ANTITRUST MODERNIZATION COMMISSION

PUBLIC HEARING

Wednesday, October 18, 2006

Federal Trade Commission Conference Center
601 New Jersey Avenue, N.W.
Washington, D.C.

The hearing convened, pursuant to notice, at 10:03 a.m.

PRESENT:

DEBORAH A. GARZA, Chairperson
JONATHAN R. YAROWSKY, Vice Chair
BOBBY R. BURCHFIELD, Commissioner
W. STEPHEN CANNON, Commissioner
MAKAN DELRAHIM, Commissioner
JONATHAN M. JACOBSON, Commissioner
DONALD G. KEMPF, JR., Commissioner
SANFORD M. LITVACK, Commissioner
DEBRA A. VALENTINE, Commissioner
JOHN L. WARDEN, Commissioner

ALSO PRESENT:

ANDREW J. HEIMERT, Executive Director & General Counsel

SUSAN S. DESANTI, Senior Counsel
WILLIAM F. ADKINSON, JR., Counsel
NADINE V. JONES, Counsel
MARNI B. KARLIN, Counsel
HIRAM R. ANDREWS, Law Clerk
CHRISTOPHER N. BRYAN, Paralegal
KRISTEN M. GORZELANY, Paralegal

CONTENTS

Statutory Immunities and Exemptions:
The McCarran-Ferguson Act

Panelists:

MICHAEL T. MCRAITH, Illinois Department of Financial and Professional Regulation, Division of Insurance (*on behalf of* the National Association of Insurance Commissioners)

JAY ANGOFF, Roger G. Brown & Associates

JULIE GACKENBACH, Confrere Strategies (*on behalf of* the National Association of Mutual Insurance Companies)

THEODORE VOORHEES, JR., Covington & Burling LLP (*on behalf of* the American Bar Association)

J. STEPHEN ZIELEZIENSKI, American Insurance Association

These proceedings were professionally transcribed by a court reporter. The transcript has been edited by AMC staff for punctuation, spelling, and clarity, and each witness has been given an opportunity to clarify or correct his/her testimony.

PROCEEDINGS

MR. HEIMERT: I would like to welcome everybody to the Antitrust Modernization Commission hearing on immunities and exemptions.

We will begin now, and I will turn it over to the Chair, Deb Garza.

CHAIRPERSON GARZA: I, too, would like to thank everyone for being here - obviously, the panelists, for the time you have taken to prepare your very thoughtful statements and to come and testify before us. I would also like to thank the audience in their interest in our activities.

Over the course of the last several decades, the U.S. has increasingly moved away from command and control regulation toward a reliance on competitive markets, coupled with effective antitrust enforcement against unjustified private restraints on free markets. In each case, this transformation has been based on the conclusion that government regulation was having the opposite of its intended effect, hurting industry and consumers by encouraging inefficient investment and operations, unnecessarily restricting entry in the movement of capital, and inhibiting innovation. In many cases, deregulation reflected significant changes in technology and markets that made regulation no longer the right answer. The U.S. has also strongly urged trading partners to adopt a similar approach, and we continue to do so.

This is the context in which the Antitrust Modernization Commission agreed to study immunities and exemptions, for the purpose of assisting the President and Congress and ensuring that our government's regulatory and competition policies continue to maximize economic and social welfare.

With the power to regulate, of course, comes the responsibility to ensure that regulation is sound, to reevaluate it periodically from a neutral perspective that appreciates the interest of all stakeholders, and to make adjustments when appropriate.

Previously, we held hearings focusing on a general evaluation and approach to immunities and exemptions, on the Export Trading Company Act, on the state action doctrine, on the local governmental immunity, and on regulated industries.

Today, we are taking testimony on two specific immunities relating to two important regulated industries, insurance and shipping. Each of these two immunities appears to be of particular current interest to the policymakers. Congress has begun to hold hearings on McCarran-Ferguson and insurance industry regulation more generally. Senators Specter and Leahy have introduced potential legislation, and other lawmakers have been drafting alternative and complementary approaches. Significant debate is likely to ensue.

The shipping industry has also been subject to some deregulatory movement. For example, amendments to the Shipping Act were made in 1998. Since then, the industry has changed substantially. The European Union, after two years of study and extensive review, has decided to repeal its block exemption for liner conferences.

Let me just take a minute to explain the format of the hearings, which will be similar to what we have done in the past. I will ask each panelist to present a short statement summarizing his or her written testimony. Particularly, because there are so many of you on this panel, we want to keep to our time limits. I ask that you keep your statements to five minutes.

To help you keep track of time, we do have a light system in front of me, and also on the table in front of you. It will flash green when you have two minutes left, yellow when you have one minute left, and red when your five minutes is up. I will not interrupt you, but I will hope that you will kind of self-police, and try to wind up your remarks as it turns yellow and then red.

After all of the panelists have spoken, we will take questions from the Commissioners. Vice Chair Yarowsky will ask the first set of questions on behalf of the Commission for about 20 minutes, and then each of the other Commissioners will have five minutes to ask their own questions if they desire. If we have time left at the end, then we will have follow-up questions.

So, with that, I would like to begin. Mr. McRaith, can you please begin the session?

MR. McRAITH: Sure.

Chairwoman Garza, Vice Chairman Yarowsky, Commissioners, thank you for inviting me to testify this morning on behalf of the National Association of Insurance Commissioners.

I am Michael McRaith, Director of Insurance in Illinois, a participant in the NAIC's continuing active leadership on national insurance matters. I serve as Chairman of the NAIC's broker activities taskforce.

As insurance commissioners, our core priority is to protect consumers. Insurance is a uniquely personal and complex contract. Analogies to other financial products like banking are inherently misleading. With debt or equity products, even with deposits, the consumer assumes risk. With insurance, the consumer transfers risk. Consumers pay in advance for a benefit that may never be needed, or may be needed significantly in excess of the purchase price or the price paid. Insurance is unique to the individual or unique to the insured property, business, or community. Insurance is always local, personal, and often intimate.

Some may interpret McCarran-Ferguson in the context of federal insurance regulation. The 290-page bill advocating for a federal regulator contains 15 lines devoted to consumer protection. The bill preempts state-based laws that prohibit unfair competition, and precludes application of Section 5 of the FTC Act.

The creation of a massive federal bureaucracy to benefit a small segment of the largest carriers in the industry is an idea that consumers and Congress should, and will again, reject. With the limited exemption of McCarran-Ferguson, state-based regulation fosters a competitive marketplace. The U.S. has not less than 5,700 active insurers. Fewer than 300 hundred have more than 500 employees. More insurers have been formed in each decade since 1950, and only .66 of 1 percent of insurers becomes insolvent.

Smaller insurers compete by providing niche markets, providing more personalized service, or as a rural farm mutual. State-based regulation affords comprehensive, cradle-to-grave supervision, ensures solvency, monitors market conduct, and enforces prohibitions against unfair competition and deceptive practices.

Illinois laws governing insurance fill a book of 823 pages. Discussion of McCarran-Ferguson's repeal must be considered in the broad economic context, and not in a legalistic vacuum. The exemption is limited in scope, but repeal, even with purported safe harbors, would subject industry regulation to years of uncertainty and instability, enthroning state and federal courts as de facto regulators.

Enumerated permissible practices merely illustrate the difference between insurance and other industries. McCarran-Ferguson's exemption authorizes insurers engaged in supervised, cooperative activities that foster competition, consumer choice and awareness, and help maintain marketplace integrity. But the label of an antitrust exemption is misleading, because states extensively and actively regulate all aspects of the industry. Organizations involved with cooperative activity are licensed, structured, and regulated consistent with state law. Price-fixing, bid rigging, tying, boycotting, and any anticompetitive practice are subject to prosecution by regulators and law enforcement.

While abuse of contingent commission practices have been in the spotlight, NAIC members have worked on investigations and settlements with many attorneys general. NAIC members have guided resolutions returning more than $1 billion to policyholders, and impose business reforms that honor consumer protection.

McCarran-Ferguson's repeal would not improve the affordability, reliability, or availability of insurance. Repealing the exemption would impose uncertainty, reduce stability and predictability, deter capital infusions, eliminate competition, and raise costs. McCarran-Ferguson's limited exemption enhances consumer benefits and protections. It is only one tool in the wide range of complex systems that comprise effective regulation, regulation that works for consumers, but respects business realities.

The NAIC looks forward to continued work with Congress, with law enforcement, large and small industry participants, and consumer advocates.

Thank you again for the opportunity to be with you today.

CHAIRPERSON GARZA: Thank you.

Mr. Angoff.

MR. ANGOFF: Thank you, Madam Chair, members of the Commission. I am Jay Angoff. I live in Jefferson City, Missouri. I was the Insurance Commissioner of Missouri for six years; before that, Deputy Commissioner in New Jersey; before that, I was an antitrust lawyer with the FTC, and I have also taught antitrust at American University Law School.

Big picture, McCarran-Ferguson allows insurance companies - it authorizes both horizontal price-fixing and vertical price-fixing in the insurance industry without requiring, as the state action doctrine would require, that the state actively supervise that price-fixing.

That is what McCarran-Ferguson does. That is what the state laws enacted pursuant to McCarran-Ferguson do. There is no disagreement about that. What there is a lot of disagreement about is, are these things good or bad? Are they necessary or unnecessary?

Just a few words about the horizontal price-fixing statutes that have been enacted in virtually all states that are made possible by McCarran-Ferguson. They are all based on model acts promulgated by the NAIC. The Missouri statute says that ten or more insurers may act in concert with each other, and with others, with respect to any matters pertaining to the making of rates or rating system. That is a pretty explicit authorization of price-fixing. So there is no question that authorization of price-fixing exists. That does not mean, necessarily, that just because price-fixing is authorized that insurance companies do fix prices.

Now, there have been debates for decades about the extent to which the McCarran-Ferguson exemption facilitates the cyclicality of the insurance industry. Every 10 or 12 years, insurance rate go way up for a couple of years, then they level off, and often go down, for several years after that. I had the good fortune of being Commissioner during a period when rates were going down. So there was no crisis when I was Commissioner, but obviously, in the last couple of years, rates, particularly in malpractice, went way up. There is a question about the extent, if any, to which McCarran-Ferguson has contributed to that.

The more fundamental issue, though, is this: insurance companies, in order to make to rates, have got to have – in order to make rates as accurately as possible, you have got to have as much historical loss data as possible. There are insurance industry organizations that collect, compile, and disseminate this data, and there is a consensus that having as much historical loss data as possible is pro-competitive. I think the law is pretty clear that it is allowed by the antitrust laws, as long as it is the historical loss data.

The controversial issue is, how much should insurance companies be allowed to get together and project that data into the future, and what would be the status of that activity under the antitrust laws, if the antitrust laws did apply. I believe, after having been pretty closely involved in insurance ratemaking, both inside and outside the government for quite a while that it is very important that insurance companies be allowed to jointly collect, compile, and disseminate historical loss data, but that is where it should stop. When it comes to projecting data into the future, whether it is called loss development or trade - and they can get into what the details of those are - but when it comes to projecting data into the future, I think it is very important that insurance companies be required to do that independently. McCarran-Ferguson allows them to do that collectively. I think that is anticompetitive.

Just a few words about the anti-rebate laws. The anti-rebate laws mandate what is illegal - they do not just authorize vertical price-fixing; they mandate vertical price-fixing. And in any industry, until recently anyway, vertical price-fixing was *per se* illegal. It still is pretty much illegal. In the insurance industry, though, it is mandated. If an agent gives a discount, that is a violation of the anti-rebate law. So there is no competition on the agent level. That is something that I think has gotten relatively little attention and should get more attention.

I am happy to answer any questions that the Commission may have.

CHAIRPERSON GARZA: Thank you.

Ms. Gackenbach.

MS. GACKENBACH: Good morning. My name is Julie Gackenbach, and I am pleased to be presenting testimony today on behalf of the National Association of the Mutual Insurance Companies.

NAMIC represents 1,400 companies that comprise 40 percent of the nation's property and casualty insurance premiums. Those range from the smallest of state writers, to the largest of the international insurance giants.

I think it is important to remember that McCarran-Ferguson provides a very limited exemption from federal antitrust laws. The application of this exemption has worked well for decades to foster and develop a very vibrant and healthy competitive insurance market. As we have noted, there are more than 5,000 insurance companies operating successfully in the United States today, and the majority of them are relatively small.

Numerous studies over the years have always concluded that the industry, under every economic classic test, is very competitive. The competitiveness and diversity is represented, in fact, in NAMIC's membership. It is the McCarran-Ferguson limited antitrust exemptions that have helped to contribute to this diversity by increasing the number and competence of insurance companies, and by making it easier for smaller and mid-size companies to actually compete in the marketplace.

The exemptions have helped foster this competitive market by allowing companies to exchange critical loss data and other factors, develop standardized policies and forms, facilitate participation and oversight of guarantee funds, and development and operation of state-assigned risk pools, and other joint cooperative efforts.

Over the past six years, there has been a substantial body of case law that has developed to interpret the limitations on this exemption. That has worked well for the industry. McCarran-Ferguson has enabled the development of standardized policy and form language and risk classifications, which have helped consumers enormously in their ability to comparison shop, and to evaluate competing offers.

The ability of insurers to engage in effective ratemaking activities goes to the very heart of what is the business of insurance, which is the transfer and spreading of risk. Insurance is fundamentally different from other products, including all other financial products, in that it is the promise of a future financial obligation. Policy premiums must be based on an estimate of future costs. To do this, insurers must rely on a large number of loss data over a significant period of time.

Very few insurers would have the ability on their own, and from their own loss history, to develop that for all of the risks for which they underwrite. Very few would have the ability to develop credible, actuarially sound data, if they had simply to use their own loss data.

This is particularly true for smaller- and medium-sized insurers. And without the ability to have advisory loss cost data, including the prospective elements of that, they would be unable to compete with larger insurers in the marketplace.

McCarran-Ferguson’s limited antitrust exemption has provided the legal framework through which this data is collected and analyzed, and through which insurance companies are able to pool and use this aggregated information. However, they do not collectively set rates.

Consolidated collection and analysis of data, and publication of advisory loss cost data has improved the quality of the marketplace by making it easier for insurers to compete, and for insurers to move and expand into new products and into different lines. The availability and affordability of this advisory loss cost data has helped to maintain a blend of both large national writers and smaller single-state and regional writers in the marketplace.

In the absence of the ability to do this, you would see a consolidation that ultimately could threaten the ability of these smaller and regional companies to participate. It could also have a chilling effect on the ability of insurers to move into new markets and to offer new products.

Over the years there have been numerous proposals to either repeal or limit the McCarran-Ferguson antitrust exemption. Proponents often ground their cause on unfounded calls of collusion within the industry. There is no evidence to support this. As Mr. McRaith has noted, this is a highly regulated industry, and state regulators monitor not only safety and soundness, but also potential anticompetitive and unfair trade practices.

Others have recommended replacing the exemption with a series of safe harbors. While safe harbors seem appealing and simple and attractive on the surface, over the years, policymakers have recognized their numerous pitfalls. They have recognized it would be nearly impossible to craft a series of safe harbors that would cover all the current and future data needs of the industry.

In addition, the uncertainty that would be created by moving to safe harbors would be an open invitation to litigation, and could have a chilling effect, particularly in the short-run, but even into the long-term, on the industry's ability and willingness to engage in pro-competitive and efficiency-enhancing cooperative activities.

We urge the Commission to be very wary of the unintended consequences of changes to the current limited antitrust exemptions. Changes to the existing and well-functioning antitrust regime could actually decrease market stability, reduce affordability and availability of products, stifle innovation and expansion, diminish industry efficiency, and perhaps, ultimately, inhibit, rather than increase, competition in the industry.

NAMIC appreciates the opportunity to present comments today and looks forward to working with the Commission.

CHAIRPERSON GARZA: Thank you.

Mr. Voorhees.

MR. VOORHEES: Madam Chair and members of the Commission, I am Ted Voorhees. I am an attorney at Covington and Burling, but I am speaking today wearing my hat as an officer of the Antitrust Section of the American Bar Association.

The ABA submitted its comments on April 10 of this year, and I am going to try to neither add to, nor subtract in any way from, those comments, because they were prepared in a very deliberate way by the Section and represent the long-term views of the Section.

Basically, those views are to look at antitrust exemptions with skepticism. The view of the Antitrust Section is that consumer welfare should be the target, and that consumer welfare is most often best achieved by allowing competitive free market forces to work, subject to the oversight of the antitrust laws.

We believe that, in many cases, if not most cases, statutory antitrust exemptions, over time, rarely achieve the objectives they were intended to achieve, and often, at worst, have unintended and antagonistic consequences. So that is the background for our view of exemption. We believe that industries seeking statutory exemptions should have a very heavy burden of persuasion that their exemption should be granted, or that the exemption that they have been enjoying should be continued.

In the case of the insurance industry and McCarran-Ferguson, the ABA's position goes back almost 20 years, and I would describe it as a proposal for modest reform. Basically, we believe that the McCarran-Ferguson exemption should be repealed, but that the transition should be softened by the creation of safe harbors, which we spell out.

We have a confidence that this is a desirable outcome, in large part because we believe the insurance industry is already well protected in at least two respects. Many of the their more important functions that have been described in other comments are already, we believe, protected not only by an appropriate rule of reason treatment, which we believe they would receive in the courts, but also by the state action doctrine exemption, which is of paramount importance in an industry like this that is so heavily regulated by the states.

As I said, we believe this is a modest reform proposal that softens the adjustment for the industry through safe harbors. We say that because we are cognizant of the concerns that some of the industry spokespeople have presented, in terms of unpredictable litigation outcomes. We recognize that is a sensitivity that should be given regard. But we believe that safe harbors that have been proposed in our comments go a long way toward providing that comfort. They are designed to address five situations that we believe are areas of very appropriate insurance industry joint activity. We spelled them out in our comments.

We believe that those five areas would be protected, not only by our safe harbors, but also by rule of reason, and also, in many cases, by the state action exemption. So we do not feel very apprehensive that what we are suggesting should genuinely be considered to be a problem for the industry.

Let me just note, before closing these preliminary remarks, what we are not talking about in our comments. We are not taking the position in our comments on whether the insurance industry engaged in abusive practices or anticompetitive behavior under the McCarran-Ferguson Act. We include a bibliography and point the Commission to the literature on that subject, but we have not staked out a position on the existence or the need for reform of state regulation. Our comments assume that state regulation will continue to be a pervasive aspect of insurance industry activity in this country. We do not take a position on some of the comments on federal chartering of the insurance industry, which is a subject we have not studied or stated a position on.

Really, when you think about it, what the ABA is proposing really moves the needle in the direction of allowing market forces to work in this sense. Under the current McCarran-Ferguson, the assumption is that industry activity subject to the Act would be exempt, with the exception of boycotts and coercion spelled out in very specific language. Our proposal is, in effect, the reverse of that, that insurance activity should be subject to the antitrust laws, subject to the state action exemption, with the exception of certain carefully spelled out safe harbors.

I will stop there and take any questions later.

CHAIRPERSON GARZA: Thank you.

Mr. Zielezienski.

MR. ZIELEZIENSKI: Yes. Good morning.

I am Stephen Zielezienski, general counsel of the American Insurance Association. Thank you for the opportunity to appear before the Commission today to discuss the McCarran-Ferguson Act.

McCarran-Ferguson is a power-sharing statute reflecting Congress's judgment to delegate, not abdicate, authority over insurance to states that regulate the business of insurance themselves. In doing so, McCarran-Ferguson provides insurers with an antitrust regime that recognizes the insurance regulatory role and entrusts it to the states. Because of the delicate balance of power contained in McCarran-Ferguson, discussion of its repeal cannot be divorced from discussion of the nature of state insurance regulation itself.

Congress enacted McCarran-Ferguson in 1945 in response to the *Southeastern Underwriters* decision, holding insurance to be a product in interstate commerce. McCarran-Ferguson entrusted states with authority to regulate and tax the business of insurance, giving them three years to implement their regulatory systems. Also, no federal law was to be presumed to interfere with that authority unless clearly designed to do so. Under McCarran-Ferguson, federal antitrust laws apply, to the extent that such business is not regulated by state law, or insurers engage in, or attempt, boycott, intimidation, or coercion.

During the three years after enactment, all states adopted comprehensive regulatory schemes, including numerous antitrust-type protections. States also faced the usual question related to regulated industries, how to balance the role of regulation and antitrust policy. In response, they placed insurers' collective activity under regulatory control, scrutiny, and review, in effect, replacing antitrust litigation with regulatory oversight of collective activity.

That same balance exists for the banking and securities industries. Federal courts have held that such balance is critical, and that antitrust scrutiny is inappropriate where activity is subject to regulation; otherwise, chaos would rule. Private antitrust litigation constantly would battle federal regulatory systems, creating enormous uncertainty for business and customers to no one's benefit.

Importantly, banking and securities are principally federally regulated. Insurance is state regulated. When federal antitrust laws are balanced against federal regulation for an industry, courts give precedence to the regulatory system that Congress established over broad, non-specific antitrust laws. For the insurance market, McCarran-Ferguson is necessary to provide the same balance of regulation versus antitrust that exists for federally regulated banks and securities firms.

Without McCarran-Ferguson, that balance would be quite different. It would be governed by the state action doctrine, meaning federal antitrust laws would outweigh state regulation, unless state regulation is particularly intrusive. When affordability or availability problems arise in a line of insurance, critics blame McCarran-Ferguson. The misguided solution often is to suggest repeal of McCarran-Ferguson. Ironically, when the problem subsides, they never credit McCarran-Ferguson with the cure. In truth, insurance price spikes or shrinking availability signal that an underlying problem must be examined and addressed, rather than blaming it all on the McCarran-Ferguson exemption.

Instead of looking at McCarran-Ferguson, it is always better to examine fixed, real cost-driver-related problems. Part of that examination must include a critical look at the state of the regulatory system itself.

In the early 1990s, AIA worked with Congress to develop legislation to retain essential McCarran-Ferguson antitrust exemptions through specific safe harbors. Today, we believe that the regulatory reform route is the way to go. The National Insurance Act introduced this year in both the House and Senate is a thoughtful approach and has McCarran-Ferguson ramifications. This bill creates an optional, national regulatory system focused on tough financial and market conduct regulation. Open competition would determine prices. Under this system, McCarran-Ferguson would not apply to pricing activities of nationally chartered insurers. Instead, federal antitrust laws would apply to their pricing activities to the extent that states no longer regulated them.

AIA would take the risks inherent in this approach because we strongly believe that a competitive market is critical to being able to serve our customers in the years ahead. For AIA members, the issue is not whether a balance must exist between antitrust principles and regulation, but where that balance ought to be drawn.

To that end, we oppose McCarran-Ferguson repeal without initiating the paradigm shift resulting from creating an optional federal charter.

Thank you for the opportunity to testify. I would be pleased to answer any questions.

CHAIRPERSON GARZA: Thank you, witnesses.

Commissioner Yarowsky, would you like to begin?

COMMISSIONER YAROWSKY: Yes.

Thank you for all of your testimony. It is good to see you all.

You know, this is a hearing that takes place pursuant to a larger inquiry that the Commission has been doing. One of those subject matter areas has involved immunities and exemptions - a generic inquiry.

And a lot of our attention has been focused on whether or not it is possible to generate some kind of framework, generic framework, that might be helpful to Congress and others, in considering existing exemptions and immunities that are on the books, but also, obviously, important future proposed immunities and exemptions.

And many of the same concepts that Ted - good to see you, Ted - mentioned were mentioned in those larger deliberations. Was there a sufficient deliberative period - the nature of the deliberations? Was input received from the antitrust agencies and other interested parties that would have a lot to say - and we are glad that you are all here - on the burden on the moving party seeking the exemption, perhaps a high burden?

And then, only going to an exemption if other values - business, societal, or other values - strongly outweighed the commitment we all have to competition principles. Those are just some of the subjects. We have not adopted any framework yet. The last concept was interesting, the sunset provision, for both existing, as well as new ones, so that there would be some fresh revisiting, which Congress may do this year, this new Congress, or not, even if there is not a new proposal.

Having set that stage, if you will just indulge me for a minute or two, I just want to go through quickly a brief history of those final exciting days when McCarran-Ferguson was passed.

On June 18, 1945, almost three months after the Supreme Court denied a motion for a rehearing in the *Southeastern Underwriters* case, Senators McCarran and Ferguson introduced a bill that bore a striking resemblance to a proposal developed by NAIC - Michael, your group was very influential back then, as it is today.

As introduced, the bill made the business of insurance subject to state laws that relate to regulation or taxation of such business. Now, although the bill would have exempted insurance completely from the FTC Act and the Robinson-Patman Act, it did set up a transition period so that it would only be exempted from the Sherman Act until 1947, and then from the Clayton Act until 1948 - again, we were in 1945 - at which point, the full force of the antitrust laws would apply.

Within two weeks of that introduction - Makan and Steve, I know you will particularly take interest in this -

COMMISSIONER CANNON: I was not on the Hill at that time.

[Laughter.]

COMMISSIONER YAROWSKY: I know.

The Senate of the United States passed a bill with one additional amendment, but there had not been a single hearing. That amendment was interesting. That amendment made more explicit that the antitrust laws would clearly apply after these moratoria periods had run.

Now, the body that I come from, the House, moved with equal speed, if not with equal deliberative power. It passed the bill with absolutely no hearing. So the bill proceeded. There was a slight difference. They did not have the amendment that the Senate had passed, so they had a slightly different – they passed the original version that McCarran and Ferguson had introduced.

There was a conference. There were three Senators, and three Representatives from the House. Two of the three Senators were McCarran and Ferguson. There were three other Representatives from the House. At the very last minute there was real concern about this amendment that was offered on the Senate floor that clarified that there was truly going to be a transition period of about three years.

That is when the phrase, "To the extent that such business was not regulated by state law," a very cryptic phrase, was added. Things moved quickly. The conference report was returned to both Houses, and it went into law.

Well, interestingly, as you all know, *Parker v. Brown* had just occurred. Think of the sequence, *Parker v. Brown*, state action, 1943, *Southeastern Underwriters*, 1944, and then you see this legislative language. By the time the Supreme Court reviewed it, they had to make the logical assumption that Congress was fully aware of *Parker v. Brown*. By having such cryptic language they would not put any additional gloss on how much regulation was required to meet the standard, and it was almost any regulation.

Again, I just think that is an important, brief history, because, obviously, that process, if we adopt any kind of framework about future – let's say, future –

immunities and exemptions, would probably be one that we would not recommend. But that is the past.

Moving to the future though, and I think the future is here - and Mr. Zielezienski, you pointed out that there is a real political force gathering about revisiting the nature of insurance regulation. I mean, some of it may be that the least part of it is the legal fiction about interstate commerce. I do not say that derisively, but some people still talk about it.

Obviously, the state action doctrine that all of you have addressed - there is a question about why this one industry cannot subject itself to the same standards - and we will hear from you, too, Michael - but why regulators in this area are not able to comply with that, or why that would be a difficulty, other than that it breaks with custom and practice in some states. And lastly, the power of having a more unified federal regulation that might be more efficient, at least for some companies.

With all of that, I think I just want to cut to the chase, because we really need your input about state action. That is a whole separate area we have talked about in this Commission's deliberative period, but this is now coming together. Help us understand as succinctly as you can, because we do have a couple of other questions, why state action can or cannot be applied to this industry, because, from a political standpoint - and I will just say this, Mr.

Zielezienski - if the industry could accept the concept of state action, that might foreclose the need for - and Julie - a lot more grand change in the halls of Congress, in terms of the whole industry transformation.

I think that is a core concept. So that is something that we would like to understand. I am sure the Hill also would care a lot about all of your answers about why the - can the insurance industry move to that like every other industry, and why not, if you think it cannot?

Do you want to start?

MR. ZIELEZIENSKI: Sure.

I think, first of all, addressing your state action doctrine question, it is a change, and with change comes uncertainty, and with uncertainty comes predictable requests to regulators. What I fear is that we have had this system that has grown up under the McCarran-Ferguson exemption, which is different, and interpreted differently, and has a body of case law that has grown under the McCarran-Ferguson exemption, which would be wiped away in favor of state action.

So what I would predict would happen, and it is something that I would not like to see, is that insurers would go to their regulators and say, because we have this climate of uncertainty, we are now - we would like you to regulate us more. More so than we are doing now, with all of the warts that go along with that.

So we would not be addressing the real problem here, which I believe is, how do you achieve this balance between antitrust policy and regulation? So I would not want to entertain that without also entertaining the question of reform.

COMMISSIONER YAROWSKY: Okay. So you would not want to separate that out.

I think this is the kind of central question that, if everyone just wants to chime in briefly, that would be great, if you so desire.

Ted, would you want to –

MR. VOORHEES: I guess the only thought I would offer in response to Steve's comments just then is that, perhaps another way of looking at the dialogue that would take place between the industry and the state regulators would not necessarily be characterized as, please regulate us more, but might be described as, let's articulate what is going on more clearly and have more transparency, because that would be both necessary and helpful for a state action defense, and it would also keep more with modern state regulatory behavior.

COMMISSIONER YAROWSKY: Michael.

MR. McRAITH: Yes, Vice Chairman.

I would, first of all, emphasize that all the states are currently actively regulating all aspects of the industry.

COMMISSIONER YAROWSKY: And I have no reason to doubt that, it just depends on how you define that.

Jay – and I am using everyone's first name, which is easier for me – Jay mentioned a couple of instances in which you could actually collectively set a rate and file, and then, basically, after a certain number of days, implement it if you had not heard back, or a case of just self-implementation, unless later you hear from the regulatory authorities.

Those are the kinds of paradigms or models that people say, well, that is not – whether you call it, "active supervision," or just say it is not active, those are the kinds of questions, Michael, that people raise.

MR. McRAITH: Sure.

COMMISSIONER YAROWSKY: So how do we address those?

MR. McRAITH: Well, let me start by saying that, as I understand the purpose of any antitrust provision or an exemption in this case, the objective is to facilitate competition.

And the examples that Mr. Angoff provided offer the competition that was described by Ms. Gackenbach. There are fewer insurers who can play at the level of the AIA companies than you might expect. As I mentioned in my testimony, it is only about 300 of nearly 6,000 insurance companies that have more than 500 employees; most do not.

So if we want competition in Marion, Illinois, or

Pierre, South Dakota, in the workers' compensation market, for example, we need companies of any size with the ability to set a rate that not only is appropriate in the marketplace, but is appropriate to prevent them from going insolvent and ultimately not being able to perform on the promise they made to the consumer.

That is why it is important, as we consider this question today, and consider the question of state action, that is why to consider that the McCarran-Ferguson exemption is limited - it is a limited exemption, but it is part of a massive insurance regulation. It is one component that has, in fact, fostered a very competitive insurance market in the states.

COMMISSIONER YAROWSKY: Thank you.

Julie, would you like to comment?

MS. GACKENBACH: Sure.

I think Stef is right. We are talking about, if you are moving strictly to a state action doctrine versus the exemption, many of these activities, Michael is correct, have led to competitive activities. One of the big issues that has come up is the exchange of data and whether that is limited to just historical data or prospective data.

When you start to begin to put limitations on that and talk about how active you would have to have the regulation, it begins to raise a number of concerns about how regulated the industry would be, whether the industry would then be able to deal with timing issues and competitive forces.

In order to keep this marketplace competitive for all of the forces for companies that have to rely on this aggregate loss cost data - we have to have a system that allows people to be comfortable with the system, to be able to get their products to market, get their rates approved in a timely fashion, and be able to all compete on a level playing field.

And I think the biggest concern right now is, is it going to be a state action doctrine where you are talking about active supervision? We would be in court for years on what exactly active supervision is on each one of these, and then trying to deal with that. So I think, particularly for smaller and medium insurers, that paradigm shift, while it may seem small to us, talking about just going from an exemption to a state action doctrine would actually have a profound effect on the way the industry looks and operates.

COMMISSIONER YAROWSKY: Thank you.

We are going to come back and talk about, if there is time, the data issue, because I think it is important to get it on the record.

Jay, what do you think about state action?

MR. ANGOFF: As you know, Mr. Vice Chair, and as members of the Commission know, there is a big difference between the state regulation required to trigger the

McCarran-Ferguson exemption and the state regulation required to trigger the state action doctrine.

And my only quibble with Julie is that I do not think there would be - it is pretty clear that most state regulation does not meet the active supervision requirement -

COMMISSIONER VALENTINE: The law is very clear. You are correct.

MR. ANGOFF: - of the state action doctrine in many respects.

Let me give you a couple of extreme examples. In Missouri, and in virtually all states, there is a rating law. There is a law that says rates cannot be excessive, inadequate, or unfairly discriminatory. In Missouri, we have got that law, but the commissioner has no practical authority. He has no statutory authority to approve rates before they take effect, and he has no real authority even to disapprove rates after they take effect.

There is one state that is even more extreme than that, and that is my friend Mike McRaith's state, which does not even have a rating law. That is, in Illinois, there is no law - except for worker's compensation and medical malpractice - for the property casualty industry that says that rates cannot be excessive, inadequate, or unfairly discriminatory. That does not exist in Illinois.

So it seems to me that it is hard to argue that, in Illinois, and also in Missouri - we are not that different.

We have got the trappings but no real authority. It is hard to argue that there is active supervision in either state.

COMMISSIONER YAROWSKY: Mike, I will let you briefly – because we do want to go on to some other inquiries, but you deserve –

MR. McRAITH: Sure. I think Mr. Angoff actually proved the point, because without that regulation, Illinois has the most competitive auto insurance market in the country. We determine that by looking at the number of carriers and the premium average paid by auto owners. Illinois has the second most competitive homeowners' market in the country. Illinois has more workers' compensation carriers offering workers' compensation insurance than any other state in the country.

So Mr. Angoff appears to be arguing that we should increase the regulation of rates. I think Mr. Zielezienski would oppose that position. I am here to say that effective regulation fosters exactly the competition that we have in Illinois.

COMMISSIONER YAROWSKY: Okay.

Jay, you will get a chance if you want to say some more.

Can we talk about some data collection, data issues, because I think this is really important, because this goes to whether there is a certain singular quality to the insurance industry, which is one of the rationales for this exemption. Quite honestly, that it is different.

Julie, your testimony, and others', explain why it is kind of a different business. Certainly, when I was on House Judiciary, we spent three or four years really trying to understand that, thanks to Craig Berrington and others. But here is what we came away with. There are four basic – I am really simplifying this, so let's accept that if you can –

One, there is historical data. You need to know what has happened in the past so you can set premiums. There are always gaps in that, because claims have not come in, right? So at any moment in time you are sitting there, and you know what was filed, but you do not know that there are incidents that are out there about which someone has not just simply notified the company yet.

Those are gaps, statistical gaps. You need to try to get as good a universe of information as you can. Now, I always thought that was called loss development, Jay. I know loss development and trending started blurring together, but I will call that loss development, trying to round out, statistically, the hard historical data you have.

The third stage, from what I remember, was called trending. That is, once you have that universe of claims, both real and expected-to-be-filed, then you try to project other factors onto that to figure out what will happen with the economy. I am not saying that it is always macroeconomic, but a lot of the times it is. What is the rate of inflation? Things like that.

And the fourth stage, again, being very simple about this, is the final rate-setting stage. As you know, and Craig knows, when we work with AIA - the Committee worked with them, and it was a very good experience - what we did - we all have to make a decision. As Ted says, there is no bright line. It is just trying to move the ball in what you think may be a more competitive area - state of affairs. What we did was kind of safe harbor the first two stages, understanding that you needed to collect that data.

When we got to trending, it was very hard to understand why insurance companies, which have to apply certain factors like inflation and other macroeconomic factors, were any different than any other company in America or around the world. That is important for every business to do, in terms of setting costs and developing a budget.

And obviously, rate setting was our biggest problem, collective rate setting. So we did create some safe harbors. Loss development and historical was set up. Trending, we transitioned out, what, over two or three years. We allowed standardized forms - this is very close to what the ABA - as you presented, Ted, - and others have presented it. And we had the risk retention pool.

So, if there was some public necessity, people who were high-risk and could not get insurance - you had to have an overflow mechanism, and we permitted that.

Having set all that up, we then had state action apply. Those are safe harbors. We know that there will be litigation around the margins of any safe harbor. But, and I am not holding you to this, Stephen, but I am just saying that was kind of the consensus that we worked out.

Now, NAMIC was not on board, nor were the agents, and that was fine, because we understood. There was much more change and risk for you all. But that is kind of where we ended in September of 1994. Now, here we are approaching 2007. I think there is going to be some real energy around this.

On loss development, is there a fair way to try to insulate what is absolutely necessary for the industry versus what might be shared by other industries, so perhaps a little harder to justify the first two stages of the four that I talked about?

MR. ZIELEZIENSKI: I am not going to back away from safe harbors, but -

COMMISSIONER YAROWSKY: No. No. I am not trying to make you.

MR. ZIELEZIENSKI: - I go back to the point that that was the first stage. In our view, that is first stage.

The second stage is to get rid of those elements of the regulatory system that create market dysfunction. And that is the pervasive system of government price and product controls. I think, again, Illinois is a great example of what can happen if you get rid of those elements of the regulatory system that do not empower consumers in the marketplace, that do not enable competitors to react to market conditions in a way that allows them to exercise business judgment and get the regulator out of the business of exercising business judgment that insurers ought to.

COMMISSIONER YAROWSKY: Madam Chair, I see the red light. Is it possible just to have a few quick responses from all of the witnesses?

CHAIRPERSON GARZA: To the last question?

COMMISSIONER YAROWSKY: To the last question, absolutely.

Ted, do you want to – I mean, this is kind of a, "Business of insurance" question, but –

MR. VOORHEES: Yes, and I will note that we did try to capture the concept that you are describing in the first of our safe harbors.

MR. McRAITH: Let me be clear that I have tremendous respect for the ABA and Mr. Voorhees, who I just met today, and they know infinitely more than I do about antitrust law, but as an attorney, when six out of the seven safe harbors include the words, "unreasonable" and "interpretation that requires the rule of reason," that is an invitation to litigation, and I do not think any of us who have litigated in state courts around the country and many federal courts want our judges making decisions. We want regulators making decisions.

The purpose of the loss-development data is ultimately to protect consumers from insolvency concerns. There could be insurance companies setting up in every one of your counties, in every one of your cities, setting rates that would be significantly lower than might be available in the marketplace right now. Those insurance companies would not survive.

And you would have neighbors, friends, and constituents who had paid a premium for a promise that was not going to be delivered.

MS. GACKENBACH: I agree, just to get back on your issue of the data. Obviously, the safe harbors proposed by the ABA do recognize the need to exchange historical data, nor has Mr. Angoff.

Where they differ from us is on the issue of prospective loss cost data. I think it is important to remember what this really is. To just to dump raw historical data on a lot of these people is instructive, but it does not really enable many insurers to go forward in setting their rates. When you are talking about what these advisory organizations actually do, they are taking those millions and millions of points of data and taking this and looking at it, because what you are talking about is a future cost, not a historical cost.

And so, when you are talking about looking - it sounds simple, and you talk about applying an inflation rate, or things like that, but that is really not what happens in this case. You look at a number of other issues, such as changes in the policy, changes in deductibles, litigation patterns, all of those other type of things. And you have to look at that to try to project forward.

Asking many small- and medium-sized insurers to take on that burden themselves would essentially preclude them from making these rates or dealing with that - coming up with rates that are both competitive and ensure solvency, because it is a delicate balance of making sure that the rate you charge is going to keep you in business and make sure that you are competitive, but it is also not too low.

So when you talk about this, I think you have to look really hard at what this is trying to achieve. The use and exchange of this data has ensured a competitive marketplace that is stable and solvent. To try to limit that to just historical data, I think, would threaten both of those.

COMMISSIONER YAROWSKY: I am going to go to Jay, but - just a comment -

When we looked at that, and we probably made the conclusion on trending, and I have simplified it, that smaller companies could hire an accountant or an economist.

MR. McRAITH: Raising the cost.

COMMISSIONER YAROWSKY: It does raise the cost, but competitively, it might have some benefit.

MR. ANGOFF: There is a bright line between historical loss data on the one hand, and loss development and trending on the other.

Historical loss data is objective stuff. It is claims that were actually paid, and there is no antitrust prohibition on pooling that type of data. That is pro-competitive, because the more data that you have, the more claims that you know have been paid, the more accurate you can be in projecting that data into the future.

There is no judgment involved as to what the claims are, but there is a tremendous amount of judgment involved in both the loss development and the trending process. Loss development simply means claims that have been paid in prior policy years. Let's say certain claims for a certain year take about 10 years to be paid. So let's say that you go back to the 1995 policy year, and you see what percentage of those claims was paid in the first year, what percentage in the second, what percentage in the third, and so forth.

That is what loss development is. You look at that pattern in prior years, and you project that into the future. But there is a tremendous amount of discretion - and I think this is a more fundamental problem in the industry than McCarran-Ferguson is - there is essentially an unlimited amount of discretion that actuaries have in choosing how many years of data to look at, and choosing how to average those years, and choosing the different types of averages, and choosing the different weights to give different averages.

They have unlimited discretion. And depending on what judgment the actuary makes, the ultimate read indication can vary wildly. So that is why it so important to have individual companies doing their own projections based on the industry-wide historical loss data.

COMMISSIONER YAROWSKY: Thank you.

CHAIRPERSON GARZA: Thank you.

Commissioner Cannon.

COMMISSIONER CANNON: Thank you.

Well, you will be happy to know that, since I have only five minutes, I cannot ask a ten-minute question.

Commissioner, when I was listening to you, I was thinking, maybe you and Mr. Angoff were kind of in violent agreement, in terms of the regulation that we have out there, unless I heard you wrong. I think you slipped. You said, "Excessively and actively regulate;" you probably meant "extensively."

MR. McRAITH: Either that, or it was my phonetics.

COMMISSIONER CANNON: Either that or it was a Freudian slip. Who knows?

But it raises the question – I am sitting here thinking, okay, if that is the case, then what is left to protect by McCarran-Ferguson that the state action doctrine does not protect? And there is kind of a crease there between state action and, as Mr. Voorhees says in the ABA proposal, certain activities that would be subject to the rule of reason, that would be a safe harbor.

So, what is in between those two pillars?

MR. McRAITH: Let me start with a question that may be rhetorical. Do we think or agree that legal or court interpretations of state action, active state action under the state action doctrine are well defined in every jurisdiction?

COMMISSIONER VALENTINE: Yes.

COMMISSIONER CANNON: Yes. I would say that it is - there is a big body of law out there. The Supreme Court has weighed in on that a couple of times.

MR. McRAITH: Right. The Supreme Court has. But I think, when it comes to the regulation of insurance, and the interpretation of state action in the regulation of insurance, there is a massive grey area that fills that void you indicated with your two hands.

And, for example, is it effective or active regulation if the regulators do a marked conduct examination of an insurance company once every five years? Is it effective solvency regulation if there is a financial exam of an insurance company once every five years?

COMMISSIONER CANNON: Well, let me ask you this: how would you answer those questions with your experience in Illinois?

MR. McRAITH: In my experience, in Illinois, that is effective regulation, absolutely.

COMMISSIONER CANNON: For an every-five-year examination.

COMMISSIONER VALENTINE: It is not an antitrust issue - Solvency is not -

COMMISSIONER CANNON: Right; it is not an antitrust issue.

MR. McRAITH: The point, ultimately, is that, if the objective of this Commission and the objective of antitrust laws is to promote competition, there is no indication from anyone at this table that there is a lack of competition in the insurance market. No one has complained about the profitability of the insurance market, at this point, except, I think, Mr. Angoff has alluded to excessive profitability.

So the point is, is there something that needs to be fixed? And, secondly, the regulation - a change now, I think, would lead to tremendous uncertainty, and, while we can dismiss uncertainty as a being a traditional factor in economics, or the change in regulation, it is something that, in this case, would impact every single American who has any insurance interest.

COMMISSIONER CANNON: Well, I would only comment that, obviously, the nature of the free enterprise system that we all enjoy - uncertainty is kind of a watchword every day that most businesses have.

Jay, would you like to comment on that?

MR. ANGOFF: Yes.

First of all, I agree with Mike. Illinois is an example of a state where there is no antitrust enforcement and rating law, yet he is right, in auto anyway, and in several other lines, based on this study this NAIC puts out every year, profits in those lines are not excessive, despite the fact that there is no rating law and no antitrust enforcement.

I would say this, though, about the state action doctrine: there is a difference, obviously, between regulation, which all of the states do, and the active supervision required, and the *Ticor* case is very good at explaining - not only setting out the doctrine, but going through the analysis that you would have to go through - it had to do title insurance - but it goes through the same type of analysis that you would have to go through in analyzing the state's regulation of other types of insurance.

And, as I said before, most states do not meet the state active supervision test, as explained by *Ticor*.

COMMISSIONER CANNON: Great. Okay.

Do you want to respond?

MR. McRAITH: Only to clarify that we do regulate for antitrust. And, in fact, as the insurance regulator, I have been involved with the Commission - investigations, and settlements that have been in the papers nationally.

COMMISSIONER CANNON: Thank you.

Anybody else want to comment on that?

MR. ZIELEZIENSKI: Yes, just two comments.

Mr. Angoff has mentioned that he considers that most state regulation would not meet the active supervision test. I think that says at least two things. One, that it would be as I fear if we shifted to the state action doctrine, and that is constant litigation or attempts to define the level of regulation necessary to meet the state action doctrine, which would create chaos in the industry.

The second would be the other thing that I fear, and that is, in order to get over the state action hurdle of active supervision, insurers would feel obliged to go to their regulators and say, please regulate us more than we are being regulated today, which I think we would agree is way too much in certain areas.

COMMISSIONER CANNON: Okay.

Thank you, Madam Chair.

CHAIRPERSON GARZA: Okay.

Commissioner Litvack.

COMMISSIONER LITVACK: Thank you. I really only have a couple of questions. I must tell you, I do not think I understand - indeed, I am sure that I do not understand the point that you make, Ms. Gackenbach, and I think you make too, Mr. McRaith, that companies have to get together, have to have the resources to project, with respect to future rates.

And my problem is, I understand what you are saying, and you have said, as I understand it, that small and medium sized companies just could not afford to analyze this and project. But I am not really sure why I understand why that is different from any other business in the United States. We are projecting all the time what sales are going to come, what new products are going to come. How do I best price my product so as to assure a longer life of my product and not invite competition, or make it low, or go so low that I go broke? You seem very concerned making sure no one goes broke, but they do in this country. Maybe it is your right to go broke if you cannot figure out how to do it.

So why should this be different? In other words, why should I be worried, which you are - why should I be worried about the fact that each one will make their own judgment, and those who are wrong will go by the wayside?

MR. McRAITH: I will take first stab at answering that.

Let me give a specific example: workers' compensation insurance. As each of you knows, I expect, there is a different classification for payroll, depending on everything from concrete workers who build bridges versus concrete workers who build patios. That means that you pay a different level of premium depending on that.

If I live in Marion, Illinois, which is close to the Kentucky border, and I have a concrete business there, by law, I am required to have insurance. In order for an insurer to price that product appropriately, the insurer needs to have sufficient data as to what the loss history is for that industry that I have.

Then, in addition to that, to project on that, as an insurer, I collect premiums for my exposures in that premium year. That means I need to know what the expected costs are. What is it that, nationally or regionally - what are the increased healthcare costs? What are, perhaps, the costs of litigation? What are all of those things that factor into the cost of a projected claim, so that, when I, as the concrete employer, have a claim, my claim gets paid?

So it is different from other products, in that it is not, I am buying a car, and the car either works or does not work, and the seller might go broke; it is, there are thousands of people, thousands, who are injured if that premium is too low, if that premium does not take into account what might be the projected loss cost. Thousands, not just the company that goes down; every one of those claimants, every one of those employers, have a problem, too.

That falls on the backs on the taxpayers.

COMMISSIONER LITVACK: Would you be equally concerned about the company who wrongly projects the impact of a future drug or item being offered by a drug company, and wrongly projects it and goes bust as a result, and 20,000 workers lose their jobs? Would you be equally concerned?

MR. McRAITH: I would be concerned about that, except to the extent that those workers have not paid for a promise. Those 20,000 workers have shown up, received a salary, understanding that they might not, in fact, have a job one day. That is different from an employer who has paid a premium for a product that might never be needed, but when they need it, it might be significantly in excess of the premium that they have paid. That is different.

COMMISSIONER LITVACK: So would you also agree, for instance, that employers could get together and project costs for pension-type benefits? Everyone gets together and decides what is going to happen, and whether the average age is going to increase or not increase, people are contributing money - companies could get together and do that.

MR. McRAITH: I am not sure that I understand the pension industry enough to comment on that.

COMMISSIONER LITVACK: Fair enough.

One last question. I am going to address it, if I may, to Ms. Gackenbach. This one is slightly different: if I understand your position correctly on the safe harbors, your concern, at the end of the day, if I understand, is, basically, litigation. In other words, what you are saying is, it does not cover everything, no matter how you do it. And that has to be true. And secondly, because it does not, or even to the extent it purports to, or attempts to, it is just going to generate litigation. Is that it? I do not mean to minimize it, but just so I understand it. The problem of the safe harbors is the threat, or the uncertainty, to use the word that has been used so much, of litigation.

MS. GACKENBACH: I think it is part of that, but it is a little more involved than that. It is not only the threat of litigation, but it is what the threat of litigation does to the industry. It is the impact and the fact that it freezes insurers in, and it keeps people from being willing to engage in these types of activities that are very pro-competitive.

For instance, if you had people withdrawing from data reporting or other types of activities because of the fear of litigation, then you would be reducing the credibility of those numbers, because, as you reduce the number coming into the pool, you have less. If a large insurer takes its data out, you have whole missing chunks of data.

So, yes, we fear the litigation and the uncertainty that that brings to the industry, but we also fear the impact of just what the fear of litigation does.

COMMISSIONER LITVACK: Yes, the problem with that, just so you know, from the standpoint, I think, of this Commission, is that we hear that from everybody. Everybody says, the fear of litigation is going to paralyze the country.

And there may be some truth to it. The question is, does that justify an immunity?

MR. McRAITH: Well, if I could briefly add to that, the real problem, from a regulatory perspective, is that that would establish a dual regulatory system where you have courts interpreting a regulation, and states trying to enforce a regulation. You would have different interpretations throughout the country, and perhaps even within a state.

COMMISSIONER LITVACK: My time is up, so I am not going to ask a question, but I am going to make a comment, only because I wrote it down when you said it. I should not speak for anybody else, but I would not agree with your characterization that I would prefer to have regulators making decisions than judges. I am afraid I disagree with that.

[Laughter.]

COMMISSIONER BURCHFIELD: It depends on the regulator, and it depends on the judge.

[Laughter.]

COMMISSIONER LITVACK: I will take my chances with the judge.

CHAIRPERSON GARZA: Commissioner Kempf.

COMMISSIONER KEMPF: Thank you, and good morning.

As I have stated previously, I have reservations about the necessity and wisdom of today's hearings. As Chairman Garza and Vice Chair Yarowsky have already indicated, we have held extensive prior hearings on immunities and exemptions that were more broadly focused.

Today, we have selected two in particular out of a long laundry list and focused on those. Curiously, they are not the two that are, at least to my mind, the most costly to consumers, those being the labor immunities and exemptions and the food and dairy immunities and exemptions. My fear is that, the result of this is that, at the end of the day, there is a danger that the Commission will inappropriately overemphasize some immunities and exemptions, while deemphasizing others, attacking some and giving a pass to others, based primarily on who the victims and beneficiaries are, and their political constituencies, rather than on sound public policies.

That is why, as I have also said previously, I favor a broader position by the Commission, one that expresses a disfavoring of immunities and exemptions across the board and calls for such things as regular periodic reassessment of all immunities and exemptions.

The staff materials remind me of that when I looked at them. While they are purporting to address, and do address, these specific ones, many of the arguments against the immunities and exemptions are really not specific to the two we are talking about today but would go to all immunities and exemptions.

Let me just give you one example: it is on page eight of the shipping memo, where there is a concern expressed that elimination of the immunities and exemptions would lead to increased competition. The statement appears, "There are strong theoretical reasons to prefer capacity rationalization by an oligopoly constrained by a competitor fringe to rationalization by cartel." That, of course, is not unique to either of these industries, but is applicable to all.

Against that backdrop, let me just ask a few questions. Two of the witnesses emphasize that the insurance industry is, to use your words, "unique" or "different," and I see phrases like that running through the submissions we have this afternoon, and, indeed, through all of them. And before the *per se* rule was adopted, the court decisions all made similar types of statements.

In considering those arguments, we have two hours scheduled today. I know Congress is considering many of these things right now. In fact, two of our panelists have attached statements that were submitted to Congress as recently as June 20th. And my question to the panel is this: will Congress be spending more than two hours on this or less?

MS. GACKENBACH: Well, I will do that, because it takes two hours to get through the opening statement. So, yes.

COMMISSIONER KEMPF: Congress will be spending more time; am I correct?

Does anybody disagree with that on the panel?

Okay.

There was a discussion about rates, particularly in Illinois. This may be an overly simplistic question, but are insurance rates generally going up or going down?

MR. McRAITH: I can offer this perspective, and that is that the question is very difficult to answer. It depends on the line of insurance. It depends on the location. And, as I did emphasize in my opening comments, insurance is unique. It is local, personal, and often intimate. So the rates will vary from individual to individual and from location to location.

COMMISSIONER KEMPF: Anyone else?

Okay.

Mr. Voorhees, you started off by saying that you did not want to add or subtract from the ABA's position - the written submission. And I, in looking at that, and in listening to your remarks - you refer several times to what you call "the ABA's position," and I assume that that was shorthand for the Antitrust Section of the ABA, because the written thing says that these views have not been approved by the delegates or the board of governors, and accordingly should not be construed as representing the policy of the ABA

MR. VOORHEES: That is correct. Sometimes ABA becomes shorthand, and that is politically incorrect. It is the Antitrust Section of the ABA.

COMMISSIONER KEMPF: Okay.

Now, several of you referred to things that sounded like you thought they were good things, but that was not clear to me. For example, the statement, "There are more insurers now than in the past." One of the written submissions says there were 5,000 in whatever category it was – that there 823 pages of regulations in Illinois and things like that. I do not get any divine beam that tells me if those are good, bad, or neutral facts, and my instincts are that 823 pages of regulations is not a good thing, and that 5,000 insurers is too many, and we would have more efficiency if we had less.

Does anybody want to comment on that?

MR. McRAITH: I would be happy to. I am the one who offered both of those numbers. It is actually, in 2005, and I did not want to bore you with the exact details, there were 5,789 active insurers not subject to any kind of regulatory supervision at this time. In each decade since 1950, we have had an increasing number of insurers formed.

In Illinois, we do have 823 pages of insurance regulation. Illinois is, of course, held high as the paragon of insurance regulation because, as Mr. Angoff has so graphically described, we do not regulate rates and allow the market forces to dictate what is an appropriate price.

I will say that I mentioned that number so that the Commission does understand that insurance regulation is a not monolith. It is not one issue about a McCarran-Ferguson Act exemption. It is a massive undertaking, even in a state like Illinois, which the AIA and other associations do hold up, as I said, as the paragon.

COMMISSIONER KEMPF: I have no further questions.

I do have one request, however, and that is - the question I asked earlier about information on whether rates have gone up or down. If anybody has additional information that they could submit to that, I, for one, would certainly welcome taking a look at that. That is all I have.

CHAIRPERSON GARZA: Commissioner Valentine.

COMMISSIONER VALENTINE: Good morning.

I just have a few questions as well. I am going to start with you, Mr. Voorhees, and you may need to deviate from the ABA position, and, if so, you can just say that you are speaking on your own behalf.

CHAIRPERSON GARZA: How are you going to make him do that?

MR. VOORHEES: We are old friends.

COMMISSIONER VALENTINE: You may have noticed that your Section has submitted some testimony, with respect to the Ocean Shipping Act, which advocates a clean repeal of the exemption, has no safe harbors, even though shippers obviously engage in collaborative activity, share vessel space, equipment, things like that, and are doing so increasingly. And it is all very pro-competitive, just as I would agree that this historical data sharing is very pro-competitive.

Some of your fellow panelists have commented that your safe harbors are not very safe at all. So, first of all, I am wondering why you need them in the insurance industry as opposed to the ocean shipping industry, and if you still want to insist on having them, would it be cleaner, to industry participants, to simply say things like, "Collection and dissemination sharing of historical loss data is legal. Future trending of loss projections would be subject to *per se* rule"?

Your development of standardized policy forms – you say you do not want them to unreasonably limit choice. Why not simply have that be subject to active state supervision?

Your residual market mechanisms, you essentially say also should be subject to active state supervision. Why wouldn't you substitute state action doctrine principles to give pretty much clear protection to some of these things and make other things absolutely clearly legal, and make others illegal? What kind of certainty are you giving here, and/or why don't you just have no safe harbors, like your ocean shipping friends?

MR. VOORHEES: Well, speaking as the spokesperson for the Antitrust Section, the safe harbors are there because that is what the Section believes should be there.

Speaking for myself, I guess I have already intimated that I believe that the areas covered by those safe harbors are already actually pretty safe, both under the rule of reason, and probably, in many cases, under the state action defense. There may be some states that may have to get their acts a little more together to buttress that defense, but I think when we are talking about collecting past loss data, and when we are talking about basic joint venture activity, we are talking about areas that are fairly well understood and would be relatively safe, except at the margins, without these safe harbors. But then, I am just speaking as an attorney.

COMMISSIONER VALENTINE: Mr. Angoff and Mr. Zielezienski, if we were to recommend repealing McCarran-Ferguson, would you - explain why you would advocate either just a federal regulatory system, or a state regulatory system, or perhaps, in Mr. Zielezienski's case, a mix?

MR. ANGOFF: What matters, I think, is the quality of the regulation, not necessarily the place where it is regulated. I have some experience with federal health insurance regulation at what is now CMS - it used to be HCFA - and I thought that was very inefficient. And just, as a matter of efficiency, I suppose, I think, all things equal, state regulation is better.

But still, what is most important is the quality of the regulation. Unfortunately, what is the case today in most states, and it is not because it is state versus federal, but it just happens to be the case that, in many cases, the consumer cannot get an adequate remedy.

In most states, the insurance Commissioner has no authority to order refunds even if he does find a law violation. And, in most states, there is no private right of action under the Unfair Insurance Trade Practices Act. So, even if a consumer could prove a law violation, he could not get damages.

So, in most states, the consumer has no effective remedy. Now, that could be fixed by the state government. It could be fixed by the federal government. So, again, what matters is the quality, not where it is.

COMMISSIONER VALENTINE: Mr. Zielezienski.

MR. ZIELEZIENSKI: I think what matters is the quality, efficiency, and the focus of the regulatory system.

You are right that we do sort of straddle the fence here with a dual charter system. What is proposed is, for those who come under a federal regulatory system, they are not principally regulated at the state level, at least for most pricing activities. And to the extent that they are not, the McCarran-Ferguson exemption would go away.

To the extent that you are preserving the state regulatory system for those who remain there, the McCarran-Ferguson exemption would continue to apply.

COMMISSIONER VALENTINE: We are going to repeal it, in my world. So then you would have either state action at the state level or something at the federal level.

MR. ZIELEZIENSKI: I still think that is problematic, because, for those who would choose to remain on the state system, you would still have this uncertainty, with potentially duplicative regulation if Mr. Angoff gets what he wants, and that is sort of a supplemental private right of action to accompany regulatory enforcement.

Just speaking purely under an optional federal charter system for those who would choose to be nationally chartered, that has the benefit of re-balancing the regulation versus antitrust equation in a way that I think we would take the risks in order to get freedom from government price and product controls. We would take the tradeoff, at least in pricing activities that are no longer regulated at the state level with state action doctrine and federal antitrust laws.

COMMISSIONER VALENTINE: Okay. Chairwoman, are we not going to have time for another round of questions?

CHAIRPERSON GARZA: Well, if we keep going at this pace, because of the absence of two Commissioners, I think we will have 10 minutes of play. So if you would like to reserve some time –

COMMISSIONER VALENTINE: Yes, there is just one question for Mr. McRaith, and he probably will not even be able to answer it now, but I would like to get it on the record. Is that okay?

CHAIRPERSON GARZA: Sure. Go ahead.

COMMISSIONER VALENTINE: Mr. McRaith, you said that to call it an exemption is misleading because states are actively regulating.

I would like to know, since the *Hartford Fire Insurance* case that went to the Supreme Court in the late 1980s – I think the case started about 1986 or 1987 – so after that, and then excluding all the Spitzer, AIG, Marsh-McLennan, broker commission cases, because I do not care how you all piled on after Elliot Spitzer, how many cases have state AGs or commissioners brought between those two bookmarks in which you actively prosecuted rates that were agreed upon, or a single form, leaving no form choice that was agreed upon? If you remember the *Hartford Fire* case, that was when there was claimed to be a boycott of the form.

MR. McRAITH: Sure, that was Justice Scalia's –

COMMISSIONER VALENTINE: Correct. Correct. If you know the answer, you can tell me that, but I would not expect you to.

MR. McRAITH: I want to make sure that I understood the question. Actively prosecuted what issue?

COMMISSIONER VALENTINE: Rate-fixing or form –

agreement on a single form.

MR. McRAITH: Well, I will not answer - I do not have the information to answer your specific question.

I would like to correct you, with all due respect. Your comment about piling on after Mr. Spitzer, is unfair -

COMMISSIONER VALENTINE: I am sorry, that was -

MR. McRAITH: And I would also like to add, I heard the allusion to preferring judges, as opposed to regulators - I do not think that anyone wants their insurance regulated by a judge who has dealt with a PI case, and then a medical malpractice case, and then maybe a car crash, and then an insurance regulatory question.

COMMISSIONER VALENTINE: Okay. That was not my issue, so that is not my time.

MR. McRAITH: But I am happy to answer your question. We will get you that information.

CHAIRPERSON GARZA: Thank you, Commissioner.

Commissioner Delrahim.

COMMISSIONER DELRAHIM: Thank you, Madam Chair.

I agree with you. I do not think I would want any judge to be issuing regulations or controlling that market. For that matter, I would like that limited to regulators with some clear guidance, as well.

But that leads me to a couple of questions. One of the concerns about repealing McCarran-Ferguson is that, and again, this is not unique, and you have heard it as a complaint from other Commissioners, constant litigation. Is this litigation that would be frivolous, or is this litigation because the law is not clear what the rights and liabilities are? I understand an antitrust law, because we have the rule of reason, and it is very fact intensive. There might not be as much guidance in certain areas, certainly in the insurance field. Because of the McCarran-Ferguson Act, you do not have as many cases that have been developed. But is the concern that you are going to have a lot of frivolous and creative lawsuits, or is this going to be that there is not enough of a standard for insurers to know what to do?

MR. ZIELEZIENSKI: Yes. I think that really – I think the dynamic we struggle with here, and as expressed by the panel's diverse views on these issues – if you would ask us what would happen with some of these collective activities in which the insurance industry engages, I think you would probably get at least three people on this panel who would say that those activities are pro-competitive and would vigorously argue that in the courts.

On the other hand, you have heard from Mr. Angoff that he believes that most state regulation now does not meet that active supervision hurdle. So whether we would view it as frivolous or not I think is beside the point. There would be contested cases, and there would be uncertainty. I think it is not the litigation dynamic so much that I am worried about; it is the push back on the regulatory side, because if you view this as I do, as a balance between antitrust and regulation, the push back could be – we have got to meet that active supervision hurdle, so, to get over that, we need to over-regulate in areas that we contend now, are already heavily regulated. Even growing up under McCarran-Ferguson and having 50-some odd years of experience, there are areas of regulation that are not normal for competitive industries.

COMMISSIONER DELRAHIM: I do not want us to confuse the different types of exemptions that might be there, and whether a particular activity is pro-competitive and would therefore pass muster on a rule of reason. It would be totally different than whether it meets the state action doctrine and the active supervision prong of that.

So I think whether somebody would argue – those two are not necessarily incompatible. Somebody can argue that it is pro-competitive, get one exemption, and yet not meet the active state requirements. So be it. It still is exempt. And that is why I still go back to it, putting aside the other types of exemptions where certain activities might qualify.

I think Mr. Angoff's illustration of some of the data, the historical data, and the future cost projections seem to have a pro-competitive reason. Again, it depends on the judge, and it depends on who will view that as pro-competitive, but I don't disagree with you there. But there is guidance in antitrust law, even if it is not in the insurance field itself of what the proper test is.

Anybody else who would like to comment on what the -

MR. McRAITH: Yes.

COMMISSIONER DELRAHIM: Go ahead.

MR. McRAITH: I think it, first of all, is an excellent question.

I do not want to belabor a point that I tried to make earlier, but actually, I misspoke. I said there were seven safe harbors proposed, and six included the words “reasonable” or “unreasonably.” Five are proposed, four of which include the term “do not unreasonable restrain.” Three actually have “do not unreasonably restrain.”

Now, the question is, who interprets “unreasonably restrain?” Is it going to be Madison County Circuit Court in Illinois, or is it going to be the Northern District of Illinois, or is it going to be the D.C. Circuit Court? That is the problem.

So then we have insurance companies trying to do business, and they cannot do what they do now, which is turn to their regulators, and they know what those regulations say. They know how those laws are interpreted in each state. They would have to vary their operations depending on the precedent of a certain jurisdiction. That is the problem.

COMMISSIONER DELRAHIM: Good point.

MR. ZIELEZIENSKI: Can I just make one follow-up comment?

COMMISSIONER DELRAHIM: Sure.

MR. ZIELEZIENSKI: Director McRaith raises a good point about the various courts that could be interpreting this. You know, we have an issue with the lack of uniformity within the state regulatory system with 50-plus regulators. Imagine the environment with an infinite number of judges interpreting, or trying to do the job that those 51 regulators are trying to do.

COMMISSIONER DELRAHIM: Mr. Angoff –

MS. GACKENBACH: I would just add that I think Stephen and Michael are correct in that we have that uncertainty, but then I also go back to the point that I do not think that we are necessarily talking about just frivolous lawsuits. We are talking about the point of legitimate difference of opinion over what unfairly restrains competition and what regulation is. And we would be litigating each and every one of those.

And in the period of time during which we are litigating, we are going to have people who are going to be very fearful of continuing to engage in these very pro-competitive activities. And that would have disruptive effects on the marketplace.

COMMISSIONER DELRAHIM: Madam Chair, I have just a yes-or-no follow-up question, if that is okay with you.

CHAIRPERSON GARZA: Okay.

COMMISSIONER DELRAHIM: To address some of that, the concerns about whether the not the proper standard is there, would you agree with, if not a full repeal of the McCarran-Ferguson Act, at least a step towards – as we change a regime – a more competitive environment, providing just the federal antitrust enforcers with the authority to bring cases? In the meantime, while there is either case law developed, there are business review letters and other types of comfort letters for particular types of activities that go to those agencies and describe, ahead of time, so you have some certainty, and you will not have the force of litigation on the private side, initially.

Again, I am not trying to cut out a consumer from having his private right of action, but I would rather have a federal enforcer enforcing the competition laws. Then, having the full blanket immunity if it is between those two. And so, allowing the Department of Justice and the FTC to bring those, but then giving you advance comfort letters ahead of time.

If we could just get a yes-or-no, to the extent you can, given the timing. I ask each of the panelists' views on that, please.

We will start with Mr. Zielezienski.

MR. ZIELEZIENSKI: If your question is, do you, as an interim step, assuming no decreased regulation to create a more competitive environment, whether I would favor an interim step of having the FTC or Department of Justice act as the antitrust enforcement authority? I would say no.

COMMISSIONER DELRAHIM. Mr. Voorhees, your personal opinion?

MR. VOORHEES: I really have no comment on that question.

MR. McRAITH: As a supplement to the current system of state regulation, I can see some merit to that proposal, but I cannot speak for the NAIC on that position.

MS. GACKENBACH: I think if we are talking about, as Stef said, an add-on, I think no, because I think that just adds a dual regulatory system and is just one more level of complexity for the industry.

MR. ANGOFF: Yes.

[Laughter.]

COMMISSIONER DELRAHIM: I think we are tied on this panel.

CHAIRPERSON GARZA: All right.

I am calling on myself, now.

I would like to understand a little more about what is going on in Illinois, since there have been three references to it. There seems to be some agreement between Mr. McRaith and Mr. Angoff that - although I still want to clarify this - that the insurance market, for certain lines, at least, in Illinois, is operating the way we would hope a competitive industry would operate.

What I want to understand is - Mr. McRaith, you are saying that, in Illinois, there is no rate regulation, at least for certain lines of insurance; is that right?

MR. McRAITH: That is correct. Well, correct in this sense, we continue with our financial examinations. We do review rates after they are filed. And our primary concern is that the rates might be too low.

CHAIRPERSON GARZA: So tell me how that works. Well, let me ask a preliminary question. You said that, with respect to certain lines - which lines were those?

MR. McRAITH: Medical malpractice, workers' compensation, and long-term supplements are subject to review.

CHAIRPERSON GARZA: In your opinion, those rates are competitively set, I think you said, or competitive.

MR. McRAITH: Exclusive to those three, yes. I can be more clear.

CHAIRPERSON GARZA: Okay.

MR. McRAITH: As I mentioned, in auto, homeowners', workers' compensation, and health insurance, we have a very, very healthy, vigorous, competitive market.

CHAIRPERSON GARZA: Let me just stop you there. I want to understand what the basis is for your saying that is so. And what I want to try to understand is, with respect to those lines in Illinois, are the insurers agreeing, among themselves, as to the rate classifications, rates, and common forms? And if not, how do you know they are not? What gives you the confidence to state that?

MR. McRAITH: We know they are not – well, first of all, I tell you they are competitive markets based on the number of carriers, and also participating in each one of those markets, and then also the range of products and prices for products.

CHAIRPERSON GARZA: What about the prices that are out there that convince you that market is operating competitively?

MR. McRAITH: Well, let's start with this simple reality. If you have one individual who goes to four or five different insurance companies for auto insurance, homeowners' insurance, whatever it might be, the rates are going to be pretty similar, because that individual has the same life, and living habits, and work habits, regardless of which company he goes to.

So the underwriting criteria are going to be similar. They are going to view that person as having the same amount of risk. So the premium is going to be the same, but there are additional – it is going to be similar, okay?

CHAIRPERSON GARZA: Assuming that everybody -

MR. McRAITH: Driven by the market reality.

CHAIRPERSON GARZA: And you are saying that is going to be similar, assuming everybody – there is some transparency of information, and that is just – there is going to be sort of an equilibrium price, you are assuming. A range, but –

MR. McRAITH: There is going to be a range, absolutely.

Some companies are considered the higher-end – property, casualty – they are going to have a higher rate because they pay claims like that. And other companies might be lower-rated; they are going to be cheaper, but the service they provide is not going to be the same.

CHAIRPERSON GARZA: And that is assuming no agreement among the producers, no agreement among the insurance companies.

MR. McRAITH: That is absolutely right.

CHAIRPERSON GARZA: In Illinois, then, right now, you do not perceive that there are any agreements among the insurers.

Now, what if tomorrow, just hypothetically – what if, tomorrow, they all got together and agreed on rates, agreed on premiums, agreed on what they would insure and not insure, agreed on all of the competitive things – all the items in which they compete now – and they came up with a mechanism to enforce it, to detect deviation and to enforce it – now, if they did that tomorrow, would you have a problem with that? Would you be concerned?

MR. McRAITH: Absolutely.

CHAIRPERSON GARZA: And, in Illinois, what could you do about that?

MR. McRAITH: Well, that would be a violation of our unfair competition statute under the insurance code. We would shut them down and require them to only service their existing customers. That would be an immediate – that would be a cease and desist order immediately. We would also report it to our state attorney general, who would prosecute that promptly.

CHAIRPERSON GARZA: So your insurance code, then, has a provision that would prevent insurers from –

MR. McRAITH: What you have described would fit within our unfair competition statutes.

CHAIRPERSON GARZA: Does every state have that similar type of regime?

MR. McRAITH: It is my understanding, and I have not independently verified every state, but it is my understanding that yes, virtually every state has an unfair competition and deceptive practices statute, or something very similar to that.

Now, whether it is the regulator who can take that action within the insurance code or whether it is the attorney general, I am not sure.

CHAIRPERSON GARZA: And then, what – final question. When I ask how you enforce, I mean, do you have the ability, under your statute, then, to investigate? Let's say you think that there – somebody brings to your attention

- I mean, how would it come to your attention that there was a conspiracy? How would you actually enforce that? Is it something where you could - you said something about a cease and desist order - would you have to go to a court? Would you be able to issue an administrative complaint? How does that actually work?

MR. McRAITH: Okay, in terms of how that would come to us, it could come to us through any number of ways. One, it could come, of course, from a consumer. It could come from an agent. Somebody within the company could report it as a whistleblower. We could discover it through our own market conduct examinations or documents that are filed with us. They do file their rates with us. They do file their underwriting criteria with us, and we review every one of those.

If we were to discover what you described, I can issue a cease and desist order without having a hearing.

CHAIRPERSON GARZA: And one final question. From what you are telling me, I take it, you do not think that it is necessary for the insurers to be able to get together and agree on these otherwise competitive terms in order to ensure against the kind of insolvency issues and what not that you have described today as being the basis for wanting to preserve the McCarran-Ferguson exemption?

MR. McRAITH: Insurers should be able to use common policy forms. Insurers should be able to rely upon the data that we have already discussed, yes.

Insurers should not be able to agree, in a competitive market, on the rate. They should not be able to collude and, among themselves, agree what they are going to charge certain people in a certain region.

CHAIRPERSON GARZA: I have overstepped my time, so I am going to turn it to Commissioner Burchfield now.

COMMISSIONER BURCHFIELD: Thank you, Madam Chairman.

There seems to be an emerging consensus here that the exchange of historical loss information does not present a serious antitrust problem. And that sounds right to me, because we know that financial institutions obtain, from unified sources, credit history information before they make loans. And of course they have, at least in that respect, similar concerns. There is a similar policy concern about insolvency for financial institutions, as there is for an insurance company. They are not only guaranteeing to pay me something based upon a contingency in the future, but they also have my money, and I am interested in getting that back.

And I think that consensus that we seem to have reached on the exchange of historical loss information not being a serious federal antitrust problem - that does sound right to me. I have a similar view about the non-coercive opportunity to use common forms, so long as there is no mandate that precludes a particular insurer from offering terms that are more beneficial to a consumer.

With that as a background – and those two areas seem to me to be the most persuasive case for cooperative activity in the insurance business – putting those aside, because I think there is a reasonable consensus there, that leaves us with the rate-setting type activities that the Chairperson was just asking about, which it sounds like, at least in Illinois, are not condoned. The state does not condone collaborative pricing of polices.

In some states, as I understand it, there may be ratemaking, but I am a little unclear on that. But in other states where there is ratemaking, there is a state action-type exemption. So I put that in another category.

Then we move to a category where insurers might be engaging in collaborative conduct with no regulatory mandate. And, taking Mr. McRaith's point, at least in his state and, I take it, in other states, that can be subject to an unfair competition charge or a state antitrust charge

That leads me to the question, what are we fighting about here? What is it that the McCarran-Ferguson Act is protecting that is so fundamental to the insurance industry? And, to put the question somewhat more pointedly, let's assume – and I am not, having just looked at the safe harbors that the ABA has proposed, those sound to me like they are precise statements of the rule of reason in a particular context – but let's assume that those safe harbors existed for the industry. What would change if the McCarran-Ferguson Act were repealed? Can you give me some examples of what we are really fighting about here?

I will start at the end with Mr. Zielezienski.

MR. ZIELEZIENSKI: I think, to answer that you need to go back to H.R. 9, and you mentioned a couple of the safe harbors that were agreed to in H.R. 9.

But I think the things that you are left arguing about are things that we would argue are pro-competitive, such as loss development.

COMMISSIONER BURCHFIELD: Prospective loss.

MR. ZIELEZIENSKI: Prospective, right.

COMMISSIONER BURCHFIELD: But I think that that would be the way companies would compete, looking at losses differently, or segregating the data in different ways, or using different econometric or loss models to project how to price the policy.

MR. ZIELEZIENSKI: And I think that what happens today is that they are advisory in nature. So there is an encouragement to use your own data.

Julie would be better able to address this from the perspective of small and medium companies, to the extent that they need that to be able to effectively compete.

COMMISSIONER BURCHFIELD: But presumably, an analog of Equifax in the consumer credit could do those projections and market them to small insurers and they could use them for what they are worth, without that being an antitrust problem, I would think.

MR. ZIELEZIENSKI: There are other areas.

COMMISSIONER BURCHFIELD: Go ahead. I will stop interrupting.

MR. ZIELEZIENSKI: You talked about standard policy forms. Back in H.R. 9 that was within the safe harbor as long as there was no agreement to actually adhere to a collectively developed form.

Other areas include development of rating or form manuals filed with the state, again, as long as there is no agreement to actually adhere to, the jointly developed rating and form manuals.

Residual markets, an important area to preserve availability within the insurance mechanism, providing insurance pursuant to one of these public necessity market mechanisms.

Historical underwriting capacity risk pools. Again, another availability tool within the insurance industry.

Administering a state residual market.

Development of building and fire codes, which are important for loss mitigation in the insurance industry.

And, as I think Director McRaith mentioned earlier, worker's compensation is an area where there was a particular safe harbor in H.R. 9, preserving the ability to develop experience modifications based on common experience, which you could then extrapolate for each employer, based on comparisons.

And the final area is trending, where – the agreement in H.R. 9 was, you would have a transition period where collective development of trend factors would be okay, to the extent that it was regulated by state law. Then, following that, collective trending would be subject to the state action doctrine. The individual trending, along the lines of what Commissioner Burchfield was talking about in terms of credit, would be permitted.

And I guess I end on the point that these are all beneficial, pro-competitive activities that should be the subject of a safe harbor. But then I go back again to that that is half of the pie. The other half of the pie is the regulation that is built up under McCarran-Ferguson. So –

COMMISSIONER BURCHFIELD: Let me interrupt you and let other panelists have a change to respond to this question, if they could briefly state either whether they think anything would change, or if they have anything in addition to what has just been mentioned to add to the issues that you see if McCarran-Ferguson were repealed.

Ted.

MR. VOORHEES: As I mentioned, I don't believe much would change, especially with the safe harbors, given the existence of rule of reason and state action exemption.

MR. McRAITH: I have already expressed my opinion about the safe harbor approach.

What we are protecting with McCarran-Ferguson – ultimately, the issue is consumer protection. It is a question of competition from the industry side, if it fosters an environment in which small- and medium-sized insurers can responsibly participate. And it gives people in areas throughout the country – the Gulf region, and California, where earthquakes are likely – it gives them availability.

I would also point out, for the residual markets, insureds who are rejected by the conventional insurance market go to the residual market. Workers' compensation insurance, for example – many employers, small employers and large, in order to participate in their businesses, have to have, by law, workers' compensation insurance. So this trending data that we are talking about right now facilitates the operation of the residual markets that function as a necessity in our economy.

MS. GACKENBACH: I think Stef did a good job of enumerating – I agree; I think that trending data and the other would have the greatest impact, probably on smaller- and medium-sized insurers.

And Michael is right, also on niche markets and those really high-risk areas where people may be much less willing to go into those markets.

COMMISSIONER BURCHFIELD: Thank you.

MR. ANGOFF: Yes. I think it is a good point. I don't think much would change. I think that, just because the current law says that price-fixing is allowed does not mean that, in fact, companies do fix prices, and Illinois is a good example of that. So I do not think much would change. I do think that the biggest change would be that the insurance cycle would be moderated.

There still would be swings, but we would not have these hysterical, huge, dramatic price increases suddenly, and we would not have as much price cutting industry-wide during the down periods of the cycle either. I think, on balance, that that would be a good thing.

COMMISSIONER BURCHFIELD: Thank you very much.

Madam Chairperson, as I turn to you, I would just say that this industry, as is true with many of the industries that we have talked to, recognizes the litigation risk that is inherent in the antitrust laws, and certainly my clients confront that.

CHAIRPERSON GARZA: Thank you.

Commissioner Jacobson.

COMMISSIONER JACOBSON: There are two questions that need to be asked of every exemption. The first is, what are these people doing that is illegal that needs to be protected by an exemption, and second is, what behavior do we need to encourage?

So I am going to ask each of you to answer those questions. And particularly, no one has talked about the overlay of state antitrust laws, which are not exempted by McCarran-Ferguson. So, given the overlay of state antitrust laws and the regulatory activity that we have seen, what is it that the beneficiaries of this exemption are doing that would otherwise be illegal?

MR. ZIELEZIENSKI: I have two responses.

One, on the issue of what insurers are doing that is illegal, I do not think they are doing anything that is illegal. I cannot be –

COMMISSIONER JACOBSON: I don't want to hear about uncertainty, because we hear about that on –

MR. ZIELEZIENSKI: I am not going to talk about uncertainty.

The problem with repealing McCarran-Ferguson is that you then open up to duplicative enforcement. So you overlay –

COMMISSIONER JACOBSON: But there is nothing that is illegal? I want the other panelists to answer, also.

If there is nothing, let's move on.

Mr. Voorhees.

MR. VOORHEES: I don't have anything that I could identify as being illegal but for McCarran-Ferguson.

COMMISSIONER JACOBSON: Mr. McRaith.

MR. McRAITH: Nothing to add to that.

COMMISSIONER JACOBSON: Ms. Gackenbach.

MS. GACKENBACH: I think your question of whether it is illegal – clearly, insurance companies do share data, which we have talked about. I do not think that is illegal. Some people might argue whether that would be illegal or not. Absent the exemption, they do have agreed-upon common forms. We could argue whether that is illegal or not without the exemption.

To the second part of your question, is that something that we want to encourage, I think the answer from the regulators, and from the industry, and from, frankly, most of the benefits the consumers have seen, is clearly yes. We do want to keep encouraging this type of behavior.

COMMISSIONER JACOBSON: But if there is nothing illegal that they are doing, what is it that we want to encourage? What is otherwise illegal?

I think if we say that there is nothing they are doing that would otherwise violate the antitrust laws, we are done.

Finally, Mr. Angoff.

MR. ANGOFF: I don't want to make more work for you, but I believe that, yes, joint loss development and joint trending would violate the antitrust laws but for McCarran-Ferguson. I think that is the big issue that there is disagreement about. I feel very strongly that that would violate the antitrust laws.

I would also like to point out one thing about the state antitrust laws, and how the state antitrust law system relates to the insurance law system.

And let me use Missouri as an example. It is typical; there are other states that are a little different, but Missouri is typical. Missouri has an exemption in its state antitrust laws for the insurance industry. So the state attorney general does not have jurisdiction over the insurance industry. There is an express exemption.

In addition, the insurance regular law expressly permits price-fixing, and the unfair competition law, or the Unfair Insurance Trade Practices Act that applies to insurance companies, specifically makes unlawful boycott, coercion, and intimidation, but it does not make any other anti-competitive activities unlawful.

COMMISSIONER JACOBSON: Let’s talk about trending for a second. What would be illegal about trending done on a clearinghouse basis, whereas, in other industries, the data that are provided to the analysts are provided without attribution to the company they came from, and there is a single source that is providing data that is available publicly, and available to all members of the group? Would that be illegal?

MR. ANGOFF: Is it done by the industry, or is it done an independent third party?

COMMISSIONER JACOBSON: An independent third party.

MR. ANGOFF: I don’t know. I don’t know the law there as well as I should.

I can just tell you that I would be comfortable arguing that it is a violation of the antitrust laws for insurers, directly or indirectly, to agree on a projection.

COMMISSIONER JACOBSON: That I agree with you on.

I am going to be the one Commissioner not to go over today.

CHAIRPERSON GARZA: Commissioner Warden.

COMMISSIONER WARDEN: Thank you, Madam Chairman.

I will be at least as brief as my friend Commissioner Jacobson.

Let me make comments at the outset.

First, Mr. Zielezienski, I thought, to borrow a phrase from Fox, your statement was "fair and balanced," and I commend you for it.

MR. ZIELEZIENSKI: Thank you.

COMMISSIONER WARDEN: Second, I think that the case made against repeal of the immunity is wholly unpersuasive. The use of loss data and assigned risks, or residual markets, are complete red herrings. I believe not only those things but also all the safe-harbors mentioned by Mr. Zielezienski and the examples in Mr. McRaith's written testimony of desirable and necessary activities would be lawful under the Sherman Act. I am going to come back to trending.

Finally, the uncertainty of litigation is common to all industries. I am very sympathetic to that concern, and I think it should be dealt with by private litigation reform.

The idea that this is a unique market I find wholly unpersuasive. As Commissioner Burchfield pointed out, we entrust, to use your term, Mr. McRaith, the value of these assets to banks, securities firms, and so on. And, with respect to the opening point you made on this, I could reword that to read, "Private jet aircraft are a unique, complex, and personal product that are much different from other industrial products, such as golf carts and self-propelled lawnmowers." I don't think these kinds of arguments prove anything at all.

As to trending, I associate myself with the remarks in question form of Commissioners Jacobson and Burchfield.

My final comment is that I don't think, Commissioner Kempf, that the industries that we are hearing about today were selected by anybody on the basis of who the beneficiaries of their exemptions are.

COMMISSIONER KEMPF: How were they selected?

COMMISSIONER WARDEN: I have no idea, but I cannot believe that was it.

CHAIRPERSON GARZA: Actually, to be clear, since it has been put on the record - and, Commissioner Kempf, I think you are aware of this - we absolutely did make clear that we were conducting hearings on these two industry-wide exemptions so that we could enrich our understanding of the way that immunities and exemptions operate, and the rationales for them and the arguments against them.

It is virtually impossible to do a detailed examination of every single one. What commended these two industries to us were, one, the wide application they have, in the sense of applying to entire industries, and the length of time that we have been living with them, and the fact that they happened to be, today, on the minds of policymakers.

As I indicated at the beginning, McCarran-Ferguson is something that is an active issue before our legislators, who have asked us to advise there on antitrust policy and lawmaking. And, as to the shipping industry - we have circumstances where one of our major trading partners, the EU, and part of the insistence of the U.S. has gone and removed immunity from that industry. And that, again, I think, is going to put pressure on our policy makers to do something.

So it also occurred to us that these two might be of particular interest to the folks to whom we are going to report. But I agree with Commissioner Warden; there was not any kind of focus on who the victims or the beneficiaries were. And I think, from our standpoint, we care about are the consumers, and I think we have made that plain from the beginning, and that continues to be our concern.

And with that, I get to have the last word. That's the only thing that is good about this position; I get to have the last word. The other thing is that I could get mugged when we leave here.

But it is 12:05 p.m. I am going to release our witnesses. Thank you very much, again, for both your written testimony and your oral presentations.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]