

CIVIL JUSTICE PRESIDENTIAL PLATFORM

Insurance Industry Reform

The Problem: An Under-regulated Industry Harms Insurance Policyholders

Responsible citizens who invest in insurance should be able to expect it to help them if it ever becomes necessary. Insurance companies do an excellent job of collecting policyholders' premiums, but in the wake of recent natural disasters like Hurricanes Katrina and Rita, it has become clear that these companies are often reluctant to meet the corresponding task of paying policyholders when the unexpected happens. Aggrieved policyholders can always take these companies to court, but as long as the insurance industry is shielded from federal anti-trust laws, profits from bad faith business practices will outweigh the costs of related lawsuits, and insurance companies will have little incentive to change.

Lawsuits to force the payment of a claim require additional time, very frequently measured in years, during which the plaintiff must grapple with the consequences of having a damaged home or automobile or an unpaid medical bill, but during which insurance companies lose little. Insurance companies are not forced to find a way to make "ends meet" while waiting for a claim; they continue to charge and collect premiums from the very policyholder whose claim they have denied; and they make an additional profit from interest earned each day that they are able to hang onto a claimant's money during the period of litigation. In short, **there is little consequence for insurance companies that deny legitimate claims for the sole purpose of attempting to avoid their contractually obligated payment to the policyholder.**

In the backdrop of often egregious treatment of policyholders is the federal law that gives **the insurance industry some of the most preferential treatment by the federal government of all American industries.** In 1945, Congress passed the McCarran-Ferguson Act, a law giving the insurance industry a special exemption (shared only with Major League Baseball) from federal anti-trust laws and giving each state the role of regulating the industry within its borders. The stated goal of the McCarran-Ferguson exemption was to allow the insurance industry to collaborate for data collection and other purposes. But in effect, it allows monopolistic collusion and price-fixing of insurance premiums and prohibits the federal government from applying its anti-trust regulations to the industry, with a few extreme exceptions.(1)

Accompanying this legislatively granted advantage has been the shift in the "management and claims" process of many insurance companies. **Insurance companies have increasingly adopted sophisticated claims processes that are not geared towards fair dispute and resolution of claims,** but instead direct staff to reject enough claims for the insurance company to reach a given profit goal.(2) **The tactic is especially effective in deterring small claims,** because defensive litigation and stalling by insurance companies makes pursuing small claims prohibitively expensive as the lawsuit itself can cost more than the actual claim.(3)

The result has been **a pattern and practice of bad faith claim denials,** concomitant with **record industry profits** nationally.(4) A recent six-part series from CNN documents this practice across insurance areas.(5) News articles feature tragic stories of individuals who were denied claims, or offered severely inadequate payment, for damages they were led to believe their insurance policies would cover. For instance, State Farm offered one couple 0.5 percent of the value of their Hurricane Katrina-ravaged home, which was valued at over \$1 million; and Nationwide offered another homeowner \$515.62 for his \$230,000 home which "virtually every

insurance adjuster and engineer who inspected the scene” concluded was destroyed by wind damage covered under his policy.(6)

Even in the wake of the massive destruction of homes resulting from Hurricane Katrina, property casualty insurance companies have enjoyed excessively high, record-breaking profits.(7) Just after the hurricane, insurance CEO William Berkley spoke at a conference, saying:

“our loss will leave us with enough capital to really thrive in the market opportunity that’s going to follow... We think there’s a lot of profitability left in the cycle, and we think that the hurricane will in fact extend that.”(8) (Emphasis added)

His assessment that the property/casualty insurance industry was going to “thrive” as a result of Katrina devastation was correct. In 2005, property-casualty insurance industry profits reached \$49 billion. In 2006, those profits rose an additional 49 percent, to \$73 billion. In 2007, Robert Hartwig, chief economist at the Insurance Industry Institute, a trade group for insurers, said: “The insurance industry can be justifiably proud of its performance. It’s in the insurance industry’s best interests to settle claims as fairly and as rapidly as possible.”(9)

Upon close examination, the only incentive for insurance companies to pay legitimate claims when they are initially filed is a moral one. While insurance companies may argue that there is a competitive incentive to practice business in good faith, this argument is particularly hollow given the industry’s almost singular exemption from federal anti-trust law, which permits them to legally collude in setting prices, increasing premiums, and resolving claims in bad faith without fear of recourse. As a result, **insurance companies have little incentive to resolve legitimate claims quickly or fairly.**

To explain its consistently skyrocketing premiums, many in the insurance industry have resorted to blaming lawsuits and lawyers for increasing insurance premiums. The use of lawsuits and plaintiffs-lawyers as scapegoats is not merely an attempt to detract attention from the insurance industry, it is also an attempt to justify tort “reforms” that limit access to the courts to victims of insurance companies’ unfair claim denials. But access to the civil justice system is often the only or last safeguard for citizens to hold insurance companies to the terms of their policies. Rather than buy into tort “reform” rhetoric which would further shield unscrupulous insurance companies by reducing the limited recourse policyholders currently enjoy, the next President should support and promote legislation that focuses on curbing bad faith behavior in the industry. Doing so will increase the efficiency of the civil justice system by reducing the number of aggrieved policyholders, and thus reducing policyholders need to ever step foot in a courtroom.

Policy Proposal: Repeal McCarran-Ferguson Exemptions

Our next President should support legislation to repeal McCarran-Ferguson exemptions in order to create a uniform system of oversight, encourage competition, and discourage bad-faith business practices in the industry. To do this, he or she should urge Congress to pass the **bi-partisan Insurance Industry Competition Act of 2007**, which would give the Department of Justice and the Federal Trade Commission the authority to apply antitrust laws to anti-competitive behavior by insurance companies, just as it does for other industries.(10)

In 2005, several U.S. Senators introduced The Medical Malpractice Insurance Antitrust Act of 2005, which focused on curbing the industry’s practice of overcharging doctors “unconscionably” and “shifting the blame for their increases on to lawyers and victims.” The legislation, which called for federal oversight of the medical insurance industry, would have been a limited but effective step in the right direction towards increasing accountability among insurance companies.(11) The bill did not pass.

In February 2007, Senator Leahy and others initiated another, more comprehensive effort to hold insurance companies accountable under anti-trust laws. This bi-partisan push for The Insurance Industry Competition Act of 2007 would apply national anti-trust rules to the entire insurance industry, not just the medical insurance sector.(12) The law would require insurance companies to abide by the same competition laws as every other industry. According to bill sponsor Senator Patrick Leahy:

Federal oversight would provide confidence that the industry is not engaging in the most egregious forms of anticompetitive conduct – price fixing, agreements not to pay, and market allocations... Insurers may object to being subject to the same antitrust laws as everyone else, but if they are operating in an honest and appropriate way, they should have nothing to fear. American consumers and American businesses rely on insurance – it is a vital part of our economy – and they have the right to be confident that the cost of their insurance, and the decisions by their insurance carriers about which claims will be paid, reflect competitive market conditions, not collusive behavior.(13)

This bill will have a positive impact on individual consumers by increasing their confidence that insurance claims are being processed fairly. Introduced after homeowners affected by Hurricanes Katrina and Rita spoke out and increased public scrutiny of the insurance industry, this bill would apply federal anti trust laws to the insurance industry, and thus create incentive for insurance companies to practice business in good faith. Civil penalties for bad faith practices like price fixing, agreements not to pay, and market allocations, as well as an increase in competition among companies for satisfied customers, will make it more expensive for insurance companies to delay or deny claims than to handle claims efficiently and based on their merits. Simply put, this bill evens the playing field by treating the insurance industry the same as other industries and by giving consumers confidence in the way insurance claims are processed.

The nature of the insurance industry, which sells a product people are often required to purchase to engage in basic, every-day activities like driving or contracting to build a home, makes Americans particularly vulnerable to monopolistic behavior under the McCarran Ferguson Act. Improving regulation of the insurance industry will directly benefit Americans, their families, and their businesses. It will also increase competition within the industry. As competition grows, consumers will enjoy more competitive prices and selection. This increase in market competition will in turn promote a stronger, healthier economy. Because Presidential leadership on this front will benefit the American economy as well as Americans from all walks of life, the next President should support and urge Congress to pass this bill.

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(1) See Testimony of J. Robert Hunter, Director of Insurance, Consumer Federation of America, Committee on the Judiciary of the United States Senate, McCarran-Ferguson Act: Implications of

Repealing the Insurers' Antitrust Exemption; exceptions include extreme collusive actions surpassing price-fixing such as "intimidation."

(2) The Center for Justice and Democracy, The Insurance Industry's Troubling Response to Katrina, available at www.centerjd.org/air/pr/KATRINAREPORT.pdf; The Center for Justice and Democracy, Insurance Companies Raking in Huge Profits, available at <http://centerjd.org/air/pr/AIRProfit.pdf>.

(3) The Center for Justice and Democracy, The Insurance Industry's Troubling Response to Katrina, available at www.centerjd.org/air/pr/KATRINAREPORT.pdf.

(4) The Center for Justice and Democracy, Insurance Companies Raking in Huge Profits, available at <http://centerjd.org/air/pr/AIRProfit.pdf>.

(5) CNN Presents: The Town That Fought Back (vols. 1-5)

(6) David Dietz and Darrell Preston, "Home Insurers' Secret Tactics Cheat Fire Victims, Hike Profits" (BLOOMBERG PRESS Aug 3, 2007), available at <http://www.bloomberg.com/apps/news?pid=20601170&refer=home&sid=aIOpZROwhvNI>.

(7) The Center for Justice and Democracy, The Insurance Industry's Troubling Response to Katrina, available at www.centerjd.org/air/pr/KATRINAREPORT.pdf

(8) William Berkeley, CEO of Greenwich, Connecticut-based specialty insurer W.R. Berkeley Corp., 9.07/05 Insurance Industry Conference (Emphasis added)

(9) (David Dietz and Darrell Preston, "Home Insurers' Secret Tactics Cheat Fire Victims, Hike Profits,"supra.

(10) S. 618, The Insurance Industry Competition Act (2007). Introduced by Sens. Leahy, Arlen Specter (R-Pa.), Senate Majority Leader Harry Reid, (D-Nev.), and Senate Republican Whip Trent Lott, (R-Miss.).

(11) S. 1525, Introduced by Sens. Leahy, Kennedy, Durbin, Rockefeller, Boxer, Feingold, Salazar, Obama, and Mikulski.

(12) S. 618, The Insurance Industry Competition Act (2007). Introduced by Sens. Leahy, Arlen Specter (R-Pa.), Senate Majority Leader Harry Reid, (D-Nev.), and Senate Republican Whip Trent Lott, (R-Miss.).

(13) Office of Sen. Patrick Leahy, "Leahy Leads Bi-partisan effort to hold insurers accountable under the anti-trust laws," Press Statement, available at <http://leahy.senate.gov/press/200702/021507c.html>