Testimony of

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H.R. 375, the "Competitive Health Insurance Reform Act of 2017"

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The Property Casualty Insurers Association of America (PCI) is pleased to offer testimony on the impact of H.R. 372, the Competitive Health Insurance Reform Act of 2017, which would repeal certain antitrust provisions of the McCarran-Ferguson Act as they apply to health insurers. PCI is the leading property-casualty trade association representing nearly 1,000 insurers, the broadest cross-section of insurers of any national trade association. Our members are leading providers of home, auto and business insurance.

PCI appreciates that the sponsor and cosponsors of H.R. 372 are genuinely concerned about the availability and affordability of health insurance for consumers, and we share their concern. This is an issue that policymakers have been debating for decades. Now that we have a few years' experience with the Affordable Care Act under our belt, it is indeed an appropriate time for Congress and the Administration to take a fresh look at how it has worked and consider whether improvements or other approaches to the problem are in order.

PCI also appreciates that the sponsor of H.R. 372 has taken care to draft the bill to apply to the health insurance industry only and not to the property casualty industry. It is for that reason that PCI has taken no formal position on the bill. Nevertheless, PCI is extremely concerned that enactment of this bill might establish a precedent that could ultimately lead to future consideration of broader legislation that *would* apply to the property casualty industry. The McCarran-Ferguson Act serve a *pro-competitive* and not an anti-competitive purpose, and this is especially true as it applies in the property casualty industry. Thus, *any* proposals to repeal those provisions are worrisome. PCI therefore believes it is critical that the Committee carefully consider the anti-competitive impacts that proposals to repeal the antitrust provisions of McCarran could have on insurance markets and consumers generally, including in both the health and property casualty sectors.

PCI has two broad concerns about H.R. 372. First, while the bill's proponents argue that it is a cure to the availability and affordability problems they see in the health insurance industry, they have mistakenly identified McCarran-Ferguson as a source of those problems. We discuss in more detail below some of those problems and the mistaken connection made to McCarran.

Second, PCI believes that the bill is premised on a misunderstanding of the reason Congress enacted the McCarran-Ferguson Act. While the Act does provide a limited exemption from Federal antitrust laws, insurers are <u>not</u> entirely exempt from the application of Federal antitrust laws, it is not a wholesale exemption. More importantly, insurers are subject to <u>state</u> antitrust laws. Indeed, the intent of Congress in passing McCarran-Ferguson was not to give insurers free reign to engage in anticompetitive activities, but instead to delegate to the states the power to regulate certain competitive issues via state rather than federal antitrust laws along with the power to regulate the business of insurance generally. In so doing, Congress recognized, that state antitrust enforcement is complementary to state insurance regulatory authority. The result is that abuses are not permitted under state insurance law. All states have laws governing rates and insurance conduct, generally prohibiting any rates that are excessive, inadequate, or unfairly discriminatory. In addition, anticompetitive price fixing, bid rigging, and market allocations are generally illegal under state antitrust laws. In the rare event that state regulators should become aware of an insurer engaging in inappropriate activity, they have the power they need under their own antitrust and insurance regulatory authority to deal effectively with such situations. It is for that reason that there is little evidence of such activity in the industry.

Just as Congress intended when it passed McCarran, the state insurance regulatory system has, on balance, performed extremely well and has avoided industry-wide meltdowns such as those that occurred in the savings and loan industry in the 1980s and more recently in the banking industry in the 2008 financial crisis. Indeed, the insurance sector remained strong and well-capitalized throughout the 2008 crisis. PCI therefore questions the wisdom of reversing this delegation of power to the states and transferring power to federal regulators whose record is much less impressive.

McCarran-Ferguson Purpose and Background

The McCarran-Ferguson Act was enacted by Congress in 1945 in response to a Supreme Court decision that preempted state control and governance of insurance. McCarran provides that:

> "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance" (15 U.S.C. 1012(b), 1013(b) (1976)).

A separate provision of the statute then limits certain provisions of the Sherman Act, the Clayton Act, and the Federal Trade Commission Act to the "business of insurance." Thus, McCarran does not give insurers a blanket exemption from antitrust laws – some Federal antitrust jurisdiction remains applicable to insurers. Rather, Congress passed McCarran recognizing that insurance is a local issue with very different regional risks and tort laws, and that the states are better equipped to respond to local competitive needs than the federal government. In addition to state antitrust and insurance law, federal antitrust laws apply to insurers unless:

(1) The activity is the business of insurance,

(2) The activity is regulated by state law, and

(3) The activity does not involve boycott, coercion or intimidation.

Congress had a very good reason for enacting this limited insurer exemption from federal antitrust laws. Insurers must price their products before they know the costs of providing them. One of the many factors that goes into pricing risks is the historical "loss costs" associated with similar risks. Insurers must have a reliable way of projecting those loss costs in order to price their products in a sound manner. McCarran-Ferguson, with its delegation of antitrust supervision of insurers to the states, was enacted to permit the pooling of aggregated historical loss cost data necessary for sound underwriting, residual market mechanisms, risk pools, forms uniformity, and a number of other activities that Congress and the states have agreed *promote* competition and are beneficial to consumers.

Without state-governed loss pooling, smaller insurers, as well as new market entrants of any size, would have too little data to develop actuarially reliable rates, would have to charge consumers an extra risk premium, and would be more prone to insolvency. Research by the Wharton School of the University of Pennsylvania confirmed that repeal of McCarran Ferguson would likely reduce competition, increase the cost of insurance and reduce availability for some high-risk coverages, because the threat of antitrust litigation would make insurers unwilling to engage in efficiency-enhancing cooperative activities.[1]

Many larger insurers, including some PCI members, do not rely heavily on aggregate historical loss costs to support the underwriting of their products because they write enough business to have a statistically significant base of information without need to use industry-wide data. Many of the larger insurers in the health sector may be among them, and we therefore believe that enactment of the bill would not have the impact on health insurance markets that the bill's sponsors are seeking to achieve. However, start-ups and many medium and smaller insurers need such information on an ongoing basis. Even large insurers of any size seeking to enter new states, markets, classes of business, or product lines depend upon industry wide data that is available to them only because of the McCarran limited antitrust exemption. Repealing the McCarran antitrust delegation could affect the marketplace only by imposing a massive barrier to entry for new competition and smaller insurers, raising costs and further reducing choices for consumers. Thus, while PCI believes that the sponsors of H.R. 372 are genuinely seeking to promote competition in the health insurance industry, repealing the antitrust provisions of McCarran could have exactly the opposite effect.

[1] Patricia M. Danzon, the Wharton School of the University of Pennsylvania*, The McCarran Ferguson Act Anticompetitive or Procompetitive?*, Regulation - The Cato Review of Business and Government, 1991.

Misunderstandings About the Impact of McCarran-Ferguson

Proponents of this bill have made a number of statements about the impact of McCarran-Ferguson on insurance markets and insurance consumers that appear to reflect a misunderstanding about why Congress enacted McCarran and how it works.

First, they have suggested that the enactment of McCarran was an "historical error" that has resulted in an "unbridled" antitrust exemption being applied to insurers. On the contrary, Congress made a very deliberate and purposeful decision to delegate to the states the authority to regulate the business of insurance, but that delegation was in no way "unbridled." It applies only to activities that constitute the "business of insurance" and not to any other activities in which insurers engage. That wise decision has worked out just as Congress intended and the result today is a strong, robust and effective state regulatory system that has protected the interests of insurance consumers much more effectively than has too often been the case with federal financial regulators with respect to other parts of the financial services sector.

Second, proponents have suggested that the McCarran antitrust delegation is a barrier to the ability of health insurers to sell insurance across state lines. However, PCI sees no connection between the antitrust delegation in McCarran and the issue of selling health insurance across state lines. Moreover, provisions of McCarran that delegate general regulatory (in addition to some antitrust enforcement) authority to the states are not without limits. In enacting McCarran, Congress reserved the right to apply Federal laws to the business of insurance whenever it wants to. All that is required is that the Congress make it clear that the Federal law applies to insurers. Indeed, Congress has done this many times. For example, Congress expressly applied the Affordable Care Act, the Terrorism Risk Insurance Act, the Dodd-Frank Act and many other federal statutes to insurers. PCI takes no position on whether Federal legislation is necessary to address the issues of selling health insurance across state lines. However, in the event that the Congress determines that it is, McCarran is no obstacle. Congress has the full power to enact whatever legislation it thinks is necessary to address that issue and it can do so without any amendment to McCarran-Ferguson.

Third, proponents have noted that there is a high level of concentration, and thus less competition than there might be, in the health insurance industry. They are not alone in expressing that concern. However, they then suggest that the McCarran antitrust provision is the cause and that repealing it will cure the problem and increase competition. PCI knows of no support for this proposition.

The commonly accepted measure of market concentration is the Herfindahl-Hirschman Index (HHI), which is utilized by the Justice Department and the Federal Trade Commission. Markets in which the HHI is between 1000 and 1800 points are considered to be moderately concentrated and those exceeding 1800 are highly concentrated. For 2015, the HHI for the property casualty industry calculated on an individual company basis was 75.2. When calculated on a group basis it was 290.8. By either measure, the level of concentration in the property casualty sector of the industry is <u>extremely</u> low and the sector is <u>highly</u> competitive. While PCI does not have data on HHI concentration measures in the health industry, the dominance of large major companies in the sector would appear to suggest higher concentration levels than in the property casualty industry. However, the McCarran antitrust provision applies to *all* sectors of the insurance industry. So if McCarran were the cause of concentration in the health insurance industry, we would expect it to have the same effect in all other sectors as well. Clearly it does not, which demonstrates that, whatever the causes of higher concentration levels in the health insurance industry may be, McCarran is not one of them.

It is also worth noting that McCarran provides no obstacle to federal review of proposed mergers and acquisitions in the insurance industry. Indeed, just last year, the Department of Justice filed suit to block the proposed merger of Aetna and Humana, , last month a Federal court sided with DOJ, and earlier this week the parties called the transaction off. States also review these transactions under their own antitrust laws. While reasonable people may disagree on the outcome of the antitrust review of any particular merger or acquisition, there is no evidence that McCarran-Ferguson poses any impediment to such reviews at either the Federal or state level. To the extent concentration in the health insurance industry is a concern, Congress cannot effectively address that concern if it misidentifies the cause.

Fourth, proponents have suggested that the limited McCarran antitrust exemption as applied to insurers results in vastly different rules being applied to insurers than to all other businesses. In fact, the practical effect of the exemption is not at all different from the way in which the courts have applied Federal antitrust laws to other industries. With respect to other industries, courts have sometimes ruled that certain activities that might otherwise be found to violate Federal antitrust laws can nevertheless be permissible if they have pro-competitive effects. The McCarran antitrust provision is unusual only in that the decision to protect pro-competitive activities was made by Congress rather than the courts. Some have suggested that, if the limited McCarran exemption from Federal antitrust laws were repealed, courts might follow the example they have set in some other industries and fashion safe harbors to accomplish the same pro-competitive objective the Congress did in enacting McCarran. While this is possible in theory, it would take many years of expensive litigation for the law in this area to settle, and with no guarantee that the courts would ultimately get it right. In the meantime, the pro-competitive activities made possible by McCarran would become prohibited, forcing smaller players to leave the market and increasing market concentration – just the problem the bill's proponents say they are trying to solve.

Conclusion

The Congress is justifiably concerned about the cost of health care and health insurance, and we share that concern. However, repealing any provision of the McCarran-Ferguson Act in a way that could threaten pro-competitive activities and serve as a barrier to new entrants in the market would not solve problems of availability, affordability, and consumer choice. We therefore ask that Congress take care not to mid-identity the McCarran-Ferguson Act as the cause of current problems in the health insurance market, and in particular, to recognize the competitive benefits that McCarran has particularly in the property casualty market.