory issues involving automobile insurance.[171] Particular automobile insurance issues examined in the report were price regulation, risk classification and insurance availability.[172]

A significant finding of the GAO report was that relative rates with respect to age, sex and marital status are based upon an analysis of *national* data and not upon individual state data.[173] Harry S. Havens, Director of the GAO Program Analysis Division, stated that although a youthful male driver is charged twice as much as an older driver all over the country, *none* of the state insurance departments visited during the study conducts a regular independent actuarial analysis to determine whether such a rating difference is valid in its state.[174] Havens further stated that state insurance departments

166. General Accounting Office Report, *Issues and Needed Improvements in State Regulation of the Insurance Business*, Executive Summary at i (Oct. 9, 1979)(hereinafter, Executive Summary). The General Accounting Office Report is summarized in THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, Oct. 12, 1979, at 1, 85.

167. Sen. Metzenbaum is the Chairman of the U.S. Senate Subcommittee on Antitrust, Monopoly and Business Rights. *See* note 17 *supra.*

168. Executive Summary, *supra* note 166, at i. *See also* THE NATIONAL UNDERWRITER, Property & Casualty Edition, Oct. 12, 1979, at 85.

169. Executive Summary, *supra* note 166, at i.

170. *Id.*

171. *Id.*

172. *Id.*

173. General Accounting Office Report, *Issues and Needed Improvements in State Regulation of the Insurance Business* 119 (Oct. 9, 1979)(hereinafter, GAO Report)(emphasis added). *See also* THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, Oct. 12, 1979, at 85.

174. THE NATIONAL UNDERWRITER, Property & Casualty Edition, Oct. 12, 1979, at 85.

normally do not collect and analyze the information necessary to make such rating judgments on either a statewide basis or with respect to specific areas within their states.[175] Havens also noted that similar problems exist with territorial rating because most state insurance departments do not have sufficient loss information to evaluate whether the territorial boundaries used by insurance companies are fairly and accurately drawn.[176]

In short, according to the information gathered by the GAO, presently imposed rating systems do not accurately reflect the losses of individual states. Assuming this to be true, the supposed advantages of individual state ratemaking are nonexistent. If national data is used to set state rates, the insurance industry's defense of the presently utilized rating system is unfounded.

The GAO report found that similar problems exist in attempts to monitor possible "redlining" by insurance companies. Redlining is an arbitrary refusal to insure based solely on geographic location. The report concluded that most states do not systematically collect data or conduct special studies to determine whether redlining exists in a particular state.[177]

The report also concluded that state insurance departments lack systematic procedures for handling consumer complaints.[178] In addition, state insurance departments lack systematic procedures for implementing trade practice surveillance.[179] These two conclusions in the report were based on the study's field sample of seventeen states and on the results of questionnaires sent to all states.

The GAO also investigated price regulation of automobile insurance. The report concluded that practically no automobile insurance rate difference existed between states that have prior approval price regulation and states that do not.[180] This indicates that the state insurance commissioners may not play such an active role in automobile rate scrutiny as is generally believed.

One major problem under the present system as pointed out by the GAO report, is that consumers do not have enough information to permit the greatest possible competition between insurers.[181] In this context, the report concluded that the state insurance regulatory process is in need of (1) more and better information and (2) more systematic procedures to assure that consumers receive adequate protection.[182]

---

175. *Id.*

176. *Id. See also* GAO Report, *supra* note 173, at 133-42 (with few exceptions, the states have not done an actuarial or other statistical review of whether loss data justifies existing territorial boundaries).

177. GAO Report, *supra* note 173, at 149, 164.

178. *Id.* at 52, 57.

179. *Id.* at 41-57.

180. *Id.* at 93. For an explanation of "prior approval" regulation, *see* Hansen, *The Interplay of the Regimes of Antitrust, Competition and State Insurance Regulation of the Business of Insurance*, 28 DRAKE L. REV. 767, 839-40 (1979).

181. GAO Report, *supra* note 173, at 95-96. *See also* THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, Oct. 12, 1979, at 85.

182. GAO Report, *supra* note 173, at 57, 100-01. Another periodical cited the GAO Report

The comprehensive GAO report expressly remained neutral on the issue of whether the business of insurance should remain primarily under state regulation, or become subject to federal control. However, it did assert that the presently utilized risk classification system is an area appropriate for federal study, and perhaps for federal legislation.[183] In fact, the report stated that because state insurance departments have not yet examined the current classification plans with "sufficient rigor" to assure that they are not unfairly discriminatory, continued federal consideration of risk classification is "necessary."[184] Although a fully detailed examination of the GAO report is not undertaken here, its importance in terms of documenting flaws in the present system and making suggestions for improvement in state regulation of the insurance business cannot be overemphasized. The report is certain to have substantial influence upon the Subcommittee when it reviews the ICIA - Staff Draft in the future.

Recent developments in one state also reinforce the conclusion that improvements are needed in present state insurance systems. Michigan has recognized the need for reform in the insurance industry. Legislative activity in Michigan has resulted in a rating reform bill which parallels the ICIA - Staff Draft in many respects. Michigan Senate Bill 428 has passed the Michigan Senate and is scheduled for House action shortly.[185] The most important provisions of this bill would bar the use of sex and marital status as rating factors for automobile insurance and would limit the use of territorial rating factors for both automobile and homeowners' insurance.[186] It should also be noted, however, that this bill would primarily affect Michigan's no-fault automobile insurance law.[187] It should also be noted that Michigan Senate Bill 428 is in response to the Michigan Supreme Court's decision in *Shavers v. Kelley*.[188] In *Shavers*, the court held that the Michigan no-fault act was constitutional, but further held that the actual mechanisms for protecting the welfare of individual motorists were constitutionally deficient in failing to provide due process.[189] The court concluded that measures in the automobile no-fault statute designed to assure that compulsory no-fault insurance would be available to motorists at fair and equitable rates were inadequate to protect individual motorists from potentially unfair insurance rates, insurance

---

as stating that there are sharp shortcomings in state regulation. *See* BUSINESS INSURANCE, Oct. 29, 1979, at 11 (more than twenty state insurance departments lack sufficient staff for consumer protection and trade practice regulation; in addition, the effectiveness of the National Association of Insurance Commissioners in representing consumer interests is questionable).

183. GAO Report, *supra* note 173, at 142.

184. *Id.* This statement further supports the argument made earlier that the presently utilized classification scheme may violate state law. *See* note 138 and accompanying text *supra*.

185. THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, Oct. 26, 1979, at 1.

186. *Id.*

187. MICH. COMP. LAWS ANN. § 500.3101 *et seq.* (1979).

188. 402 Mich. 554, 267 N.W.2d 72 (1978).

189. *Id.* at ____, 267 N.W.2d at 77, 78.

refusal or cancellation.[190] Instead of immediately striking the no-fault act, the court permitted the provisions of that statute to remain effective for eighteen months from the issuance of its opinion.[191] The court stated that during these eighteen months, the Michigan Legislature and Commissioner of Insurance should remedy the act's deficiencies by taking corrective action.[192] The court also detailed the types of corrective actions necessary to remedy the act's due process deficiencies.[193]

It is against this backdrop that Michigan Senate Bill 428 was formulated. Although *Shavers* was limited to an examination of the automobile no-fault act, the rating reform bill includes provisions for homeowners' insurance as well.[194] Several provisions of the Michigan bill are similar to provisions in the ICIA - Staff Draft. For example, agents or insurance companies would be required to inform declined applicants, orally or in writing, the reason for their rejections.[195] The bill also enumerates rating factors permissible for use in setting automobile and homeowners' premium rates.[196] For automobile insurance, acceptable factors would be objective and individual: for example, differences based upon age and actual miles driven would be permitted.[197] The bill also requires an automobile insurance merit rating plan which would allow premium surcharges for at-fault accidents and convictions.[198] Insurers would not be permitted to use rating factors based upon sex and marital status.[199] A permissible rating factor for homeowners' insurance would be the type of construction of the insured structure.[200]

In addition, the Michigan bill would limit the territorial factor for both automobile and homeowners' insurance by prohibiting insurers from using more than twenty territorial base rates for automobile insurance and not more than three territorial base rates for homeowners' insurance.[201] Significantly, the bill would limit rating differences for adjacent territories; rates for adjacent territories would not be permitted to differ by more than ten percent.[202] However, the Michigan insurance commissioner is granted authority to approve additional rating factors and territorial base rates at some

---

190. *Id.*
191. *Id.* at ___, 267 N.W.2d at 78.
192. *Id.*
193. *Id.* at ___, 267 N.W.2d at 86-93.
194. THE NATIONAL UNDERWRITER, Property & Casualty Insurance Edition, Oct. 26, 1979, at 1.
195. *Id.* at 62.
196. *Id.*
197. *Id.*
198. *Id.* The article in THE NATIONAL UNDERWRITER is unclear as to what type of convictions would permit an insurer to surcharge an insured.
199. *Id.*
200. *Id.*
201. *Id.*
202. *Id.*

subsequent time.[203]

The Michigan bill also provides several avenues for consumer protection. For example, insurers would be required to send each insured explanatory material regarding: (1) the basis of rates; (2) variance of rates; (3) underwriting rules; (4) procedures for obtaining a lower rate and (5) procedures for consumer complaints.[204] Another provision requires automobile insurance agents to annually provide an explanation to each insured which details the system of insurance eligibility points.[205] If an insured could qualify for a lower rate, the agent would be required to so inform that individual.[206]

As of publication, the fate of Michigan Senate Bill 428 was undecided. However, it is significant that the Michigan Senate passed such a sweeping rate reform bill. The action of that legislative body is at least an indication that shortcomings in present ratings systems exist and can be remedied with appropriate legislation. The GAO report and the Michigan legislative activity are helpful in assessing the need for federal legislation like the ICIA - Staff Draft.

As indicated, the insurance industry is coming under increased scrutiny from many sources. It is clear that this scrutiny will continue and that far-reaching changes may result. However, it is by no means clear whether changes should come from the United States Congress or the individual states. It is at least arguable that improvements of state regulation such as those called for by the GAO report should be implemented by the states. However, the ICIA - Staff Draft is a thoughtful proposal to implement needed substantive changes with a minimum of actual federal control. In this respect, the ICIA - Staff Draft may offer a happy medium for improvements in the insurance industry. However, even if the ICIA - Staff Draft merely acts as an impetus to force the industry to engage in serious self-examination, it will have made a significant contribution. In any event, it seems certain that the GAO report and the Michigan Senate's activity will act as such an impetus independently from the ICIA - Staff Draft. It is submitted that the industry should examine its current practices and evaluate their overall accuracy, validity and fundamental fairness. It is further submitted that state insurance departments should engage in a like process of self-examination. The evidence which calls for industry improvement is mounting. Unless improvement is effected in the near future, federal intervention of some sort is likely. Any such intervention would drastically curtail, if not abolish entirely, the primacy of state insurance regulation which has existed in this country since the enactment of the McCarran Act in 1945.

Kent J. Lund

---

203. *Id.*
204. *Id.* Under the bill, this material must be furnished to insureds at least annually. *Id.*
205. *Id.*
206. *Id.*