



Insurance Regulation: The Case for a Trade

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A regulatory trade

- Much greater reliance on market
 - ⊙ Little role for state in price setting
 - ⊙ Little role for state in form regulation
 - ⊙ Exit from most subsidy schemes such as TWIA
 - ⊙ Statutory constraints on judicial market subversion
- But make sure market works
 - ⊙ Tougher enforcement of state antitrust laws
 - ⊙ Maybe some regulations and safe harbors
 - ⊙ Heightened intermediary regulation
 - ⊙ Lower effective cost of educated choices

What will make the trade possible


- Insurers will have to show willingness to accept tougher competition regulation
 - ⊙ More open actuarial models
- Greater conceptual agreement on what sort of price “discrimination” is permissible
- More resources to solvency regulation
- Pilot demonstrations of success in Texas
- Education and good faith
 - ⊙ So long as Sarkisyan myth is nightly television reform will be hard

Education

- Concept education
- Shopping education
 - ⊙ Websites
 - ⊙ Facilitation of comparisons
 - ⊙ Have TDI audit 50ish random claims files per carrier, redact them and either grade the insurer and/or make them available to third parties
- Greater responsibility of intermediaries
 - ⊙ Disclosure of incentives / conflicts / certifications
 - ⊙ Heightened education
- Permit recycling of learning from other states



Specifics on homeowner insurance

- Substitute process regulation for price regulation
 - ⊙ Vigorous enforcement of state antitrust laws coupled with regulatory clarity on permissible practices
 - ⊙ Facilitate publicity on differential terms rather than regulation of differential terms
 - ⊙ Hold independent agents to a high standard
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TWIA: Some minimal steps

- Start lowering maximum limits on TWIA policies
 - ⊙ Make sure modeling techniques by a few actuaries doesn't lead to collusive pricing
- Condition unlimited assessment of insurers for final tier of TWIA liability on certification by independent body that state has taken out full insurance against contingent "liability" for premium tax shortfalls

Other specifics

- Clarify ability of liability insurers to limit by contract duty to defend and duty to settle
 - ⊙ Should be permissible under Ch. 2301
- Put insurance education in high school curriculum

Why is insurance different from carrots?

- Complexity
- Importance to economy
- Importance to consumer
- Discomfort with inequality
- Primacy of state law
- Federal antitrust immunities

Complexity

- Myriad possible futures
 - ⊙ Non-expert humans tend to be bad at this
- Purchase of expert advice difficult
 - ⊙ independence?
 - ⊙ knowledge?
 - ⊙ Marginal benefit often small
- Comparison is challenging
- Not toy-like
 - ⊙ Compare to cars, computers, etc.

Importance to economy

- Insurers are major financial intermediaries
- Ripple effects when they “fail” relative to expectations
 - ⊙ True even if expectations unjustified

Importance to consumer

- Investment and even existence in a modern economy depend on it
 - ⊙ Health insurance
 - ⊙ Property insurance
 - ⊙ Automobile insurance
 - ⊙ Liability insurance
- Long term promises for life insurance and occurrence liability insurance

Price As A Signal of Inequality

- Some inequalities make us uncomfortable
 - ⊙ Faultless differentials in health
 - ⊙ Differentials in economic risk due to factors that seem
 - ⊙ difficult to control (living on the coast?)
 - ⊙ A surrogate at best (credit scoring)
- Price manifests inequality
- Yet failure to price in accord with risk creates
 - ⊙ Moral hazard
 - ⊙ Inefficient risk retention
 - ⊙ Need for subsidization via taxation, unfunded mandates, market contraction

Primacy of State Law

- Unlike most commercial transactions
 - ⊙ No UCC
 - ⊙ Except in health insurance little federal law
 - ⊙ Multiple forms of insurance regulated differently
- Creates barriers to entry
- Some homogeneity achieved via
 - ⊙ NAIC
 - ⊙ ISO
 - ⊙ Reinsurance

Immunity from Federal Antitrust Law


- McCarran-Ferguson Act
- Legacy of Paul v. Virginia
- Fear of cut-throat competition
- Fear of applying “rule of reason” to some practices
 - Information sharing
 - Pricing models

How does Texas address these “special” problems?


- Prospective solvency regulation
- Regulation of rates and terms
 - ⊙ But see Ins. Code Ch. 2301 effective April 2007
- Mild regulation of intermediaries
- Judicial doctrines that channel terms
 - ⊙ Significant modifications of contract law
- Texas Free Enterprise and Antitrust Act of 1983
 - ⊙ Bus. & Com. Code § 15.01 et. seq.

Complexity

- Plain language requirements at times
 - ⊙ Even when it works does not address inherent complexity
- Form regulation for consumers
- Minimal competency regulation for intermediaries
- But ...
 - ⊙ Little effort at education
 - ⊙ Minimal burdens on intermediaries
 - ⊙ Little effort to facilitate assessment of intermediaries
- Beginning efforts at comparison shopping




Alternative Ways of Addressing Complexity


- Serious educational efforts
 - ⊙ High school curriculum
 - Making the choice problem finite
 - ⊙ Medigap example
 - ⊙ Exempting sophisticated parties
 - Heightened regulation of intermediaries
 - ⊙ Testing
 - ⊙ Bonding
 - Compacts with other jurisdictions
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Addressing Importance to Economy

- Solvency regulation
 - ⊙ Examination
 - ⊙ Licensure
 - ⊙ Investment restrictions
 - ⊙ Premium adequacy
 - ⊙ Form restriction
- Guaranty Funds




Alternatives to Addressing Importance to Economy

- More emphasis on solvency regulation
 - Education on the importance of solvency and financial rating
 - Disestablishment of government guaranty funds
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Addressing The Importance to Consumers

- Health insurance regulation
 - ⊙ Various mandated cross subsidizations
 - Expansive judicial interpretation of liability insurance provisions
 - Anti-discrimination provisions
 - Limitations on ability to cancel or non-renew
 - Extracontractual penalization of some breaching insurers
 - Public investigations of systematic violations
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Alternative Ways of Addressing Importance to Consumers

- Recognition of conflict between consumer “protection” and market vitality
 - ⊙ Subversion of provisions preventing moral hazard, adverse selection, systematic risk
 - Contractual bonding rather than judicially mandated bonding
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Addressing Price As A Signal of Inequality

- Anti-discrimination provisions
- Constraints on using some rating methods
- Subsidized insurance
 - TWIA
 - THIRP
- Actual price fixing or bounding

Alternatives

- Recognition of shortcomings of price regulation
 - ⊙ Wrong and counterproductive signals
 - ⊙ Dependency on perpetuation
- Fostering more competition in actuarial methods
- Recognition that choice often contributes to risk
- Education on risk reduction