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FEDERAL DEVELOPMENTS

Moderator:	ARNOLD A. DICKE
Panelists:	JONATHAN E. GAINES*
	GARY D. HENDRICKS†
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Recorder:	ARNOLD A. DICKE

- Federal regulations versus state regulations
- Status of Dingell/Metzenbaum bills
- Industry response

MR. ARNOLD A. DICKE: Ms. Jean Rosales is a professional staff member of the U.S. House of Representatives Subcommittee on Commerce, Consumer Protection and Competitiveness, chaired by Representative Cardiss Collins of Illinois. This is a subcommittee of the Committee on Energy and Commerce, chaired by Representative John Dingell.

Jean is a graduate of Sangamon State University. She started out as a theater major but decided she had to make money and, after discovering that accounting took too long, went into economics. She attended the University of Illinois to do graduate work and then moved on to the University of Texas, where she received her Ph.D. in government. She taught statistics for a few years at Lehigh University. Finally, her career took her to Washington, where she joined the staff of the Cardiss Collins subcommittee.

Jean assures me that staffers have an important role. She points out that John Sherman didn't like the final version of the Sherman Act, but his name stuck. So when you get the final version of the Dingell bill, you may not know who to blame.

Jonathan Gaines is vice president and associate general counsel at The Equitable. He's a graduate of Tufts University and Cornell Law School. After working for a law firm, he joined the government, too, and spent ten years at the Federal Trade Commission (FTC), in what he considers the "glory years" of 1971-81. We all remember that as the time when the FTC was starting to look at the insurance industry. But luckily he left the FTC and joined the insurance industry, so we're in good shape.

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I knew Jonathan when I was at The Equitable; we were both working hard on the demutalization project. But he's going to talk about the McCarren-Ferguson Act, including recent developments in that area.

Finally, Gary Hendricks is the director of government relations and chief economist at the American Academy of Actuaries. He's a graduate of the University of Michigan, and he also did his graduate work there. He then went to the Urban Institute, a think tank in Washington. From the Urban Institute, he went to the Department of Labor, where he was the chief economist. After that, he was hired by the Academy. He has been very instrumental in getting actuaries in touch with government people who are working on various items of interest to actuaries.

Jonathan will speak on developments in regard to the McCarren-Ferguson Act. Gary is going to bring us up to date on some issues relating to redlining. Jean was going to talk about where the Dingell bill stands, but because there hasn't been much development of that bill, last night she broached the topic of the role of insurance companies in the new health care bill. Apparently, her subcommittee is more involved with that bill than I realized.

MR. JONATHAN E. GAINES: As Arnold said, I came to the insurance industry from the FTC in 1981. At that time, for reasons best known to the people who hired me, the company thought it needed someone with antitrust expertise. I joined the company with that in mind. As it turned out, very little antitrust expertise was really needed. Indeed, from an antitrust point of view, the life insurance business is not all that interesting. This fact flavors a discussion of the McCarren-Ferguson Act and the proposals to repeal it.

I'd like to start at the beginning and talk briefly about what the antitrust rules are, why the McCarren Act is important, and about some recent case developments that are at least interesting, if not all that pertinent to what we do daily. Then I'll talk a little bit about what's going on in Washington.

How many of you are involved in the health insurance business, as opposed to the life insurance business? Not many. The health industry does have some interesting antitrust issues. But I won't get into that very much. It usually comes up in the form of questions.

The basic antitrust rule that we need to focus on is the prohibition on price-fixing, which is a very general concept. Essentially, this rule prohibits agreements among competitors with respect to what price is going to be charged, what product is going to be offered, where products would be offered, and to whom they would be offered. All of these go under the broad rubric of fixing prices or fixing the terms of trade.

Flat-out price-fixing agreements existed when antitrust laws first came into being. For 20 years thereafter, people thought that if you met in a smokey room with your competitors and agreed on price, that was bad, and it provided wonderful evidence for prosecutors and for people filing treble-damage claims. A whole law began to be built up as to what it takes to prove agreement, other than an explicit handshake between competitors. Parallel conduct by people already charging the same price is an example of some other activity that could be seen as implying agreement.

These kinds of activities include systematically exchanging price information, exchanging views as to future prices, having meetings that have no other apparent purpose, and so on. The range is enormous. And it's that range of kinds of situations that has led to, for example, the antitrust guidelines that I read in my speakers guide, carefully explaining that nobody at any of these meetings should ever talk about future prices or future conduct. But you can talk about concepts.

The McCarren Act was enacted primarily to ensure that states would retain the ability to regulate and tax the insurance business. But in addition to that, it provides an exemption from antitrust law, which has been very important, particularly in property/casualty (P&C) business, but less so in the life business. As I said before, the life business typically has not involved activities that would be seen as price-fixing.

The McCarren Act does two things. First, it expressly says that no federal law will preempt or supersede a state law dealing with the business of insurance. So that's one standard. If there's an explicit state law that requires a certain conduct, then the antitrust laws can't make that conduct bad.

Second, in general, the antitrust laws don't apply to the business of insurance, to the extent that business is regulated by the states, provided that the activity in question does not involve a boycott. Both of these concepts, what the business of insurance is and what a boycott is, have been the subject of litigation over the years, including a few cases that recently went through the courts.

I thought I would summarize briefly the recent developments on these two concepts. Then I want to mention two other exemptions, in addition to the McCarren Act exemption, which are very important to the context in which a McCarren repeal is being discussed. Those other two exemptions are both court-made exemptions. They don't depend on statute; they will evolve through court decisions.

One is called the state action exemption. It basically exempts any kind of activity from antitrust law that is the result of state legislation that contemplates a reduction in competition resulting from the practice and which is supervised by the state. This has come up in the P&C world, in which there are state-regulated rates. In those situations, it is appropriate and permissible, and provided for under state regulations, for the companies to jointly submit rates. Those rates are examined and approved by a state regulator. In that context, the agreement to submit joint rates is not illegal. It's exempt because it's part of a state program.

The other exemption that's important is the one carved out for lobbying, more broadly described as "petitioning the government." It covers all kinds of activity ranging from lobbying Congress to lobbying legislatures to dealing with the regulatory agencies. That exemption is very important to the insurance industry, because it's the context in which so much of the actual coordination goes on. All the NAIC activities and all of the committee work that goes on in connection with it is broadly protected under the "petitioning-the-government" exemption. That's really critical.

Now let me come back to McCarren. The business of insurance has been given a fairly narrow interpretation by the courts. It doesn't exempt insurance companies; it exempts conduct that involves the insurance business. The courts look at three

criteria to determine what that is. The most important is risk-spreading. Premiums involve risk-spreading. Coverage involves risk-spreading. The other two criteria are sort of derivative, but they're also important. One is whether the practice is part of the policyholder relationship. The other is whether the participants in the arrangement are all within the insurance industry or whether outsiders are involved. For example, the courts have said that agreeing on the premium to be charged involves the business of insurance, but agreeing on how to use peer review in the health insurance industry is not the business of insurance. The latter involves dealing with a source of supply, not the relationship with the policyholder.

A recent case involved the title insurance business in which the courts held that fixing the price of titles, title surveys, and title reports was not part of the business of insurance, even though it obviously affected in some way the cost of providing title insurance.

Let me mention a few recent Supreme Court cases. One case involved the first aspect of the McCarren Act, which says that if there's a state law regulating the business of insurance, it can't be preempted by a federal law. The case involved the insolvency of an insurer, a surety company that had issued surety bonds to a federal agency. The federal agency was trying to get priority before policyholders in the insolvency. The state insolvency law would put the federal agency in the same class with policyholders. The court said that the state law dealing with priority in insolvency was, in fact, a law dealing with the business of insurance, because it dealt with the performance of the insurance contract. Therefore, the federal law, which otherwise would have given the federal agency priority in that case, has been preempted.

The other case, which I'm sure that you have heard about, is the effort by several states to challenge the effort of the commercial liability insurance industry to do away with claims-incurred policies. Because this case so clearly describes a series of events that I can see happening in any context, life or P&C, I will give a quick listing of some of the allegations of the complaint.

First, it was alleged that Hartford agreed with General Reinsurance to seek elimination of the claims-incurred policy form. And then, it was said, General Reinsurance got the reinsurance association to say that its members would not reinsure the claims-incurred policies unless certain changes were made that the industry wanted. Then, there was an allegation that Hartford, Aetna, Cigna, and Allstate, collectively, had lobbied the London reinsurers to do the same thing, and, as a result of that, the London reinsurer went to the Insurance Services Office (ISO), that wonderful price-fixing organization the P&C world has, and told it that they, the London reinsurers collectively, would not reinsure the claims-incurred policies. That led to the ISO withdrawing support, it was alleged, for the claims-incurred form (the form was out there, but the ISO wouldn't support it), and it wouldn't provide rates for it. So people really couldn't use the form. And, finally, it was said that the London reinsurers told U.S. companies that they wouldn't insure new business unless the direct policies contained the changes that the industry wanted.

I can see all of that going on in a similar way in the context of the life industry. Think of pricing structures that are very competitive. People don't really like that because

you can't make enough money. I think I vaguely remember hearing that there was a lot of concern at one time about nonsmoker rates. You can see this evolving in a life industry context.

I read through this whole list of things and, in a normal antitrust contact, that list would be terrible. People would go to jail as a result of that. But it was clear in this case that it was exempt. It was part of the business of insurance. They were fixing the terms and conditions of an insurance contract. That was OK. The issue in the case that divided the court was whether there was a boycott involved. I won't bore you with the highly rarified thinking that nine people going nine different ways had on the question of how to distinguish a boycott from a cartel.

In essence, the final result and the majority opinion was if the reinsurers were saying that they wouldn't reinsure any business of a company that didn't change the particular policy forms involved, that would be a boycott. But if all that was being said was that they wouldn't reinsure the particular forms that were raising the issue, that would just be part of an overall "unitary cartel with conspiracy" not a "boycott." In the typical way the Supreme Court has, having settled that, it sent it back to a lower court to determine the facts. I just wanted to emphasize the kind of protection that McCarren gave to the underlying practice.

I mentioned before the case of the title insurance in which it was held initially that fixing the price of title reports is not part of the business of insurance. However, it could still have been exempt under the state action rules if joint setting of prices were complemented by a state law and if the states actually examined the prices and determined that they were fit. That led the court in that case to look at what two states actually did. The states, I think, were Connecticut and Arizona.

In both cases, the court held that there was not a sufficient state examination to cause the state action exemption to work. Rates had been filed, and they'd been approved. But the court actually looked into whether the state insurance department had done any real work. It actually substantively examined the rates.

So that was 15 minutes on the antitrust laws and how exemptions work, usually at least four hour-long sessions in law school. As for the McCarren repeal issue, I've always thought the life insurance industry is very competitive. It has not had the kinds of practices that have driven the P&C world to need to rely on the ISO to actually fix prices. Nevertheless, it is somewhat helpful as you can see. It gives you a little sense of freedom if you can get together and talk and do things like that, even though it doesn't happen very often. If it should happen, you know that you're exempt.

Senator Metzenbaum has been proposing the repeal of McCarren for years, but it's never gone anywhere. There's also a bill proposed by Congressional Representative Brooks. It hasn't gone anywhere, for political reasons, as I think that my two colleagues could better explain. From my point of view, the Brooks bill is very badly drafted. So even if you think that repeal of McCarren isn't the worst thing in the world for the life insurance industry, this particular bill is terrible. First, it doesn't clearly preserve state action and petitioning exemptions. So you'd have litigation from the outset as to whether those exemptions still exist.

Second, it uses terms that are common in antitrust, but are not really perfect terms of art that you would use in legislation. It uses, for example, the word "price-fixing." Now, as I said earlier, price-fixing covers a wide range of things. It's a conceptional notion. To stick it in a law is going to raise questions as to whether Congress meant the same thing or something different from what the courts developed.

The Administration did make a statement this year to the effect that it supports repeal of McCarren. This is the first time that's happened in many years. What's happening now is that the Justice Department is actually working with the Brooks people to revise this bill and make it (I hope) better drafted. If something is enacted, that won't depend on whether it's well drafted or poorly drafted. It's going to be enacted because of political reasons. But having a well-drafted bill on the table, at least, is an advantage, in terms of protection from unnecessary litigation later on.

I think this work is going to go forward, and the revised bill is going to be put on the table in the near future. As best I can tell, there's a quite reasonable likelihood that it will be enacted this year. And then, my raison d'etre at the Equitable, ten years later, will become obvious.

MR. GARY D. HENDRICKS: I'm going to talk about two bills that address the issue of redlining in insurance. I expect the actual substance of these bills will be of little interest to a group of life, health, and pension actuaries. However, I think these bills are important, because each of them is an indication of things that may come -- what we might expect from Congress in the future. The Academy staff has been tracking these even though, they aren't very interesting bills, even for P&C actuaries, in that they have really no important actuarial aspects to them.

The first bill that I'm going to discuss is HR 1188, the "Anti-Red Lining in Insurance Disclosure Act." It was introduced by Congressional Representative Cardiss Collins. It was then referred to the Energy and Commerce Committee, which referred it to the subcommittee that Jean works for, which, surprise, is chaired by Congressional Representative Cardiss Collins. There have been several hearings on this bill. The original bill really would have been very burdensome for the P&C industry and for its agents. It's a bill that essentially collects data about where agents are, where populations are, and where the insurance is being sold. It's a disclosure act; it doesn't really outlaw redlining. Anyhow, the hearings were very interesting because, although you could come up with many explanations, when people put up data of where agents were in large metropolitan areas, it certainly looked like redlining existed in a rather clear and startling way.

I can think of many reasons why agents would be where they are, because they like to make money. The Academy has nothing to say about that issue, but it really was striking in these hearings. Let me tell you very briefly what the final bill, after it was marked up, does. This bill is now not supported by the casualty and property liability trade association, but it is acceptable to it. The subcommittee really did a very good job of working with the trade group to come up with something that was mutually acceptable.

In general, the legislation would require annual disclosures by larger insurance companies of insurance activities in larger urban areas. The disclosure requirements would

apply to automobile and property insurance. The information to be disclosed would include breakdowns of information on insurance policies sold by zip code. Originally in this bill, it was by census track. I don't know if any of you know what a census track is, but in New York City, I think one building might be two census tracks. Not a very credible data base.

Also reported would be information about the number of insurance agents by zip code, along with a number of cancellations and nonrenewals by zip codes. This is all done by zip code, because for both homeownership and automobile policies much of the rating is done by zip code, so the insurers have the data in some way or another. The Secretary of Commerce would end up implementing this, and in addition to the disclosures, which the Department of Commerce would make available publicly each year, the Secretary would be required to establish a task force to review the problems that innercity and minority agents have in receiving appointments to represent P&C insurance companies, along with the practice of insurers in terminating such agents.

The reporting requirements take effect in 1995. There's a five-year sunset, so in the year 2000, this dies. In the fourth year out, the Department of Commerce is required to report back to Congress what it has learned and whether practices seem to have changed because of the bill. Then, presumably, Mrs. Collins or her successor will consider whether to do something else or leave this bill in effect.

The bill is now in committee. As I said, the casualty trade organizations find it acceptable. It will now go to the parliamentarian, where there will be a judgment about whether it has to be referred to another committee. I think it's safe to say it will not be referred to another committee. So it goes to the rules committee, which will then decide how the bill would proceed according to the very strict rules in the House. There are more than 400 members, and they can't spend a lot of time on a lot of this.

The leadership in the House could keep it from getting to the floor. If it gets to the floor, I think it's likely to pass. There's no similar bill in the Senate. But Senator Bryant, who would probably be responsible for this in the Senate, is well aware of this bill and is willing to introduce a bill that would go perhaps, or almost, as far.

The reason this bill is important is because, first, it's not a tax bill. So we're not taxing the insurance companies. And, second, Congress has decided that the state regulators and the NAIC aren't taking care of very specific problems, so Congress has decided to act. I think there's a lot of support, and if this bill ever gets to the floor, I think it will pass.

We at the Academy think that is important, because there are many other specific small issues in which Congress can say, "Gee, the states aren't doing it. The NAIC is not doing it; nothing's happened. We've heard about this for years. We're going to do something." What happens every time you have a bill like this, and when you get people like Jean Rosales working for subcommittees – when the subcommittees have the staff that can understand these issues – they start using their knowledge. That's what happens.

So we're very interested in this. There are other issues in which this could happen. It has happened with regard to insurance fraud, which is now a federal offense. I think most everybody agrees that's a good idea. Another issue is reinsurance, in which the NAIC and the states say, "We really can't regulate it; maybe we'd like your help." That's another place where Congress might decide to act. There have been several hearings on sales illustrations. The NAIC has gotten nowhere on this issue. I don't know how long the actuarial task forces of the NAIC have been spinning wheels, and I can see no visible progress.

The Society has gotten involved in this issue. Judy Faucett headed up a task force that looked at sales illustrations on the life side and came up with some findings that were not all that pleasant. Judy has testified before Congress on that report. She and some of her Society colleagues have now become part of a subcommittee of the Life Committee of the Academy. This group will try to figure out what, if anything, can be done and how it can help the NAIC.

I must say they're doing very badly. It's a difficult issue. That doesn't mean Congress wouldn't pass a piece of legislation. So there are many small things, and if Congress gets involved and interested in these, I think we could see many little bills. Sooner or later, one of them, I think, will deal with sales illustrations. Sooner or later, we're going to come up with some bills that have implications for how actuaries do their jobs. The profession needs to give Congress a lot of support, or the bills will not be very good technically.

The second bill is interesting. This is HR 1257, the Federal Insurance Administrative Act. This bill is interesting partly because of where it came from: it was introduced by Congressional Representative Joe Kennedy from Massachusetts. I'm sure you've all heard of Joe. This bill was referred to the House Committee on Banking, Finance and Urban Affairs. It went to the Banking Committee, which referred it to the Subcommittee on Consumer Credit and Insurance. The chair of that subcommittee, surprise, is Joe Kennedy. There have been many hearings on this bill. This bill also includes redlining provisions.

It also includes other things. Let me read the labels and the titles. I'm not going to talk about them. They sound really interesting, but they're not. It's technically a disaster. It wasn't even stillborn! I think the pregnancy failed. Anyhow, the first title would establish the Federal Insurance Administration as an independent agency. The second title of this bill would be the Regulation of Foreign Insurers. Sounds like a great idea. It only applies to P&C in this bill, because of committee jurisdiction. And it's a disaster.

The third title would be Liquidity Assistance by Federal Reserve Banks to Well-Capitalized Insurance Companies. I never could figure that out. Maybe Jean could shed some light on this. But I thought they were trying to address the Mutual Benefit Life situations -- runs on the bank. But, of course, it only applies to P&C companies. I don't know that there's been a run on the bank in a P&C company. Not in my lifetime.

The final title of the bill is Disclosure of Insurance Availability Information. The bill is extremely onerous. They did not work successfully with the casualty trades. The

data collection would cost the industry. It would be very expensive and burdensome for agents. The reason this bill is interesting, and the reason we're tracking it, is because it's a way of asserting jurisdiction – another committee in the House trying to make a claim to doing more regulation of the insurance industry.

So we care about this bill, because we might find things coming up in places where the staff doesn't understand the business of insurance and where the motivations are not very healthy.

One of the pieces of this bill would require that P&C insurers provide data on where they invest their money. The notion (which might apply in the life insurance area) is that, like banks, insurance companies should reinvest parts of their money in the areas where they do business as sort of an urban redevelopment fund. That makes a certain amount of sense for banks. Banks are in the business of making loans. Insurers are not in the business of making loans. But there's quite a bit of activity and thought about this. We consider it rather dangerous. It's not an actuarial issue. But the danger, as far as the Academy staff is concerned, is that there may be things in it that can have important implications for the profession.

MS. JEAN K. ROSALES: I'm a professional staff member with the Subcommittee on Commerce Consumer Protection and Competitiveness of the Energy and Commerce Committee of the United States House of Representatives. I think that our subcommittee still holds the distinction of having the longest title on the Hill. And I have found that's quite useful, because it takes the place of counting to ten, if I just repeat my entire title, and my subcommittee has generally calmed down before I get into arguments with people about anything.

If the Society had held its meetings two months ago, and I had been asked to talk about what Congress was working on that affects the insurance industry, my answer would have been very different. As you probably know, in the beginning of September, the White House circulated a privileged and confidential document to a very select audience, which included only certain members of Congress, key congressional staff, and the combined readerships of *The New York Times, The Washington Post,* and *The Wall Street Journal.*

I'm not in that particular cultural elite, so I had to wait for a photocopy of a photocopy of a photocopy of a photocopy to show up on my desk in its 236-page glory, shortly before Mr. Clinton addressed Congress in joint session. I have come to think of that day as The Day, because it made a substantial change in my life; particularly professionally, but also personally, because I haven't worked this hard since I was in graduate school, studying for comprehensive exams.

Fortunately, I do find health care reform quite interesting. And there are things going on there that I'd like to share with you. My subcommittee has a very different perspective of what's happening. And I think you might be interested in it. But I was asked to generally address congressional developments in insurance, so I'm going to give you a quick headline-news update on what is happening.

Gary did a very good job of going over what's happened with the two redlining bills in Congress. Our bill HR1188, was reported out by the full Committee on Energy and

Commerce. I don't know if you know this, but it has been placed on the union calendar. If you don't know the ways of the House of Representatives, you wouldn't understand what that means. Basically, being put on the union calendar means the bill will not be referred to another committee. It means the parliamentarian has decided on some grounds, which no one necessarily understands, that, in fact, Mrs. Collins's bill is insurance as it relates to the energy and commerce committee. So the Banking Committee has been blocked in terms of trying to get jurisdiction over Mrs. Collins's bill.

My understanding is that they're not having equal success going in the other direction. Some of the provisions in the Kennedy redlining bill, which seem rather bizarre, are actually in there because there was an attempt to make sure that the Banking Committee would have jurisdiction over that particular bill. So the bill's sponsors had to relate it back to either banking or housing or urban affairs. Many people wonder why the Banking Committee has any jurisdiction over insurance to begin with. Actually, it's because it had jurisdiction over Department of Housing and Urban Development (HUD). Those of you who remember the very first flood insurance bill know that flood insurance was originally operated by HUD. And that is the source of the Banking Committee's current claim to jurisdiction.

They also are pushing financial intermediation questions, and I am looked down upon by some of my colleagues because in a former incarnation, when I worked for the Congressional Research Service, I put together a 150-page report for the Banking Committee that justified why the Banking Committee has jurisdiction over insurance. It is constantly cited, and my colleagues are constantly grumbling at me. And I keep trying to point out: I wrote it, so I know where the flaws are.

Since Mrs. Collins's bill is on the union calendar, the next step is to go to the Rules Committee and ask for a rule that would allow the bill to go to the floor of the House. It's my understanding that Mr. Dingell, who would be the one to make that request, has not sought a rule yet. So this is all in limbo right now. If something happens, I'll make sure that the Academy knows about it. And it will either be a very bloody floor fight, because I'm sure that Mr. Henry P. Gonzales and Mr. Kennedy are going to pursue this if it goes to the floor of the House, or it will end up being an interesting jurisdictional battle. If you're interested in Congress -- if you're a Congress junky like I am -- this has been a lot of fun to follow. If, however, you know something about insurance and the insurance industry, this is terrific, as Gary more or less pointed out.

The other major piece of legislation that Congress is looking at, at least the House is looking at, is HR1290, which has become known as the Dingell solvency bill. I am the staff member on the subcommittee that has the responsibility for that bill. I knew it while it was being born, and I've memorized all 253 pages of it. I'm working on the section numbers. But basically the Dingell solvency bill comes out of the Oversight and Investigation Subcommittee investigations of solvency problems in the P&C industry.

Mr. Dingell and the subcommittee found that there were many problems, and they felt that solvency wasn't being properly regulated by the state. So Mr. Dingell decided to write a bill that would do it better. The Commerce Subcommittee held hearings on some sections of HR1290, the solvency bill, in April 1993. We had two

days of hearings, almost ten hours worth of hearings, on it. And I spent most of the summer working on various drafts of it, accepting additional input from the insurance industry and any other interested parties we could find.

Some of you may not know that the subcommittee made a great effort to get input on that bill. We circulated a rather famous 47-item questionnaire. No, it was longer than that. Many questions went to 43 different organizations, including the American Academy of Actuaries and its constituent groups, asking for input and recommendations on the bill. I have an entire file cabinet drawer that's dedicated to just those questions and answers. We've gone through all the questionnaires, we've gone through all the answers, we read the bill and tried to figure out where we could make changes to it. The bill is being redrafted and tightened up a bit. There are parts where it's a little ambitious, and we're trying to get that together.

Right now all I can tell you is, whatever the final bill looks like, it will be a bill that definitely deals with the regulation of reinsurance and the P&C industry. That one is a given. Mrs. Collins and Mr. Dingell both sometimes refer to it as "that reinsurance bill." I think that's because they remember the reinsurance part of it. What else gets included really depends on what happens in the future and where things are going along. Right now, ever since The Day when the health care plan arrived on my desk, I have not looked at the solvency bill. So it's literally on hold on my desk.

Janet Potts, who is the full committee staff person with primary responsibility for the bill, and the primary author of the bill, is not responsible for health care reform. But she has the enviable task of shepherding NAFTA through Energy and Commerce, so I don't think she's got very much spare time either. So that one is on hold, which from my point is lovely, because anytime Congress can't move on a bill, that gives us that much more time to look at it and figure out what we should do instead of what the original authors thought we should do.

So that brings us to the plan that was presented by the President. Many people have asked me what the Subcommittee on Commerce, Consumer Protection and Competitiveness has to do with health care reform. Why would we expect to have jurisdiction over that issue? Our jurisdiction comes from two very different vantage points. One is the fact that the Supreme Court in the 1945 Southeastern Underwriters case decided that insurance is, in fact, commerce. And if it's commerce, it's our area.

Therefore, we tend to be very concerned about what's happening in the insurance industry. Thus, when the plan arrived on my desk, I looked it over to see what it would do to the insurance industry. I am not a health care specialist, so I have tended to skim over the pieces that talk about the providers and the relationships between providers and communities and alliances, because that, frankly, is the jurisdiction of the Health and Environment Subcommittee, which is chaired by Henry Waxman. We have instead looked at the things that we think are unique and interesting to our subcommittee. And as I said, one is the impact on the insurance industry.

The other is our consumer-protection charge. Mrs. Collins in particular takes consumer protection very seriously. The redlining bill is a consumer protection bill. We

don't really see it as an insurance bill. So we're looking at both of those aspects when we take a look at the health care bill.

Some of the issues that we immediately started looking for were the appropriate use of utilization review by insurers and noninsurer health plans to protect consumers. Another issue that we looked at was what should be in the health plan report card. What types of things are going to be most useful to families? In reviewing the very first 80 pages of the plan, I came up with more than 113 questions. And as I said, it was the most complicated thing I've done since graduate school. I felt like I was studying for comprehensive exams without ever having taken the course. There are many questions there. I don't know if it makes sense.

I remember one of my questions was, what is a risk history? I didn't know if that was some terminology I hadn't learned about in four years of studying the industry or whether the task force decided to make up a word. I have so far polled a number of actuaries, and all of them have looked at me like I've lost my mind. So I assume that "risk history" is in fact an invented concept. If it is, it's going to have to be defined. Incidently, as you may know, the task force is still drafting the legislation to be introduced on behalf of the President. My latest information says the bill is already more than 1,600 pages long. My guess is they'll have at least 200 pages of definitions.

There are many of new concepts in here. They're talking about a very new world that none of us really understands very well. So I thought it particularly interesting that *The Washington Post* reported that the original Social Security Act was 32 pages long. That says something; I'm not sure what.

So I have a lot of information that I'm thinking about, a lot of questions, and I'm very pleased to say that both the American Academy of Actuaries and the constituent group, the Society of Actuaries, have offered to act as a resource for me and for the subcommittee as we go through the health care reform.

I understand that you already have heard a lot of the discussion of some of the health care issues. I want to bring up some issues you may not have thought of, because I think some are going to be very important for our subcommittee. One issue that really isn't looked at very closely is that a lot of that deals with life and health actuaries.

The health care task force assumed a lot. I don't mean to criticize them or denigrate them. I think they did a wonderful job in a very limited amount of time in creating a very different world. But it's very clear, if you read through the plan, that they are health-policy people. They're not insurance people; they're not insurance industry people. I don't think they are very aware of how the industry works right now. Many holes in the plan need to be filled, and they came out quite clearly to me on my first reading.

For example, a real basic question has been not answered. Who is going to regulate the health insurers when the brave new world occurs? As you all know, health insurance is currently regulated by state insurance regulators. That question isn't addressed in the health care proposal at all. There's a possibility that the state will

regulate the health insurers, but it's not clear whether the state will give that to the insurance commissioners or create a different entity.

There's a part in the bill that says that the Department of Labor will be responsible for overseeing the financial status of all health plans. The Department of Labor does such a brilliant job with the PBGC that I think it's a very good idea to put it in charge of health insurers. But I'm willing to accept other input on that issue.

A question that came up to me is that many health insurers also do life insurance business. What do we do about that? Should we separate the health part of the business from the life part of the business? If we don't, there is the possibility of predatory pricing. If we don't, there is the possibility of allowing the life company to basically be drained of its own assets, because health alliances can get carried away and start setting prices entirely too low.

But if we do separate the two, I would assume that's going to have a substantial impact on how companies do business, because it is very difficult to separate out assets when they've been mixed for all these years. So that's a question that comes up. Another question is, what are the standards going to be for checking the solvency of health insurers? Can you use the same standards in solvency regulation for a traditional fee-for-service-type plan as you do for HMO plans? I noticed that, in one of the recent Society of Actuary newsletters, there was a very good article discussing the risk-based capital (RBC) formula and its application to health-insurance-oriented companies. Those questions aren't even hinted at in health care reform. It's something that I frankly think needs to be answered. Because if they're not answered, we'll make it up as we go along, and I've never thought that's a very good way to legislate.

The President's plan also relies very heavily on the risk-adjustment mechanism. And I've asked for input from companies on that. I've talked to actuaries about that. It's one of those things that seems to work in theory, but nobody is really sure what it's going to look like. Nobody is really sure whether it will do what it's supposed to do. Even if it does do it, somebody has to develop it. Somebody has to test it. Somebody has to put it into place. And I'm quite concerned about a massive transition into a new system, when we're using a risk-adjustment mechanism and we don't know whether it works, given that it's reallocating assets from one company to another.

Another question that isn't raised is the transition period. Now we have the current state; then we will have the brave new world. How do we get from here to there? I'm concerned that smaller companies that could, in fact, compete effectively in the brave new world may get run out of business during transition, because larger companies can adjust more quickly. And, as you know, adaptation in the marketplace is often a substantial competitive advantage. So that's something that we need to talk and think about.

We need to consider questions of assumption reinsurance. As firms exit the market, how are we going to handle transfers of large blocks of business? Ira Magaziner has said that during the transition, he favors freezing premiums and not allowing any company to cancel or refuse to renew policies. I don't know if that's necessarily the

best solution. But we need to talk about it, so that when I go to Mrs. Collins and Mr. Dingell, and other people involved in the legislation, I can explain why this is a bad idea.

So I see this as a real opportunity to make a big impact on something that is probably going to be the major legislative business of the 1990s for Congress. And I see a lot of areas in which the task force did assume a lot. I'm encouraging everybody here to give me input. Let me know what you think. I have forwarded a subset of my 113 fabulous questions to the Academy. And it has either graciously volunteered or has been bullied into coordinating some of the information flows for me. If you have an interest in getting involved in this, if you have information you think I should have, you can probably send it to the Academy and the staff will make sure it gets to me or send it to me directly. I think this is a very exciting time. But it's a time in which technical expertise is absolutely necessary. And if anybody knows it, you do. And if you don't, I need to know that, too.

MR. DICKE: Jean mentioned that you give input to the health care reform bill. Actuaries who want to get involved in this process should contact Sam Gutterman, who is the Vice President of the Society for the health practice area.

The second thing I think I should clarify relates to Gary's remarks about the actions taken on illustrations. The NAIC put out a white paper on that subject at its recent meeting. The draft is not new; it has been around for quite a while. It does start to address the issues. But it's preliminary rather than definitive. It certainly needs to be worked on.

MR. RICHARD M. STENSON: Has there been any thinking in Congress about the guarantee system? The guarantee association system is also the state mechanism for picking up the pieces when there are solvency problems with life insurers. Or has that been a nonissue? Is the system likely to be affected one way or another, deliberately or not?

MS. ROSALES: It had better be affected one way or the other. The 236-page document has 1.5 pages devoted to guarantee funds. What they describe as a guarantee fund is not like any guarantee fund I've ever heard of. It does things that guarantee funds were not intended to do, I think. There's a rather frightening sentence that says that states can continue to use their existing guarantee funds, as long as they meet federal regulations. I personally think that's a horrible idea.

Again, the potential for mixing funds and confusing the industry is extraordinary. This issue is in my subcommittee's jurisdiction. We're the only ones who are really looking at it. I haven't quite come up with the best way to handle it. But I think that we do need to do something specifically about the guarantee funds. Talk about what's the best way to do it. There have been some minor discussions about whether we should have a national guarantee fund. Should we have state-level guarantee funds? Should we have alliance-level guarantee funds? Are we going to end up with problems of forbearance if there is a national-level guarantee fund, given that the federal government is not really regulating financial solvency. So there are many questions, and I am concerned about them. I have been in touch with Jack Blaine of

the National Organization of Life and Health Guarantee Association (NOLHGA) on the issue, he also is concerned.

We're trying to figure out the best way to address that. It is going to come up in one of the hearings at the subcommittee level, and I would appreciate input. Because I think it can make a big difference. It has to be structured carefully if it's going to work at all. I don't know that a guarantee fund is all that necessary, if you have guaranteed coverage for everybody. It's really just a matter of moving a policyholder from one health plan to another, in the case of an insolvency, and the guarantee fund is paying off the bills of the health plan.

Another issue that's come up is, do the fee-for-service companies contribute to a fee-for-service guarantee fund? Do the HMOs contribute? How do you mix them? How do you handle them? If you're working on a very small profit margin, can you assess 2% of premiums realistically without taking the whole system down with you? It is an important question; I don't have an answer.

MR. STENSON: Jean, just let me direct that back off health to the life and annuity area. The life and annuity guarantee funds are in place. They were certainly considered in the original version of the Dingell bill and were closely related to federal regulation of insurer solvency. Do you see particular changes that need to be made if the state systems are to remain viable? Or do you think that the only approach is to go to a federal approach to this guarantee system for life and annuities?

MS. ROSALES: Well, I really do have to emphasize that I have a bias in that I'm an economist. And I see things the way economists see the world, and not as politicians and not as actuaries see the world. I personally am not really very much in favor of guarantee funds, except as a temporary mechanism for smoothing out a transaction.

The only change that I would actually make in the life and annuity guarantee system is that it would be nice, from Congress's point of view, if you all had understandable rules that were reasonably uniform from state to state. When I was working with the Congressional Research Service before I joined the subcommittee, I had the joyful task of being in charge of the Executive Life Insurance Company failure and I answered questions over and over and over again. I probably answered ten questions a day from staffers and from congressmen about what was going on. What do you mean, we don't regulate it? What do you mean, we don't run things? People were trying to figure out why it is that, if one worker lives in New Jersey and another worker lives in Illinois, they're not going to get the same kind of treatment. Who is running these guarantee funds anyway? It was very difficult to explain to members of Congress. And it's very difficult to explain to the public, who assumes, if they know what a guarantee fund is at all, that it's like the FDIC.

So I think there's more need for a little more uniformity and a lot more education on the issue than there is necessarily a need for restructuring. I know that there is support among consumer groups in particular for starting a national guarantee fund. I'm not crazy about it, but I'm willing to be convinced another way.

MR. ALLAN W. RYAN: I am curious about how the solvency bill relates to the current Academy efforts in pushing the idea of an actuary's report on solvency -- an opinion to include surplus as well as just reserves.

MR. HENDRICKS: The current version of the bill, which Jean is not working on, lays out the appointed-actuary system much as it exists now. We talked a lot with Janet Potts, who drafted that section. In fact, a few Academy committees ultimately drafted that section of the bill. Janet was extremely concerned that nothing controversial be included. There were much bigger fish to fry.

And she was very generous and very kind in letting us define what a qualified actuary is, making reference to the Academy and the Actuarial Standards Board, and to do these parts the way the profession would have them done. It asks for actuarial reports not actuarial opinions. That was really a decision that was made by the profession, not by Janet. That was acceptable to Janet.

We could not address dynamic solvency testing. That was just too controversial. It would have been controversial for the industry, and Janet made the rules very clear to us. "Anything that you guys want, that the industry will go ape on for me, you can't have. Hold your right hands up on bibles and say, 'This is not controversial, Janet,' when you give me the language."

MR. DICKE: That's a good point. The exact way that this dynamic solvency testing might be implemented has been under a lot of discussion. It's moved from the original concept of an opinion to some sort of a report that won't be mandatory. There's so much still under discussion on our side that it's probably not time to bring it up. But, we might ask, "Is there a role that actuaries might usefully fill in the oversight of solvency?"

MS. ROSALES: I think that it's an interesting idea. Something that I have learned in the two years I've worked with the subcommittee, and the three years before that with the Congressional Research Service is that the toughest part of getting any bill passed is explaining to the members what the bill does.

Mrs. Collins, as it turns out, has a substantial background in accountancy. And when we had hearings on the NAIC and its regulation of foreign reinsurance, I had some questions about whether Carlos Miro could have done what he did if there had been an independent actuary reporting on his reserves. There were other interesting issues like that. She caught on right away and enjoyed grilling the NAIC on that. She understood the importance of financial reporting. So I think that she would be very sympathetic to something like that.

One problem that I think arises with the solvency bill is that it is very bulky and is very controversial, and it does an awful lot. I would frankly recommend that if you were interested in pursuing something like that, consider trying to draft a free-standing bill -- we can talk to Mrs. Collins and see if she would be interested in pursuing something like that -- rather than attaching it to solvency, because you're going to end up basically getting lost. It's hard enough trying to explain what all these issues are without getting into "What is dynamic solvency? What are they talking about?"

But I think it's an interesting concept. It's also something that can be brought up informally, or less formally, in the committee report.

MR. EDWARD H. COLTON: Would you mind repeating your concern about financing and keeping assets separate? I didn't quite catch it.

MS. ROSALES: I'm basing my reaction on a gut feeling, that if you have a company out there, and it does both life and health insurance, if the life end of the business ends up being regulated by the state and the health end of the business ends up being regulated by some other entity as yet undefined, it seems to me that it can get fuzzy about where the money is and where the money is going. It may in fact be that I don't understand this and everybody else knows what's going on and it's perfectly easy to keep track of which assets belong to which part of the business. I tend to doubt it. But, frankly, that's precisely why I need actuaries to come and explain it to me. How are the assets handled? Can you, in fact, have a combined company? Or is it a good idea to have a fire wall, just to make sure? Should we basically treat the health plans as if they were the equivalent of separate-account business (which I understand is a specialized type of business that has you voluntarily taking on more investment risk than you normally would with other more traditional plans)?

I also don't want to end up having health plans subsidized by the life end of the business. As an economist, I think it's just totally inefficient to misrepresent the cost of producing health care. That's the whole reason that we've gotten into a lot of the problems with the health care system presently. And to the extent that you can slide assets back and forth, you may end up not estimating correctly what those costs should be. I don't know if that clarifies it a little bit. But if you think about it and you say, "don't worry about it, Jean," I'll stop worrying about it.

MR. COLTON: I think it's worth thinking about and worrying about. But I think it might be helpful to realize that in the business of life insurance, particularly with regard to annuities and other interest-sensitive products, we've got to change to what you might call spot-rate pricing, using commodities as an analogy. We have to be sure that new business isn't being sold at the sacrifice of old business. This is a current consideration in the insurance industry. How does one assure oneself as a regulator that that's not happening? This issue is a very current issue in the industry. It might help form some basis for dealing with the issue you raised.

MS. ROSALES: Again, I'm less concerned with coming up with answers, although I would love it if I could come up with answers. But I want to at least make sure that members of my subcommittee, and the members of Congress, are aware of the fact that there's a decision to be made here. We can't just ignore the question. So even if you can't give me an answer, I'd like to at least be able to say that we looked at it. We're not going to do anything about it just now.

MR. DICKE: I might comment on that. In the case where there is some regulation of pricing, both on the P&C side and, I think, on the health side, as in California and also in New Jersey, there were times when the various state regulators were actually at odds with one another in that they felt that the states with rate regulations were asking for subsidization of the rates within their states through the charging of higher

premiums outside the states. When you bring in a regulatory framework that insists on a certain price level, such subsidization can easily happen.

MR. JEREMY STARR: My question on the solvency bill has to do with regulation of reinsurance. In early forms, the bill seemed to lump life and P&C reinsurers together. Life reinsurers are very different from P&C reinsurers. Life reinsurers tend to have affiliates; they also tend to be within companies that have other lines of business, unlike P&C reinsurers, which tend to be stand alone. It gets into the same issue that we talked about on the health side: how do you build a fire wall between companies? The sections of the bill regulating reinsurance didn't make sense.

MS. ROSALES: The drafting of the Dingell bill was an interesting process in and of itself. Mr. Dingell and the Oversight Investigation Subcommittee have always been very interested in P&C. And that's what they were really directing the solvency bill toward.

The Commerce Subcommittee has been somewhat more directed toward life insurance. We did hold hearings on Executive Life and on problems of risky assets. My colleague, Richard Huberman, and I did try to pull in the reins periodically and say, "wait a second, you can't treat life as if it were P&C. They're different critters."

Because I have spent six years now looking at insurance, I've gotten to the point where I think that there are actually three industries out there that just happen to have a word that is the same in their titles. P&C is one, health is one, and life is one. They behave very differently, they compete differently, and the rules can be very different. So to the extent that we could, we tried to stop and say, "wait a second; do we mean life? do we mean P&C?"

The reinsurance section was one about which I frankly didn't know enough to say to stop. I knew about guarantee funds. I caught that. The life reinsurance section is very badly written. I think it was clearly directed at P&C, and there wasn't enough discussion of life. I would welcome any input on a better way to handle it. Is it an issue? It could very well be something that's not that big of a deal, that we don't need to address it all. Perhaps the bill should explicitly say that life reinsurance is not part of this title.

MR. STARR: I'm on the ACLI steering committee on reinsurance. The steering committee did come down and talk with some of your folks. We gave an introduction as to what life reinsurance is. I wonder if another session like that would be useful.

MS. ROSALES: As the bill progresses, we will be back in touch with you. Having had a lot of training as an academic, having been a professor, I always call colleagues and say, "tell me about this." I just add everybody to my Rolladex. I'm calling people constantly. It's one reason I like being invited to meetings like this. It just gives me a few more resources. We will certainly be looking at the life reinsurance section as well as other parts of the bill. And I expect that there will be changes.