AN HISTORICAL AND ECONOMIC ANALYSIS OF INSURANCE REGULATION IN THE UNITED STATES AND VIRGINIA

by

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I. INTRODUCTION

This thesis is divided into several parts. It begins with a summary of the history of insurance regulation in the United States and the historical relationships between the state and federal governments with respect to insurance regulation. Special attention has been given the relationship between the insurance industry, the state regulator and state regulatory legislation. It then presents a summary of insurance regulation history, both legislative and institutional, in Virginia using the same approach. Next, a brief empirical section is included in which several aspects of the operational performance of the Virginia Bureau of Insurance are analyzed. Finally, a comparison of insurance regulatory agencies among the states and of the methods and purposes of current rate regulation is briefly outlined. Thus, the purpose of this thesis is, first, to provide a historical perspective of some of the factors which have affected the development of insurance regulation. Second, this thesis provides a brief empirical evaluation concerning the operating performance of the Virginia Bureau of Insurance.

II. INSURANCE REGULATION IN THE UNITED STATES: AN OVERVIEW

Early Insurance Regulation

Before the Revolutionary War insurance was almost totally carried on by individual underwriters. Eventually, many of these single agents joined together to form mutual associations for the obvious reasons of pooling underwriting information and spreading losses. Also, a few mutual companies appeared during this period.[1] After the Revolutionary War several states allowed the formation of some stock companies through special charters. The licensing of individual underwriters by some states and chartering became the first forms of regulation. These methods were used to obtain information considered valuable in ascertaining the integrity and stability of the insurer.

By 1810 numerous states had granted charters generally containing similar requirements for keeping liquid assets on deposit for losses and reserves on deposit in state banks or treasuries for insolvency.[2]

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[1] Lester W. Zartman and William Price (eds.), Yale Readings in Insurance (Hartford: Yale University Press, 1923) p. 77

[2] Edwin W. Patterson, The Insurance Commissioner In America (Cambridge, Mass: Harvard University Press, 1927), p. 524-527.

By the 1830's the use of charters as a method of formation and regulation quickly declined with the development of incorporation legislation and use. This development was of particular significance in that it provided a structural form for the centralization and development of the business of insurance which facilitated regulation.

In those early days of regulation states did tax insurance premiums and company stock. Taxation as such also became an important means of obtaining information as to the insurer's financial condition and set a precedent for future informational requests. It also seems to have established the states in a traditional position as sole taxers of insurance activity.[3]

As insurance became more institutionalized and widespread in use pressures mounted for effective regulation. The small policy holders were reportedly at a disadvantage and beckoned for relief as abuses increased.[4] Supposedly, there was a lack of financial or legal guarantee that losses would be paid on time or in the case of insolvencies at all. Insurers are said to have formulated policies to escape liability and to protect their interests. In general the doctrine of caveat emptor appeared to be the rule.[5] Thus with the spread of

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[3] Ibid., p. 529.

[4] Ibid.,

[5] Hugh F. Fegan, "Recent Tendencies In Insurance Laws," Virginia Law Review, XV (March, 1929), p. 421.

insurance among the classes of moderate means following the Civil War, a flood of insurance regulation appeared for the purpose of protecting the insured against fraudulent and incompetent agents and companies. Another factor which led to the regulation of insurance was taxation. Effective taxation often necessitated a full financial report from insurance companies. Initially, then, many states came to require periodic financial reports and policy form filings.

Concurrent with the reporting was a growing sentiment among insurers for action in concert to protect themselves from the supposed "vagaries of competition". In reference to the insurance industry this development has been characterized as follows:

> " The existence of the evils attending inter-company conflicts, the penalties for which are levied on the insuring public as well as on themselves, has been recognized from the beginning of these conflicts, and has resulted in an almost uninterrupted history of attempts to control competition." [6]

Prior to and around 1850 fire insurance was allegedly in a depressed state and characterized by numerous insolvencies. Unrestricted entry conditions and excessive competition were held as major contributing causes. However, it seems highly unlikely business conditions were this bad. There were a

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[6]William H. Wandel, The Control of Competition In Fire Insurance (Lancaster, Pa.: By the Author, 1935), p. 15.

number of insolvencies and a moderately depressed state of business probably due to the immaturity of the insurance business. The causes, some propose, were more likely unsound financial practices, the lack of sophisticated statistical or scientific methods for determining the necessary level of reserves to insurce solvency, large unexpected losses, and a rapidly increasing incidence of fraud fires and incendiarism.[7] According to one student of insurance history, initially low loss ratios and large profits lured new and often incompetent companies with the hope of fast riches. Insurance companies were easy to start, as very little capital and equipment were necessary. Thus a new company, not setting up sufficient reserves, could enjoy the illusion of big profits even though the business was potentially insolvent. The lag between premium payments and claim payments meant that income could be greater than outflow as long as the business was expanding. Consequently, conflagration losses, insufficient reserves and competitively low premium rates drove incompetent companies out of business.

Local cartels were formed as early as 1819 to control price competition. By 1850 a compact system had become fairly well established though less than successful as rate

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[7]Alden L. Todd, A Spark Lighted In Portland (New York: McGraw-Hill Book Company, 1966), p. 74.

cutting or cheating continued.[8] In 1866 the newly formed National Bureau of Fire Underwriters had some very limited success in organizing fire insurers nationally in an effort to control price competition. The compact system became a veritable success at least at the local level by the 1880's, finally. Several factors are held responsible for this eventual success. The failures and large losses due to the Boston and Chicago fires of 1870-71 provided some of the impetus.[9] Further impetus to collude to control price competition, it is held, came about from insurer unhappiness over increasing expenses in the form of increased agents' commissions (an effect of competition for more customers), increasing losses, and low premium rates which squeezed their profits.[10] Also insurers reportedly became aware of the benefits of centrally collecting data on the expense and loss experience of many insurers to more economically and safely determine rates. The system provided for the making and maintainance of uniform rates by local compact managers under the jurisdiction of regional company associations. Effective methods of enforcing the cartel also began to be developed. These consisted of penalties and exclusion policies towards

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[8]U.S. Congress, Senate, Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, Hearings on the Insurance Industry, 86th Cong., 1960, p. 4360. Cited hereafter as Senate Subcommittee on Antitrust and Monopoly, Insurance Hearings, 1960.

[9]Wandel, Control of Competition, p. 51.

[10]Alden, A Spark Lighted in Portland, p. 51.

non-members. Valuable informational, reinsurance, and producer services were witheld from them.[11]

Meanwhile, strong public hostility toward big business and high finance had emerged. Not surprisingly some attention focused on insurance company practices. Many policyholders felt, though realizing their vital interest in insurer solvency, that collusion precluded lower rates and better service and that reserve requirements and stock assessments were adequate measures to avoid insolvency.[12] Beginning in 1885 many states enacted anticompact legislation. These laws were directed at prohibiting membership in associations which fixed premium rates. Generally, however, these laws were easily circumvented (eg. through secret meeting) or otherwise not uniformly enforced among the states. Consequently, free and open competition was not restored.[13]

From 1850 to 1900 we had a period of increased awareness on the part of the states of the need for more sophisticated regulation. The failure of periodic reporting, the increased number of insurance lines offered, and the great complexity and abuse of insurance contracts were responsible.[14]

In the early days of limited regulation usually some

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[11] Irvin M. Stelzer, "The Insurance Industry and the Antitrust Laws: A Decade of Experience," The Insurance Law Journal, No. 386 (March, 1955), pp. 149-50.

[12] Kimball, Insurance and Public Policy, p. 180.

[13] Wandel, Control of Competition, p. 31.

[14] Patterson, The Insurance Commissioner, p. 533.

state fiscal officer was responsible for insurance laws and regulation. Usually, his job as insurance supervisor was not one of his important duties. With the voluminous growth and increasing complexity of insurance, this type of administration was unsatisfactory. These officials were generally unable to handle the growing abuses. It became evident to the states that a full time insurance expert and staff were needed. The Paul vs. Virginia case sustaining the states' right to regulate insurance led to many states establishing insurance laws and departments.[15] By 1890 authorities were supervising insurance in seventeen states.[16]

The crux of the commissioner's power came to be his authority to revoke or refuse licenses to insurance companies. Though seldom exercised, this power was used as a lever of coercion over companies. While at first mainly ministerial, the commissioner's duties expanded through legislation increasing informational requirements and giving insurance departments examination and visitorial powers.[17] By 1930, generally speaking, the scope of many commissioner's authority had grown to where his responsibility concerning insurer stability and solvency led to increased surveillance over

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[15]C. Arthur Williams, Jr. and Richard M. Heins, Risk Management and Insurance (New York: McGraw-Hill Book Company, 1964), p. 583.

[16]Robert I. Mehr and Emerson Commack, Principles of Insurance (Homewood, Illinois: Richard D. Irwin, Inc., 1966), p. 933.

[17]Patterson, The Insurance Commissioner, p. 337.

such business decisions as reserve levels, valuation of assets, investment policy, consolidation, reinsurance and changes in capitalization.[18]

Beginnings of State vs. Federal Controversy Over the Authority to Regulate Insurance

Supervision of the insurance business had begun and in its infancy developed at the state level. By the end of the Civil War, however, an active debate had developed as to whether insurance should be regulated by the states or federal government. The insurance industry at this time advocated replacement of state with federal regulation. With the expansion of insurance business across state borders, regulations by the various states had become grossly uneven, burdensome, and even unconstitutional. Industry members pointed out the numerous instances where foreign and alien insurers were subject to more stringent regulations and generally higher reserve requirements than domestic companies. Though perhaps these burdens and inequities were real enough, it has been held that industry proponents were most likely seeking federal regulation because it would at this time be weaker or at least less restrictive to expansion of business than state regulation. On the other hand, the states fearing

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[18] Spencer L. Kimball and Herbert S. Denenberg, (eds.), Insurance, Government and Social Policy (Homewood, Illinois: Richard D. Irwin, Inc., 1969), pp. 131-32.

encroachment of their authority to regulate and prerogative to tax insurance were naturally opposed to an imposition federal regulation. Also the states held that in fact (at least at this time) the existence of more stringent laws and requirements for non-domestic insurers was justified due to the jurisdictional limitations of regulation where the state regulator had no recourse against an insolvent or otherwise violating company incorporated in another state.[19]

Several attempts were made by the industry to secure federal control through legislation. In 1865 some industry people urged Congress to pass the National Incorporation Act which they had drawn up. This act was designed to make insurance businesses, institutions similar to banks. Nothing came of this and similar attempts at such legislation, however.[20] The case of Paul vs. Virginia was an effort of several fire companies to get a ruling from the courts that insurance was interstate commerce. Their intent and belief was that such a ruling would bring federal control and also make insurance not subject to what they considered was onerous state control. Eventually, however, the Supreme Court upheld the Virginia court's ruling that insurance transactions were not interstate commerce and confirmed the states' primacy

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[19] U.S., Congress, Senate, Subcommittee of the Committee on the Judiciary, Joint Hearing on Insurance, 78th Cong., 1st Sess., 1943, Part 3, p. 254.

[20] C. A. Kulp and John W. Hall, Casualty Insurance (New York: Ronald Press Co., 1968), p. 961.

in insurance regulation. This decision set a precedent relied on for many years to turn back other attacks on state regulation.[21]

The investigations of the Armstrong Commission of New York in 1905-06 marked an important step in the development of insurance regulation. The recommendations of this commission, especially those concerning uniform policies, were adopted by many states.[22]

Insurance Regulation 1900 - 1945

The first use of rate regulation occured in Kansas in 1909. The state insurance commissioner ordered a blanket reduction in fire insurance rates. Intense industry opposition was encountered. However, this method of regulation was upheld as constitutional by the Supreme Court in 1914. In an important pronouncement the Supreme Court declared that the business of insurance was sufficiently affected with the public interest to justify state regulation even of this form. This decision set a precedent for similar cases concerning state rate regulation.[23]

In 1911 concern over collusive activity led to the creation of the Merritt Committee of New York which investi-

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[21] Ibid., p. 960.

[22] Mehr and Commack, Principles, p. 935.

[23] German Alliance Insurance Company vs. Lewis, 233 U.S. 389, 416 (1914).

gated state regulation. The committee contended that anti-compact legislation was a failure because it had encouraged unrestricted competition and rate wars which dangerously lowered the protection afforded insureds. In any event, the anticompact laws were said to be easily evaded. The committee also claimed that rate wars still existed to some degree and in regards to open competition had this to say:

> " The universal effect ... of open competition ... has been cutting of rates ... below the actual cost of the indemnity. The rate wars ... meant ... the dissolution of the smaller and weaker companies. The effect on all companies is weakening. The policy holder, to be sure gets his insurance very cheaply; too cheaply, for the weakening of the companies is not in the long run and on the whole an economic good." [24]

The committee consequently noted the desirability of basing rates on the combined experience of many insurers. Joint rate making, it suggested, should be allowed and regulated under a statute rather than direct state supervision. Perhaps naively, they perceived that competition would regulate rates through the medium of rating organizations. In the same year, however, New York passed a law allowing joint rate making practices but under the direct supervision of the state insurance department.

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[24] Senate Subcommittee on Antitrust and Monopoly, Insurance Hearings, 1960, p. 2804.

A National Association of Insurance Commissioners committee, also investigating rate making, soon after presented a report which essentially concurred with the Merritt Committee findings. It further recommended that membership in rating bureaus, especially for fire insurers, be made mandatory and that the rates set by bureaus be subject to commissioner approval. Filing all rates with state regulatory bodies was also recommended. They reportedly envisioned competition which was controlled.[25]

The significance of these reports was that consequently several states soon adopted these recommendations while others, accepting their conclusions, permitted rating bureaus to operate uncontrolled.

The fear of ruin from insolvencies due to unbridled competition has long lingered in the beliefs of many in the insurance world. Insurers have used it to justify their cartelization and regulators to justify mandatory bureau membership laws as a means of protecting insureds from loss due to insolvencies. However, no thorough study of insolvencies has ever been made in the property-casualty and most other lines.[26] The Merritt report contains no documentation that insolvencies were specifically caused by excessive price

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[25]National Convention of Insurance Commissioners, Proceedings, 45th Annual Session (Ashville, N.C., 1914), p. 19.

[26]Richard M. Heins, "Liquidations of Insurance Companies," Insurance and Government (Madison: Fund for Insurance Education and Research, 1960), p. 54.

competition. The failure of competition as a regulating force at that time was thought by some not to be so "... vicious as many would have us believe."[27] Attempts of large firms to monopolize the industry by operating below cost in the short run and driving out other business would have been improbable. For as soon as they raised their rates to reattain an economic level, newcomers would be attracted by the freedom of entry, low fixed costs, and large profits.

During the period approximately from 1900 to 1945 cartels, mainly in the fire insurance line, reportedly flourished.[28] Besides the fact that in most states there were not many effective regulatory controls, other factors have been listed as probable causes for the reported success of the cartel movement. The existence of the American System in insurance is one of these. This system entailed a body of single line laws which existed in most states. Specialization was artificially encouraged by these insurance laws which separated property, casualty, and life insurance. For example, if a company insured autos against collision it could not also provide liability and property damage coverage. It has been proposed that this system, which compartmentalized insurers, closed a phase of competition; i.e., multi-

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[27]Thomas O. Carlson, "Rate Regulation and the Casualty Actuary," Proceedings of the Casualty Actuary Society, XXXVIII, No. 69 (May, 1951), p. 49.

[28]Stelzer, "The Insurance Industry," p. 150.

line operations, which may have otherwise undermined cartels.[29]

There was official justification for these laws. Two main objectives are cited. The first was that by allowing individual insurers to specialize in extremely technical problems of particular lines of insurance, they would thus develop proficiency and safety in the treatment of specified hazards. Consequently, on those accounts, specialization was assumed to be in the best interests of the insureds.

Secondly, it was presumed desirable to segregate the different classes of insurance so that a more accurate appraisal of the financial qualifications to be demanded of insurers could be made. The regulatory requirements also could be specifically set by state regulatory officials which would fit the various conditions existing in the different phases of the insurance business. Thus, economy and accuracy in regulation was purportedly being sought also.[30]

Another probable cause, it has been proposed, was the development of sophisticated methods to enforce the cartels. One method reportedly was the use of independent agent associations to police rates. Bureau stock fire and other stock insurance companies characteristically acquired their business through independent agents while mutuals and

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[29]Samuel B. Jones (ed.), Property and Liability Insurance Investment Management (Homewood, Illinois: Richard D. Irwin, Inc., 1971), p. 1

[30]Gustav F. Michelbacher, Multiple Line Insurance (New York: McGraw-Hill Book Company, 1957), p. 143.

independent companies generally employed their own agents or wrote insurance directly. The bureaus functioned as stamping officer for its members through which every member agent had to report all policies written for each bureau company and receive stamped approval. In this way then, reportedly, bureaus kept surveillance over rates and agent associations over agent commissions. Undercutting in rates and in agent commissions would then be relatively unconcealable.

A set of reciprocally favorable rules were said to also have existed among this insurance fraternity to deter price competition. A few of these proposed rules are listed here: (1) the "non-intercourse rule" denied non-affiliated companies the opportunity to reinsure their risks with bureau companies; (2) the "separation rule" prevented non-member agents from representing a non-member company; and (3) the "non-deviation rule" was an implicit agreement among all bureau members to refrain from rate cutting.[31]

The South Eastern Underwriters Association Decision and the McCarran Act

Over time state regulation of insurance became more comprehensive and extensive. Each state had detailed statutes to protect the public against loss due to insurer insolvency.

[31]Stelzer, "The Insurance Industry," pp. 137-38.

There were other laws which dealt with policy forms; and long and detailed financial statements were required to be filed annually. There were prohibitions against monopolies, discriminations, and rebating. Most states also required the licensing of brokers, agents and other insurance producers. In addition, nearly every state had an insurance department to provide constant vigilance over insurance operations.

Nevertheless, the effectiveness of regulation, it has been generally agreed, was in 1940 very poor, varying widely among the states.[32] Rate regulation by 1933, though several states had such statutes, was considered virtually nonexistant. By 1944, with some exceptions, it was still limited to selected lines with varying degrees of effectiveness. Combinatory rate making, often under state supervision, with no safeguards was said to be the pattern. Anticompact laws in those few states which still had them were routinely circumvented. The increasing interstate character of insurance in lieu of jurisdictional limitations of regulation also led to abuses. Finally, inadequate regulatory staffs and budgets along with uncertain and often insufficient authority to enforce insurance laws on the part of commissioners were held as contributing greatly

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[32]John G. Day, Economic Regulation of Insurance In The United States, U.S. Department of Transportation (Washington: U.S. Government Printing Office, 1970), p. 13.

to the predicament.[33]

These problems were not brought into sharp focus until 1942. In that year the Attorney General of Missouri, McKittrick, complained to United States Attorney General Biddle that his office had been frustrated in prosecuting a group of fire stock insurance companies for violation of Missouri antitrust laws. Ironically, fire insurance was the most regulated insurance line at that time. Further, McKittrick stated, the interstate nature of insurance left the state authorities powerless to deal effectively with abuses.[34] The result was the indictment of the South Eastern Underwriters Association, a fire underwriters association of 198 members operating in five southern states. The indictment charged the defendants with conspiring to fix rates and using boycotting and coercive practices on non-member insurers to monopolize trade and commerce. Upon conviction of the association, the Supreme Court judged that now insurance was indeed interstate commerce and thus subject to the federal antitrust laws which would prohibit the above practices. Paul vs. Virginia was cited now as only relating to the validity of state regulation and not the exclusion of

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[33]Spencer L. Kimball and Ronald N. Boyce, "The Adequacy of State Rate Regulation: The McCarran Furgeson Act in Historical Perspective," Michigan Law Review, LVI, No. 4, (February, 1958), pp. 547-48.

[34]Phillip R. Rose, "State Regulation of Property and Casualty Insurance Rates," Ohio State Law Journal, XXXVIII, (April, 1967), pp. 682-83.

federal authority over insurance as interstate commerce.[35]

This decision deeply disturbed the industry. Subjection to the federal antitrust laws prohibiting perhaps all price fixing agreements would supposedly threaten a return to the evils of unbridled competition.[36] Immediately, efforts were made to obtain exemption from the antitrust laws by lobbying in Congress. A number of bills were introduced by legislators friendly to the industry. Nonetheless, the industry failed to secure such legislation as Congress felt state regulation to be ineffective and that there was a dire need to strengthen it somehow. Having failed on its own on the federal level to nullify the possible consequences of the S.E.U.A. decision, the industry took another approach. It now supported the states in their efforts to retain their almost exclusive role as insurance regulator. To with, it was feared by many in the industry that the antitrust laws and possible further regulation would invalidate the system of state regulation which they had become accustomed to and which presumably would now be the weaker.[37] The Justice Department saw this tactic as "no more than a cloak surrounding the real purpose

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[35] U.S. vs. South Eastern Underwriters Association, 322 U.S. 533 (1944), p. 553.

[36] The Senate Subcommittee of the Committee on the Judiciary, Joint Hearings on Insurance, 1943, Part 2, p. 61.

[37] Spencer L. Kimball and Herbert S. Denenberg (eds.) Insurance, Government and Social Policy, p. 423.

of the legislation"[38], which was probably to absolve the insurance companies from any effective government control whatsoever.

The N.A.I.C. and the states were equally disturbed by the decision. They feared federal government takeover or at least its assumption of a major role as an insurance regulator which would reduce their authority. Also the states were worried that their exclusive rights to tax insurance premiums would be infringed upon.[39]

Hearings before a Congressional Judiciary Subcommittee consequently were held due to this confusion and apprehension which had developed as to the exact implications of the decision. During the hearings the results of a general recent Justice Department investigation of the insurance industry and state regulation were presented. It reported that upon investigation of 43 states with rating bureaus, the insurance laws of one half of those which specifically permitted or required membership in them, "left the public virtually at the mercy of combinations of fire insurance companies which fix and maintain rates to be charged by their members".[40] In the Justice Department's opinion the states were powerless to deal effectively with restraints of trade in interstate commerce.

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[38]The Senate Subcommittee of the Committee on the Judiciary, Joint Hearings on Insurance, 1943, Part 2, p. 61.

[39]Ibid., Part 3, p. 254.

[40]Ibid., Part 2, p. 56.

Also the Department presented evidence suggestive of the existence of very high profits and thus perhaps monopoly in the insurance industry nationally. Over a ten year period, the report stated, an unusual record of earnings was found for insurance as compared with other industries. In their opinion they have found that a good or unusual ten year earnings record such as evidenced in the insurance industry over such a period along with monopoly and restraint of trade because as stated:

> " Time after time in our investigations we have found a monopolistic condition to exist, we have found this constant rather stable earnings, but not under conditions of competition." [41]

Finally, this Department suggested that subjecting insurance to the antitrust laws would be the simplest and best means of regulating insurance in its interstate operations and would not replace but supplement state regulations. Not surprisingly, the industry and state advocates presented contrary testimony condemning this and other proposals for federal regulation. It was apparent that something should be done to strengthen regulation. Thus, the debate boiled down to whether it should be done by the states or federal government.[42]

Consequently, in 1945, in relation to the hearings

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[41] Ibid., Part 3, p. 160.
[42] Ibid., Part 3, p. 163.

Congress passed the McCarran Act to establish its position on the matter and clear up any confusion concerning the S.E.U.A. decision. In this act Congress opted for state primacy in the regulation of insurance. The possible disruption that might be caused by replacing an established state system with an unknown and yet to be structured federal system was cited as a major reason for this decision. Also they were to contend that the state system afforded a means to meet problems which might arise under unique local conditions. However, they still recognized the need for more effective regulation. A compromise of a sorts was struct. Federal regulation would be imposed, but only where state regulation was not. Essentially, the bill provided these major guidelines: (1) state regulation and taxation of insurance is confirmed and continued; (2) where state laws did not regulate federal laws would; (3) the Sherman Act and all other interstate commerce laws would now apply to insurance.[43] Subsequently, Congress granted the states a three year grace period to modify their insurance laws, thereby, strengthening state regulation and avoiding federal intervention and also the antitrust laws. Obviously, the passage of such a bill was a victory of a sorts for the insurance industry, the states, and the insurance commissioners.

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[43]U.S., Congress, An Act to Express the Intent of Congress with Reference to the Regulation of the Business of Insurance, Public Law 15, 79th Cong., 1st Sess., 1945, p. 33.

In order to keep federal antitrust laws inapplicable to insurance and deter federal intervention, it was imperative that states revise their insurance laws. With much at stake, the National Association of Insurance Commissioners and some industry representatives, known as the All-Industry Committee, joined together at the request of the N.A.I.C. to draft model legislation aimed at satisfying the requirements of the McCarran Act. Their efforts proceeded under the assumption that rate making in concert was still necessary.[44] The results were the Commissioners'-All Industry Bills. Significantly, their provisions outlined a rather strict rate making system. Under them rating bureaus could continue to operate, although under strict and extensive state control and with the option for any company to either file independently or deviate from bureau rates. However, the procedures for filing independently or deviating were held to be extremely cumbersome. Bureaus or any other company had the right to object to any deviations filed; whereupon hearings were held. Also, the burden of proof, that these filing of rates or coverage plans were proper, rested with the applicant. Finally, even if approved, such filings would only last one year whereupon new applications need be made. Foreseeably then, rates likely would tend to be uniform. The bills also

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[44]Herbert C. Brook, "Public Interest and the Commissioners-All Industry Laws," Law and Contemporary Problems, XV, No. 4, (Autumn, 1950), p. 606.

entailed mandatory filing of rates and rating plans by all insurers. Previously, in most states this was required in only a few selected lines such as fire insurance. The rates and rating plans could not be used at least from 15 to 30 days after filing. Finally, the insurance commissioners were to be given this time to consider the filings for approval.[45]

Other model bills, described as "Little Clayton Acts", developed by the Commissioners' All Industry Committee, were directed towards unfair trade practices, mergers, interlocking directorates and conglomerates. Under them the insurance commissioner theoretically was given the right to cause a discontinuance of any practices which generally lessened competition or tended to create monopoly. These too were adopted by a number of states, no doubt to avoid such federal sanctions.

The All-Industry Bills and the "Little Clayton Acts" were adopted with some modification in almost every state by 1951. Three states, Louisiana, Texas and Virginia retained mandatory bureau membership and uniform rating laws. Two others, California and Missouri adopted laws which required no filing at all, but rates and rating plans were subject to investigation and disapproval by the commissioner in lieu of complaints or whenever he deemed it necessary.

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[45] Senate Subcommittee on Antitrust and Monopoly, Insurance Hearings, 1960, pp. 4886-87.

Such strict laws came about as a result of the prevailing influences of three powerful groups. One group, the states and their insurance commissioners were naturally jealous of their prerogatives to regulate insurance. From the effect of general revenue alone it could be seen that they had a vital interest in continued state supervision. Consequently, this group naturally would have liked nothing better than to have effected legislation which would avoid federal intervention for all times.[46]

Another group, the mutual insurers, purportedly saw it would be to their advantage to have such a system which tended to sustain uniform rates. They could use the same rates which were generally filed by other companies and undercut the rates on any choice piece of business through their dividends. Thus, their competitive position would be enhanced.

Finally, bureau companies were reported to have a vital interest in a rating system which detered deviations, fostered uniform rates and tended to make the entire industry conform to the standards of those acting in concert. Characteristically, independents' acquisition costs of insurance were lower than bureaus because they employed their own agents rather than independent agents as the bureaus generally did. The independents would have a natural competitive

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[46]Brook, "Public Interest," pp. 607-608.

advantage over the bureaus. It has been proposed that the bureaus, to eliminate their disadvantage, pushed for these laws requiring all insurers to make rate filings practically uniform. It has been also held that the bureaus (mainly fire bureaus) tried to induce the various states to pass legislation which permitted and regulated their concerted activity. Otherwise, it would have been necessary for bureaus and bureau companies to change their methods of operation to conform to what was permissible concerted activity under the antitrust laws.

Independent insurers were divided as to how far the proposed state legislation should go. Many did not see the effects of the imposition of the antitrust laws as being nearly disastrous as was thought. They voiced some support for more liberal regulatory laws such as file and use which would tend to enhance their competitive position. These insurers were definitely opposed to any legislative program which might necessitate uniformity in action, discourage competition especially in pricing and coverage, or tend to require rigid adherence to particular rating or operating methods. However, their not so forceful efforts did not prevail nor appear to have a significant influence in the designing of the laws. According to one scholar this was due in part to a lack of representation of independents on

the All-Industry Committee.[47]

What were possibly some of the social and economic implications of these strict laws? First of all, they could have possibly been harmful to existing competitive markets. In the casualty field generally and in the automobile line competition was considered to be the rule. The All-Industry laws could perhaps have the effect of forcing uniform rating and coverage in these markets. The consumers interest appeared to be of little interest in the forming of the laws. Their installation possibly meant that they would lose the benefits of lower rates which independent insurers offered and more "tailor made" policy coverages which their more flexible operations would permit.

The Regulation of Insurance 1950 to Present

The decade beginning in 1947 was a period of intense bureau resistance to independent filings. The main threat to the bureaus was a number of large and very determined independent insurers who were attempting to assert their competitive advantages (due mainly to their lower acquisition costs) by trying to file new coverage plans which were more flexible and rates which were lower than what bureau companies offered. The battle was principally conducted in the field

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[47] Henry S. Moser, "Operation of Independents Under The Rate Regulatory Pattern," Law and Contemporary Problems, XV, No. 4 (Autumn, 1950), p. 527.

of fire insurance where local and regional rating bureaus had long occupied a dominant position. In the casualty field relatively little organized opposition was encountered except in the mandatory bureau and uniform rate states. Strong opposition came from bureau companies and sometimes agents and other producers, in at least twelve states. Numerous rate hearings resulted with victories gained on both sides. Only a small number of cases reached the courts as most were resolved at the administrative level.[48]

In 1958 the whole issue finally came to a head. In that year a Senate Antitrust Subcommittee launched a study[49] to investigate state regulation and the numerous complaints over bureau resistance to deviations. In August, 1961 the committee issued its report. It denounced what it considered the disadvantageous aspects of the deviation and individual filing provisions of the All-Industry Bills. These were the procedural quirks and burdens which made it impractical for all but the largest firms with legal staffing to attempt such filings because the burden of proof was on the applicant to present evidence that the deviation or independent filing was proper. The filing, if approved, lasted only one year upon which the proceedings might have to be gone through again.

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[48] Arthur C. Mertz, "The First Twenty Years: A Case Law Commentary of Insurance Regulation," American Bar Association Proceedings (1964), pp. 172-173.

[49] Senate Subcommittee on Antitrust and Monopoly, Insurance Hearings, 85th Congress and 86th Congress, 1958, 1959, 1960.

Obviously, this entailed large legal costs and delays. The committee consequently urged the N.A.I.C. to reconsider modifying the All-Industry rating laws to eliminate these procedural inpediments and to replace the prior approval requirement with a file-and-use provision. In 1963 the N.A.I.C. only went so far, however, as to modify the bills to eliminate several of the features which had impeded competition and imposed unnecessary procedural burdens. It opposed a file-and-use system of rate making. Nonetheless, the changes did tend to foil the bureaus attempts to control ratemaking and subsequently most bureau members, it has been stated, came to favor a more liberal and competitive system.[50]

The committee also maintained that the requirement of a few states statutes of bureau membership substantially lessened competition and seemed to be in conflict with the McCarran Act in that it certainly did not justify compulsion. A judicial test of these laws was recommended. However, the Supreme Court repeatedly declined to review such cases for lack of substantial federal issue.

The committee also went on to admonish the states for their inadequate insurance staffs and budgets and for their laxity in insurance regulation. Nevertheless, it did go on record as favoring continued state regulation. Signifi-

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[50] C. Arthur Williams, "Insurer Views on Property and Liability Insurance Rate Regulation," The Journal of Risk and Insurance, XXXVI, No. 2 (June, 1969), pp. 218-222.

cantly the report noted:

> " absolutely no support for federal regulation [was found] from any groups representing important segments of the industry. From certain academic sources and representatives of the insurance buying public come only support for a limited kind of federal supervision." 51

By the early 1960's it appeared that the once powerful fire cartels and those in the casualty lines were on the wane. A number of factors, including the modification of rating laws and the dropping of the mandatory bureau requirement in several states, were held as responsible. By 1949 a movement to completely abandon the American System had succeeded in two-thirds of the states. The change eventually altered the operating climate by removing this protective unbrella ushering in a new phase of competition and diversification began. This must certainly have been a blow to the cartels.[52] Also, eventually the "direct writers" successfully stepped up their incursion into the business of the old line companies.[53] Incidental to the decline, most likely, was the fact that the line of fire insurance in which the cartels were mainly entrenched no longer was the most important type of insurance in terms of premium volume. The casualty field in general

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[51] Senate Subcommittee on Antitrust and Monopoly, Insurance Hearings, 86th Cong., 2nd Sess. (1960), p. 2809.

[52] Jones (ed.), Insurance Investment, p. 1.

[53] Ibid.

and the automobile line, where bureaus were not as prevalent, had outstripped the fire insurance field. Finally, high premium rates, refusals and non-renewals have elicited complaints from consumers and pressure from consumer advocates for more liberal laws. This pressure and threats of federal intervention appear to have resulted in more liberal state insurance legislation.

In more recent years federal government interest in insurance regulation and for further inroads into the insurance business has grown. The principal public pressures which have generated support for federal re-examination of insurance stem from consumer outcrys over cancellations, non-renewals, and inability to get insurance. State insurance regulatory agencies, the states themselves, and the industry on the other hand, it appears, have joined in many instances to attempt to shore up these weaknesses and check federal intervention.

In 1964 stock insurance companies, for fear of increased burden of regulation via federal regulation, sought exemption from the Securities Act Amendments of 1964. These were designed essentially to require firms whose securities were traded "over-the-counter" to meet disclosure requirements required of companies whose securities are listed on the exchange. In the course of consideration of the bill, insurance companies were exempted from the new registration and

reporting requirements provided the insurance companies are required to fulfill similar requirements with the state. The N.A.I.C. promptly acted to provide the proxy regulation called for. The exemption was reportedly obtained through industry lobbying and even through pressure from certain commissioners alleged to be captives of the industry.[54]

Further concern over interlocking directorates, conglomerates and merger take-overs of insurance companies have caused increased scrutiny of the business by the Justice Department but not essentially in its purely insurance aspects.

The government has been also active in establishing programs to aid persons unable to obtain insurance through private means. For example, civil disorders in cities have made insuring central city properties difficult and costly to obtain. Consequently, the Urban Property Protection and Reinsurance Act, an act to give persons with such property the opportunity through public means to obtain protection, was enacted in 1968.[55]

In 1965 the Senate Judiciary Antitrust Subcommittee held hearings on the problems of policyholders and claimants resulting from the insolvency of a number of "high risk" auto

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[54] William L. Cary, Politics and Regulatory Agencies (New York: McGraw-Hill Book Company, 1967), pp. 113-114 & 116.

[55] U.S., Congress, Urban Property Protection and Reinsurance Act of 1968, Public Law No. 90-448, 90th Congress, 1st Session, 1968.

insurers. The result was the introduction of the Motor Vehicle Guarantee Bill. This entailed a national plan designed to protect affected insureds and claimants from the economic disaster caused by insurance company insolvencies. It would set up a national fund to accomplish this. There was, however, sufficient political pressure brought to bear in Congress by the industry and commissioners to block the bills passage.[56] Many states soon thereafter adopted their own versions of this type of bill.

In 1968 Congress ordered the Department of Transportation to undertake a complete study of auto insurance looking into all aspects going from public attitudes of auto insurers practices to government regulation of the industry. On the issue of state versus federal control the D.O.T. in its report recommended and clearly favored reform on a state by state basis. It recommended a state regulated first party no-fault coverage to provide compensation for all economic losses. On the issue of private versus public insurance the study took a strong stand, expressing a preference for private insurance programs until it was shown beyond doubt that they could no longer function effectively. Essentially the D.O.T.'s faith in state regulation revolved around its belief that state agencies were more experienced and could supervise the

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[56]National Association of Independent Insurers, Proceedings of the 20th Anniversary Meeting, Address by Thomas J. Dodd (November, 1965), p. 85.

industry more efficiently especially on the local level. Concern over further growth of the federal bureaucratic collossus with its concommittant problems of red tape and inefficiency was mentioned as a factor also.[57]

Soon after the D.O.T. report appeared, a bill was sponsored by Senators Hart and Magnuson which outlined a complete national first-party no-fault program. This plan refused to follow the D.O.T. guideline that each state develop its own no-fault system. Their belief was that the states would not or could not adopt true no-fault plans.[58]

In August of 1972 after much debate the bill was sent back by the Senate to the Judiciary Subcommittee for further study, allegedly because the bill was of questionable constitutionality and raised other unanswered questions. Senator Magnuson felt that this delay on this bill would mean no congressional action on no-fault for two years. By some the stall was hailed as a "momentous battle won for all those who believe ... in the preservation of state insurance regulation and in the right of states to determine their own destinies".[59] Elsewhere it was claimed as another

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[57] Day, Regulation of Insurance, p. 75.

[58] Willis Parks Rokes, No-Fault Insurance (Santa Monico, California: Insurors Press, Inc., 1971), pp. 118-119.

[59] National Underwriter (Property and Casualty Insurance edition), August 18, 1972, p. 1.

triumph of special interest groups over public interest.[60]

The opponents of the bill have been the Nixon Administration (in favor of states rights), the commissioners, segments of the industry and trial lawyers.[61] Consumer advocate groups have consistently endorsed it. The commissioners' opposition again comes from their fear that the bill would essentially lead to a federal takeover of their roles as insurance regulators. Also it is believed that the states have not been given enough time to reform state regulation and further that the bill would impede experimentation in regulation by the states. Some segments of the industry see this as a dangerous plan which may be an avenue for further actual federal participation and regulation in the business. Of course, the trial lawyers have generally been opposed to all no-fault plans as they threaten to eliminate a quite prosperous portion of their business.

Traditionally, the insurance industry has successfully resisted federally imposed standards. Because of the D.O.T. report and the Hart-Magnuson Bill, it is believed the states and insurance industry will be found coming forward with more innovative suggestions of their own. Several states

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[60] Ibid.

[61] Eugene Sullivan, Where Did The $13 Billion Go? (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1971), pp. 182-183.

have already converted to partial no-fault packages. In view of the state-wide reform, if it sufficiently progresses, some consider it unlikely that sufficient support will exist in Congress to pass the Hart-Magnuson plan.[62]

Some Pros and Cons: State Regulation vs. Federal Regulation

Again, appeals for federal re-examination of state insurance regulation have in recent years come from consumer oriented groups primarily because of high rates and lack of market capacity in automobile insurance, while state laws on the other hand have made auto insurance virtually compulsory. The alleged failures of state regulation have been cited by many as the cause for this predicament. Critics of state regulation strongly feel that insurance commissioners and regulatory agencies are beset with political constraints, laws, and weak enforcement authority which have made them virtually unwilling or impotent to take the measures necessary for reform which would be significantly beneficial to consumers. They point to still relatively inadequate state insurance department staffs and budgets as a major cause. Reportedly, too, insurers work hard and spend much money to assist politicians in their bids for re-election in return for favoring the interests of insurers. Critics also point out that generally commissioners are political appointees

[62]Paul Gillespie and Miriam Klipper, No-Fault (New York: Praeger Publishers, Inc., 1972), p. 174.

who are more interested in keeping their jobs than upsetting the status quo.[63] A good example of these contentions concerning some political aspects of state regulation is found in a recent interview of Herbert S. Denenberg, Insurance Commissioner of Pennsylvania. He states that the reason it is such a rarity to have a state commissioner who has taken a strong pro-consumer stand is because if as in many cases " ... you have a governor who is committed to certain special interest groups, he is not going to let you do [some things]".[64] Previous to his appointment in the term of Governor Shapp, he said, the insurance industry could practically pick who it wanted for commissioner.

The ability of insurance industry, its lobbies and other interest groups to influence legislation is also often criticized as blocking needed reform in state legislatures. No matter how conscientious, lacking adequate staff and engrossed in other important matters, it is felt that legislators cannot simply cope with spokesmen for these interest groups.

Beyond the political conflicts, critics also claim that a "live and let live" philosophy has developed between the regulator and the industry which has been harmful to regulatory performance. Richard E. Stewart, former Superintendent of Insurance of New York, recently related this contention

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[63] Sullivan, The $13 Billion, pp. 42-43.

[64] The Washington Post, November 1, 1972, p. 8.

of this situation quite well as follows:

> " Left alone with each other, the regulator and his industry unconsciously find a mutual interest in ritualizing the relationship. The regulator must emphasize law and regularity against the day he is challenged in court or denounced in public. He thus must look away from the operating realities of the industry and from the expectations of the public. The industry relies on the ritual of regulation to make government behavior predictable, and to keep the regulator occupied in areas where interference can be tolerated." [65]

Pointing to the modest surplus and capital requirements that exist in most states, it is often declared that monopolistic oligopolistic tendencies in insurance were precluded by the consequent ease of entry. However, critics of the state systems have stated that while this may in fact be the case for domestic insurers, entrance into other states is time-consuming and expensive. Dilatory tactics are said to often be used.[66]

In essence, then, a major contention of advocates of federal control is that given the current political environment and philosophy that surrounds state regulation, no meaningful pro-consumer regulation could be forthcoming.

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[65] Kimball and Denenberg (eds.), Insurance, Government and Social Policy

[66] Day, Regulation of Insurance, p. 70.

Thus they contend that national supervision would avoid these political pitfalls and other regulatory problems, and in short the public interest would be better served.

Some presumably beneficial effects of a federal system have been detailed by opponents to state regulation. Purportedly, it would work better across state lines by freeing insurance from the economic burdens of multiple state regulation which fall on the consumer. Insurance needs, problems and geographical influences, it is pointed out, cannot neatly be compartmentalized within state borders. Spillover effects must be taken into account; federal control would, its proponents contend, eliminate this balkanization of insurance regulation which tends to produce some socially undesirable consequences. Finally, there would not be the jurisdictional limitations with state regulators face in prosecuting violators.[67]

Retention of state regulation has been as vigorously defended for various reasons. One contention is that the state system is an established and known system which could be modified with fair confidence in the results. Federal regulation and its problems are unknown, and it would be costly to set up a whole new system. Pointing to the federal regulatory commissions, state advocates believe that federal regulation would create as many new problems

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[67]Kulp and Hall, Casualty Insurance, p. 1030.

as were solved. A federal commission would possibly also be too big a bureaucracy to be efficient or effective especially in such a complex field as insurance, many feel, and also that it would just replace state regulation. State regulation is seen by its advocates as being more responsive to local needs and conditions than federal regulation. Another presumed advantage is that state regulation allows freer and more cautious innovation and experimentation with various methods of regulation. Also the fact that in a state system companies can withdraw from states is seen as a beneficial and effective lever against unwise legislation not existent in a national system. Many also feel that all premium taxes should effectively go to the states since they derive their basic protection from them. Finally, in federal assumption of insurance regulatory duties it is believed that the government would be encroaching on the last outpost of state authority and regulation.[68] Some students of insurance have stated that the very basis of our federal system is at issue here.[69]

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[68] Day, Regulation of Insurance, pp. 74-75.

[69] Kimball and Denenberg (eds.), Insurance, Government and Social Policy, p. 417.

III. HISTORY OF INSURANCE REGULATION IN VIRGINIA

Early Period of Regulation

Virginia has an early history of insurance regulatory legislation dating back to the 1840's. Like most pioneer states in insurance regulation, Virginia's laws have run the gamut from an absolute minimum in regulation to its recent system of mandatory membership in a rating organization for fire, automobile liability and automobile physical damage insurance.

The first insurance statutes enacted in Virginia solely provided for the control and regulation of foreign agents[83] such as in their licensing, taxation, and through penalties for violations. The next statutes enacted provided for the licensing of foreign companies, the taxing of their and foreign agents premiums and a requirement for putting up bonds with the Auditor of Public Accounts, who was the state insurance official at this time. Reserve requirements were also established to make foreign firms leave deposits in the state treasury as insolvency security.[84]

In 1898 Virginia enacted an anti-compact statute.

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[83] Foreign agents or companies are those licensed or incorporated in another state. The term "alien" is referred to those firms incorporated in other countries.

[84] Code of Virginia, Section 1271 (1887).

Within four years, however, it was repealed because it supposedly brought in its wake chaotic conditions, unreasonable competition and discriminatory rates and practices. With this repeal, the Virginia Legislature, in effect, invited collaboration in rate making through a voluntary rating organization.[85]

By 1904 the Auditor was given investigatory and examinatory powers over all insurers; domestic, foreign and alien; all were now required to file financial reports with him. Complaints concerning violations discovered by the Auditor were now to be referred to the newly formed State Corporation Commission. Alien insurer's deposit requirements were at this time set at $200,000 in U.S. bonds.[86]

The Bureau of Insurance, the Virginia regulatory body, was created by statute in 1906 and a commissioner elected by the General Assembly. The commissioner acquired the duties of the Auditor of Public Accounts of surveillance of insurance law violations but was also given expanded authority such as that, though seldomly exercised, to prosecute offenders in the District Court of Richmond with permission of the S.C.C. He could also revoke licenses of companies and agents who failed to conform to statutory requirements; however, this power was hardly used except as a threat.

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[85] National Association of Insurance Commissioners, Proceedings, 90th Annual Session (1960), p. 77

[86] Code of Virginia, Chap. 6, Sec. 4211 (1904).

The main duty of the S.C.C. with respect to the Bureau initially was to hear appeals of the Commissioner's decisions. In practice, the commissioner's job was one of serveillance over insurers to safeguard policyholders from the ruinous results of insolvencies.[87]

Regulation 1920 - 1945

In 1920 a statute was enacted which provided for the creation of a fire insurance inspection rating bureau. Two or more fire companies could form a bureau. The implied intention of such a statute was to make use of modern insurance theory, which involved scientific and statistical determination of risks, the central collection of a wide range of loss and expense data for and from all companies to effect safe and economic rate making. Consequently, risks would be more accurately determined and the threat of loss to the insured due to insolvency of insurers would be reduced. A bureau was formed and was known as the Virginia Inspection Rating Bureau.[88]

Public outcry over certain abuses attributed to this bureau and over excessive rates led to a full scale investigation, in 1936, of these claims by the Virginia Advisory

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[87] Report of State Corporation Commission for the Year Ending June 30, 1906 (Richmond: Superintendent of Public Printing), pp. 265 & 270-71.

[88] Code of Virginia, 38.1 - 266 (1950).

Legislative Committee appointed by the General Assembly. The committee found that the South Eastern Underwriters Association supervised and controlled inspections and practically controlled rates for nearly all fire stock companies. Further it stated that the South Eastern Underwriters Association* "dictates the policies of companies, political and economical, and has its representatives to appear before the legislatures of (several) states in the interest of their control".[89] In fact the Virginia Inspection Rating Bureau** had become known as the "Virginia Committee" of the S.E.U.A. which controlled stock fire rates in Virginia with some latitude but essentially subject to the S.E.U.A. central authority in Atlanta, Georgia, the committee went on to say.

Several methods or conventions, they reported, were used to enforce this apparent cartel. First, the rating bureau became a stamping office. That is, for its members, every agent had to report all policies which were written by him and received stamped approval. In this way the central authority could police the rates (given). The

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*From here on South Eastern Underwriters Association is referred to as the S.E.U.A.

[89]Report of the Commission to Investigate Fire, Liability, Casualty and Workmen's Compensation Rates, "Fire Insurance Only", House Doc. No. 5 (Richmond: Davis Bottom, Superintendent of Printing, 1928), pp. 51-52.

**From here on the Virginia Inspection Rating Bureau is referred to as the V.I.R.B.

V.I.R.B. had been also able to include in its bylaws a law which prohibited bureau membership to any insurers who returned a part of the premium as a dividend to the policyholders; thus they excluded mutuals from the advantages of membership such as sharing loss and expense experience information and from its reinsurance facilities. This would tend to stifle the competition via mutuals. Also there was admittedly a tacit understanding among all the members as to the rates which were set, policed by the stamping procedures and penalties enforced on those who undercut bureau rates. These penalties consisted of the taking away of reinsurance or of the informational privileges of the bureau. Overall, also, rates were determined to be excessive. One reason for such, it was concluded, was that caution had led to statutes which adopted for a test of insolvency, a measure which always overstated actual liability and thus understated income. This no longer was a necessary device, they argued, because the statutes were enacted in a time not as now when the great evil of the day was insolvency. Furthermore, competition was then keeping rates down and governmental regulation of rates was not contemplated. In the presence of current regulation, insolvencies were not nearly as likely while rate excessiveness had become the major question.

The committee also concluded from its investigations that the only forces holding rates down were fear of entry

of new stock companies and fear of competition from the mutuals. Consequently, they suggested that the aid of the mutuals must be invoked by the states. However, they felt this would not be enough in that essentially there was no rate competition considering the extend of cartel control over rates. They recommended that "since competition in rates has been eliminated as to stock companies, it is essential to have full state control".[90] It was suggested legislation be modeled after the Louisiana and Texas systems. This advice, however, was not followed.

Legislation was enacted, however. Insurers writing fire insurance in Virginia, with few exceptions, were now required to become members of the Virginia Rating Bureau under the sole and strict supervision of the State Corporation Commission. This Commission was made the constituent insurance authority in the state, while the Bureau of Insurance became a division of the Bureau of Banking and Insurance, a newly organized division under the S.C.C. All rates were to be filed through the Rating Bureau and with the S.C.C. and permission from the Commission to use them was also required. The statute contemplated the filing of a uniform schedule of rates for all members by the bureau. There was a provision which, in theory, allowed deviations for members from bureau rates upon their showing that the

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[90] Commission to Investigate Rates, "Fire Insurance Only," p. 72.

deviation was justified. This provision was supposedly intended to permit healthy competition.[91]

In 1930 the rates on certain fire risks were ordered reduced. The fire stock companies vehemently protested these reductions. The constitutionality of this rate regulation was, consequently upheld by the State Supreme Court of Appeals in 1934.[92]

In essence, then, it appears that the regulatory philosophy of Virginia came to be one assuming that a system of direct regulation of rates would be the best means of promoting the public interest.

An automobile insurance Inspection Rating Bureau was formed in 1932. Intercompany cooperation in rate making was approved. Membership in this bureau was not to be construed as mandatory, however, and exclusion of any parties that wished to join was prohibited.

In 1938 the Bureau of Insurance reassumed its former separate entity but not its former authority. The main duties of the Bureau have remained essentially the same since then. They are those of licensing, examination of rates and rate making procedures, surveillance over insurance companies for insolvency, collection of special fees and premium taxes, and investigation of insurance law violations.

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[91] National Association of Insurance Commissioners, Proceedings (1960).

[92] Ibid.

The bureau remains under the authority of the S.C.C.

In 1936 a statistical section was set up under the Bureau to gather information concerning automobile bodily injury and property damage liability insurance in the state of Virginia as well as fidelity surety coverages and workmen's compensation. Rate reductions since 1934 and in following years ordered by the S.C.C. were supported to a great extent by information furnished by this section. From 1928 to 1941, the bureau ordered reductions in rates, approved deviations from manual rates and approved manual rate reductions which resulted in claimed savings of 17.5 million to Virginia policyholders.[93]

Regulation in Virginia 1945 to Present

After the enactment of Public Law 15 (the McCarran Act) in 1945, the General Assembly directed the Advisory Legislative Council to make a study of the modifications necessary to conform Virginia Statutes to the S.E.U.A. decision and Public Law 15. From 1948-50 public hearings were held which uncovered significant industry sentiment for the liberalization of ratemaking laws especially with respect to fire insurance filing procedure. Ultimately, however, acting on the recommendations of the council, the General

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[93] Virginia Insurance Report for the Year Ending December 31, 1945, 40th Annual Report (Richmond: Division of Purchase and Printing, 1946), pp. 608.

Assembly adopted the All-Industry Commissioners approach for the kinds of insurance previously not regulated, but continued the mandatory rating bureau system for fire and allied lines of insurance. The rating bureau was continued as such under the supervision of the S.C.C., the constituent insurance authority in Virginia. It was also concluded by the Council that Virginia's Fair Trade laws were comprehensive enough to avoid federal action and therefore new legislation for such was not suggested.[94] By 1952, however, Virginia had adopted the All-Industry Bills which came to be known as the "Little Clayton Acts" again to avoid federal governance. These bills were concerned with checking monopolistic tendencies in connection with mergers and interlocking directorates. Evidently, it seems then, that the regulatory philosophy of Virginia had not changed much since 1928.

During the Senate Subcommittee Antitrust and Monopoly hearings of 1959, Virginia was deemed as one of several states where rating bureau resistance to rate and rating schedule deviations was very intensive.* From a number of testimonies it was concluded that competition under the Virginia

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[94]Virginia Advisory Legislative Council, State Regulation of Insurance Under Public Law 15 of the 79th Congress, House Journal (1949), p. 213.

*Virginia insurance law gave the bureaus or any interested company the status of "Aggrieved person", i.e., the right to demand a hearing and enlist the S.C.C. as co-complainant upon any deviation filing. The ensuing litigation made independent filing and deviations quite time consuming and costly to deviating firms.

rating system was virtually stifled. T. Nelson Parker, then Insurance Commissioner of Virginia, defended the Virginia approach to regulation and denied these allegations in part of a report by the N.A.I.C. sent to that committee.[95]

In recent years, controversy over rate regulation has actively continued in Virginia, further developing Virginia rate regulating philosophy. In one important case a S.C.C. decision was upheld by the Supreme Court of Appeals, denying a rate reduction request by American Druggists's Insurance Company on appeal by the Virginia Insurance Rating Bureau. The grounds for the decision was that the deviation was not justified. That is, it was held that for fire and allied lines of insurance, uniform rates were to be based on statistics applicable to all companies. Therefore, a firm's uniquely low loss experience did not justify a reduction. Consequently, the criterion was established that rate deviations would be allowed only those companies with lower expense ratios than the general average.[96]

In another important case it was determined that income derived by insurers from the investment of the unearned premium reserve and loss reserve is a relevant factor in fixing rates. This was significant since previously (in practice) rates were related to underwriting profit and

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[95] National Association of Insurance Commissioners, Proceedings, (1960), p. 80.

[96] American Druggists' Ins. Co. vs. Commonwealth, 201 Va. 275, 110 S.E. (2d) 509 (1959).

contingency reserve only and not investment income at all. This case was a bench mark, it seems, for further investigation of the relation of rate making and the role of insurance companies as profit makers in underwriting and finance.[97]

In 1965 the S.C.C. hired Woodward and Fondiller Incorporated, a New York actuarial firm to conduct a study of passenger car liability insurance in Virginia. In its recommendations the firm favored open competition as the simplest form of regulation and thus, logically, reliance on competition to protect the public interest as in most other sectors of the economy. They emphasized that a major benefit of a competitive system would be the removal of insurance from politics. "Under present regulatory procedures", (mandatory bureau and file-and-approval) the report stated, "insurance rates are subject to review by persons whose position of responsibility to the public cannot permit them to look upon rate increases and decreases with academic detachment."[98]

In the absence of open competition, the report suggested that a general rate level for the industry be determined by pooling the experience of all companies. A period for rate

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[97] Virginia State A.F.L.-C.I.O. vs. Commonwealth, 209 Va. 776, 167 S.E. (2d) 322 (1969).

[98] "More Flexibility in Rate Regulation," Bests' Insurance News, Property and Casualty Edition (October, 1966) p. 11.

deviations above or below that level would be designated. They suggested that data supporting filings be waived except when firms were challenged on grounds of discrimination, adequacy or when a lack of competition or excessiveness suspected. In their opinion rate making bureaus would provide rate making statistics and analyses in a form at least equivalent to reports currently used as rate filing support, and make them available to all interested companies at cost.

In further regard to rate regulation the report suggested that since the possibility of profits from underwriting were remote under present conditions companies would be little hurt by writing all policies on a parcipitating basis where any profits over a given margin would return to the policyholder. This, they said would, eradicate the rate level as a political issue and do away with the need for regulation except to enforce laws concerning unfair discrimination, inadequacy and monopoly.[99] Little action was taken on these recommendations until recently in 1972 when a "free competition" plan was introduced in the legislature with a non-fault attachment.

Also in recent years legislation has created several programs placed under the supervision of S.C.C. to give insurers unable to obtain insurance through ordinary means, the opportunity to obtain protection. The Virginia Assigned

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[99] Ibid., pp. 50 and 52.

Risk Plan (1952) provides for the equitable apportionment, among insurers in that line of insurance, of policies which may be afforded to applicants who are in good faith entitled but unable to procure automobile insurance through ordinary means. Another program, the Basic Property Insurance and Placement Plan and Joint Underwriting Association was initiated in 1968. Similarly, its purpose is to provide for the equitable apportionment among authorized insurers of the responsibility for insuring qualified property for which basic property insurance cannot be obtained through the normal insurance market. Another made effective in 1970, the Federal Riot Reimbursement Fund Act, created a fund providing for the equitable apportionment among property insurers of the responsibility for reimbursement to the Secretary of H.U.D. a certain percentage on the losses incurred and for premiums earned by that department in providing insurance, through insurer subsidization, to those in riot affected areas otherwise unable to secure insurance protection. Recently, along a similar line, the Virginia Insurance Guarantee Act of 1970 claims to avoid financial loss to claimants and policyholders of insolvent companies. For this an association was created to assess the cost of such protection among all insurers.

During the 1972 session of the General Assembly legislation was adopted repealing the statute which created the

Virginia Insurance Rating Vureau and its compulsory membership provisions, all of which had been in force since 1932. This was quite a change of philosophy and a significant step toward the liberalization of regulation in Virginia. More important, however, was the legislation also introduced in that session which would replace the traditional Virginia form of rate making procedure, file and approval, with open competition laws. This new system would allow use of rates immediately on filing only subject to later S.C.C. disapproval. Information supporting rate filings would be required only when such filings were challenged by the S.C.C. This system would supposedly allow rates to float to their natural competitive level which reportedly would mean lower rates and greater availability of insurance in the long run.

Controversy over the constitutionality of the bill and over the implications of its usage, however, has been ever present and has delayed its passage until at least the 1973 session of the General Assembly. The S.C.C. in a split (2-1) decision declared the bill, as presented, to be so vague as to make it unconstitutional. The commissioners casting the majority votes suggested the bill be rewritten. The dissenting commissioner believed that the bill was constitutional, and that, though the bill did contain some mistakes, these laws could still be imposed with no major disturbance to the business given the mutual cooperation of

the S.C.C. and the insurance industry.[100]

Some opponents of open competition rating laws in Virginia believe that instituting such laws would place the public at the mercy of the insurance companies. Their reasoning is roughly as follows. In the auto insurance business 40% of all policies are written by stock insurance companies who are members or subscribers of the Insurance Rating Board (a New York based rating organization and association of stock insurance writers). These companies pool their loss experience and operating expense information and present such figures when a rate increase is requested. A single schedule of uniform rates is thus filed. Mutual companies follow the same procedure through the Mutual Rating Board. The rest of the industry, the independents, pattern their rates after or just below those of the Insurance Rating Board. Thus it appears that the rates are, in all practicality, set by the I.R.B. Reportedly, open competition would eliminate this currently legal rate making in concert, and [illegible] alleged high rates. However, opponents feel that in this situation concerted rate making would only be eliminated if companies were required to base rates on their own loss experience and expenses and were subject to the antitrust laws. Unchecked by any laws (eg. antitrust laws), on the other hand, insurance companies, supposedly,

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[100] The Roanoke Times, July 4, 1972, pp. 1-2.

would have a tremendous opportunity to exploit the public. Consequently, opponents of "open competition" feel that the current prior approval laws have and would continue to provide the most desirable and economic form of regulation.[101]

Proponents of this type law in Virginia feel that rate making in concert will in fact be nearly eliminated as companies rates indeed will reflect more of their individual experience. Also some industry groups see this law as beneficially eliminating the delay, costs due to delay, and other costs in obtaining prior approval. The Mid-Atlantic Manager of the American Insurance Association, a national association of stock insurance companies, has cautioned Virginia motorists and legislators not to accept this bill proposing open competition with partial no-fault provisions because it "contains no meaningful reform of the present system. It merely tacks on first party benefits, without restricting law suits. This bill can only increase rates."[102] He said such a bill is one which only trial lawyers, who earn their livelihood from negligence cases, could support. Pointing out that 86% of the General Assembly's delegates and senators are lawyers, he felt those involved to rise

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[101]U.S. Congress, Senate, The Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, Hearings, Automobile Liability Insurance, Part 17A, 91st Cong., 1st Sess. (1970), pp. 11487-14493.

[102]National Underwriter (Fire and Casualty Insurance Edition), August 11, 1972, p. 14.

above self-interest, and support a true no-fault system.[103]

[103] *Ibid.*

IV. SOME DESCRIPTIVE CHARACTERISTICS OF INSURANCE REGULATION IN VIRGINIA

In this section some institutional and descriptive aspects of insurance regulation in Virginia will be presented and briefly discussed. This includes the powers, duties, and organization of the Virginia insurance regulatory authorities, the State Corporation Commission and the Bureau of Insurance. This also includes descriptive data of regulatory activity.

The State Corporation Commission was created by the Constitution of Virginia in 1902 as a department of the State government with legislative, executive, and judicial powers. The constitution imposes on it directly the duty of issuing all charters, and amendments or extensions thereof, of domestic corporations and all licenses of foreign corporations to do business in Virginia. The Commission also in general is charged with the duty of administering the laws for the regulation and control of corporations. The regulation of rates, charges and services of railroad, telephone, gas, electricity, insurance and various other companies is within the power and one of the duties of the Commission. The Commission consists of three commissioners elected for staggered terms of six years by a joint vote of the General Assembly. When sitting in its judicial capacity, e.g., in insurance rate hearings, it has the powers of a court of

record. All decisions of the Commission are subject to direct appeal as a matter of right to the Supreme Court of Appeals (no other state court can review any decision of the Commission). Numerous taxes and fees are also collected through the Commission. The administrative work of the Commission is divided among eleven divisions.[104] An organizational chart of the Commission is presented in Figure 1.

There are various sections of the Bureau of Insurance, one of these divisions, is further delineated, also in Figure 1. The Virginia Bureau of Insurance was created in 1906 by the Constitution of Virginia. The main duties of the Bureau of Insurance under the S.C.C. are the following: the licensing of foreign and domestic insurance companies and insurance agents; examination of rates and rate making procedures; surveillance over insurance companies for insolvency; the collection of special fees and premium taxes; and investigation of insurance law violations. Specifically, the bureau has been charged with the duty of approving all life, health and accident policies, riders and endorsements issued. The reserves set up by companies along with other financial indicators of company health shown in their annual reports, are reviewed and verified each year. Also, all complaints regarding minor violations and the settlement of policy claims are handled by the Bureau. It investigates

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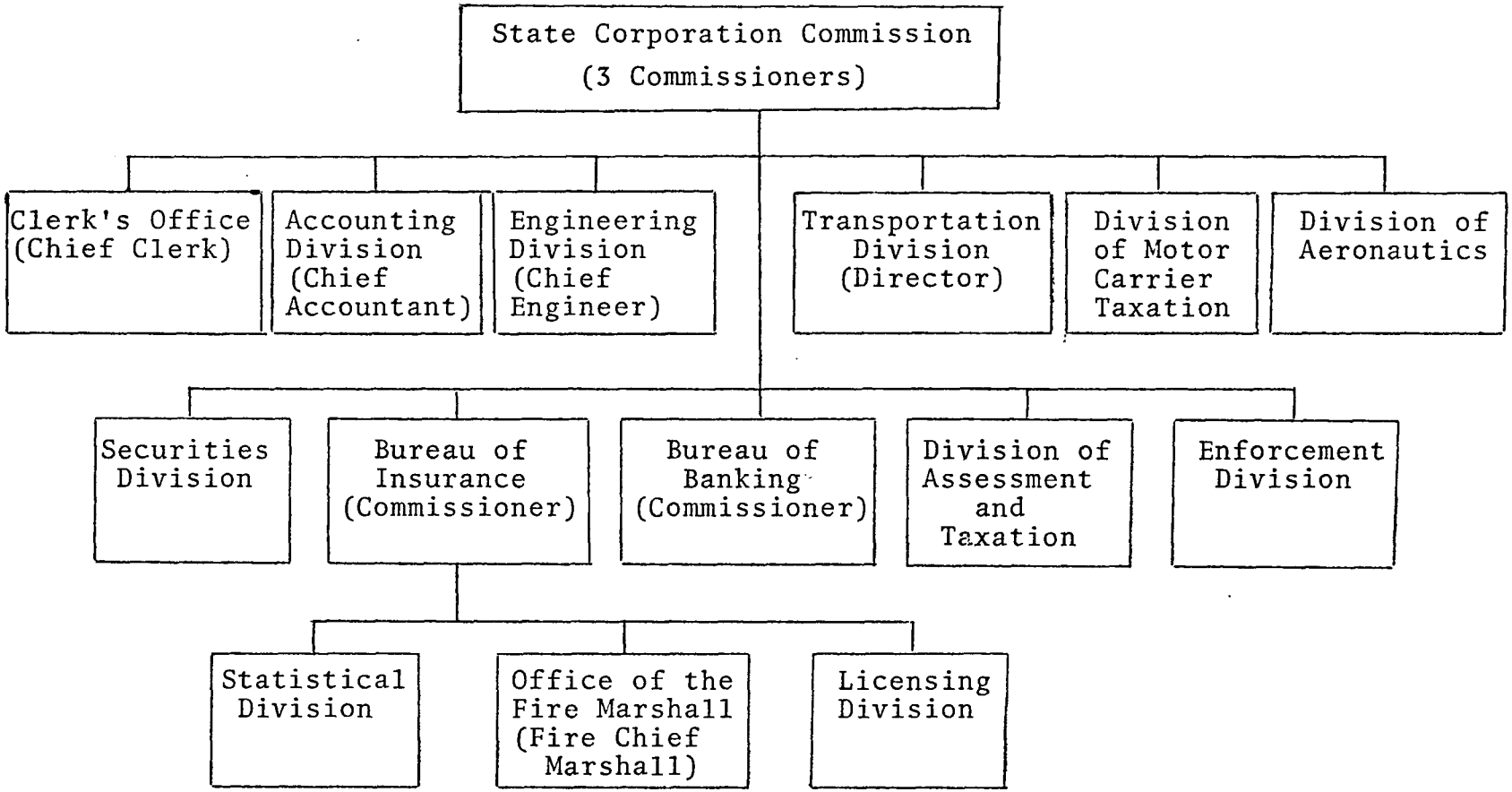
[104] George W. Jennings, Virginia's Government (Richmond: Virginia State Chamber of Commerce, 1971).



Source: Virginia's Government, 1971

Figure 1. Organizational Chart of the State Corporation Commission

and approves or disapproves ordinary rate and rate schedule filings. Appeals of these decisions and those cases involving any rate increases or reductions, considered as possibly having a significant impact on competition, are referred to the S.C.C. for decision thereupon. Hearings before the S.C.C. are often held in such cases and the Bureau acts as an investigatory body for the S.C.C. in them. The statistical division of the Bureau gathers information to assist the Commission in determining whether the rates to be changed by a great variety of insurance companies are proper.[105]

Also within the Bureau is the Office of Fire Marshall, whose duty is to enforce throughout the state fire safety building regulation promulgated by the Commission.

The Commissioner of Insurance, who heads the Bureau, is appointed by the Commission for an indefinite term. There have only been five Commissioners since the creation of the office in 1906. Their terms of tenure have tended in general to be quite long as is shown in Table 1.

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[105] Virginia Insurance Report for the Year Ending December 31, 1945, 40th Annual Report (Richmond: Division of Purchase and Printing, 1946), pp. 6-8.

Table 1. Tenures of Insurance Commissioners in Virginia

Initial Year as Commissioner	Number of Years in Office	Name of Commissioner
1906	23	Colonel Joseph Button
1929	1	n.a.[b]
1930	26	George Bowles
1957	13	Everette S. Francis[a]

Sources: Virginia Insurance Report, 1921 (Richmond: Division of Purchase and Printing); National Association of Insurance Commissioners, Proceedings, 1945, 1957, 1970; U.S., Senate, Report No. 1834, 86th Cong., 2nd Sess., 1960, p. 119.

[a]Present Commissioner of Insurance.

[b]not available.

Tables 2 and 3 present data which give rough estimates of the growth of the Bureau of Insurance (i.e., in its expenditures and employment), of its regulatory activity (in its caseload), and the activity in the industry to be regulated (in the number of insurance firms operating in Virginia). The data are for various years from 1921 to 1951. A rather steady growth over time appears to be characteristic of all these variables. Data for recent years are not presented due to the fact that they, except for Bureau expenditures, are not a matter of public record. However, an empirical analysis (involving regressions) concerning the Bureau's regulatory activity and performance is presented in Chapter VI for some recent years.

Table 2. Expenditures, case load and employment in the regulation of insurance in Virginia (for selected years)

Year	Expenditures[a]	Case load	Employment
1921	$ 32,459	2	11
1925	45,931	2	18
1928	51,944	7	n.a.[b]
1929	51,602	6	19
1930	55,730	11	20
1931	55,730	16	16
1932	67,709	13	17
1933	64,007	12	19
1934	62,964	22	n.a.
1935	62,172	22	21
1936	71,137	22	n.a.
1937	76,582	14	29
1938	88,376	15	n.a.
1939	100,496	17	31
1940	101,320	14	n.a.
1941	110,190	23	35
1942	108,353	16	n.a.
1943	106,110	25	30
1944	104,857	8	n.a.
1945	116,967	14	29
1946	134,606	15	n.a.
1947	133,831	18	28
1948	121,960	13	n.a.
1949	173,086	17	40
1950	202,876	28	n.a.
1951	216,973	44	43

Sources: Expenditures are compiled from Report of the Comptroller, 1921, 1925, 1928-1951 (Richmond: Division of Purchase and Printing). Case load and Employment are compiled from Virginia Governor Budget, 1921, 1925, 1928-1951 (Richmond: Division of Purchase and Printing).

[a]Includes expenditures in the administration of fire hazard laws.

[b]n.a., data not available.

Table 3. Total number of insurance companies operating in Virginia (selected years)

Year	Total Companies
1922	466
1930	524
1936	504
1937	549
1938	568
1939	576
1940	535
1941	553
1945	597
1946	608
1947	617
1948	618
1949	620
1950	639
1951	652

Source: Virginia Insurance Reports, 1922, 1930, 1936-1951 (Richmond: Division of Purchase and Publishing).

V. A REVIEW OF TWO STUDIES OF INTERSTATE DIFFERENCES IN THE EFFECTIVENESS OF INSURANCE REGULATION

A view of the lack of any recent studies, a detailed or conclusive comparison of state regulatory agencies cannot be made. However, some idea of the differences that do exist among agencies may be obtained from the results of a 1959 report of a Senate Antitrust and Monopoly Investigative Subcommittee.[106] Also the different philosophies and methods of regulation will be discussed.

A striking characteristic of insurance regulators has been and continues to be the apparent diversity in their ability to perform their duties. The most recent study of state regulatory agencies, though conducted by a Senate Antitrust Subcommittee in 1959, may still give some picture of what these disparities entail. Essentially, this study indicated substantial staff, budget and salary variation among states. For example, commissioners' salaries ranged from $20,000 per year in Texas to $6,000 in Delaware and North Dakota. The median salary for that year 1957 was $10,180; the Virginia commissioner was paid $12,300. Staff wages for non-civil service workers, as is the case in Virginia, were lower at all levels than civil service wages.

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[106] U.S. Senate, Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, The Insurance Industry: aviation, ocean marine, and state regulation, Report No. 1834, 86th Cong., 2nd Sess., (1960).

Such compensation the committee felt was insufficient to attract and retain qualified people and also weaken the environment for honest and efficient administration. Staff size for insurance departments in the same year varied from 583 in New York, 370 in Texas and 239 in Massachusetts to 10 or under 7 in different states. In 1957 the total budget of the New York State department was over $4 million while 31 states operated with less than $200 thousand and 18 states with less than $100,000. The figures for Virginia in that year were 69 staff members and a budget of $322,800. Also the report of this committee ranked states according to quality of state regulation involving 16 input variables such as salaries, budget, etc. New York and California were ranked one and two and Virginia tenth. It conceeded, however, that such a presentation is extremely subjective.[107]

This study also showed, in a comparison of total net premium receipts to expenditures on regulation in each state, that the revenue produced by the regulatory process is primarily used for purposes other than insurance regulation and supervision. It was also noted that premium tax revenues and other fees imposed on the business were an important source of general revenue to the states. These facts generally are still true today.

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[107] Ibid., pp. 118-139.

Of major recent and historical concern is the different types of rate regulatory systems among the states. Rate regulation has often been considered the key to solving many problems which have arisen in insurance.

There are essentially four approaches to rate regulation that have developed. These are (1) the restrictive approach of the states which permit little or no price competition; (2) the permissive approach where scarcely any attempt is made to limit competition; (3) the All-Industry approach which falls between these two extremes; and (4) the no-fault approach (really a form of the permissive approach) which proposes to replace the present tort or fault system with a no-fault one, thus reducing court and other claim adjustment costs and thus rates.

In the restrictive approach rates are made by the state or by a rating bureau to which all insurers must belong. State fixed rates is characteristic of the system in Texas. The mandatory bureau system was the recent form used in Virginia for fire and auto insurance. This type entails that rates be approved prior to their use. Also, there are no independent filings but some rate deviations are permitted. However, the procedures in making them has been described as extremely cumbersome.

The underlying philosophy of this approach is that insurance companies cannot provide coverage at (average) cost

unless uniform rates are charged and enforced through compulsory membership in bureaus. It is believed that state control of the price structure is desirable and in the public interest. Competition as such would necessarily be confined to service offered. The result is full cost pricing covering losses and expenses (and economic profit) while the rate must cover this with no excess or monopoly profit.[108] Most states do not use this system while in those states that do there are tendencies of moving toward a more liberal approach.

The permissive approach reflects the philosophy that competition is the best regulator of prices. In California and Missouri no filings are required; however, companies are answerable to their commissioners in that rates must follow certain, though not well defined, standards as to adequacy, non-excessiveness, and fairness. Several states have file and use requirements which, like the no filing states, make rates ultimately subject to the insurance commissioner's review and disapproval for the protection of the public interest. Proponents of the permissive approach feel that the commissioners have traditionally obstructed rate increases and decreases, and innovation due to political pressures and overly conservative attitudes.[109] This

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[108] C.A. Spencer, Jr., "A Comparative Economic Analysis of the Current Rate Regulatory Laws," The Insurance Law Journal No. 544 (May 1968), p. 370.

[109] Ibid., p. 373.

approach purportedly would eliminate such impediments. Its proponents also consider the insurance market to be very competitive. To substantiate such a claim they have pointed to a number of studies which have allegedly shown that (1) the insurance industry is one of the most rapidly expanding growth industries, and (2) that industry concentration during this period of growth had declined.[110]

The great majority of states adopted the All-Industry approach to regulation. This form requires filing and approval for most lines of insurance. Independent filings and deviations are allowed. There is also a provision for the maintenance of bureaus though neither compulsory membership nor exclusion from bureaus are permitted.

This form entails a compromise between government control and free enterprise. The states function is to apply general standards of adequacy, non-excessiveness and fairness to rates filed, not to specifically or directly make rates. Such a method, entailing the reasonable discretion of the commissioner in examining all rates, supposedly does not stifle but encourages competition, innovation and growth of the industry. This position holds that experience has shown that unrestricted competition has not been good to public interest. As such the public will not suffer from agreements

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[110] Ibid., p. 374.

in reasonable restraint of trade under public supervision. Moreover, it is felt that the greater danger is the opportunity of the larger companies to drive the smaller ones out of business, thus monopolizing the industry, in the absence of such supervision. The proponents of this approach see the market as one of imperfect competition and one in transition from monopolistic competition to oligopoly.[111] No analysis, as yet, has appeared to substantiate this depiction of the insurance market, however. The implied market characteristics are that insurance is a service differentiated product and that there is mutual independence or price fixing leadership.

Finally, the no-fault approach is a form of the permissive approach except that it eliminates a substantial portion of the traditional tort or fault mechanism for compensating automobile accidents losses. Each insurance company would pay the claims of its own policyholders up to a certain minimum amount no matter who is at fault. In this way extensive litigation time and costs, and other claim adjustment costs are eliminated. Savings reportedly would be such that rates could be reduced and coverages extended.[112] Free competition would also regulate prices here.

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[111] Ibid., p. 378.

[112] Paul Gillispie and Miriam Klipper, No-Fault (New York: Praeger Publishers, Inc., 1972), p. 13.

In 1969 a private study[113] was undertaken by Gerald Hartman to determine whether there were significant quantitative differences (e.g., in rate level, degree of competition, etc.) attributable to a difference in the type of rate regulation. Two no-file states (i.e., with permissive laws), California and Missouri, were compared with nine file and approval or Commissioner's All-Industry approach states. The volumes of business done in the two groups were quantitatively comparable; however, no steps were taken to account for possible geographical disparities. The observations were taken for the period 1964-69. Loss ratios, innovation, and firm concentration were compared between the two groups. Little significant results which could be attributed to the type of rating system were found, as states with prior approval laws were found at both ends of the spectrum in each case. However, the two "no-file" states overall tended to appear to show more competitiveness in the first two categories. Loss ratios (total cost of claims paid over total premium dollars) were on the whole higher for the "no-file" states. That is, insurers had more claim costs per premium dollar than in the other states. This could suggest rate levels attained levels which were competitive or significantly lower than those in the prior approval states. On

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[113]Gerald R. Hartman, "Insurance Experience and Rating Laws," The Journal of Risk and Insurance, (June, 1970), pp. 203-224.

the whole filings of new coverage plans were more frequent in the file and use states. Finally, the study found in general a greater degree of market concentration in the file and use states suggesting that market concentration tends to decrease with more competitive price flexibility.

In conclusion Hartman noted that these findings seem to cast some doubts on the argument of some industry people that the amelioration of market conditions (i.e., in fewer cancellations, underwriting losses, lower rates, etc.) can only be effected by legislative change in the rating laws, i.e., from the prior approval to the no-file permissive approach. Differences in the effects of regulation, he held, were probably more likely due to the administration of the law than the type of law itself.[114]

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[114] Ibid., p. 222.

VI. BRIEF EMPIRICAL ANALYSIS OF INSURANCE REGULATION IN VIRGINIA

As can be seen from the preceding historical sketchs, the area of insurance regulation has been highly controversial. Apparently, certain politico-economic factors and considerations have molded and otherwise affected the statutory development, structures and philosophies of insurance regulation. Possibly the effect has been a significant distraction of regulation from its primary goal (assuming it to be the promotion of the economic public interest). Perhaps such a situation has developed and has affected operating rationale of the regulatory agency itself. One recent study[115] made by George Stigler concerning the federal regulatory agencies and those of the state of Illinois suggests this to be so. Stigler found that the expenditures of public service commissions could be explained much better by the availability of funds than the industry activity to be regulated. This suggested that their regulatory activity was characterized by bureaucratic behavior.

In this section a limited and brief empirical analysis along the lines followed by Stigler will be presented. This involves analyzing the budget of the Virginia Bureau of

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[115]George J. Stigler, "The Process of Regulation," The Antitrust Bulletin, XXVII, No. 1 (Spring, 1972), pp. 207-235.

Insurance, a division of the State Corporation Commission and the group primarily responsible for insurance regulation in Virginia.

Two tests of "bureaucratic" (i.e., Stiglerian) hypothesis will be made. The first concerns the relative strength of state revenues (availability of funds) vs. the activity in the industry to be regulated in explaining variations in Bureau expenditures. The second concern the magnitude of the response of regulatory activity to a change in the amount of the activity to be regulated.

First, if a regulatory agency were performing well, we could expect its activity or regulatory output, approximated by its expenditures, to be strongly correlated with the activity of the industry to be regulated. In this case, we would conceivably be observing a regulatory phenomenon possibly in line with the initial regulatory goal. On the other hand, it also seems plausible that expenditures (thus regulatory activity) might also be highly dependent on the availability of funds measured by the yearly flow of state revenues, the Bureau's source of funds. If this were the case, we would appear to be observing a bureaucratic phenomenon. The model used by Stigler to identity which phenomenon is observed will be used here. As proxies for the activity in the industry we have taken income per capita (which should be fairly well correlated with the total revenues of

insurance companies) and, alternately, gross premium taxes per capita (a small ad valorem tax on all premiums earned annually). All data are for Virginia (1948-1964) and are presented in Table 4. The equations used were the following:

$$(1) \quad E = b_0 + b_1R + b_2I$$

$$(2) \quad E = c_0 + c_1R + c_2P$$

with E equal to expenditures (on insurance regulation) per capita;

R equal to state revenues per capita;

I equal to personal income per capita; and

P equal to gross premium taxes per capita.

The results[116] in both linear and logarithmic form, are presented in Table 5. The extent of the economic activity to be regulated appears to be a much better predictor of regulatory expenditures than the availability of regulatory funds; this suggests that the Bureau is performing its job as intended. At least, alternatively, it does not appear to be appreciably affected by bureaucratic budgetary contraints.

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116 Ordinary and logarithmic first differences were used, however, in the hope of eliminating a high degree of multicollinearity in the initial specification. The results of the new specifications were still not satisfactory as reflected in the insignificant t-values and low coefficients of determination.

It is recognized that the presence of serious multicollinearity affects the reliability of the estimated coefficients. Given this deficiency, our results must be interpreted cautiously.

The results[117] are not appreciably changed if each independent variable is separately correlated with E.

The second test concerns the coefficient of income (or tax premiums) in the equations for our model taken in lagarithms to obtain elasticities. A coefficient greater than unity would indicate either: (a) diseconomies of scale in regulation or (b) "boondoggling". A coefficient significantly less than unity might be interpreted as scale economies; i.e., the greater the amount of regulation, the lower the per unit cost.

The results are again presented in Table 5 in equations (3) and (4). The elasticity of expenditures per capita with respect to income per capita is roughly 1 (expenditures increase in about the same proportion in which the activity to be regulated increases). Assuming that perhaps gross premiums taxes per capita may be a better proxy for the activity to be regulated, the elasticity is about .59. To test for difference from unity we can compute the following:

$$t = \frac{\text{coefficient} - 1}{\text{standard error}} \quad .$$

[117]The coefficients in all four equations were estimated using both deflated and undeflated data. No appreciable differences in the results were obtained.

Table 4. State expenditures on insurance regulation, state general revenues, state income and state gross premium taxes, 1948-1964 (all data in per capita terms)

Year	Expenditures[a]	State Revenues[b]	Income[c]	Gross Premium[a] Taxes
1948	$.0371	$ 92.92	$1130	$1.1032
1949	.0370	93.74	1100	1.2841
1950	.0412	96.32	1228	1.4117
1951	.0438	101.13	1327	1.5479
1952	.0489	103.94	1470	1.5907
1953	.0479	104.37	1488	1.7782
1954	.0533	109.86	1502	1.9224
1955	.0523	112.40	1571	2.1774
1956	.0508	121.31	1635	2.2300
1957	.0533	146.62	1657	2.4044
1958	.0597	130.03	1684	2.4449
1959	.0632	138.76	1770	2.5685
1960	.0637	156.84	1856	2.6602
1961	.0653	163.87	1898	2.9392
1962	.0701	172.72	2018	3.0368
1963	.0706	187.45	2095	3.1751
1964	.0720	202.88	2267	3.3851

[a]Calculated from: Report of the Comptroller, 1948-1964 (Richmond: Division of Purchase and Printing) and the Statistical Abstract of Virginia, 1970, The Thomas Jefferson Center for Political Economy, University of Virginia (Charlottesville, Virginia, 1971).

[b]Calculated from: State Finances, 1948-1964 Bureau of the Census (Washington: Government Printing Office) and the Statistical Abstract of Virginia, 1970.

[c]Compiled from: Statistical Abstract of Virginia, 1970.

Table 5. Coefficients of regression of state expenditures for insurance regulation on state revenues, state income, and state gross premium taxes, 1948-1964 (all variables in per capita terms)

Equation	Intercept	Regressions			Coeff. of Deter.
		R[b]	I[c]	P[d]	
(1)	-0.00207	-0.00002 (-0.103)	0.00040 (5.135)	———	.9551
(2)	0.02009	-0.00004 (-0.554)	———	0.01798 (4.909)	.9555
(3)[a]	-4.53373	0.02449 (0.157)	1.00203 (5.192)	———	.9552
(4)[a]	-1.58024	0.05677 (0.036)	———	0.58716 (4.993)	.9518

Note: The numbers in parentheses are t-values.

[a]Equations 3 and 4 are the logarithmic forms of equations 1 and 2, respectively.

[b]R equals state revenues per capita.

[c]I equals state income per capita.

[d]P equals state gross premium taxes per capita.

At the .01 level the coefficient of income is not significantly different from unity (i.e., t = 0.01279). This possibly suggests constant returns to scale in insurance regulation. On the other hand, at the .01 level the coefficient of insurance premium taxes is significantly different from unity (i.e., t = 3.51024). This tentatively suggests the existence of scale economics in insurance regulation. Of course, it may also simply indicate reduced regulatory activity in insurance. Investigation of these alternative explanations is beyond the scope of this paper, however.

VII. CONCLUSIONS

1. The history of insurance regulation, both federal and by states, suggests that the major goals of regulation have been (a) to provide revenue (for the states); (b) to protect consumers of insurance from fraudulent activity and losses due to insolvency of insurance firms; (c) to set rates which are "fair" to consumers, i.e., which allow a "fair" rate of return to insurers and which protect insurance firms from "ruinous" competition. Clearly, the last goal involves conflicting aims and it is not possible at this point to determine which "sub-goal" has predominated. However, it seems that the first two goals have been reached.

2. The issue of federal vs. state regulation of insurance has yet to be resolved. By threatening the assumption of the regulatory function the federal authority appears to have caused an improvement in state regulation of insurance. The states are still quite tenancious with respect to their insurance regulatory authority. Whether federal involvement will increase or decrease may be determined by the ability and willingness of the various states along with the industry to solve problems created by the new demands on the insurance industry.

3. In recent years the activity in the insurance industry in Virginia appears to be a much better predictor

of insurance regulatory expenditures than the availability of funds. This suggests absence of bureaucratic phenomena in insurance regulation. However, due to data deficiencies these results must be cautiously interpreted.

4. Insurance regulation in Virginia in recent years has grown roughly in proportion to the growth of the insurance industry in the state. If anything, there appear to be scale economies in insurance regulation. However, this result is consistent with both cartel-level and competitive rates.

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AN HISTORICAL AND ECONOMIC ANALYSIS OF INSURANCE REGULATION IN THE UNITED STATES AND VIRGINIA

Thomas William Hannigan

Abstract

Insurance has been regulated in the United States since colonial times, albeit in many faces. This thesis summarizes the history of insurance regulation in the United States and Virginia. Special attention is given to the relationship among the insurance industry, the insurance regulator, and some aspects of the role of economic and political self interests in the development of insurance regulation. This paper also summarizes the various arguments involved in the state vs. federal controversy over regulatory control. The various methods and purposes of current rate regulation are also briefly discussed. Finally, some descriptive characteristics of insurance regulation in Virginia are presented and an empirical analysis of budget behavior of the Virginia Bureau of Insurance is offered.