Insurance Regulation in the United States: Can’t it be Less Complicated?

By Heidi A. Lawson

I. Introduction

Insurance regulation in the United States is carried out on a state by state basis. Insurance is not regulated by the federal government. The result is a very complex insurance regulatory regime. Not only is an insurer doing business in fifty states subject to fifty sets of state insurance laws, that insurer is subject to fifty *different* sets of state insurance laws. Obtaining authorisation to sell insurance in the United States is, therefore, both difficult and time consuming due to the complexity of varying state requirements. But is all this complexity necessary? The purpose of this article is to explain the basis for state regulation and provide insight as to why state insurance regulation, as complex as it is, might not be an unreasonable approach.

II. The Historical Regulatory Regime

It is important to have a basic understanding of insurance regulation’s history in order to appreciate why state regulation exists. One of the prominent issues frequently debated in the United States is whether insurance should be regulated by the federal government, the state governments, or by a two-tiered system. This “federal-versus-state” issue has been around for more than one hundred years and is still active today.

The first major federal-versus-state debate occurred in 1869, in the case of *Paul v. Virginia*, argued before the United States Supreme Court *(Samuel B. Paul v. Commonwealth of Virginia*, S.C., 8 Wall., 168-185 (1869)). Samuel Paul wanted to become a licensed insurance agent in his home state of Virginia but also wanted to represent New York insurers. Paul's license was denied in Virginia because the insurers he wanted to represent had not deposited a bond with the Virginia state treasurer. Paul was convicted of selling insurance without a license. Appearing before the Supreme Court to appeal his Virginia conviction, Paul argued that insurance was interstate commerce and only Congress (the federal government) could regulate interstate commerce. The Supreme Court disagreed, holding that insurance was a contract that was delivered locally and was, therefore, not interstate commerce. Insurance was, in other words, a business to be regulated by the states.

After *Paul v. Virginia*, states continued to regulate insurance on an ad hoc basis. As a problem arose in a particular state’s insurance market, the state legislature enacted legislation intended to correct the problem. Because insurance was not subject to federal law, each state arrived at its own unique solutions. Patchwork state regulation continued until the next major federal-versus-state battle was fought in the *South-Eastern Underwriters Association* case in 1944. (*United States v. South-Eastern Underwriters Association, et al.*, 322 U.S. 533 (1944)). In *South-Eastern Underwriters*, criminal indictments were brought against South-Eastern Underwriters for, among other things, controlling 90% of the fire and allied lines insurance market, fixing premium rates and using coercion to force non-members to comply with the South-Eastern Underwriters' rules. Despite the *Paul v. Virginia* decision, the United States Supreme Court, much to the surprise of the insurance industry, determined that federal antitrust laws applied to insurance:

> *No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory powers of Congress under the Commerce Clause. We cannot make an exception for the business of insurance.*

The *South-Eastern Underwriters* decision caused insurance companies to become extremely concerned because much of their business (e.g., sharing information for the purpose of developing rates and underwriting criteria) would likely be in violation of the federal antitrust laws. Because insurance was previously determined not to be interstate commerce, insurance companies developed their business practices based on state law. The *South-Eastern Underwriters* decision meant that federal law, anti-trust law in particular, was now applicable to their business.

In response to the *South-Eastern Underwriters* decision, United States Congress passed the *McCarran-Ferguson Act*, 15 U.S.C. §§1011, et seq. (1945), which, subject to certain restrictions, returned the regulation of the "business of insurance" to the states. The *McCarran-Ferguson Act* states in relevant part:

> *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.*

In the United States, federal law normally pre-empts state law. In contrast, the *McCarran-Ferguson Act* allows state insurance regulation to preempt federal law when it comes to the "business of insurance," thereby allowing state regulation to continue. As long as states regulate "the business of insurance" (defined in subsequent cases to include setting rates, underwriting, selling and protecting policyholders), then federal law does not apply.

Following the enactment of the *McCarran-Ferguson Act*, states quickly passed laws to make sure the insurers in their state would continue to be subject to state regulation. Since the enactment of the *McCarran-Ferguson Act*, each state has continued to develop its own set of insurance laws, regulations, and rules. State insurance regulators impose these on insurance activities in their states. Thus, an insurer doing business in fifty states is subject to fifty sets of state insurance laws.

III. The Challenges of State Insurance Regulation

The primary and obvious complaint about state insurance regulation is that the various states laws are not uniform and the regulatory requirements differ from state to state. For example, an insurance company seeking to get licensed in all fifty states has fifty sets of licensing requirements to comply with. While some of those requirements are similar, or sometimes identical, fifty applications of some type still must be submitted. Depending upon the state, particular kinds of policy rates and contract forms must be approved. There may also be requirements that certain coverage provisions must be included in certain contracts of insurance. For example, if an insurer offers health insurance, that insurer might be required to cover immunization costs in the health insurance policy sold in a particular state.

The variations that exist from state to state impede an insurer's ability to do business. Thus, the more uniformity that can be reached among states, the easier it is for an insurer to compete effectively. In response to the insurance industry's desire to achieve uniformity among the states, the National Insurance Convention ("NIC") was formed and their first meeting was held in 1871. By the 1930s, the NIC eventually became the National Association of Insurance Commissioners ("NAIC"), an organization that still exists today (www.naic.org).

In the early years of the NAIC, states often chose to enact their own insurance laws despite the NAIC's efforts to achieve uniformity. However, the NAIC's influence over the uniformity of state insurance laws increased with the passage of the *McCarran-Ferguson Act*. The threat of federal intervention helped to cultivate a spirit of cooperation among state insurance regulators. States started to become more likely to enact legislation that essentially followed the NAIC's recommendations, which were in the form of model laws or model regulations. For example, shortly after the *McCarran-Ferguson Act* was enacted, the NAIC developed its Unfair Trade Practices Model Act, which regulates the sale and claim settlement practices of insurers. The model was approved by the NAIC in 1947, and by 1949 most states had enacted the NAIC model or a substantially similar version.

IV. The Benefits of State Insurance Regulation

While there are many disadvantages to state insurance regulation, there are a few significant benefits that few appreciate. Most insurance lawyers and businesses in the United States don't necessarily understand the uniqueness of each state and the particular insurance issues related thereto. However, the United States is very diverse in geography and insurance needs. Insurance availability and affordability is directly related to public welfare. This is particularly true, at least in part, because the United States lacks a national healthcare system and other social welfare protections that might be available in other countries. Thus, the Availability and affordability of adequate health insurance, personal insurance and even commercial insurance, is very important to United States citizens.

Given the size and diversity of the United States, state governments are arguably best suited to address public welfare issues, like insurance. States that might be geographically close together, can have completely different insurance needs. For example, it takes a little over three hours driving time to get from New York to New Hampshire. The insurance related issues and needs, however, in those two states are vastly different. New York, for example, has a tremendous amount of commercial business. There are thousands of doctors and hundreds of medical clinics and hospitals to choose from. There are thousands of insurance companies doing business in New York, making rates and terms competitive.

In contrast, New Hampshire is a rural state with a lot of family owned businesses and sole proprietorships. In northern New Hampshire, there is one hospital, two medical clinics and only a handful of doctors to choose from, effectively creating a monopoly. There are only a handful of insurance companies doing business in New Hampshire because there is not a large population. As a result, competitive rates and terms are almost non existent.

While New Hampshire and New York have some similarities in their insurance laws, the needs of their citizens and their approach to regulation is in many ways very different. New Hampshire, for example, may be very concerned with making sure that insurers who offer health insurance in their state, are offering coverage to those citizens in northern New Hampshire at a reasonable price. Do the officers and directors of that insurance company understand and appreciate the unique problems with offering coverage in New Hampshire? How is that company going to market and price their products? Is there a way to control costs? Without the New Hampshire Insurance Department closely monitoring the terms and rates of health insurers in their state, those living in northern New Hampshire would likely not be able to buy health insurance, at any price.

V. Will There Ever Be A Single Insurance Regulator?

Due to the complexity of state regulation and the expense involved in complying with the varying regulations, companies are very supportive of a single regulatory regime, i.e., federal regulation of insurance. Because the cost and time involved in complying with the requirements of fifty states, effectively creating a commercial disadvantage in a global marketplace, there is renewed pressure to increase that spirit of cooperation and achieve uniformity. In the current regulatory climate, the influence of the NAIC on the uniformity of state insurance laws continues to increase. As insurance market problems appear, state insurance regulators from all states try to work together through the NAIC to address them. This cooperation often results in the drafting and promulgation of NAIC Model Acts designed to achieve relative uniformity among the states.

In recent years there has been additional pressure to increase uniformity. The popularity of the Internet spotlighted how outdated state regulation is, since the Internet does not have any geographical boundaries. The passage of the *Gramm-Leach-Bliley Act*, 15 U.S.C. §§ 6801-6827 (1999), provided a layer of federal law pertaining to the insurance industry's ability to affiliate with other financial sectors such as banking and securities. The *Gramm-Leach-Bliley Act* also covered privacy requirements and uniformity among states for insurance producer's licenses.

The practical implications of federal insurance regulation, however, has its limits. While licensing of companies and brokers might ultimately be achieved through a single federal system, the regulation of market conduct and coverage terms arguably will not, at least for some kinds of insurance. Would a single federal regulator be able to monitor and address the insurance needs of citizens in northern New Hampshire? And simutaneously effectively understand and address what the commercial insurance needs are in New York? Would they have the resources and expertise to understand the local needs? Can public welfare be compromised for the sake of uniformity? Probably not. While state regulation is complex, when it comes to public welfare, it is at least, in part, justified. As a result, state insurance regulation is likely to continue to exist in some form. Only time will tell whether insurance regulation in the United States can be less complicated.

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