



American Insurance Association

1130 Connecticut Ave. NW
Suite 1000
Washington, DC 20036
202-828-7100
Fax 202-293-1219
www.aiadc.org

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Submitted by Email: comments@amc.gov

Antitrust Modernization Commission
Attn: Public Comments
1120 G Street, NW.
Suite 810
Washington, DC 20005

**Re: Request for Public Comment
(May 19, 2005 – Federal Register Vol. 70, No. 96)
Congressionally Provided Antitrust Immunities & Exemptions
McCarran-Ferguson Act Relating to the Business of Insurance**

Introduction

The American Insurance Association (“AIA”) is a trade association representing major property and casualty insurers writing insurance in every state and around the world. The purpose of this letter is for AIA to provide observations about the McCarran-Ferguson Act (“McCarran” or “McCarran-Ferguson”) in response to the request for public comment from the Antitrust Modernization Commission regarding the immunities and exemptions from the federal antitrust laws.

Our comments here are of a summary nature, as we expect you will be receiving many documents outlining the historical context for and a legal review of the antitrust limitations in McCarran. We ask that you contact AIA if you have questions on a particular aspect of the law, as we have given the issue thorough consideration.

Historical Overview¹

Insurance has been extensively regulated by the states since the mid-1800’s. More than sixty years ago, the primacy of state insurance regulation was reaffirmed by Congress when it swiftly enacted the McCarran-Ferguson Act in the wake of the Supreme Court’s 1944 decision in United States v. South-Eastern Underwriters Association.² Prior to this case, the issuance of an

¹ The United States Government Accountability Office, in a March 4, 2005 document, supplied Chairman Oxley of the House Financial Services Committee with an outline of “Legal Principles Defining the Scope of the Federal Antitrust Exemption for Insurance.” See B-304474.

² 322 U.S. 533 (1944).

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insurance policy had been held by the Supreme Court to be a transaction in *intrastate* commerce and that the state, therefore, had the exclusive constitutional authority to regulate the insurance business.

South-Eastern Underwriters reversed that view and held that insurance is an activity subject to the Commerce Clause of the Constitution and thus is subject to Federal antitrust laws. This decision raised widespread concern that the states would no longer be able to effectively tax and regulate insurance.

Within a year of South-Eastern Underwriters, Congress passed the McCarran-Ferguson Act, carving out a limited exception to federal antitrust law for the “business of insurance” to the extent that it was regulated by state law. Thus, McCarran-Ferguson became the modern charter for state regulation. But, McCarran did not dictate to the states the type of regulation that they should establish under their own laws.

McCarran-Ferguson Act - Mechanics

The insurance industry’s exemption under McCarran-Ferguson is narrowly drawn and narrowly interpreted. Under Supreme Court decisions,³ insurance company practices are eligible for the exemption only if each of three separate requirements is met:

- (1) the practices in question must constitute the “business of insurance;”
- (2) those practices must be “regulated by state law;” and
- (3) the practices must not constitute an “agreement to boycott, coerce or intimidate or act of boycott, coercion or intimidation.”

It is important to note as well that even if the above requirements are met, the McCarran Ferguson exemption does not apply to “any agreement to boycott, coerce or intimidate or act of boycott, coercion or intimidation.”

McCarran-Ferguson Act – Power Allocation

McCarran is primarily a power sharing statute whose limited antitrust exemption exists only in order to effectuate the overriding goal of the statute, that of delegating regulatory authority over insurance to the states. McCarran’s limited antitrust exemption is a necessary adjunct to this delegation of regulatory power. It assures state regulators and insurers that insurer conduct authorized and regulated at the state level will not be subject to subsequent challenge under antitrust law at the federal level.

If McCarran-Ferguson did not exist, the federal antitrust laws would preempt state regulation. Actions taken by insurers under those state laws could be – and would be – attacked day in and

³ See Group Life & Health Ins. Co. v. Royal Drug, 440 U.S. 205 (1979), Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982), and St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531 (1978).

⁴ This gets to the heart of the need for the exemption – the benefits are real for consumers, regulators and industry, though perhaps not readily addressable through a standard cost-benefit analysis. This starts an answer for the specific question set forth in (a), “What generally applicable methodology, if any, should Congress use to assess the costs and benefits of immunities and exemptions?”

day out as inconsistent with federal antitrust law, thus placing insurers in the impossible position of being caught between state regulation and federal antitrust review.⁴

McCarran-Ferguson Act - State Regulatory Environment

Just as McCarran does not direct the states as to how insurance should be regulated, it makes no judgment as to the proper treatment of insurance under state antitrust codes. But, states have enacted antitrust prohibitions for insurers as well as applicable Unfair Practices Acts prohibiting action characterized as unfair, deceptive or discriminatory. Under the umbrella of McCarran, states have generally enacted a broad system of regulatory control of insurance, including the imposition of government price controls and the prior approval of policy forms.

McCarran-Ferguson Act – Comparison to Other Financial Services Sectors

McCarran avoids a conflict between the policies behind regulation and the policies behind antitrust in much the same manner as applied to the banking and securities industries. To the extent that insurers act appropriately under a regulatory code, they can not have that activity collaterally attacked by an agency or private citizen bringing an action under federal antitrust law. This is exactly the same principle that applies to federally regulated banks and securities businesses. The only difference is that the banks and securities industries are principally regulated under *federal* regulation, while insurers are principally regulated under *state* regulatory law.

Of course, the insurance industry is the only major industry with a McCarran-type law. But this is because the other equivalent industries – banks and securities – are primarily regulated by the federal government. It is critical that insurance not be placed at a competitive disadvantage as compared to other sectors of the financial services industry that do not exist in an environment permeated by government price and product controls.

It is also important to keep in mind that insurance is an international business. Insurers must be able to provide risk transfer and contractual arrangements that operate transnationally and within the legal and market requirements of all the affected countries. If McCarran were to be changed in any way that might jeopardize the ability of U.S. insurers to meet the global insurance needs of U.S. businesses, it would be extremely harmful to insurers and would impair the ability of U.S. businesses to enter new markets.

State Action Doctrine

The state action doctrine represents a judicial determination that Congress, in enacting the Sherman Act, did not intend for the Act to prohibit states from imposing restraints on competition or from permitting cooperative activity that would otherwise violate Sherman.⁵ Although Congress adopted the Sherman Act as federal policy in interstate commerce, it did not intend to prohibit states from taking an alternative approach, provided that certain conditions are met.

⁵ The state action doctrine has its origins in the case of Parker v. Brown, 317 U.S. 341 (1943), and has been considered in Southern Motor Carriers Rate Conference v. United States, 471 U.S. 48 (1985), and Patrick v. Burget, No 86-1145 (May 16, 1988).

Those conditions constitute the state action doctrine. Where the requirements of the doctrine are met, a state is free to authorize and regulate cooperative activity which otherwise would not be permitted under the Sherman Act.

First, state action requires that the state have a clearly articulated regulatory policy permitting the cooperative activity in question as a substitute for competition. Second, the doctrine requires that the state actively supervise the activity that it has authorized. The state action doctrine is available to the states with respect to every other industry that operates in interstate commerce.

The state action doctrine stems from the notion that the federal antitrust laws should not be read as preventing a state from passing legislation to eliminate competition within its own borders. Only state action which clearly displaces competition qualifies. Under Southern Motor Carriers, that test is met when a state clearly articulates its intent to displace competition in a particular field with a regulatory structure.

Moreover, even if the state's policy is to displace competition, the state action doctrine only provides an antitrust exemption where the state actively enforces that policy. This sounds reasonable enough, on its face, but what it really means is that anyone can bring an action at any time claiming that the state is not doing enough to carry out its law. If the past is any guide, these lawsuits will often be brought by people who do not like what the state agency has done, but see litigation as an easier way to attack that action than more traditional means. The atmosphere of stability that insurance needs would be destroyed. Thus, the state action doctrine is not a viable alternative to McCarran for the application of antitrust principles to the business of insurance.

McCarran-Ferguson Act – Possible Changes

AIA does not believe that a sunset provision for the limited exemption under McCarran would be useful. In fact, it may be dangerous to the extent that there is a possibility for politics to regularly be injected into this area and/or for decisions in this area to be required under the pressure of deadlines.⁶

In 1993-94, AIA engaged in discussions with House Judiciary Chair, Jack Brooks, with regard to possible safe harbor changes to McCarran. The result was H.R. 9, which identified a variety of safe harbors. In the decade since the Brooks proposal, AIA has recognized that changes in McCarran cannot be divorced from overall insurance regulatory reform. For that reason, AIA has been working with the House Financial Services Committee on the draft State Modernization and Regulatory Transparency (SMART) Act. Moreover, AIA, along with others, has supported an optional federal charter (OFC), which provides a market-driven federal regulatory model. In our OFC proposal, we leave McCarran as it is for insurers that choose to remain in the state regulatory system, while at the same time removing McCarran protection for any federally chartered insurers (except to the extent they remain for certain purposes subject to state regulation) when their activities are market regulated and are subject to the enforcement oversight of a federal regulator. Where specific antitrust treatment is necessary, i.e., the development of common policy forms, the bill provides specific safe harbor language.

⁶ This answers the specific question set forth in (c), "Should Congress subject immunities and exemptions to a 'sunset' provision, thereby requiring congressional review and action at regular intervals as a condition of renewal?"

Conclusion

For the reasons discussed above, AIA believes that the emphasis today should be on insurance regulatory reform and not on changes to McCarran. The nature of any reform will determine the extent to which current antitrust principles applicable to insurance should be modified.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Craig A. Berrington". The signature is fluid and cursive, with a long horizontal stroke at the end.

Craig A. Berrington
Senior Vice President
and General Counsel
202 – 828 – 7156