FINAL REPORT OF THE
JOINT SUBCOMMITTEE
STUDYING

The Availability and Affordability of Liability Insurance, The Antitrust Exemption Afforded Insurers and the Reinsurance Costs Associated with Liability Insurance

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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Report of the Joint Subcommittee Studying
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To
The Governor and the General Assembly of Virginia

Richmond, Virginia
January, 1990

TO: Honorable Gerald L. Baliles, Governor of Virginia
and
The General Assembly of Virginia

I. INTRODUCTION

In 1988 the General Assembly passed House Joint Resolution No. 120 to study ways to ensure that affordable liability insurance would continue to be available to the citizens of this Commonwealth. Specifically, that Resolution asked that a Joint Subcommittee study the means of ensuring the continued affordability and availability of liability insurance in the Commonwealth, the reinsurance practices of the insurance industry, and the antitrust exemption afforded the insurance industry. The work and recommendations of that Joint Subcommittee are reported in House Document No. 63 of 1989. Recommendation No. 5 of that Joint Subcommittee was to continue the study for another year so that the Joint Subcommittee could complete its work in the three primary areas. House Joint Resolution No. 382 of 1989 was agreed to by the General Assembly of Virginia to continue the study. A copy of that Resolution appears as Appendix 1 to this report.

The membership of the Joint Subcommittee appointed in accordance with House Joint Resolution No. 120 continued to serve under House Joint Resolution No. 382. Those members were: Thomas W. Moss, Jr. of Norfolk, Richard L. Saslaw of Annandale, Frank D. Hargrove of Hanover, W. Tayloe Murphy, Jr. of Westmoreland, Lewis W. Parker, Jr. of Mecklenburg, William T. Wilson of Alleghany, John H. Chichester of Stafford, Richard J. Holland of Isle of Wight, J. Granger MacFarlane of Roanoke, William F. Parkerson, Jr. of Henrico and John Robert Hunter, Jr. of Arlington.

In House Document No. 63 of 1989, the Joint Subcommittee stated that another year of study would provide the forum necessary to permit a further examination of the three issues. In the area of affordability and availability, the Joint Subcommittee generally observed
that it was clear that significant affordability and availability problems remain in certain lines of commercial liability insurance. The Joint Subcommittee observed that evidence of such remaining problems exist in the annual troubled-lines report published by the Bureau of Insurance wherein the list of potentially noncompetitive lines of commercial liability insurance had grown from 1987 to 1988. In the area of reinsurance, the Joint Subcommittee found a need to further study the feasibility of requiring primary insurers to disclose the specific costs and benefits associated with reinsuring their Virginia risk, and requiring detailed accounting and disclosure of corporate information in cases of reinsuring with affiliated companies. Finally, in the

area of the insurance industry's antitrust exemption, the decision was made that the Joint Subcommittee needed more time to examine certain services provided by rate service organizations to individual insurers, including the practice of publishing and filing advisory rates.

II. EXECUTIVE SUMMARY

The Joint Subcommittee established pursuant to House Joint Resolution No. 382 of 1989 was charged to study the same primary issues under House Joint Resolution No. 120 of 1988: (i) the reinsurance practices of insurance companies, (ii) the advisability of modifying the insurance industry's exemption from the Virginia Antitrust Act and the role of rate services organizations, and (iii) the means of insuring the availability and affordability of liability insurance in the Commonwealth. At its first three meeting, the Joint Subcommittee received testimony from the interested parties on the three primary issues. At the fourth meeting, the Joint Subcommittee considered proposals submitted by interested parties and adopted its recommendations. The work and deliberations of the Joint Subcommittee will be discussed in detail later in this report, but for the purposes of this summary it will suffice to say that the Joint Subcommittee considered eight separate recommendations. All eight recommendations were agreed to and will require the introduction of legislation at the 1990 Session of the General Assembly. Seven of the proposals were jointly submitted by the Office of the Attorney General and the State Corporation Commission, and one proposal was submitted by the State Corporation Commission. Two of the joint proposals were in the reinsurance area, three of the joint proposals were in the antitrust area, and two of the joint proposals were in the availability and affordability area. The State Corporation Commission's proposal was in the availability and affordability area.

During 1989, the joint subcommittee focused on and reviewed the following issues:

- Whether primary insurers should be required to provide to the State Corporation Commission specific cost information associated with their reinsurance practices;

- Whether a detailed disclosure of corporate information should be made when an insurer reinsures with an affiliated company;

- Competitiveness of and existing barriers to enter the reinsurance market;

- Whether rate service organizations should be prohibited from filing final rates;

- Limiting the filing of loss costs data by prohibiting the inclusion of recommended expense and profit contingency factors;

- Whether to conform procedures for investigating and enforcing and penalties for violating anticompetitive conduct prohibited by the Insurance Code to the procedures and penalties presently found in Virginia's Antitrust Act;

- Repeal of the antitrust exemption;

- Whether to allow the State Corporation Commission to require interest to be paid on refunds to policyholders when it finds the premium for a line of liability insurance to be excessive;

- Authorizing provisional rate reductions;

- Whether there should be an increase in the amount of penalty that could be charged an insurer that filed late or nonconforming data;

- Appropriate criteria to be used for establishing a line of liability insurance as individually-rated or "A-rated";

- Periodic examination of data filed relating to all medical malpractice claims, opened, settled, adjudicated to judgment or closed; and

- Insurer profitability in commercial liability lines, and how much weight should be given to profitability in a noncompetition determination.

III. WORK AND DELIBERATIONS OF THE SUBCOMMITTEE

The Joint Subcommittee held four meetings during the course of its interim study. Each of those meetings was a public hearing and was held to elicit testimony on specific issues. Several persons and organizations assisted the Subcommittee in its work and deliberations, and they were: the Office of the Attorney General of Virginia, H. Lane Kneedler, Chief Deputy Attorney General, and his staff; the Bureau of Insurance and the State Corporation Commission, Steven T. Foster, Commissioner of Insurance, and his staff; representatives from the insurance industry, James C. Roberts, Esq., Anthony F. Troy, C. William Waechter, Jr., Esq., Philip B. Morris, Esq., J. Christopher Lagow, Esq., and Henry H. McVey, III, Esq.; Daniel Conway of the Reinsurance Association of America; the Insurance Services Office, Inc.; and Virginians for Fair Rates and Fair Compensation. The Joint Subcommittee would like to point out that, due to the considerable amount of testimony heard and written material received, it would be impossible to include within this report all of the testimony and written statements submitted.

Reinsurance

TESTIMONY BY THE OFFICE OF THE ATTORNEY GENERAL: There is considerable concern about the reinsurance practices of the insurance industry, and how those practices affect the price of insurance for individuals, business and professionals. See Appendix 2 of this report. There is virtually no regulation of reinsurance, although reinsurers licensed to do business in Virginia are subject to solvency regulation by the Commissioner. The traditional justification for exempting reinsurers from regulations is that the consumers of insurance companies have the capacity to comparison shop and the information necessary to do so effectively. In addition, the reinsurance market has either been considered competitive, or the difficulty of controlling any competitive behavior at an international level where many reinsurance transactions occur, has been considered to be too great an

obstacle of effective regulation. This aspect of the insurance industry is very different from direct (or primary) insurance. What has become increasingly clear, however, is the tremendous impact that reinsurance has on the direct insurance market. For the most part, that impact is positive. Reinsurance is necessary for insurers to distribute risk and to increase their capacity to insure business, professionals and individuals. But where reinsurance is not adequately available, or where the reinsurance market is not competitive, the result can be unavailable or unaffordable insurance in the direct market. And because reinsurance is such a highly leveraged industry, reinsurance problems with affordability and availability become greatly magnified at the level of direct insurance.

Because of the great potential for reinsurance to affect adversely the direct insurance market, there is concern that Virginia's insurance regulators have access to certain important reinsurance information. However, in keeping with the long standing view that government should regulate as little as possible in order to provide the oversight necessary to protect the public interest, it is recommended that, in a very circumscribed set of conditions, insurers be required to file reinsurance data in addition to other information already required by statute. It would be entirely appropriate for the State Corporation Commission to review the scope and nature of reinsurance transactions in situations of potential control, where such transactions may affect the competitiveness of rates charged to Virginia policyholders. For this reason, it is recommended that insurers writing coverage in lines designated as "troubled" by the Commission be required to file Virginia-based data on their reinsurance transactions with companies where there is a relation of actual or potential control. The filing of this data would permit the Commission to scrutinize such transactions to determine whether and when they are the product of legitimate pooling of risk among companies, and whether and when they involve abuses that should not be permitted. It is believed that this data is needed in these cases to make a full determination of the reasonableness of a rate request. The Commission would be able better to evaluate a request for a rate increase if it can consider losses of the total book of business of an insurer as well as its reinsurance costs, along with the other information that insurers must provide under the insurance regulatory reforms enacted in 1987. Taking this practical step will assure a more competitive insurance environment in Virginia that will be in the best interest of consumers and insurers alike. See Appendix 7 of this report.

TESTIMONY OF THE INSURANCE INDUSTRY: There should not be additional statutory nor regulatory burdens added on the reinsurance industry. See Appendix 3 of this report. Significant authority currently exists to investigate rates and examine companies to determine whether reinsurance arrangements may be a problem or a factor in rate issues; but more importantly, it is clear that the reinsurance industry itself is highly competitive and reacts accordingly. The testimony on the reinsurance issue received by the Joint Subcommittee demonstrated that by any rational measure, the reinsurance industry is highly competitive and reacts accordingly. The testimony also explained that figures concerning "interaffiliate reinsurance", which had concerned the Attorney General, reflected intracompany pooling which is closely regulated under the Virginia Holding Companies Act and under similar or identical legislation in 43 other states. Finally, the testimony explained that rates are reviewed on a gross basis and that the State Corporation Commission has significant authority to investigate rates and examine companies to determine whether, in the case of an excessive rate, reinsurance arrangements might be a factor.

In view of the evidence received by the Joint Subcommittee, any attempt to develop a detailed reporting scheme for each reinsurance transaction should not be recommended. First, the reinsurance industry is competitive and there is no evidence that reinsurance practices cause excessive rates. The competitive structure of the industry makes it very unlikely that reinsurance would exert any undue influence on rates. The reinsurance industry is relatively unconcentrated and has low barriers to entry. The industry's aggregate concentration is low compared to most major industry. Reinsurance industry results reflect those of a volatile, competitive market. Perhaps more significantly, there are no financial barriers to enter the reinsurance market, over and above those that must be meet to enter the primary market. Secondly, the existing regulatory scheme allows an efficient and thorough review of the reinsurance impact on rates without the need to produce and review volumes of questionable data. Extensive testimony has been provided at the Joint Subcommittee's first year of hearings concerning the impracticality of this suggested legislative approach. There are numerous types of reinsurance arrangements for which meaningful state-based data cannot be produced. Some other types of reinsurance arrangements would provide data that duplicate primary company data. In these cases where data could be produced, it would involve an immense amount of work for the filing companies and the Commission. Under its current investigative authority, the State Corporation Commission can examine reinsurance arrangements. Presently, a rate is determined to be excessive or reasonable whether or not reinsurance exist. If a rate is excessive, the Commission has extensive investigative and examination authority to determine the cause, including whether reinsurance arrangements could be a contributing factor. Also, the Commission has broad authority to investigate rates on its own initiative or upon consumer request. Using its existing authority to focus on circumstances where rates are thought to be excessive, or whether the financial condition of the insurer is in question is far more efficient than attempting to review filings by each insurer detailing each of its reinsurance agreements for each risk by state, line and subclassification.

Thirdly, extensive additional authority exists for regulating pooling arrangements. Prior written approval by the State Corporation Commission is required for a material transaction between a domestic insurer and any affiliate involving more than either five percent of the insurer's admitted assets or twenty-five percent of the insurer's surplus, whichever is less. In deciding whether to give approval, the Commission must consider whether the transaction meets the statute's standards and whether it might "adversely affect the interest of policyholders". Pooling agreements are subject to the act and must receive prior approval. In addition, such agreements and any non-pooling interaffiliate reinsurance agreements are to be reported on the Annual Financial Statement, which all licensed companies must file with the Commission.

TESTIMONY OF THE VIRGINIANS FOR FAIR RATES AND FAIR COMPENSATION: Where there are questions about reinsurance practices, it is in the public's interest to collect data to answer those questions and to provide a mechanisms for on-going monitoring. See Appendix 4 of this report. It is recommended that the Joint Subcommittee consider a disclosure statute for primary insurers which would require them to report specific data on business which they write in Virginia which in turn has been reinsured. Although the Attorney General's proposal for narrowing the applicability of this disclosure is persuasive, it

is recommended that such proposed disclosure is applied across the board. This reporting should include information concerning the volume of business which is reinsured and by what company, specific risks which are reinsured or the nature of the reinsurance contract, the level of reinsurance purchases, the costs for that protection, and financial data on claims paid by reinsurers. In addition, it is recommended that reinsurers who do business in Virginia be required to file information with the Bureau of Insurance as to the ownership of the reinsurance entity and other basic corporate information which may not presently be collected by the Bureau.

TESTIMONY OF THE STATE CORPORATION COMMISSION: Currently, the State Corporation Commission does not regulate reinsurance rates, but they do regulate reinsurance companies with regard to solvency and licensing. A lot of concern has been raised concerning the costs of reinsurance and how those costs affect the ultimate consumer of the primary insurer. There is concern in the case of the control situation mentioned, whether or not there exists an at-arms-length transaction. In such cases, there are raised questions of abuse and consumer overcharge. It is the Commission's general belief that it is necessary for them to have the authority to gather reinsurance information which reveals what the primary insurer's costs of reinsurance is.

Antitrust

TESTIMONY OF THE OFFICE OF THE ATTORNEY GENERAL: One of the concerns, from an enforcement prospective, is the interaction between the Virginia Antitrust Act and the Commonwealth's insurance regulatory statutes. It is a concern that when those laws appear to address similar or even identical behavior, everyone involved should know exactly who has enforcement authority, and which law is to be applied. It is a concern that where the Virginia Antitrust Act and the Insurance Code overlap or intersect the penalties for violations and the authority for enforcement be consistent. The Office of the Attorney General and the Bureau of Insurance have concurrent jurisdiction in these overlapping areas. But because of the ambiguities inherent and the way the antitrust law and the insurance regulatory laws concurrently interact, the lines of responsibility are not as clear as they might be, and the General Assembly will want to clarify its intention concerning the enforcement of these statutes.

The pre-hearing investigatory procedures for alleged anticompetitive behavior under the Insurance Code and penalties for violations should be changed to be consistent with those under the Antitrust Act. The Commonwealth's economic vitality is premised on the concept that fair and vigorous competition ultimately results in the greatest efficiency, lowest prices and finest goods and services for it and the citizens of Virginia. The Virginia Antitrust Act enables the Attorney General to police the marketplace to ensure that such competition does in fact occur. To deter firms from evading this process, the legislature has provided the Office of Attorney General with significant pre-complaint investigatory tools and the legislature has also provided stiff penalties if firms are found guilty of an antitrust violation. In addition, the legislature has determined that because of their importance to the public, some industries should be regulated. But given the fact that they are allowed to engage in conduct for which other companies would be severely punished, regulated firms have a special obligation not to exceed the scope of permitted regulated conduct. If companies do, they should

expect the same treatment as other companies that run a file of the antitrust laws. There is no logical reason to vary the treatment depending on the agency pursuing the inquiry.

It is desirable to have equivalent investigative powers under both antitrust and insurance statutes so that anticompetitive behavior is subject to the same investigative procedures under either statute. The insurance statutes do not expressly provide the same investigatory tools as are available to the Office of the Attorney General in uncovering violations of the Antitrust Act. These additional powers could be crucial to the investigation of similar practices which may violate § 38.2-1916. Pre-hearing procedures similar to the civil investigative demand authority set forth in the Antitrust Act should be provided for proceedings before the Commission with regard to anticompetitive conduct. Such investigative demands can be an important enforcement tool, and they have the added advantage of being completely confidential, thus protecting the party that is being investigated until an offense actually is charged.

It is desirable to have the penalties under the Insurance Code match the penalties under the antitrust statute for similar infractions. When compared to the Antitrust Act, the penalty provisions under the Insurance Code are insubstantial and thus would not provide a significant deterrent to possible anticompetitive behavior. Because of the wide disparity in the severity of punishment that exists between the two statutory provisions, it is recommended that the Insurance Code be amended to include penalties as severe as those under the Antitrust Act or that the penalty provisions of that Act specifically be made to apply to § 38.2-1916 violations.

Another immediate antitrust concern is that the General Assembly have the opportunity to determine what Virginia's public policy should be with regard to the functions and services on insurance rate service organizations, especially in light of the recent announcement by the Insurance Services Office (ISO) that it is prepared to end its practice of filing advisory rates except where a state will not permit it to end this practice. It is recommended that the Commonwealth prohibit insurance rate service organizations from filing advisory rates in Virginia. It is also recommended that they be prohibited from providing expense and profit factors to insurers for use in rates filed in Virginia. It is not recommended that rate service organizations be barred from providing insurers with historical loss information. It is recognized that this information, based on the largest possible statistical base, is useful to companies with limited experience in a given type of coverage because it allows them to make sound underwriting decisions and to compete in the marketplace. However, this historical data, once provided to individual companies, should be interpreted and applied independently by each of those companies, in the same way that companies and other industries must separately make pricing decisions for the future based on pass data. The interest of insurance consumers in Virginia would be advanced by limiting statutorily insurance rate service organizations to the filing of no more than trended and developed loss data, referred to as "prospective loss costs data". The insurance industry will not be unduly disrupted if rate service organizations are limited to filing prospective loss information only. See Appendices 2 and 7 of this report.

TESTIMONY OF THE INSURANCE INDUSTRY: A review of the testimony, exhibits and information that has been presented to the Joint Subcommittee over the course of its study demonstrates that there should be no modification, repeal nor any statutory change made to the Virginia Antitrust Act. To do so would impact on the ability of the Bureau of Insurance to regulate and oversee rates and practices of the insurance industry.

As emphasized in the testimony before this Committee, the McCarran-Ferguson exemption is very narrow and limited. First, the insurance industry itself is not exempt from the antitrust laws, but rather only the "business of insurance". This has proven to be an important distinction, ensuring that companies act competitively, while enabling the business of insurance to be conducted pursuant to state regulated polices. Secondly, under the McCarran-Ferguson Act, it is clear that no conduct which would constitute any agreement of boycott, coercion, or intimidation is granted any sort of exemption from antitrust laws. Thirdly, and most importantly, that act exempts the business of insurance to the extent it is regulated, or as stated in the McCarran-Ferguson Act itself, the Sherman Act and similar federal antitrust act should be applicable to the business of insurance "to the extent that such business is not regulated by state law". Consequently, this Legislature has within its power the ability to determine exactly what activity will or will not be subject to antitrust principles.

The state analogue of the Federal Antitrust Act was based upon the same philosophy that existed at the federal level. This fact is clear, not only from the 1974 report of the VALC Committee charged with studying the new antitrust laws for the Commonwealth, but also from the Act itself, which mandates that the Virginia Act "shall be applied and construed to effectuate its general purposes in harmony with judicial interpretation of comparable federal statutory provisions". The purpose of the exemption set forth in the act was "to ensure that state antitrust laws will not conflict unnecessarily with other statutes or regulatory schemes".

The antitrust prohibitions in the Virginia Insurance Code, §§ 38.2-1900 and 38.2-1916, are exceedingly broad. They use antitrust language and antitrust concepts. This language prohibits monopolization and attempts to monopolize, and prohibits unreasonable restraints of trade generally. It prohibits insurers and rating organizations from making agreements on rates. Section 38.2-1904 prohibits predatory pricing and nonjustified price differentials. Section 38.2-1917 even establishes a private right of action enabling the citizens of the Commonwealth, who believe they have been the victim of anticompetitive activity, to bring a law suit. It is clear that no matter how hard the Attorney General may have tried to characterize the treatment of insurance under the antitrust and insurance laws as an "exemption", the simple truth is that the business of insurance is not exempt from state antitrust scrutiny, but rather is subject to broad prohibitions on anticompetitive activity found in the insurance statutes.

With regard to the Attorney General's proposal relating to insurance rate service organizations, the insurance industry, because of ISO's voluntary action, offered no specific objection to the proposal, except to ask that the proposal include a third class of user of the services offered by ISO called "service purchaser". In general terms, the Subcommittee was reminded that a centralized rate service organization provides insurers with the benefits of

economies of scales through its pool historical data base, professional staff and data processing equipment. Individual company access to this pool data base, actuarial analysis and advisory rates makes statistically credible data available to any insurer that chooses to participate. The result is pro-competitive. New insurers, small and medium-sized insurers, and even larger, well-established insurers entering new geographic areas or lines of insurance can use information gathered, analyzed and distributed by the rate service organization to enter a new market or remain in an existing market. If individual insurers had to provide entirely on their own the service that is now provided by a rate service organization, many insurers would not be able to enter or remain in markets with the same reasonable degree of confidence in the measure of risk potential. All insurers would also incur higher expenses. Insurers participating in a rate service organization make their own independent pricing deviations, based on their own marketing strategies, after accessing how their book of business and their expenses compare with the industry averages. After comparing their book of business to the rates suggested by the rate service organization, some insurers may choose to price below the advisory rate in order to compete in the market to either maintain or gain market share. Insurers regularly depart from advisory rates by filing deviations from the rate service organization's rate and by applying individual risk rating plan adjustments to account for the insurer's own laws potential. See Appendix 3 of this report.

TESTIMONY OF THE VIRGINIANS FOR FAIR RATES AND FAIR COMPENSATION: The repeal of the antitrust exemption for the insurance industry is a long overdue reform of great interest to Virginia consumers. Ninety-eight percent of those persons calling the insurance hotline in the Fall of 1988 expressed the view that insurance companies should be under the antitrust laws from which they are now exempt. Serious consideration should be given to measures which will curb if not eliminate this privileged enjoyed by the insurance industry. Because of the presence of the antitrust exemption, it is lawful for insurance companies, but not other businesses, to engage in price fixing, including raising prices in concert by factors as much as 500 percent or more. The exemption makes it legal to have an organization wholly owned by insurance companies which can issue a rate for a type of insurance and require all member companies to charge that rate. It is legal to publish price data within the industry that is not available to buyers, to refuse to sell one type of insurance to an individual unless he purchases another type of insurance. It is legal to fix the price of commissions, to parcel out markets and to limit the types of coverage they will provide. It is believed that the insurance industry has failed to convince the public why it requires this special privilege of exemption from antitrust laws. The public believes that insurance companies should be treated like all other business. One goal of the repeal of the antitrust exemption is to promote greater competition in the marketplace. Competition ought to be maximized in an effort to control insurance costs to consumers and to the extent that the marketplace cannot control costs, then regulatory controls must be utilized. With little real regulations of rates taken place under the file-and-use system, it stands to reason that the antitrust exemption should be repealed in order to allow competitive forces to have greater barring on rates. The voluntary decision by ISO to discontinue the practice of preparing and filing advisory rates for member companies needs to be enacted by statute to prohibit such price fixing arrangements. This legislative action needs to be taken in order to protect Virginia consumers from any subsequent reversal by ISO of their voluntary

decision. In addition to creating a more competitive market, the repeal of the antitrust exemption for insurance companies would have a moderating effect on the periodic crisis of the insurance business cycle. Without an antitrust exemption, there is less likelihood of uniform price-cutting to take advantage of high interest rates in the correspondingly uniform sharp increases at the other end of the cycle. Repeal of the antitrust exemption would result in several other benefits. Companies would still be entitled to receive loss costs data. Prices would be set competitively, resulting in some decrease in premiums. Efficiency would be rewarded. Choice of coverage should increase. Insurance companies would be playing by the same rule as other Virginia businesses.

TESTIMONY OF THE STATE CORPORATION COMMISSION: With regard to the enforcement and investigative proposals, the State Corporation Commission did not object to the Attorney General having greater statutory authority to investigate anticompetitive conduct under the insurance statutes. The concept of the pre-hearing investigative demand authority was acceptable to the Commission as long as the Commission received notice at the appropriate steps of the investigation. With regard to the proposal providing consistency between the penalties found in the Virginia Antitrust Act and the Insurance Code, the Commission did not object with law changes to provide such consistency.

Availability and Affordability

TESTIMONY OF THE OFFICE OF THE ATTORNEY GENERAL: The 1987 insurance reforms provide a mechanism for collecting Virginia-specific insurance data, an opportunity and criteria for evaluating that data, and an overall procedure for accessing the reasonableness of requests for rate increases. Ensuring compliance with the data reporting laws was an area in which the Attorney General took great interest. It was suggested to the Subcommittee that it might be appropriate to increase the penalties that could be charged to companies that filed late or nonconforming data. There was a concern that even the maximum available monetary penalty failed to serve as an effective enforcement tool. However, insurers have been more responsible this year about filing timely and complete Supplementary Reports. As might be expected, among the many reports, there were some problems or questions about some of the data reported. After an extensive effort by the Bureau to conform and correct of this year's data, the overall quality of the Supplementary Reports significantly improved. Furthermore, the Bureau appears to have taken a firm stand with companies that failed to file timely reports, having sought some $150,000 in penalties in 1989 along. Because of these positive developments, it was believed that, for the present, there was no immediate need for legislation, and no legislation was recommended to change the penalty laws.

There was some concern raised that in its order which resulted from the trouble-lines hearing, the State Corporation Commission exempted certain of the potentially noncompetitive lines from the rate filing provisions of chapter 19 of the Insurance Code. This was done in consideration of the fact that there is reportedly no "average risk" for these lines (the so-called "A-rated" lines). For these lines, apparently, the risk may vary so much from one insurer to the next that a manual of rates cannot cover all the variations, and each risk must be rated individual. Some lines may not lend themselves to rate filing procedures and delayed effect rate scrutiny as presently set forth in the Code, but consumers will benefit from the

Commission's continued study of the competitiveness of such lines. If a line is not competitive, it should be identified as such. It may be appropriate to determine separately whether a noncompetitive line should be exempt from rate filing laws, based on evidence as to the necessity to individually rate risks covered by such a line. While it would be inappropriate to subject rates for certain individually-rated risks to prior approval, there are concerns about the criteria that are used for establishing a line as individually or "A-rated". No legislation was recommended to make a statutory change addressing this issue.

A proposed revision is recommended to authorize provisional rate reductions. This year a number of insurers applied for insurance rate reductions in noncompetitive or "troubled" lines under the provisions of § 38.2-1921, the delayed effect rate filing statute. As with all rate filings in noncompetitive lines, the General Assembly has required that these applications still be subjected to actuarial review and be approved as "not excessive, inadequate or unfairly discriminatory" prior to use. It is often the case that the Bureau of Insurance must seek from an applicant-insured data in addition to the data initially provided with the rate filing. Insurance rate filings are not considered complete until all requested data has been supplied to the Bureau. It takes time for the Bureau to determine if any additional data may be required; it takes additional time for insurance companies to respond to any supplementary data request. Then, after the filing is complete, an additional 90 days (a minimum of 60 days, which could be extended an additional 30 days) are allowed for review of the completed rate filing. Thus, a period of time may have elapsed before a rate decrease may be put into effect, even when the insurer acknowledges from the very start that a rate reduction is appropriate. See Appendix 7 of this report.

At least two major cases this year illustrate this problem. The first was the St. Paul physicians and surgeons professional liability insurance rate revision. The second, involved St. Paul's application for decreasing rates for their insurance agents and brokers errors and omissions coverage. In both cases, the interest of both insurers and consumers were not well served. A legislative proposal was developed that would allow the Insurance Commissioner discretion to put into effect, "provisional" rate reductions applied for by insurers while a full review of the rate filing was pending. This would eliminate any delay in rate reductions that might result for an insurer's failure to provide additional data requested by the insurer, or from protracted litigation or settlement negotiations.

Another proposal recommended by the Attorney General would require any refunds of excessive premiums to be paid with interest. When insurers have charged excessive rates, they have earned interest income on the excess premiums and surplus funds that they have invested. Insurers should be required to return that interest to their policyholders. Presently, the Insurance Code provides the State Corporation Commission authority to order an insurer to refund to policyholders that portion of premiums paid that are subsequently found to have been excessive. It was pointed out that insures should be required to pay any such refunds with interest because the use of an excessive rate is explicitly prohibited and insurers should not be permitted to benefit from investment income earned on excessive premiums. One need only to look at recent experience to discover a perfect example of a premium refund that in fairness probably should have been order to be paid with interest.

The case in point is the recent ruling by the State Corporation Commission requiring the Virginia Insurance Reciprocal to refund lawyers' malpractice premiums found to be excessive. See Appendix 7 of this report.

Another area of interest involved the annual reporting of data relating to insurance claims. Two provisions of Title 38.2, §§ 38.2-2228 and 38.2-2228.1, require insurers to report to the Commission annually certain data relating to all medical malpractice claims opened, settled, adjudicated to judgment, or closed without payment during each calendar year and similar reporting of data of commercial liability claims. The purpose of both statutes is generally to provide data that may be useful in testing the appropriateness of insurer reserving practices and in accessing the influence of reforms in our tort systems on insurance claims and payouts. Neither statute requires the Commission periodically to examine the data and report the results. The suggestion was that the Joint Subcommittee consider the advisability of requiring regular evaluations of the claims data by the Commission. However, the Joint Subcommittee leaned that a statute would not be required because the Bureau of Insurance was developing plans to evaluate that claims data.

A final issue brought to the attention of the Joint Subcommittee concerned the degree of insurer profitability in commercial liability lines, and how much weight should be given to profitability in a noncompetition determination by the State Corporation Commission. It was noted that there continued to be differences between the Bureau of Insurance and the Office of the Attorney General regarding profitability. There were suggestions that the State Corporation Commission is the appropriate forum in which to continue the profitability debate.

See Appendix 5 of this report for the availability and affordability presentation by the Office of the Attorney General.

The Office of the Attorney General noted its objections to the Commission's proposal to change from an annual process to a biennial process the noncompetition or troubled-lines hearing and to change from twelve months to twenty-seven months the time during which the Commission's order, resulting from such hearing, is effective. The Attorney General did not oppose the purpose of the proposals, but did oppose the biennial process because the entire process is new and still evolving, because more lines each year are being designated as noncompetitive, and because the standards which are used to identify noncompetitive lines are being further defined. The Attorney General stated concern with the adequacy in which problems created during the interim will be addressed. It was stated that because the theory of the competition hearing has changed from the first year to the next, there is a need for stability in the process before the type of changes being suggested by the Commission are implemented.

TESTIMONY OF THE INSURANCE INDUSTRY: The market for commercial liability insurance lines in Virginia is as competitive as it has ever been. While it will continue to be cyclical, it is very competitive. For the greatest portion of this business, competition continues to be an effective regulator of rates and it is this free and competitive market that the consumer has been, and is, best served in the Commonwealth. It was pointed out that one measurement for an insurer's success in commercial liability insurance lines

is the ability to write new business and retain its renewals. Many examples offered to the Joint Subcommittee indicated that insurers' new business ratios (applications submitted vs. policies written) was not very high, and the retention of their renewals was also low. The point of the examples was that it reflects the competitive nature of the business which benefits the consumer. This competitive and free market system keeps products available and benefits the consumer. It was noted that there is a perception that insurance is sold and bought on price along. While it is a consideration, it is not the sole factor. Insurance products, like other products in the marketplace, are bought not just on price. A consumer considers service, engineering, claims paying ability, audit services, quality of products and coverages, financial strength and stability, and the expertise of the underwriting staff.

From the professional insurance agents' prospective, it was stated that markets in Virginia for commercial liability insurance are open, aggressive and fiercely competitive. Given this prospective, it was difficult for agents to understand all of the current attention and concern for the competitive posture of commercial liability insurance in Virginia. Of the number of insurance agents testifying before the Joint Subcommittee, a common experience was shared: that for every new account written, one renewal account was lost to competition. On top of that, it was suggested that many renewals are being sold at premium levels that are lower than last year's. The agents also pointed out that there are many different elements that go into pricing a commercial policy. Not only do prices vary from company to company on the same insurance account, but under certain circumstances, prices for the same account may vary somewhat from underwriter to underwriter within the same insurance company. There are judgmental elements in nearly all commercial risks that must be evaluated.

The insurance industry noted that the Subcommittee had heard allegations that the commercial liability insurance market in Virginia is not competitive, that insurers fix prices and that insurers' profits are excessive. There have been suggestive solutions to these alleged problems in the form of additional restrictions on permissible activities by rate service organizations and the increase use of prior approval rate regulation. It should be emphasized that the commercial liability market is highly competitive. The allegations of price-fixing in other forms of noncompetitive behavior are unsupported and inconsistent with the reality of the marketplace. Evidence of extensive flexibility and independence in pricing and of substantial price variation among companies should be considered. The market shares of the leading firms writing general liability insurance in Virginia are low and have been subjected to considerable variation over time. Significant entry barriers for new firms do not exist. Price-fixing through the advisory rate system of the Insurance Services Office or any other mechanism would be illegal and subject to severe sanctions under existing Virginia law, § 38.2-1916. Many commercial liability insurers make independent rate filings and many other insurers file percentage deviations from ISO advisory rates. These deviations are inconsistent with price-fixing. The system benefits the consumers by lowering the total cost of ratemaking, by facilitating entry by insurers into additional classes of business, and by helping to promote financial sound competition.

It should also be emphasized that testimony averring that insurance companies profits have been excessive and that Virginia policyholders are subsidizing policyholders in other states is based on questionable and misleading analysis and interpretation of data on insurance companies operating results. Given the evidence the market is highly competitive, subjective changes and regulations are not warranted based on this analysis. Restricting rate service organizations' ability to disseminate prospective loss costs data, including loss development and trend, could be especially harmful to consumers by increasing insurance companies operating costs and impeding rather than promoting competition. The cost of developing and trending historical data would be likely to discourage some companies from writing business in many of the classes and subclasses of insurance with small premium volume. The result would be less competition. Some companies might continue to write business in certain lines without incurring the costs required to obtain developed and trended estimates of prospective loss costs.

The increase use of prior approval rate regulation probably would make insurance less available in the short run and more expensive in the long run. Restrictive prior approval rate regulation is likely to aggravate insurance affordability problems over time by distorting the incentives of insurers and consumers to control claims cost. It also is likely to result in long and costly rate hearings in which industry and government representatives and numerous paid consultants, advocates and experts would engage in irresolvable arguments about the level of raise that should be approved. See Appendix 3 of this report.

With regard to the Attorney General's proposal, relating to refunds of excessive premiums with interest, the insurance industry stated that it objected to the amendatory language of the proposal which would statutorily mandate interest. It was noted that there can be cases where interest is not appropriate, particularly where pending cases are continued. It was stated that the interest should be in the discretion of the Commission, and not statutorily mandated. The industry offered an amendment to this proposal to modify it, to give the Commission the discretion to order interest on a case by case basis. The Subcommittee adopted the industry's amendment, and thereby eliminated the industry's objections to the proposal.

With regard to the proposal on provisional rate reductions, the industry offered no objections.

The industry stated that it supported the Commission's proposal to make the "troubled lines" hearing a biennial process and to allow the Commission's order resulting from that hearing to run twenty-seven months.

TESTIMONY OF THE VIRGINIANS FOR FAIR RATE AND FAIR COMPENSATION: The association stated that it was in agreement with the proposals offered by the Office of the Attorney General. The association renewed its request for the Joint Subcommittee to consider the repeal of the anti-rebate law. It was stated that this provision represents an artificial restriction of an agent's efforts in selling insurance. The repeal of this provision would reinforce competition in the insurance marketplace.

TESTIMONY OF THE STATE CORPORATION COMMISSION: The Commission stated that it supported the proposal which would give the Commission discretion to order

interest on premiums found to be excessive. The Commission also supported the provisional rate reduction proposal. With regard to the discussion concerning periodic evaluations of medical malpractice and commercial liability claims report data, the Commission stated that the Bureau of Insurance was prepared to report on a periodic basis and that all of this information is in its computer. It was noted that this data shows trends in reserves and plans and that the amendments made to the law in 1987 afforded them better data to make such periodic evaluations. The Subcommittee was advised that more than one year's worth of data is needed to make such reports meaningful. Concerning the "A-Rated" lines of insurance, it was stated that it is difficult to establish an average rate on exposures covered by these lines because there are different variables within each case. This type of insurance lends itself to individual risk ratings. It was observed that this type of insurance covers such exposures as asbestos removal or underground storage tanks, and these exposures are areas where individualized risk-rating is essential since the risk may vary significantly from one insurer to the next. The Commission stated that it is their philosophy to want to encourage insurers to write in these lines of insurance so they allow the companies to rate individually.

The Commission offered a proposal relating to the "troubled lines" hearing provision and troubled line report provisions found in Title 38.2 of the Code. It was noted that neither proposal, in anyway, affects the annual reporting by the liability insurers.

One amendment in the proposal would eliminate the one-year limitation on the Commission's role which designates certain lines of insurance for "delayed effect." It was stated that the amending language would allow such a rule to run up to twenty-seven months. The purpose of this amendment would allow the Commission sufficient time to hold the hearing and issue a rule accordingly. Under the current language in the Code the Commission must hold its hearing and render an opinion before the expiration date of the Commission's previous year's rule. It was stated that the proposed change would allow the Commission sufficient time to hold its hearing and render its decision. The proposed amendment will afford the State Corporation Commission and the industry more time to go through the process and do a good job. It was noted that after the hearing held in 1989, the Commission had only three days in which to act and render a decision. The second amendment would require the Commission to submit a report to the General Assembly and hold a "trouble-lines" hearing at least biennially as opposed to annually. It was stated that currently the Commission must submit a report to the General Assembly annually and must hold a hearing annually for the purpose of determining whether competition is an effective regulator of rates for those lines or subclassifications designated in the Commission's report to the General Assembly. See Appendix 6 of this report.

The Joint Subcommittee learned that during the last hearing process, the Commission incurred approximately $180,000 in direct costs for holding the hearing. It was noted that the Bureau of Insurance spent roughly $100,000 of staff time in preparing for the hearing. The Commission pointed out that if it became apparent that the competition was not an effective regulator in a line of liability insurance, the Commission could always hold a hearing during the "off" year because the language of the proposal says "at least biennially." The Joint Subcommittee was advised that the Commission would report any problems to the General Assembly whenever they arose. It was also

pointed out that anyone has a right to request the State Corporation Commission to hold a hearing under these circumstances, and the Commission itself can initiate such a hearing. It was stated that the suggested changes of the proposal would not compel the Commission to file a full-blown report if problems arose.

IV. RECOMMENDATIONS OF THE SUBCOMMITTEE

Recommendations on Joint Reinsurance Proposals

PROPOSAL No. 1: That the State Corporation Commission be authorized to require an insurer to provide reinsurance information when applying for a rate revision for a line of insurance deemed noncompetitive if coverage affected by the rate revision is reinsured with an affiliated company.

LEGISLATION to implement proposal: That § 38.2-1906 of the Code of Virginia be amended to add a new subdivision to provide that the State Corporation Commission may require an insurer to produce premium, loss and expense data on a net, as well as, direct basis when applying for a rate revision for coverage both subject to delayed affect procedures and reinsured by a company affiliated with the filing insurer.

RECOMMENDATION of the Subcommittee: The Subcommittee found that the State Corporation Commission generally has the authority to require insurers to produce any needed data, but the Subcommittee decided that it was important to enact legislation that clearly puts insurers on notice that reinsurance data may be requested in situations where an insurer is filing for a rate revision for a line of insurance that has already been found to be "troubled" and the coverage affected by the rate revision is reinsured with an affiliated company. The Joint Subcommittee unanimously recommended this legislation. See Appendix 8 of this report.

PROPOSAL No. 2: That an insurer be required to certify if coverage to which a rate filing applies is reinsured with an affiliate.

LEGISLATION to implement proposal: That § 38.2-1912 be amended to add a new subsection E providing that an insurer must certify if coverage to which its rate filing applies is reinsured by a company affiliated with the filing insurer.

RECOMMENDATION of the Subcommittee: The Subcommittee unanimously agreed to this proposal. The Subcommittee found it appropriate that the Commission have the ability to review the scope and nature of reinsurance transactions in situations of common control. See Appendix 8 of this report.

Antitrust Recommendations Requiring Legislation

PROPOSAL No. 3: That rate service organizations be prohibited from filing final rates on behalf of insurers; that rate service organizations be permitted to file on prospective loss costs data (trended and developed data without expense and profit contingency factors).

LEGISLATION to implement proposal: That §§ 38.2-1901, 38.2-1905.1, 38.2-1906, 38.2-1908, 38.2-1913, 38.2-1916 and 38.2-1923 be amended to define "prospective loss costs" and "rate service organization" to eliminate the filing of final rates by rate service organizations and to authorize the filing of prospective loss costs for informational purposes only. Because the Insurance Services Office had announced it would voluntarily cease filing advisory final rates and instead will provide insurers with only trended and developed loss data without recommended expense or profit factors, the Subcommittee found that this proposal would merely codify what ISO has voluntarily agreed to do.

RECOMMENDATION of the Subcommittee: The Joint Subcommittee unanimously agreed to this proposal. See Appendix 9 of this report.

PROPOSAL No. 4: That the Attorney General of Virginia be given the power, equivalent to the Virginia Antitrust Act's "Civil and Investigative Demand" authority for investigating anticompetitive conduct volitive of the Insurance Code.

LEGISLATION to implement proposal: That the Code of Virginia be amended by adding a Section numbered 38.2-1916.1 to provide for (i) the issuance of investigative demands by the Attorney General after notice to the State Corporation Commission, (ii) the authority to compel written or oral testimony or the production of documents, (iii) confidentiality, and (iv) penalties for noncompliants.

RECOMMENDATION of the Subcommittee: The Subcommittee found that this proposal would provide for uniform procedures for the handling of antitrust violations and for anticompetitive conduct prescribed by the Virginia Antitrust Act and the insurance laws. By a five to four vote, this proposal was agreed to. See Appendix 9 of this report.

PROPOSAL No. 5: That penalties conforming to those available under the Virginia Antitrust Act be incorporated in the insurance laws for anticompetitive conduct prohibited by the Insurance Code.

LEGISLATION to implement proposal: That the Code of Virginia be amended by adding a Section numbered 38.2.1916.2 to provide for (i) penalties up to $100,000 for each willful violation of § 38.2-1916 of the Code of Virginia, (ii) injunctive relief (iii) restitution for the Commonwealth, its political subdivisions, public agencies and other persons injured by conduct and violation of § 38.2-1916, and (iv) treble damages for willful and knowing violations.

RECOMMENDATION of the Subcommittee: The Subcommittee found that the same uniformity is needed in the penalty section of the insurance laws as in investigating antitrust violations. By a five to four vote, the Subcommittee agreed to this proposal. See Appendix 9 of this report.

Availability and Affordability Recommendations Requiring Legislation

PROPOSAL No. 6: That the State Corporation Commission be authorized, in its discretion, to require that refunds of excessive premiums plus interest be paid to policyholders.

LEGISLATION to implement proposal: That § 38.2-1910 be amended to authorize the State Corporation Commission, in its discretion, to order that an insurer found to have been using an excessive rate to refund the excessive portion of the premiums paid plus interest at a rate specified by the Commission.

RECOMMENDATION of the Subcommittee: The Subcommittee found that this proposal gave appropriate discretionary authority to the Commission to order a refund with interest of a portion of the premium found to have been excessive because insurers should not be permitted to benefit from investment income earned on excessive premiums. The Subcommittee unanimously agreed to the proposal. See Appendix 10 of this report.

PROPOSAL No. 7: That, in instances in which an insurer applies for a rate reduction for coverage deemed noncompetitive and made subject to the delayed effect rate filing procedures, the Commission be authorized to implement provisionally, the rate reduction requested while the Bureau of Insurance completes its evaluation of the insurer's rate filing and supplementary rate information. The Commission would have authority to suspend the use of the provisional rate at anytime and to act pursuant to the statues governing the filing, use and disapproval of rates.

LEGISLATION to implement proposal: That § 38.2-1912 be amended to add a new subsection F providing: (i) that the Commissioner of Insurance may authorize the use, provisionally, of an insurer's requested rate reduction while a delayed effect rate filing is being evaluated by the Bureau; that insurers must still submit all data required by the Commission; that the Commissioner may suspend the use of the provisional rate at anytime; and that the use of a provisional rate reduction shall in no way interfere with the Commissioner's ability to examine, approve or disapprove either the pending rate request or the insurer's last rate in use.

RECOMMENDATION of the Subcommittee: The Subcommittee found that in the interest of both insurers and consumers, a procedure should be available to implement rate reduction proposed by insurers, on a provisional basis, while the full analysis of a requested rate change is pending. The Subcommittee unanimously agreed to the proposal. See Appendix 10 of this report.

Troubled Lines Hearing and Report Recommendation Requiring Legislation

PROPOSAL No. 8: That the time limitation on the Commission rule which designates certain lines of insurance for "delayed effect" be increased from 1 year to 27 months and that the requirement that the Commission submit a report to the General Assembly and hold a hearing at least annually be changed to allow the Commission to hold a hearing at least biennially.

LEGISLATION to implement proposal: That §§ 38.2-1912 and 38.2-1905.1 be amended respectively, (i) to eliminate the one year limitation on the Commission rule which designates certain lines of insurance for "delayed effect" and to allow such a rule to run for up to 27 months, and (ii) to require the Commission to submit a report to the General Assembly and hold a hearing at least biennially as opposed to annually.

RECOMMENDATION of the Subcommittee: The Subcommittee found that the amendment to allow a Commission rule to run for up to 27 months was appropriate in order

to provide the Commission sufficient time to hold the troubled lines hearing and issue a rule accordingly. With regard to the second portion of the proposal, the Subcommittee found that by changing the troubled lines hearing to a biennial process, the Commission could save approximately $180,000 in direct cost, but at the same time could remain responsive to a situation where it became apparent that the competition was not an effective regulator in a line of liability insurance since the language would allow the Commission to hold a hearing during the "off" year. By a vote of eight to one, the Subcommittee agreed to the second portion of the proposal. The Subcommittee unanimously agreed to the first portion of the proposal. See Appendix 11 of this report.

V. CONCLUSION

In the mid-1980s, many of Virginia's businesses, professionals, and local governments were complaining that premium increases were making their liability insurance unaffordable. Some commercial enterprises, necessary public services, and other governmental activities were curtailed or eliminated for lack of adequate liability insurance coverage. In 1987, The Virginia General Assembly responded to this crisis affecting commercial liability insurance. In addition to adopting a number of measured tort system reforms, the General Assembly enacted House Bills 1234 and 1235 which encompassed an innovative program for insurance data collection and analysis and formal regulatory scrutiny of competition and rates for designated lines of insurance. Virginia has been one of the first states in the U.S. to adopt measures to enhance reporting requirements and promote competition in the liability insurance market. The insurance regulatory reforms enacted in 1987 are beginning to bear fruit in the Commonwealth, and the General Assembly has continued since 1987 to demonstrate its firm resolve to keep liability insurance problems from getting out of hand.

In 1988, to guard against a potential crisis of unavailability in commercial liability insurance, the General Assembly passed enabling legislation authorizing the establishment of a commercial liability insurance joint underwriting association (JUA). This JUA serves as an insurance "safety net." It is designed to meet Virginian's commercial liability insurance needs when the voluntary market does not. During the 1988 and 1989 Sessions of the General Assembly, several refinements to House Bills 1234 and 1235 were enacted to ensure that these data reporting laws continue to operate both fairly and effectively.

The 1988 and 1989 Sessions of the General Assembly recognized that some of the complicated issues associated with commercial liability insurance, and its regulation by the Commonwealth, demanded careful study. The General Assembly established this Subcommittee in 1988 to examine the exemptions antitrust laws enjoyed by insurers, the practices of the reinsurance industry, and further means for insuring the availability and affordability of liability insurance in Virginia. Recognizing that these complex issues had not been fully resolved in the Subcommittee's first year of study, the General Assembly in 1989 extended the charge of the Subcommittee for another year. In making the recommendations found in this report to the 1990 General Assembly, the

Joint Subcommittee concludes that they are further positive steps in order to assure that affordable insurance continues to be available to the citizens in the Commonwealth.

Respectfully submitted,

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Richard L. Saslaw
Frank D. Hargrove
W. Tayloe Murphy, Jr.
Lewis W. Parker, Jr.
William T. Wilson
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John Robert Hunter, Jr.

VI. APPENDICES

1. House Joint Resolution No. 382.

2. Antitrust and Reinsurance Presentation by the Office of the Attorney General.

3. Reinsurance, Antitrust, and Availability and Affordability Presentation by the Insurance Industry.

4. Virginians For Fair Rates and Fair Compensation Statement on Antitrust and Reinsurance.

5. Availability and Affordability Presentation by the Office of the Attorney General.

6. State Corporation Commission's Troubled-Lines Hearing and Troubled-Lines Report Proposal.

7. Joint Proposals submitted by the Attorney General and Commission.

8. Recommended reinsurance legislation.

9. Recommended antitrust legislation.

10. Recommended availability and affordability legislation.

11. Recommended troubled-lines hearing and troubled-line report legislation.

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Appendix 1

GENERAL ASSEMBLY OF VIRGINIA -- 1989 SESSION

HOUSE JOINT RESOLUTION NO. 382

Continuing the Joint Subcommittee Studying the Practices by Which Insurance Companies Reinsure All or Parts of the Risks They Insure, the advisability of repealing the exemption from the Commonwealth's antitrust laws granting to the insurance industry, and means of assuring the continued availability and affordability of liability insurance coverage.

Agreed to by the House of Delegates, February 6, 1989
Agreed to by the Senate, February 23, 1989

WHEREAS, the 1988 Session of the General Assembly established, pursuant to House Joint Resolution No. 120, a joint subcommittee to study (i) the reinsurance practices of insurance companies, (ii) the exemption from the antitrust laws granted to the insurance industry and (iii) the availability and affordability of liability insurance; and

WHEREAS, the joint subcommittee heard considerable testimony on the three areas of the study; and

WHEREAS, a significant percentage of the liability insurance written by companies licensed by the State Corporation Commission to operate in the Commonwealth is subsequently reinsured with other companies, including corporate affiliates, for the purpose of sharing risks, and there is no existing regulatory mechanism to determine whether the expenses of insurance companies associated with reinsurance are reasonable; and

WHEREAS, the business of insurance and many activities of insurance companies enjoy exemptions from provisions of the antitrust laws of the United States and of the Commonwealth and there is significant debate as to the merits of preserving both these exemptions and the related practice of allowing insurers to establish rates and other industry policies through rate service organizations; and

WHEREAS, there is a need to determine whether the reinsurance practices of insurance companies, the exemption from the antitrust laws and the role of rate service organizations have negatively affected the availability and affordability of insurance; and

WHEREAS, although some issues appear to have been resolved by the joint subcommittee's deliberations, there are still many other issues within each of the three areas of the study that need more thorough and detailed study; and

WHEREAS, in its recommendations to the General Assembly the joint subcommittee requests that the study commenced pursuant to House Joint Resolution No. 120 be continued another year because it feels that businesses and individuals in the Commonwealth are still experiencing difficulties in obtaining affordable liability insurance, and these difficulties threaten adversely the economic health of the Commonwealth; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the joint subcommittee established in 1988 pursuant to House Joint Resolution No. 120 be continued to study (i) the reinsurance practices of insurance companies, (ii) the advisability of modifying the insurance industry's exemption from the Virginia Antitrust Act and the role of rate service organizations, and (iii) the means of ensuring the availability and affordability of liability insurance in the Commonwealth.

The membership of the joint subcommittee shall remain the same and any vacancies that occur shall be filled in the manner as provided in House Joint Resolution No. 120 of 1988.

The joint subcommittee shall complete its work prior to December 15, 1989, and report its findings and recommendations to the Governor and the 1990 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for processing legislative documents.

The indirect costs of this study are estimated to be $10,650; the direct costs of this study shall not exceed $7,920.

Appendix 2

OFFICE OF THE ATTORNEY GENERAL
REMARKS ON ANTITRUST AND REINSURANCE ISSUES
before the
HJR 382 JOINT SUBCOMMITTEE STUDYING LIABILITY INSURANCE
August 21, 1989

Recent developments

in court

in Congress

Antitrust Enforcement and Insurance Regulation

Interaction of the Virginia Antitrust Act and the Commonwealth's insurance regulatory statutes.

- Argument for concurrent jurisdiction
- Need for consistency

in investigation and prosecution

in penalties

Cooperation with Bureau of Insurance and SCC regarding investigation and prosecution

- Pursue these cases before the SCC
- Obtain equivalent investigative powers and penalties under both the antitrust and insurance statutes
- Investigative demands subject to notice to the State Corporation Commission

An important enforcement tool

Completely confidential

- **Insurance Rate Service Organizations**

  Recommendation to prohibit insurance rate service organizations from filing advisory rates in Virginia, and from providing profit, contingency and expense factors

  - Joint Subcommittee action last year
  - What has happened since then
    - -- NAIC recommendation
    - -- ISO announcement
  - Bureau of Insurance examination of ISO prospective loss cost filings

- **Reinsurance**

  Review of reinsurance issues

  - The nature of reinsurance
  - Reinsurance in situations of control

  Recommendation to require certain reinsurance information in certain circumstances

  - when line of insurance has been found by the SCC to be noncompetitive
  - where there is a controlling relationship between an insurer and its reinsurer

INTRODUCTORY REMARKS ON ANTITRUST AND REINSURANCE ISSUES

H. Lane Kneedler

Chief Deputy Attorney General

HJR 382 JOINT SUBCOMMITTEE STUDYING LIABILITY INSURANCE

August 21, 1989

Mr. Chairman, thank you for the opportunity to convey to the Joint Subcommittee the Attorney General's concerns about certain antitrust and reinsurance issues in the commercial liability insurance market. A number of recent developments serve to highlight the timeliness of your interest in these issues.

Recent Developments Nationally

For example, both antitrust and reinsurance issues loom large in a major federal lawsuit brought by California and 18 other states, alleging that certain insurance companies colluded to deny cities and businesses certain kinds of liability coverage and to drive up rates. U.S. District Court Judge William W. Schwarzer has tentatively decided to dismiss that suit, and his reasoning underscores the need to re-examine the way the antitrust laws apply to the insurance industry. We understand that Judge Schwarzer proposes to rule that, even if it were proven that the defendants conspired as alleged in the suit, they could not be held liable for that conspiracy because the McCarran-Ferguson Act exempts most insurance company activities from the reach of the federal antitrust laws. Whatever the outcome at the District Court level, both sides predict that the case will be appealed, because the questions involved are so significant with regard to the way the business of insurance is

conducted and regulated in this country.

In addition, we have seen a renewed interest in antitrust issues by Congress. Senator Howard Metzenbaum of Ohio introduced a bill (S. 719) to repeal the federal antitrust exemption for insurance companies contained in the McCarran-Ferguson Act. The Senate Judiciary Committee began hearings on that bill on April 14, 1989. Meanwhile, in the House of Representatives, the Judiciary Committee's Subcommittee on Economic and Commercial Law has begun hearings on House Bill 1663, also relating to the repeal of the McCarran-Ferguson exemption.

Mr. Chairman, the members of the Joint Subcommittee will recall that the General Assembly two years ago went on record in favor of repeal of the McCarran-Ferguson Act's antitrust exemption for the insurance industry, in the expectation that this change at the federal level would enhance the competitive environment of the insurance industry in Virginia. If Congress should repeal the McCarran-Ferguson antitrust exemption for the business of insurance, the General Assembly might want to consider legislation revising Virginia's antitrust and insurance regulatory statutes in light of the new federal framework.

But even without action by the current Congress, Mr. Chairman, there are a number of antitrust and reinsurance questions that can and should be addressed at the state level.

Antitrust Enforcement and Insurance Regulation

One of our concerns, from an enforcement perspective, is the interaction between the Virginia Antitrust Act and the Commonwealth's insurance regulatory statutes. We are concerned,

for example, that when those laws appear to address similar or even identical behavior, all players should know exactly who has enforcement authority, and which law is to be applied. And we are concerned that where the Virginina Antitrust Act and the Insurance Code overlap or intersect, the penalties for violations be consistent. In particular, Mr. Chairman, the Joint Subcommittee may want to consider conforming the penalties for prohibited anticompetitive behavior in the Insurance Code to those in the Antitrust Act, so that similar violations under each statute are subject to similar penalties.

Our position, Mr. Chairman, is that, right now, the Office of the Attorney General and the Bureau of Insurance have concurrent jurisdiction in these overlapping areas. But because of the ambiguities inherent in the way the antitrust law and the insurance regulatory laws currently interact, the lines of responsibility are not as clear as they might be, and the General Assembly may want to clarify its intention concerning the enforcement of these statutes.

In the meantime, we have discussed these jurisdictional overlaps with the Bureau of Insurance and the State Corporation Commission ("SCC" or "Commission"), and together we are pursuing a working understanding of how these cases should be investigated and prosecuted. In particular, we are discussing whether it would be appropriate to pursue these cases before the SCC rather than in the courts, since the SCC has expertise in the day-to-day workings of the insurance industry. We are also discussing the desirability of having the penalties under the Insurance Code

match the penalties under the antitrust statute for similar infractions.

Finally, to enhance enforcement, we are discussing the desirability of having equivalent investigative powers under both the antitrust and insurance statutes, so that anticompetitive behavior is subject to the same investigative procedures under either statute. In particular, we are exploring whether there should be the equivalent of "Civil Investigative Demands" ("CIDs") in cases brought before the SCC under the Insurance Code as there now are in antitrust cases brought before the circuit courts of the Commonwealth. In insurance cases, these Investigative Demands could be subject to notice to the SCC. Such Investigative Demands can be an important enforcement tool, and they have the added advantage of being completely confidential, thus protecting the party that is being investigated until an offense actually is charged.

Mr. Speaker, Senior Assistant Attorney General Frank Seales is here today to address the question of how the State's antitrust laws interact with the State's insurance regulatory statutes. He will also discuss how enforcement authority against anticompetitive activity might be enhanced.

[Presentation by Senior Assistant Attorney General Frank Seales]

Insurance Rate Service Organizations

Mr. Chairman, the Attorney General's most immediate antitrust concern is that the General Assembly have the opportunity to determine what Virginia's public policy should be with regard to the functions and services of insurance rate service organizations, especially in light of the recent announcement by the Insurance Services Office ("ISO") that it is prepared to end its practice of filing advisory rates, except where a state will not permit it to end this practice. In particular, Mr. Chairman, we will recommend that the Commonwealth prohibit insurance rate service organizations from filing advisory rates in Virginia.

You will recall, Mr. Chairman, that last year the Joint Subcommittee rejected a proposal which was made by the Commissioner of Insurance and endorsed by our Office, that insurance rate service organizations be prohibited from filing advisory rates in Virginia, and that they also be prohibited from providing trended loss factors to insurers for use in rates filed in Virginia.

That proposal, Mr. Chairman, as I am sure the members of the Joint Subcommittee remember, was something of a compromise: it went further than the Commissioner originally had recommended, but it did not go as far as the Attorney General had suggested. You will recall that we wanted to bar rate service organizations from providing developed loss information as well. And we still think that would be in the public interest.

Mr. Chairman, I hasten to add that we have never advocated

barring rate service organizations from providing insurers with historical loss information. We recognize, as does the industry, that this information, based on the largest possible statistical base, is useful to companies with limited experience in a given type of coverage because it allows them to make sound underwriting decisions and to compete in the marketplace.

But we have consistently argued, Mr. Chairman, that this historical data, once provided to individual companies, should be interpreted and applied independently by each of those companies -- in the same way that companies in other industries must separately make pricing decisions for the future based on past data.

We believe that the Joint Subcommittee had insufficient time to sort out the implications of the various positions that were being discussed last fall. But rather than rehash those issues, Mr. Chairman, we want to move forward. We note that there have been at least two significant developments since the Joint Subcommittee voted on the proposal before it last January -- developments that might cause the Joint Subcommittee to want to revisit its earlier decision.

In March, 1989, the Advisory Organizations Activities Working Group of the National Association of Insurance Commissioners recommended that rate service organizations such as ISO not be allowed to file or distribute rates.

Then, on April 3, 1989, ISO itself announced that it would "stop providing advisory rates" and would "shift to advisory prospective loss costs in all states where that's permissible

under state laws and regulations."

In effect, ISO has offered voluntarily to accept the Commissioner's original 1988 proposal -- made last October -- regarding rate service organizations: that they be barred from filing advisory rates and their attendant profit, contingency and expense factors, but that they be allowed to continue trending and developing historical loss data.

Mr. Chairman, it is still our view that all five factors, including trending and development, could be dispensed with, without unduly disrupting the commercial liability insurance market.

But this is an area where reasonable people can differ, and we can understand -- although we do not fully agree with -- the concern that barring rate service organizations from providing insurers with trending and development factors might be disruptive to the insurance market. We are prepared, therefore, to set aside our disagreement on this matter this year, and to seek common ground to improve the competitive climate of Virginia's insurance market. We are persuaded, however, that insurance rate service organizations should be limited statutorily to the filing of no more than trended and developed loss data -- what we will refer to as "prospective loss cost data" -- and that such a proposal, although perhaps only a first step, would advance the interests of insurance consumers in Virginia. The time to take this important first step is now.

Mr. Chairman, we are confident that the insurance industry will not be unduly disrupted if rate service organizations are

limited to filing prospective loss cost information only. Large companies, as you know, often generate their own actuarial data and cost projections for setting the great majority of their rates. Small companies, which do not have this capability in-house, might have to hire actuaries or retain consultants to calculate rates for the company. But both large and small companies will be able to adapt, and the result should be a more competitive environment for the insurance industry in Virginia.

But there are still anticompetitive factors at work in that environment, Mr. Chairman. In particular, we are concerned that the filing of prospective loss cost data by insurance service organizations will still tend to result in a clustering of prices in a very narrow, non-competitive range, since most companies will continue to use the modified ISO filings, and since prospective loss costs constitute the single largest factor -- and by far the overhwelming proportion -- of most rate filings. The dissemination of past loss experience is useful to both large and small insurance companies; but when a rate service bureau interprets that past data to the point of developing suggested future rates, or when it projects that past data into the future, it, in effect, provides a base line against which future rates can be established, and this can tend to narrow the range of price competition in an industry.

The best approach, Mr. Chairman, would be to have each individual company make its own reasoned judgment, do its own calculations, or engage its own independent consultants, to trend and develop the historical loss data. The best approach, in a

word, is unfettered competition.

But if we cannot yet take the best approach, let us at least take a better approach than we currently have in place. If rate bureaus are allowed to trend and develop historical loss information, then we should make sure that those trending and development practices are carefully examined as part of the Commonwealth's regulatory oversight of the insurance industry.

We are discussing with the Bureau of Insurance how this might be done. Both the Bureau and our Office agree that, if ISO continues to trend and develop historical loss cost data, the Bureau should examine ISO filings for major coverages. This will increase the likelihood that ISO's trending and development factors are accurate, fair, and reasonable.

The Bureau has the authority under current law to do this; no additional legislation is required. And individual companies may continue to file and use rates as they have been doing. But with the examination of ISO's major loss cost filings that we are contemplating, the Commission will have additional information to consider in determining whether competition is adequately regulating rates in the various lines of commercial liability insurance.

Reinsurance

Mr. Chairman, we continue to have considerable concern about the reinsurance practices of the insurance industry, and how those practices affect the price of insurance for individuals, businesses and professionals. We have a specific suggestion to make regarding the potential role of reinsurance in those lines

of commercial liability insurance which are determined to be "troubled," or noncompetitive. But it might be helpful, first, to set the larger context of reinsurance.

Our third speaker today, Mr. Chairman, is Professor Kenneth Abraham from the University of Virginia Law School, a nationally recognized expert on tort law and insurance who has testified before this Joint Subcommittee in the past. He will review briefly certain aspects of the reinsurance industry, as a preface to the specific concerns the Attorney General wishes to bring before the Joint Subcommittee.

[Presentation by Professor Kenneth Abraham]

Mr. Chairman, along with the members of the Joint Subcommittee, we have been studying reinsurance for the past two years. We have come to appreciate that this aspect of the insurance industry is very different from direct (or primary) insurance. Indeed, some even call it a separate industry. What has become increasingly clear to us, however, is the tremendous impact that reinsurance has on the direct insurance market.

For the most part, that impact is positive. Reinsurance is necessary for insurers to distribute risk and to increase their capacity to insure businesses, professionals and individuals.

But where reinsurance is not adequately available, or where the reinsurance market is not competitive, the result can be unavailable or unaffordable insurance in the direct market. And because reinsurance is such a highly leveraged industry,

reinsurance problems with affordability and availability become greatly magnified at the level of direct insurance.

Because of the great potential for reinsurance to affect adversely the direct insurance market, Mr. Chairman, our Office is concerned that Virginia's insurance regulators have access to certain important reinsurance information.

But, in keeping with our longstanding view that government should regulate as little as possible in order to provide the oversight necessary to protect the public interest, we would recommend a very circumscribed set of conditions in which we would seek reinsurance data in addition to other information already required by statute.

Specifically, we would recommend that, when an insurer files a rate request in a line of insurance that has been found by the SCC to be noncompetitive, and where certain other conditions described below apply, that the company be required to provide certain reinsurance information. This might be done, for example, by requiring such a company to report information on its direct and net business in that line.

Initially, Mr. Chairman, we would recommend that such reinsurance information be required only where there is some kind of controlling relationship between an insurer and its reinsurer, such as where the direct insurer is reinsured by an affiliated company. We understand that the State Corporation Commission also wants additional information in these circumstances. While the number of such cases might be small, the impact of reinsurance arrangements in such cases can be enormously

significant. The recent problems we have observed in the insurance industry reinforce our conviction that we need all the tools we can obtain to monitor the insurance industry in the public interest. Our immediate concern in taking this first step with reinsurance is to provide our regulators with a potentially important new tool, in a tightly circumscribed set of circumstances where there appears to be the greatest potential for abusive reinsurance practices.

Simply put, Mr. Chairman, we believe this data is needed in these cases to make a full determination of the reasonableness of rate requests. We believe the SCC will be able better to evaluate a request for a rate increase if it can consider losses on the total book of business of an insurer as well as its reinsurance costs (and the benefits the insurer has gained from that reinsurance), along with the other information that insurers must provide under the insurance regulatory reforms you enacted in 1987, at least in those cases where the parties are in a controlled relationship.

Mr. Chairman, I want to thank you and the members of the Joint Subcommittee for the opportunity to present our concerns and to outline the Attorney General's proposals for dealing with these specific antitrust and reinsurance problems.

The proposals we have outlined are intended to concentrate our efforts where they will do the most good. We have no desire to burden the industry with unnecessary regulation, or to suggest new responsibilities that the Bureau of Insurance may not have the staff or the resources to carry out. But we are

committed to taking practical steps that will assure a more competitive insurance environment in Virginia -- a competitive environment that will be in the best interests of consumers and insurers alike; a competitive environment in which appropriate state regulation protects both the solvency of insurance companies and the interests of the public as insurance consumers.

I and our other speakers would be happy at this time to answer any questions from the members of the Joint Subcommittee.

REMARKS ON ANTITRUST ISSUES

Frank Seales, Jr.
Senior Assistant Attorney General
and Chief of the Antitrust and
Consumer Litigation Section

BEFORE THE JOINT SUBCOMMITTEE STUDYING
LIABILITY INSURANCE -- HJR 382.
August 21, 1989

I. Introduction

My remarks today will address some of the antitrust concerns this Committee has focused on over the past two years. In particular, I will discuss the Attorney General's interpretation of apparently conflicting provisions of the Virginia Antitrust Act and the Insurance Code and present a proposal that will strengthen the State Corporation Commission's ("SCC's") prehearing investigatory procedures and penalties for anticompetitive behavior in the insurance industry.

II. Statutory Conflict

First, § 59.1-9.4(b) of the Code of Virginia provides:

> Nothing contained in this chapter shall make unlawful conduct that is authorized, regulated or approved (1) by a statute of this Commonwealth, or (2) by an administrative or constitutionally established agency of this Commonwealth... having jurisdiction of the subject matter and having authority to consider the anticompetitive effect, if any, of such conduct.

This statute, standing alone, would seem to exempt from prosecution under the Antitrust Act all anticompetitive behavior regulated by the SCC, a constitutionally established agency of the Commonwealth.[1] However, in 1986 when the Code Commission recodified the Insurance Code, the following provision was added:

[1]This exemption is not limited to conduct of the insurance industry, but also excludes from prosecution the conduct of electric, telephone, gas, surface transportation, securities and other industries regulated by the Commission.

> Conduct subject to regulation, review or examination pursuant to this title shall, in addition, be subject to the provisions of the Virginia Antitrust Act. (Section 59.1-9.1 et seq.) § 38.2-705.

There are several alternative interpretations of the interaction of these two sections. First, a literal reading of § 38.2-705 would provide that the Insurance Code, Title 38.2, et seq., has been carved out of the exemption from the antitrust laws leaving the other regulatory authority of the Commission exempt from the provisions of the Antitrust Act, namely electric, telephone, gas, surface transportation, etc. Or stated differently, § 59.1-9.4(b) exempts all regulatory authority of the Commission from the purview of the Antitrust Act, while § 38.2-705 excludes from that exemption the regulation of insurance under Title 38.2. Under this interpretation all anticompetitive behavior engaged in by persons in the insurance industry, including conduct specifically authorized by the Insurance Code, would be subject to prosecution by the Attorney General's Office.

Alternatively, it has been argued by some that passage of § 38.2-705, making the Antitrust Act applicable, also makes the exemption provision of the Act applicable. However, to interpret § 38.2-705 as bringing the Antitrust Act into effect including the general exemption, which includes the exemption from the application of the Act, would give the section no meaning. Moreover, the exemption in the Antitrust Act is broad and covers all conduct subject to regulatory authority of the Commission, while the exclusion provision in § 38.2-705 is narrow in its

specific application to this "title", only carving out of Commission authority the Insurance Code, Title 38.2. It is also a later act of the Legislature and should be interpreted as having a meaningful effect. Since the Legislature is not presumed to pass legislation with no meaning, we believe this interpretation would not be sustained by the courts.

Finally, an alternative interpretation, and the one that we would argue was intended, is that § 38.2-705 provides the Attorney General and the SCC with concurrent jurisdiction to prosecute anticompetitive behavior not authorized by statute, i.e., conduct specifically proscribed in § 38.2-1916 of the Insurance Code and other anticompetitive behavior not spelled out in the Insurance Code -- such as vertical arrangements affecting price, territorial and customer allocation, joint ventures, reciprocal and exclusive dealings, and tying arrangements.

This reading would be consistent with the meaning of the term "regulation" which includes not only the power of the Commission to review or examine affirmatively the setting of rates, charges, terms, and conditions for insurance, but also to prosecute for illegal activities under § 38.2-1916. Thus, the "Conduct subject to regulation, review or examination" to which § 38.2-705 was directed is, on this view, the conduct spelled out in § 38.2-1916.

III. Consistent Procedures and Penalties

If our Office were to bring an antitrust action in circuit court against a group of insurance companies and our jurisdiction to bring the action were challenged, we believe we could make a

strong case for jurisdiction, based on our role as antitrust prosecutors. Nonetheless, we do recognize that the Commission, because it regulates the business of insurance, could also make a strong jurisdictional claim, and that the interplay of § 38.2-705 and § 59.1-9.4(b) has never been addressed by the courts of this Commonwealth.

This brings me to the second part of my remarks for today. We recommend that regardless of the jurisdictional alternatives discussed above, the prehearing investigatory procedures for alleged anticompetitive behavior under the Insurance Code and penalties for convictions should be changed to be consistent with those under the Antitrust Act.

As you know, the Commonwealth's economic vitality is premised on the concept that fair and vigorous competition (i.e., operation of the free market) ultimately results in the greatest efficiency, lowest prices, and finest goods and services for it and the citizens of Virginia. The Virginia Antitrust Act enables the Attorney General to police the marketplace to ensure that such competition does in fact occur. As will be discussed below, to deter firms from vitiating this process, the legislature has provided our Office with significant pre-complaint investigatory tools and the legislature has also provided stiff penalties if firms are found guilty of an antitrust violation.

In addition, the legislature has determined that because of their importance to the public, some industries should be regulated. But given the fact that they are allowed to engage in conduct for which other companies would be severely punished,

regulated firms, we believe, have a special obligation not to exceed the scope of permitted regulated conduct. If companies do, they should expect the same treatment as other companies that run afoul of the antitrust laws. In sum there is no logical reason to vary the treatment depending on the agency pursuing the inquiry. The anticompetitive conduct spelled out in § 38.2-1916 is the same conduct that the Antitrust Act seeks to reach.

A. Comparison of Pre-Investigatory Provisions

Under § 59.1-9.10 of the Antitrust Act our Office has been granted extensive powers to investigate suspected violations of the Act. The Office is empowered to require a suspected violator to provide a statement of facts under oath regarding its practices. Additionally, and more importantly, the Attorney General may issue civil investigative demands. These CID's can be used to compel the attendance of witnesses who will be examined under oath, may be used to require the production of relevant books, documents and records, and may be used to issue written interrogatories to be answered by the witness served.

By utilizing the procedures set forth in § 59.1-9.10, we are empowered to conduct a thorough investigation into potential antitrust practices prior to initiating litigation.

While the Commission, and thus the Bureau, has broad authority to request and receive information, our review indicates that the Insurance Code does not expressly provide the same investigatory tools as are available to us in uncovering violations of the Antitrust Act. These additional powers could be crucial to the investigation of similar practices which may

violate § 38.2-1916. In the typical situations in which the Bureau requests information, the insurer is seeking approval of proposed action by the Bureau, and making the withholding of that approval or the conditioning of that approval upon compliance with responsive action by the company to requests provides all the enforcement incentive needed. In contrast, in situations in which no pending proposal by the company is before the Commission or the Bureau, such as investigations of anticompetitive conduct under § 38.2-1916, stronger mechanisms to assure accurate and timely response are called for. Therefore, pre-hearing procedures analogous to the civil investigative demand authority set forth in the Antitrust Act, we believe, should be provided for proceedings before the Commission with regard to anticompetitive conduct.

B. Increase Penalties for Anticompetitive Behavior Enforceable by the Commission

When compared to the Antitrust Act, the penalty provisions under the Insurance Code are insubstantial and thus would not provide a significant deterrent to possible anticompetitive behavior. Specifically, § 38.2-218 provides in part:

> A. Any person who knowingly or willfully violates any provision of this title... shall be punished for each violation by a penalty of not more than $5,000.
>
> B. Any person who violates without knowledge or intent any provision of this title... may be punished for each violation by a penalty of not more than $1,000. [with an aggregate of $10,000]

The Commission may revoke an insurer's license (§ 38.2-1040) or enjoin the conduct itself (§§ 38.2-219 and -220).

On the other hand, the Antitrust Act, § 59.1-9.11, provides:

> In any action or proceeding brought under § 59.1-9.15(a) the court may assess for the benefit of the Commonwealth a civil penalty of not more than $100,000 for each willful or flagrant violation of this chapter.

In addition, § 59.1-9.15 provides:

> (a) The Attorney General on behalf of the Commonwealth... may institute actions and proceedings for injunctive relief and civil penalties for violations of this chapter.
>
> (b) The Commonwealth... may recover the actual damages sustained, reasonable attorney's fees and the costs of suit. If the trier of facts finds that the violation is willful or flagrant, it may increase damages to an amount not in excess of three times the actual damages sustained.
>
> (c) The Attorney General may bring a civil action to recover damages and secure other relief as provided by this chapter as parens patriae respecting injury to the general economy of the Commonwealth.

Because of the wide disparity in the severity of punishment that exists between the two statutory provisions, we would recommend that the Insurance Code be amended to include penalties as severe as those under the Antitrust Act or that the penalty provisions of that Act specifically be made to apply to § 38.2-1916 violations.

IV. Conclusion

Our Office is willing to work with Commission officials to draft necessary regulations and proposed legislation to accomplish the above suggestions. Thank you for the opportunity to appear before you today to express the views of the Attorney General on some difficult and complex issues. I will now address any questions members of the Committee may have.

287-M90/245

COMMENTS OF KENNETH S. ABRAHAM
BEFORE THE
HJR 382 JOINT SUBCOMMITTEE STUDYING LIABILITY INSURANCE
August 21, 1989

REINSURANCE

The Nature of Reinsurance

Reinsurance is an agreement between two or more insurers, whereby all or part of the risk of loss under an insurance policy or policies sold by one is transferred to the other. The insurer selling the initial policy is termed the ceding insurer; the insurer to whom the ceding insurer transfers some or all of the risk assumed under the initial policy is termed the reinsurer. Some reinsurers specialize, sometimes exclusively, in reinsurance; these companies are known as professional reinsurers. Other reinsurers are primary insurers who sell reinsurance as a more or less minor part of their business.

Reinsurance is a device by which insurance companies diversify their risk. Consequently, the proportion of a company's book of business that it reinsures is likely to vary from line to line, depending on the volume of business it does in a given line and the volatility of losses in the line. For example, commercial liability and medical malpractice insurance tend to be more heavily reinsured, other things being equal, than auto property damage insurance. Reinsurers themselves sometimes need to diversify their own risks; the process by which they reinsure is known as retrocession. Reinsurance and sometimes several subsequent retrocessions are a means by which the risk undertaken by primary insurers is diversified widely into the global financial markets.

Reinsurance tends to be custom-made; there are no form policies or rates. The varieties of reinsurance therefore are manifold. There are, however, general categories into which different types of reinsurance tend to fall. When coverage is specifically arranged to reinsure a particular risk or policy, it is known as facultative reinsurance. When coverage applies to a specified type or portion of a primary insurer's business in advance, it is treaty reinsurance. In the latter case (and sometimes the former) the document memorializing the parties' agreement is called a treaty rather than a policy. In both facultative and treaty reinsurance, the risks reinsured may be transferred in a variety of ways: in some specified proportion between the ceding insurer and the reinsurer (pro-rata or quota-share reinsurance), or above a specified retained limit (excess-of-loss reinsurance).

There is virtually no regulation of reinsurance, although reinsurers licensed to do business in Virginia are subject to solvency regulation by the Commissioner. The traditional

justification for exempting reinsurers from regulation is that the consumers of reinsurance are insurance companies that have the capacity to comparison shop and the information necessary to do so effectively. In addition, the reinsurance market has either been considered competitive, or the difficulty of controlling anti-competitive behavior at an international level, where many reinsurance transactions occur, has been considered to be too great an obstacle to effective regulation.

Reinsurance in Situations of Control

One subset of issues related to reinsurance regulation, however, is worth much more serious consideration. This involves reinsurance among or between companies where one of the companies has an opportunity to control the other, and thereby to set an artificial price for the reinsurance coverage sold. This may occur under several different situations. First, a group of primary insurance companies may each be controlled, or wholly owned, by a third insurance company, which serves only as a holding company or actually functions as an insurer itself as well. One of these wholly owned companies may reinsure with another. Neither has any formal legal relationship with the other, but each is controlled by the third company. Second, the same situation may exist, but one of the wholly owned companies may actually function as a professional reinsurer. Third, two legally independent companies may be governed by overlapping boards or directors, or owned by overlapping or wholly identical sets of shareholders. One such company may then reinsure with the other. Finally, there may be other situations in which a company engaging in reinsurance transactions with another has de facto or de jure control over the other.

Reinsurance in such situations may be perfectly appropriate. For example, several companies owned by a third may reinsure a portion of their books of business with each other in order to pool their risks and thereby even-out the degree of exposure faced by each individual company. Such transactions may take the form of reinsurance, but their purpose is simply to equalize risk among a group of "sister" companies, not to transfer risk to a third-party reinsurer. On the other hand, it is unclear whether such "reinsurance" transactions in situations of actual or potential control produce other abuses, such as under or over-charging for coverage, excessive or under-payment of ceding commissions, or inconsistent reporting of loss reserves and investment income for ratemaking purposes.

Moreover, it appears that the practice of "reinsuring" in situations of actual or potential control, whether for the legitimate purpose of pooling among affiliated companies or otherwise, is very common among Virginia companies. Figures compiled in 1988 for the Office of the Attorney General showed that the eleven major Virginia General Liability insurers reinsured over half of all their business, but that over 80 percent of the reinsurance activity of these companies took place

with companies where there was a relationship of actual or potential control. At the national level, many of the largest professional reinsurers are owned by parent companies whose major source of revenue is the sale of primary insurance: Aetna is the parent of American Re, Hartford is the parent of New England Re, Crum and Forster is the parent of Constitution Re, and AIG manages Transatlantic Re.

Given this situation, it would be entirely appropriate for the State Corporation Commission to review the scope and nature of reinsurance transactions in situations of potential control, where such transactions may affect the competitiveness of rates charged Virginia policyholders. For this reason, we recommend that insurers writing coverage in lines designated as troubled by the SCC be required to file Virginia-based data on their reinsurance transactions with companies where there is a relationship of actual or potential control. The filing of this data would permit the SCC to scrutinize such transactions to determine whether and when they are the product of legitimate pooling of risk among companies, and whether and when they involve abuses that should not be permitted.

BEFORE THE VIRGINIA JOINT SUBCOMMITTEE STUDYING REINSURANCE, INSURANCE ANTITRUST EXEMPTION, AND THE AVAILABILITY AND AFFORDABILITY OF LIABILITY INSURANCE - HJR 120

INTRODUCTION

This Joint Subcommittee was charged with an overview of issues associated with three specific areas that were to be studied: (1) the advisability of repealing the insurance industry's exemption from the Virginia Antitrust Act; (2) the availability and affordability of liability insurance in the Commonwealth, and (3) the reinsurance practices of insurance companies.

A review of the testimony, exhibits and information that has been presented to the Joint Subcommittee over the course of numerous hearings demonstrates first, that there should be no modification, repeal nor any other statutory change made to the Virginia Antitrust Act. To do so would impact on the ability of the Bureau of Insurance to regulate and oversee rates and practices of the insurance industry. Moreover there should not be any additional modifications in the Insurance Code that would restrict the activity of rate service organizations - the premise for the Attorney General's called repeal of the exemption. To do so would adversely impact small insurance companies and the consumer. Secondly, it is clear that continued availability and affordability of liability insurance in the Commonwealth must be maintained under the competitive rate setting systems that were

put into effect fifteen years ago; a change from that competitive system would adversely impact consumers of insurance in the Commonwealth. Lastly, there should be no additional statutory nor regulatory burdens added in the reinsurance industry. Significant authority currently exists to investigate rates and examine companies to determine whether reinsurance arrangements may be a problem or a factor in rate issues; but more importantly, it is clear that the reinsurance industry itself is highly competitive and reacts accordingly.

I. ANTITRUST EXEMPTION

The Attorney General has advocated, as a first priority, the repeal of any antitrust exemption, at the state level, for the insurance industry. See Va. Code Section 59.1-9.4. The Attorney General would also seek, at the Federal level, repeal of the McCarran-Ferguson Act, 15 U.S.C. Section 1011-1015, which provides limited immunity to certain aspects of the business of insurance. The rationale for the Attorney General's advocated repeal is centered upon the role of rate service organizations, and more specifically, the Insurance Services Office (ISO), which is one of a number of rate service organizations that are authorized to file certain types of proposed rates in this Commonwealth. See Va. Code Sections 38.2-1908 and 38.2-2004. This Committee should review both an analysis of antitrust laws as well as the manner in which rate service organizations operate. A review will demonstrate that no statutory change should be instituted.

From the testimony heard by this Committee, it is manifest that (1) it would be inappropriate and ill-advised to make any modification of the existing state antitrust laws, and (2) the legislature already has in its power the ability to regulate any conduct where it deems such regulation appropriate.

Insurance has been extensively regulated by the states since the mid-1800's, and that concept remains uninterrupted to this date. The Supreme Court's 1944 decision in United States v. Southeastern Underwriters Association, 322 U.S. 533 (1944), (which held that a fire insurance company conducting a substantial part of its transactions across state lines was engaged in interstate commerce, and that Congress did not intend to exempt the business of insurance from the reach of the Federal Antitrust laws; specifically, the Sherman Act) lead to fears that there would be an undermining of the ability of states to engage in taxation and effective regulation of the insurance industry. Congress thus promptly enacted the McCarran-Ferguson Act, confirming what up to then was always presumed - that the issuance of an insurance policy was not a transaction in interstate commerce, and that states should be able to have exclusive domain over regulating the insurance industry.

As emphasized in testimony before this committee, the McCarran-Ferguson exemption is very narrow and limited. First, the insurance industry itself is not exempt from the antitrust laws, but rather only the business of insurance. This has proven to be an important distinction, ensuring that companies act competitively, while enabling "the business of insurance" to be

conducted pursuant to state regulated policy. Secondly, under the McCarran Act, it is clear that no conduct which would constitute any agreement of boycott, coercion or intimidation is granted any sort of exemption from antitrust laws. Thirdly and most importantly, the McCarran Act exempts the business of insurance to the extent it is regulated, or as stated in the McCarran-Ferguson Act itself, the Sherman Act and similar Federal antitrust acts shall be applicable to the business of insurance "to the extent that such business is not regulated by state law." Consequently, this Legislature has within its power the ability to determine exactly what activity will or will not be subject to antitrust principles.

The state analogue of the Federal Antitrust Act was based upon the same philosophy that exists at the Federal level. (This fact is clear, not only from the 1974 report of the VALC Committee charged with studying, reporting and recommending the new antitrust laws for the Commonwealth, but also from the Act itself, which mandates that the Virginia Act "shall be applied and construed to effectuate its general purposes in harmony with judicial interpretation of comparable Federal statutory provisions." See Section 59.1-9.17) (See also House Document 20, 1974 Acts of Assembly at 9, explicitly stating that the purpose of the exemptions set forth in Section 59.1-9.4(b) was "to ensure that state antitrust laws will not conflict unnecessarily with other statutes or regulatory schemes.") It was with these purposes in mind that the state antitrust Act, as adopted, set forth in Section 59.1-9.4 that conduct "authorized,

regulated or approved (1) by statute of this Commonwealth, or (2) by an administrative or constitutionally established agency of this Commonwealth, ... having jurisdiction of the subject matter and ... authority to consider the anticompetitive effect, if any, of such conduct, shall be exempt from the antitrust act."[1]

Again, it must be emphasized that the State Antitrust Act, similar to the McCarran-Ferguson Act, exempts activity only to the extent that it is regulated either by statute or administrative order of a state agency which, in the case of the insurance industry, is the State Corporation Commission. In short, the exemption applicable to numerous industries ensures that there is not unnecessary conflict between the antitrust act and other provisions of state law.

As the testimony before this Committee demonstrates, if the exemption was repealed as to the insurance industry itself, all of the provisions of Title 38 would still be in full force and effect. What would be created are numerous issues of statutory construction among conflicting principles of antitrust

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[1]It must be emphasized contrary to the allegations and statements made by the Attorney General's Office and a number of speakers that there is no specific exemption in the Virginia Antitrust Act for the insurance industry. The antitrust exemption is not one unique to insurance, but rather is applicable to numerous industries which gain a measure of exemption to the extent that their activities are regulated and thus mandated, including among other industries, the electrical industry, gas, water, telephone, air, motor and rail carriers, pipelines, ocean shipping, water carriers, stock exchange, television and radio communications, banking, and a host of other industries, including not only the insurance industry, but as an example, the mortgage lending and brokerage industry, which was just put under the jurisdiction of the State Corporation Commission at a recent session of the General Assembly.

laws and mandates set forth in the State Insurance Code. What ultimately would develop is a battleground for a turf war between the Bureau of Insurance and the Office of the Attorney General for the ultimate regulation of the insurance industry. The assurance of a proper methodology of regulating the insurance industry for the benefit of the consumers of the Commonwealth would not be created, but in fact would be destroyed.

Remembering that the purpose of the exemption is to ensure (1) against unnecessary conflict between the Antitrust Act and the other provisions of state law, and (2) that this Assembly, through specific statutes in the insurance code, can mandate the type of regulation that it deems advisable, then the call for the repeal of the antitrust act should quickly and soundly be rejected by this Committee. If it determines that statutory reform of some type is needed, then it should modify those specific provisions of the insurance code that are deemed appropriate for modification. This is the manner in which the scheme of regulation has always worked and the manner that is in the best interest of consumers. In short, amend the insurance code and leave the state antitrust act alone.

This brings into focus, however, exactly what provisions of the Insurance Code, as opposed to the Antitrust Act, should be modified or repealed? Also, how should rate servide organiztaions be treated? The Assembly, it is suggested, should not tamper with the provisions of Chapter 7 of Title 38.2, which prohibit certain interlocking directorships or certain mergers, which might substantially lessen competition or tend to

create a monopoly, nor for that matter should the Assembly tamper with the provisions in Title 38.2 dealing with rate service organizations such as ISO, which prohibit those organizations from monopolizing the business of insurance, fixing insurance rates, unreasonably restraining trade, refusing to deal, or more importantly, interfering with an insurer's rights to make rates independently. See Va. Code Section 38.2-1906.

The Attorney General's presentation before this Committee on October 27, 1988 did not offer any rebuttal to the legal analysis that has been presented to this Committee regarding the applicability of the State Antitrust Act. Instead, her office simply raises questions, such as what short term dislocations in the insurance industry might result if rate service organizations were prohibited from filing advisory rates in Virginia; would small companies be able to compete within a reasonable period of time with industry giants; over the long term, could small Virginia-based companies survive; what would happen to the industry and the ability for new companies to enter into the market if rate service organizations were prohibited from publishing certain data relating to rates; and what would happen if smaller companies, without the necessary resources to develop rates and trends in actuarial estimates, were prohibited from utilizing such rate organization data? In short, the questions raised are economic issues, not legal issues.

Prior to responding to such questions, an understanding of rate service organizations and the beneficial impact they have on the industry, is necessary. Preliminarily an understanding of

insurance itself is necessary.

Insurance exists because of uncertainty, that is, because of the inability of people and businesses to predict future events. In order to protect their assets, the financial consequences of future accidental -- and potentially catastrophic -- losses are transferred to an insurer in exchange for a premium.

An insurer can assume the risk of these losses and liabilities only by spreading them among many insureds, each of whom pays a relatively small premium. Determining the amount of insurance premium is a process that bears little resemblance to the way prices are determined in other industries.

Since the tangible benefits of an insurance policy are not received until after an insured buys a policy, the costs of that policy to the insurer are not known until long after the policy is sold. Firms in other industries are generally able to base their prices on known or knowable costs. At the time of sale, they usually know how much they have spent and will spend on labor, raw materials, equipment, transportation, and the other costs of the goods and services they sell. Insurers, on the other hand, face claim costs based on future fortuitous events outside their control and can only try to predict those costs at the time of sale. This is the essential insurance pricing problem and constitutes the essential difference between insurance and almost every other industry.

Central to the process of insurance ratemaking is the statistical database from which the insurer's future costs must

be estimated. As is generally the case with statistical analyses, the larger the statistical sample, the greater the probability that the predictions based upon it will prove accurate. (This principal is commonly referred to as the law of large numbers.) With a broad aggregate database of loss experience, the actuarial analysis of expected losses is more reliable.

No insurer enjoys a market share large enough for all lines and classes of insurance to develop actuarially sound rates based solely on its own loss experience and actuarial analysis. The insurance marketplace is characterized by many competitors, of which none has a dominant market share. This is particularly true in commercial lines insurance where, in addition to this fragmented market, the type of risks insured are not homogeneous. Indeed, there is an extraordinary variety of disparate risks in commercial lines insurance. An insurer with 5% of the overall market is likely to be writing policies for many different kinds of businesses. Commercial general liability insurance, for example, provides for more than 1,000 distinct classes, ranging from hardware stores to schools to hotels to coal mines, with many different territories, coverage options, deductibles and policy limits.

Competition is so significant, market share so fragmented among the companies writing commercial insurance, and commercial risks so disparate that probably no insurer in business today could price its product credibly without access to aggregate industry experience. Such small market shares do not

give individual companies enough statistical experience to generate credible statistical samples for specific risk classifications. In addition, most companies do not have the resources to employ sufficiently large actuarial staffs that would be needed to perform all the required analyses. Actuarial analysis, loss development, trending, etc., permits the underlying costs to be estimated in spite of the random fluctuation that appear in even aggregate actual insurance losses, and the costs can then be projected into the future. Therefore, the availability of a large aggregate data base of experience and accompanying actuarial analysis is critical.

Insurance Service Office, Inc. (ISO) is a licensed rate services organization that makes available to any participating insurer advisory rates which represent the average prospective loss cost for each class and includes provisions for the average expenses and profit. Insurers participating in ISO make their own independent pricing decisions, based on their own marketing strategies, after assessing how their book of business and their expenses compare with the industry averages. The more confident insurers are in their calculation of future costs, the less they need to seek a high contingency margin in the premiums they charge their insureds. Moreover, the more that insurers are able to base their pricing on accurate predictions of their future costs, the less likely that they will face future financial instability or insolvency and the less likely that they will default on their obligations to their insureds.

THE COOPERATIVE ACTIVITIES PERFORMED BY A RATE SERVICE ORGANIZATION ENHANCE COMPETITION BY ENABLING MORE INSURERS TO COMPETE, BY LOWERING BARRIERS TO ENTRY AND BY REDUCING THE COSTS OF CONTINUING IN THE MARKET PLACE

Individual company access to ISO's pooled data base, actuarial analysis and advisory rates makes statistically credible data available to any insurer that chooses to participate. The result is procompetitive. New insurers, small and medium-sized insurers, and even larger, well-established insurers entering new geographic arears or lines of insurance can use information gathered, analyzed and distributed by ISO to enter a new market or remain in an existing market.

A centralized rate service organization, such as ISO, provides insurers with the benefits of economies of scale through its pooled historical data base, professional staff and data processing equipment. If individual insurers had to provide entirely on their own the services now provided by a rate service organization such as ISO, many insurers would not be able to enter or remain in markets with the same reasonable degree of confidence in the measure of risk potential. All insurers would also incur higher expenses.

If an industry that markets its products largely through independent businessmen, there is great utility in the widespread availability of ISO manuals which contain gross advisory rates. There are seveal hundred insurers providing property/casualty insurance products in Virginia and literally thousands of independent insurance agents and brokers. Insurers do not use advisory rates in a lockstep fashion. Rather, ISO

advisory rates provide valuable information about the average prospective loss costs and average expense costs in each of the literally thousands of classes. Many insurers use this information to develop independent rate filings and programs. Others file percentage deviations to reflect differences between insurers in production costs, anticipated loss experience, risk selection and coverage terms. The flexible rating plan produces considerable independence and results in price variation by company. This is true regardless whether companies file percentage deviation.

Insurers participating in ISO make their own independent pricing devisions, based on their own marketing strategies, after assessing how their book of business and their expenses compare with the industry averages. After comparing their book of business to the ISO rates, some insurers may choose to price below the advisory rate in order to compete in the market to either maintain or gain market share. Insurers regularly depart from ISO's advisory rates by filing deviations from the ISO rate and by applying individual risk rating plan adjustments to account for an insured's own loss potential. Thus, the final price, although a function of the ISO advisory rate, often is quite different from one insurance company to another.

Furthermore, price is not the only means of competition in the insurance industry. Insurers also compete fiercely in terms of their distribution methods (e.g., independent agency, direct mail), their customer services and claims handling, their

packaging of coverages, and their specialization (e.g., by line of insurance, by geographic region, by class of risk, etc.)

Insurers need an advisory rate which reflects both pooled historical data and actuarial forecasting of that experience (e.g., loss development and trending).

As an alternative to her proposal of repeal of the antitrust exemption, the Attorney General has proposed that the insurance industry's antitrust exemption be limited by carving out the authority for rate service organizations to pool historical data only, but not to develop prospective cost information or rates. This proposal is not a viable alternative because insurers need prospective cost information which reflects both the pooling of historical data and actuarial forecasting.

To credibly forecase future loss costs for a particular line of insurance, two conditions must be satisfied. First, there must be available a reliable data base that provides an accurate history of losses paid or incurred on similar types of insurance coverages in the past. Second, there must be available a staff of skilled actuaries and economists. These professionals use historical data (claims that have been paid, along with related expense such as legal fees and other claim handling expenses) as a guide. By applying sophisticated mathematical and economic analyses to historical data, actuaries estimate the costs that can be expected to arise in connection with future insurance policies.

Most people can readily understand why the broadest possible data base incorporating historical data is essential to

the fair pricing of insurance. However, in addition, it is necessary to do sophisticated actuarial analysis of the pooled historical data to produce a realistic forecast on which future prices can be based.

Data collection, as essential as it is, is only the first step in the process of projecting future costs. Historical data can provide a good, although frequently incomplete, picture of past costs but give little information about future costs. Actuarial research skills and expertise, as well as proper judgment, are needed to produce prospective loss costs and rates.

When predicting future costs for a given coverage, the most recent similar policies for which data is available would seem to provide the information that is most related to these future costs. However, in "long-tail" lines such as commercial general liability insurance, it can take many years before enough claims have been reported and settled to accurately determine the ultimate costs on a set of policies. Consequently, general liability policies written in 1986 would provide very little in the way of loss information to use as a guide for pricing 1987 or 1988 policies. Only a portion of the losses that will ultimately be paid on those policies would have been reliably quantified by 1987 or 1988.

The insurer faces a dilemma. Ideally, it would like to use the loss information generated by the most recent policies, since the economic and social factors that affected the loss costs for those policies are more likely to be similar to those factors that will affect the loss costs associated with policies

that will be written tomorrow. Unfortunately, the most recent policies are those for which the information is the least complete. Historical data is incomplete because it does not reflect:

*Claims that will be reported after the evaluation date (incurred but not reported -- IBNR),

*Necessary refinements of the case reserves (additional information that later becomes available for known but as yet unpaid claims).

LOSS DEVELOPMENT

There is a resolution to this dilemma. It is called loss development. By analyzing the loss development of earlier policies, an actuary is able to make the best possible estimate of the total losses that will be ultimately paid out on policies that were written in recent years and for which only a fraction of the loss information is currently available. The actuary knows that the paid losses plus case reserves (the most current estimates of the losses that will be paid on unsettled claims that have been reported to the insurer) for the most recently written policies are not "mature" enough to be used without some type of adjustment. The adjustment that is needed for the losses on the most recent policies is due to the same phenomenon -- loss development -- that was observed on older policies.

Thus, in a sense, the actuarial technique called loss development does nothing more than fill in the otherwise incomplete picture given by an historical data base. A rate service organization is the logical and most cost-effective

entity to calculate the loss development factors needed to complete its historical data base. The alternative would be to force each company to individually reproduce essentially the same calculations, at significant cost on an industrywide basis.

Loss development refines the estimates of historical loss data as more information becomes available, that is as the policy year matures. However, loss development is not sufficient in itself to produce sound prospective loss costs or rates. It does not tell what loss costs will be for a future period when a policy, for which a premium is being collected now, will be in effect.

TRENDING

To determine what the loss costs will be for a future period, historical developed loss data for a number of years must be analyzed for frequency and severity trends. Actuaries calculate average claim costs, observe the trend in these costs and project this trend into the future. The frequency and severity trend factors developed through actuarial analysis are applied to developed historical loss costs to place them at the cost and frequency level anticipated for the period in which the new rates will be in effect. As with loss development, trending is based on verifiable historical facts. And as with loss development, it is far more efficient for the industry to take advantage of the economies of scale inherent in the calculation of these factual numbers by allowing a central entity -- a rate service organization -- to apply appropriate trend to its

developed historical loss costs.

As data gatherers, rate service organizations are well aware of the composition of the historical database, the various data elements available for analysis, along with changes in internal and external influences on insurance costs. This knowledge is essential in performing actuarial analyses for loss development and trend on a database. It enhances the accuracy of the projected results which, in the long run, leads to greater price stability, and increased competition/lower prices due to the greater confidence in prospective loss projections.

The Virginia Commissioner of Insurance has proposed that rate service organizations "be prohibited from filing average expense factors on behalf of member companies." Implicit in that proposal is the recognition of the value of the actuarial forecasting (i.e., trend, loss development) in prospective loss costs, a conclusion with which we concur. However, we do not agree that rate service organizations should be prohibited from filing average expenses for use by their participating insurers, because to do so would eliminate from the insurance marketplace the efficiencies that accompany a rate service organization manual including advisory rates.

As previously stated, insurers evaluate their own books of business, expenses and profit needs to determine their own pricing requirements in relation to ISO rates. To the extent that insurers are forced to individually replicate calculations that could be done once for use by all, insurers' costs -- and therefore insurance prices -- must necessarily rise. Small

insurers may not have -- nor be able to afford -- the actuarial expertise and sophisticated computer systems needed for loss development and trending undertakings. And the actuarial and computer resources maintained by larger insurers would need to be expanded in order to handle the additional workload.

Companies will have to rely on in-house or consulting actuaries to develop their rates from available industry data. Administrative costs should rise and be passed along to customers. At least in a transition period, rationing of scarce actuarial talent will pose many problems and present the likelihood of severe disruption in rate setting functions generally. Certainly during such a transition period, the effect of rate making uncertainties will likely have the effect of reducing capacity in "problem" lines and in certain territories, especially of more marginal competitors. Even over time, smaller companies will be disadvantaged from a cost and perhaps skill viewpoint in ways that should reduce the competitiveness of the industry.

Lastly, limiting the exemption by carving out authority to pool historical loss data only would create barriers to market entry and thereby reduce competition. As previously stated, the economies of scale which a rate service organization's advisory rates created permits prospective insurers and small companies to easily enter the market and compete. It also facilitates market entry for large insurers.

As previously pointed out, rate service organizations create economies of scale through cooperative actuarial

forecasting (trend, loss development of historical data) which enhance competition by facilitating market entry. To limit rate service organizations to the collection of historical loss data would negate those economies of scale and thereby make the costs of market entry prohibitive to many prospective insurers, small insurers and large companies considering writing new lines of insurance.

The creation of barriers to market entry would result in fewer insurers competing in the marketplace.

In short, the insurance industry is unique. It is not like the airline industry, which, with deregulation, has seen the failure and insolvency of numerous small companies and the merger and acquisition of numerous other industry giants. And what the Attorney General is advocating is deregulation of the insurance industry. It would adversely impact an insured. Deregulation of an airline industry might inconvenience a traveler. To allow volatility to enter the insurance market means potential insolvencies and the disruption (in the future) of the insurance and indemnification that numerous consumers today are relying upon in planning economic stability. In short, this Assembly has the choice of experimenting, as proposed by the Attorney General, and seeing if insolvencies will or will not happen, with their attendant dire consequences, or it can choose to continue the regulation of insurance by the State Corporation Commission, in accordance with the mandates as set forth in Title 38.2. The choice should be obvious.

II. AFFORDABILITY AND AVAILABILITY

The Subcommittee has heard allegations that the commercial liability insurance market in Virginia is not competitive, that insurers fix prices, and that insurer profits are excessive. The Attorney General's Office has suggested solutions to these alleged problems in the form of additional restrictions on permissible activities by rate service organizations and increased use of prior approval rate regulation. Three main points should be emphasized.

1. The commercial liability insurance market is highly competitive. The allegations of price-fixing and other forms of noncompetitive behavior are unsupported and inconsistent with the reality of the marketplace. Evidence of extensive flexibility and independence in pricing and of substantial price variation among companies was not considered by the Attorney General's Office.

(a) Market shares of the leading firms writing general liability insurance in Virginia are low and have been subject to considerable variation over time. Significant entry barriers for new firms do not exist. While the market shares of leading firms for the six "troubled" lines emphasized by the Attorney General's Office are higher than for the overall market, there are no significant barriers to entry by additional firms or to expansion by firms already writing business in these lines.

(b) Price-fixing through the advisory rate system of the Insurance Services Office (ISO) or any other mechanism would be illegal and subject to severe sanctions under existing

Virginia law (Virginia Insurance Code, Section 38.2-1916). Many commercial liability insurers make independent rate filings, including 30-40 percent of the insurers with positive written premiums for the six troubled lines in 1987. Many other insurers file percentage deviations from ISO advisory rates. These deviations are inconsistent with price-fixing. Individual risk-rating plans (which include expense modification, experience rating, and schedule rating plans) provide insurers that use the ISO advisory rate system with substantial flexibility in pricing. Moreover, substantial evidence of significant price variation exists. Given the illegality of price-fixing and lack of an enforcement mechanism for a price-fixing arrangement, it is highly unlikely that the ISO advisory rate system raises prices to consumers. Instead, the system is likely to benefit consumers by lowering the total cost of ratemaking, by facilitating entry by insurers into additional classes of business, and by helping to promote financially sound competition.

2. The assertions that insurance company profits have been excessive and that Virginia policyholders subsidize policyholders in other states are based on questionable and misleading analysis and interpretation of data on insurance company operating results. Given the evidence that the market is highly competitive, substantive changes in regulation are not warranted based on this analysis.

The assertions by the Attorney General's Office were based on (a) a comparison of written premiums and paid claims for Virginia general liability insurance, (b) a comparison of

Virginia's general liability insurance loss ratio to the countrywide loss ratio, (c) an analysis of the rate of return on surplus for general liability insurance in Virginia, and (d) low incurred loss ratios calculated with the HB 1235 data for the six troubled lines.

(a) Paid losses on current policies and for policies written in prior years cannot be meaningful compared to written premiums for current policies. When expected losses are growing rapidly over time, written premiums in a competitive market will exceed paid losses by a substantial margin, and the margin will tend to increase over time.

(b) The comparison of Virginia's loss ratio to the countrywide loss ratio and attendant discussion assumed that any difference in loss ratios across states indicated a difference in expected profits when policies were sold. The fact that Virginia's loss ratio was lower than the countrywide loss ratio was treated as prima facie evidence of excessive prices in Virginia and of subsidies from Virginia consumers to consumers in other states. This approach is not valid, especially in view of the evidence of vigorous competition in the Virginia general liability insurance market.

Many states have had high loss ratios for general liability insurance in recent years as a result of unexpected growth in losses. High loss ratios often were associated with severe availability problems. The impact of large, unexpected losses in a few large states can have a pronounced impact on the countrywide loss ratio. Calculations were done of the

countrywide loss ratio for general liability insurance in 1987 excluding experience for the five states with the greatest general liability insurance premium volume. The loss ratio excluding these five states was 61.2 percent, compared to a ratio of 59.4 percent in Virginia.

Moreover, in a competitive market the loss ratio that is expected when policies are sold will differ across states due to differences in underwriting costs per dollar of premiums and in the average length of time between the receipt of premiums and the payment of claims. These variables will be influenced by many economic and demographic factors. The Attorney General's Office should have asked whether Virginia's loss ratio was significantly lower than those in other states after controlling for factors that could effect differences in loss ratios across states in a competitive market. This question would be very difficult to answer. However, the evidence that the market is competitive should lead to the presumption that the observed differences in loss ratios were not caused by noncompetitive behavior. If the loss ratio in Virginia were too low, the profit incentive would lead new and existing insurers to expand their production in an attempt to increase market share and profits. These actions would drive prices down and increase the loss ratio to its breakeven level.

(c) The Attorney General's Office has claimed that the rate of return on surplus from writing general liability insurance in Virginia is excessive. Calculations of the rate of return on surplus for general liability insurance in Virginia are

based on numerous assumptions for which economic analysis provides little guidance. Rates of return are especially sensitive to assumptions concerning the amount of investment income and surplus that should be allocated to general liability insurance. The calculations also assume the applicability of countrywide expense and investment results to Virginia. The underlying loss experience also is volatile over time. Calculations of rate of return for general liability insurance for Virginia in 1987 under a variety of assumptions produced a wide range of figures. Assumptions used by the Attorney General's Office could significantly overstate the unknown true rate of return. Moreover, the evidence that the market is competitive makes it highly unlikely that the rate of return for general liability insurance in Virginia would be excessive.

(d) Incurred loss ratios for lines with small premium volume are highly volatile. For this reason, interpretation of the HB 1235 data on losses and premiums for the six troubled lines is problematic. It also is likely that reported losses for many of the companies did not include loss development or estimates of incurred but not reported losses. The omission of these items would substantially understate ultimate losses on the business reported. Furthermore, the ease of entry by additional insurers and of expansion by existing insurers again makes it highly unlikely that prices would be excessive given market conditions in these lines.

3. The proposals by the Attorney General's Office for regulatory change would be likely to harm the citizens of

Virginia. New restrictions on the activities of rate service organizations would be likely to increase insurance company operating costs and to impede rather than promote competition. They also could destabilize the market and lead to a greater number of insolvencies. Increased use of prior approval rate regulation probably would make insurance less available in the short run and more expensive in the long run. It also would be likely to result in subsidies from low-risk consumers to high-risk consumers.

(a) Given the evidence that the market is competitive, the alleged benefits of restricting the activities of the ISO are at best speculative. In contrast, it is certain that such changes would increase some costs that ultimately would be borne by consumers. Restrictions on the ability to disseminate prospective loss costs, including loss development and trend, could be especially harmful to consumers. The cost of developing and trending historical data would be likely to discourage some companies from writing business in many of the classes and subclasses of insurance with small premium volume. The result would be less competition. Some companies might continue to write business in certain lines without incurring the costs required to obtain developed and trended estimates of prospective loss costs. If so, a greater tendency to underprice during soft markets, less stability, and an increased number of insolvencies could result.

(b) Evidence from other states that have actively practiced restrictive prior approval rate regulation in recent

years suggests that political pressure to hold rates below prospective costs leads insurers to supply less coverage. The reduction in supply in turn leads to pressure for mandated markets, such as joint underwriting associations and reinsurance pools. Restrictive prior approval rate regulation and the mandated markets that follow have a pervasive tendency to raise rates for low-risk consumers so that high-risk consumers can pay lower rates. Restrictive prior approval rate regulation is likely to aggravate insurance affordability problems over time by distorting the incentives of insurers and consumers to control claim costs. It also is likely to result in long and costly rate hearings in which industry and government representatives and numerous paid consultants, advocates, and experts engage in irresolvable arguments about the level of rates that should be approved.

During the 1970's, Virginia replaced its system of prior approval rate regulation with a file-and-use system. This decision was made only after extensive analysis of the advantages of competition and of the evidence of competition in the Virginia marketplace. The Attorney General's proposal to turn back the clock and adopt prior approval regulation for more and more lines of insurance should be rejected. It would be harmful to the average consumer in Virginia.

III. REINSURANCE

At the Joint Subcommittee's first hearing, the Attorney General offered an "introductory and tentative" analysis of

reinsurance practices. Ms. Terry questioned whether the reinsurance industry is competitive and expressed concern that a large amount of reinsurance may be transacted among affiliates without regulatory oversight. In Ms. Terry's view, each circumstance, if true, could lead to excessive rates. A regulatory scheme was suggested that would require ceding companies to report on each reinsurance transaction by state, line and subclassification.

The Joint Subcommittee heard a full day of testimony concerning reinsurance practices. The testimony demonstrated that by any rational measure the reinsurance industry is highly competitive and reacts accordingly. The testimony also explained that figures concerning "interaffiliate reinsurance," which had concerned Ms. Terry, reflected intracompany pooling, which is closely regulated under the Virginia Holding Companies Act and similar or identical legislation in forty-three other states. Finally, the testimony explained that rates are reviewed on a gross basis and that the State Corporation Commission ("SCC") has significant authority to investigate rates and examine companies to determine whether, in the case of an excessive rate, reinsurance arrangements might be a factor.

In view of the evidence received by the Joint Subcommittee an attempt to develop a detailed reporting scheme for each reinsurance transaction should not be recommended. First, there is no evidence that undue influence by reinsurers has caused inflated rates. The competitive structure of the reinsurance industry strongly argues against this conclusion.

Secondly, a detailed reporting scheme would be unworkable and is unnecessary. To the extent reinsurance could be used to improperly influence rates, regulatory authority exists to deal with any abuse in a thorough and efficient manner.

1. The Reinsurance Industry is Competitive and There is No Evidence that Reinsurance Practices Cause Excessive Rates

Competitiveness is a function of both concentration and ease of entry. The competitive structure of the industry makes it very unlikely that reinsurance would exert an undue influence on rates. The reinsurance industry is relatively unconcentrated and has low barriers to entry.

At the August 17, 1988 hearing Professor Scott Harrington presented a detailed analysis of the reinsurance industry's competitiveness. He noted that the industry's aggregate concentration is low compared to most major industries. Harrington Testimony at 6. The largest U.S. reinsurer enjoys less that 10% of the U.S. market. Zech and Kroner, National Underwriter (August 29, 1988) II at 7. Moreover, reinsurance industry results reflect those of a volatile, competitive market. The average return on surplus for 26 reinsurers selected by Ms. Terry's expert was approximately 9% for 1982 through 1986, including a negative 10.7% figure for 1984 and 2.4% for 1985. This average is indicative of competition. See Harrington Testimony at 13. Importantly, much of the increase in surplus between 1985 and 1986 came from capital infusions from owners and investors. Owners and investors contributed large amounts to

surplus to replace that which had been lost the previous year and to strengthen their companies for the future. Id. at 16.

The volatility in the market is also reflected in the industry's combined ratio figures. For 1982-86, reinsurance combined ratios in percent were: 112, 121, 141 and 111, a range of 111 to 141. This compares to the aggregate market's combined ratios of 110, 112, 118, 116 and 108. Harrington Testimony at 9.

Perhaps more significantly, the reinsurance industry also has low barriers to entry. There are no financial barriers to enter the reinsurance market over and above those that must be met to enter the primary market. Harrington Testimony at 5; Rondepierre Testimony at 2. In Virginia a company with $2 million capital and surplus can receive a license to write property casualty coverage. Va. Code Sections 38.2-1024 to 1036. No additional requirements are imposed in order for a licensed company to write reinsurance in Virginia. Nor are there additional financial requirements imposed in order that a licensed company may take credit for the reinsurance ceded. Id. at Section 38.2-1316.A.1.c. In other words, a company may reinsure whatever line it is permitted to insure. In Virginia, reinsurance may also be provided by a non licensed company if it has capital and surplus of at least $2 million. Id. at Section 38.2-1316. Capital is free to flow into the industry and the Commonwealth when investors perceive a reasonable opportunity for profit.

2. The Existing Regulatory Scheme Allows an Efficient and Thorough Review of Reinsurance Impact on Rates Without the Need to Produce and Review Volumes of Questionable Data.

The suggested legislative approach is unnecessary and would be unworkable. The existing legislative scheme permits review of reinsurance arrangements in an efficient manner.

Extensive testimony has been provided concerning the impracticality of the suggested legislation. There are numerous types of reinsurance arrangements for which meaningful state based data cannot be produced. Some other types of reinsurance arrangements would provide data that duplicate primary company data. Importantly, in these cases where data could be produced, it would involve an immense amount of work for the filing companies and the SCC. Tens of thousands of separate filings would be required, and the data would be fragmentary and serve no useful purpose. No agency could be expected to deal with such a volume. Gilmartin Testimony at 4; Rondepierre Answers at 2-3.

However, the existing rate regulatory scheme provides an efficient, thorough means for avoiding potential, adverse impact on rates. Rates are made and reviewed on a gross basis. A rate is determined to be excessive or reasonable whether or not reinsurance exists. Va. Code Section 38.2-1904; Rondepierre Testimony at 8; Gilmartin Testimony at 7. If a rate is determined to be reasonable, no further inquiry is necessary. On the other hand, if a rate is excessive the SCC has extensive investigative and examination authority to determine the cause including whether reinsurance arrangements could be a

contributing factor. Rondepierre Testimony at 8.

Aside from the hearing process, Va. Code Sections 35.2-1904; 1910, the SCC has broad authority to investigate rates on its own initiative, or upon consumer request. Id. Section 38.2-1909. The SCC has authority to examine licensed companies. Id. at Section 38.2-1317. Additional authority empowers the SCC to order production by holding company members of "any records, books or other information papers ... necessary to determine the financial condition or legality of conduct of the insurer." Id. at Section 38.2-1332. The SCC can require licensed companies to file reports in addition to the Annual Statement concerning, among other things, "transactions or affairs of the insurer." Id. at Section 38.2-1301.

Under each investigative avenue the SCC can examine reinsurance arrangements. And, in fact, the agency frequently reviews reinsurance arrangements. Minutes of August 17, 1988, Hearing at 3-4. Using its existing authority to focus on circumstances where rates are thought to be excessive, or where the financial condition of the insurer is in question is far more efficient than attempting to review filings by each insurer detailing each of its reinsurance agreements for each risk by state, line and subclassification. Limited resources can better be focused on specific problems.

3. Extensive Additional Authority Exists Regulating Pooling Arrangements

One of the concerns that prompted the Attorney General's legislative suggestion was a fear that extensive

interaffiliate reinsurance could cause excessive rates. For example, Ms. Terry was concerned that approximately 80 percent of all reinsurance business of selected companies was placed with affiliates. A.G. Outline of Issues and Background Materials, July 8, 1988, Hearing at 4. In fact, however, these figures reflected interaffiliate pooling, not traditional reinsurance transactions. Insurance groups in fact retain very little reinsurance within the group. Carpenter Testimony at 5.

As explained, pooling serves the legitimate need of an insurance group to evenly spread results among its members by way of sharing (pooling) premiums and losses.

Pooling provides no means for hiding profits and in fact pooling, as all material interaffiliate transactions, is extensively regulated under the Virginia Holding Companies Act and similar acts in other states. Va. Ins. Code Sections 38.2-1322 et seq.; Carpenter Testimony at 6-7.

A "material transaction" with an affiliate must comply with numerous standards including the need to be "fair and reasonable." Id. at Section 38.2-1330, A.1. A material transaction includes "any reinsurance treaty or agreement." Id. Section 38.2-1322.

Prior written approval by the SCC is required for a material transaction between a domestic insurer and any affiliate involving more than either five percent of the insurer's admitted assets or twenty-five percent of the insurer's surplus, whichever is less. Id. at Section 38.-1331. In deciding whether to give approval, the SCC must consider whether the transaction meets the

statute's standards and whether it might "adversely affect the interest of policyholders." Id.

Each licensed insurer that is a member of a holding company system must register with the SCC. Id. at Section 38.2-1329. Foreign insurers subject to disclosure requirements and standards in their jurisdiction of domicile substantially similar to those adopted by Virginia are exempt from registration. However, the SCC can require such foreign insurer to furnish a copy of the registration filed in its domiciliary jurisdiction. Id. at Section 38.2-1329.B.2.

The SCC has the authority to examine the books and records of a company subject to the Virginia Holding Companies Act and the authority to employ experts at the company's expense for such an examination. Id. at Section 38.2-1332. Forty-four states have Holding Companies Acts similar to Virginia's. Official NAIC Model Insurance Laws, Regulations and Guidelines, Vol. 2 at 440-26.

Pooling agreements are subject to the Act and must receive prior approval. In addition, such agreements and any non-pooling interaffiliate reinsurance agreements are to be reported on the Annual Financial Statement, which all licensed companies must file with the SCC. Reinsurance ceded to affiliates must be separately stated. Schedule F, Part 1A, Section 1. Reinsurance assumed from affiliates must also be reported on the Annual Statement. Schedule F, Part 1A, Section 2. See Carpenter Statement at 7.

Pooling serves important risk spreading functions and is subject to close regulatory scrutiny.

The industry suggests that no legislative change be made concerning regulation of reinsurance. The evidence is that the proposed regulatory scheme is not needed and, in any case, could not accomplish its stated purpose. Interaffiliate reinsurance and pooling are extensively regulated under the Virginia Holding Companies Act. Rates are regulated on the basis of the gross rate charged to policyolders, without regard to the existence of reinsurance. The SCC has significant authority to investigate rates and examine companies to determine whether, in the case of an excessive rate, reinsurance might be a factor. The reinsurance industry has low concentration, ease of entry and is highly competitive. To the extent it would involve substantial additional expenses to insurers and to the SCC, the proposed regulatory scheme would increase costs to Virginia policyholders with no corresponding benefit.

VIRGINIANS FOR
FAIR RATES AND FAIR COMPENSATION

Mr. Chairman and members of the Joint Subcommittee, my name is Rick Cagan. I appear before you on behalf of Virginians for Fair Rates and Fair Compensation, a statewide consumer coalition interested in insurance reform.

To reiterate Mr. Kneedler's remarks, I was surprised to learn only recently that today's meeting would be taking up the anti-trust issue along with the reinsurance issue for which this date had been set a long while back. I would like to note for the record that had more notice been available we may have been able to bring forth additional witnesses. I would ask the Subcommittee to consider hearing or receiving additional testimony on the antitrust issue beyond today's date.

Having heard the Attorney's General's proposals in the antitrust area, I want to be clear in saying that we support them despite the fact that our own testimony may go further. In addition, this testimony is based on the premise that the business of insurance is exempt from antitrust law, which has seemed to be an assumption of the resolution authorizing this study and which is still a viable argument which can be made.

As I have previously testified on several occasions before this body, the repeal of the antitrust exemption for the insurance industry is a long overdue reform of great interest to Virginia consumers. During the 1989 General Assembly, I reported to you that 98 percent of those persons calling our insurance hotline in the Fall of 1988 expressed the view that insurance companies should be bound by the antitrust laws from which they are now exempt.

It is now time for elected officials to fall in line with the wishes of the consumer public by giving serious consideration to measures which will curb if not eliminate this privilege enjoyed by the insurance industry. After all, consumers spend 12% of their disposal income on insurance, accounting for more than any other household expenditure except food and shelter.

To my understanding, because of the presence of the antitrust exemption, it is lawful for insurance companies, but not other businesses, to engage in price fixing, including raising prices in concert by factors as much as 500% or more. The exemption makes it legal to have an organization wholly owned by insurance companies which can issue a rate for a type of insurance and require all member companies to charge that rate. It is legal to publish price data within the industry that is not available to buyers, to refuse to sell one type of insurance to an individual

unless she or he purchases another type of insurance. It is legal to fix the price of salespeoples' commissions, to parcel out markets and to limit the types of coverage they will provide. I believe that the insurance industry has failed to convince the public why it requires this special privilege of exemption from antitrust laws. The public believes that insurance companies should be treated like all other businesses. If competition works for the rest of us, why not then for insurance companies?

I offer the following excerpt from testimony of J. Michael Mullin, of Counsel, Crowell & Moring on the subject of repeal of McCarran Ferguson:

> Insurance industry witnesses seem to argue that because many markets in this business are competitive, it should be exempt from the antitrust laws. This is a novel argument, but it has no merit. Can you imagine a group of car dealers seeking an exemption from the antitrust laws because their business is very competitive? If the existence of "workable competition" was a justification for an exemption from the antitrust laws, a large segment of the American economy would be exempt. This would be obviously unacceptable and would give rise to wholesale price fixing and other market constraints that the antitrust laws are intended to prohibit and punish.

Testimony presented during 1988 from industry representatives argued that there is adequate, if not cut-throat competition in the marketplace. If that is the case, then there should be no objection to the repeal of the antitrust exemption or to adoption of any specific prohibition for rate service organizations.

One goal of antitrust repeal is to promote greater competition in the marketplace. That is the nature of American business. We believe that competition ought to be maximized in an effort to control insurance costs to consumers and to the extent that the marketplace can't control costs, then regulatory controls must be utilized.

For example, evidence presented to you in 1988 by the Attorney General documented the vast majority of companies using ISO rates, half or more without deviation, to insure commercial contractors, day care providers, municipalities, school divisions, recreation programs and other categories of insureds.

We have come to understand that Virginia grants the antitrust exemption to insurance companies pursuant to Section 59.1-9.4 of The Virginia Code, based on the fact that insurance rates are under the jurisdiction of the Bureau of Insurance. However, with little real regulation of rates taking place under the file-and-use system, it stands to reason that our antitrust exemption should be repealed in order to allow competitive forces to have greater bearing on rates.

Again, I offer an excerpt from the testimony of Jeffrey Teitz, a state legislator from Rhode Island, speaking on behalf of the National Conference of State Legislatures, regarding the repeal of McCarran Ferguson:

> The McCarran Ferguson exemption cloaks an entire industry in a robe of immunity. As a result, anticompetitive insurance company behavior can presently occur free from control by either state regulation or federal antitrust law. ... Particularly at a time when liability insurance premiums are rising so steeply, it should not be legal for insurance companies to fix prices. ... In every other industry in America, such action would be criminal. Why in the business of insurance should it be sanctioned?

The voluntary decision by ISO to discontinue the practice of preparing and filing advisory rates for member companies now needs to be enacted by statute to prohibit such price fixing arrangements. Perhaps seeing the handwriting on the wall, ISO hopes to avoid legislative action in the antitrust area. However, we should take this action in order to protect Virginia consumers from any subsequent reversal by ISO of their voluntary decision.

In the case of ISO, the need for antitrust reform clearly impacts on the question of affordability and availability which is to be addressed at your September meeting. While you received extensive information about ISO in 1988, I don't believe that the extent of ISO's control over the property/casualty insurance industry was properly described in terms of the concentration within the industry.

According to data assembled by the Texas Attorney General from A.M. Best and Company records, companies represented by 8 key members of ISO's Executive Committee wrote 28% of all commercial insurance in the U.S. in 1984. Companies represented by only 37 ISO Board members between 1982 and 1986 wrote fully 60% of all commercial insurance in the U.S. for the same year. Compare these few companies, who effectively control the property/ casualty industry, with the more than 1,300 ISO member and the more than 3,400 property/casualty insurance companies in the U.S.
The plea to stop short of repealing the antitrust exemption was made in 1988 in part on behalf of the smaller companies which might be at a disadvantage without access to industry-wide loss data. However, we see no legal reason to prevent ISO from making such data available under antitrust law. With these numbers in hand, the smaller companies should be able to compete effectively, assuming that they are operating efficiently by keeping a variety of overhead costs down.

Related to this issue, I recall four questions on the antitrust exemption posed by Professor Abraham on behalf of the Attorney General at your meeting on October 27, 1988. To my knowledge,

these questions have not been addressed by industry representatives. Among these questions, a precise answer was requested as to why the process of individual rate setting would be too costly for individual companies. In light of ISO's voluntary decision, the detailed answer may appear to be a moot point; nonetheless, the industry's response is still needed. I urge you to press for information on all of the unanswered questions raised by Professor Abraham.

In addition to creating a more competitive market, repeal of the antitrust exemption for insurance companies would have a moderating effect on the periodic crises of the insurance business cycle. Without an antitrust exemption, there is less likelihood of uniform price-cutting to take advantage of high interest rates and the correspondingly uniform sharp increases at the other end of the cycle.

Repeal of the antitrust exemption would result in several other benefits. Companies would still be entitled to past cost data. Prices would be set competitively, resulting in some decrease in premiums. Efficiency would be rewarded. Choice of coverage should increase. Insurance companies would be playing by the same rules as other Virginia businesses.

Switching gears to reinsurance, I have only a few brief comments. I refer to my testimony on reinsurance from last year which was based on the comprehensive report focusing on Lloyd's of London's domination of the reinsurance market, which to date has not been effectively rebutted.

Where there are questions about reinsurance practices, it is in the public's interest to collect data to answer those questions and to provide a mechanism for ongoing monitoring. Last Fall you received a response, from Mr. Rondepierre of the Reinsurance Association of America, to questions posed by Professor Abraham regarding the possibility of disclosure requirements for reinsurers. Mr. Rondepierre suggested that it would be both impractical and costly to obtain such data from the level of reinsurance companies.

Instead, I urge you to consider a disclosure statute for primary insurers which will require them to report specific data on business which they write in Virginia which in turn has been reinsured. Although the Attorney General's proposal for narrowing the applicability of this disclosure is persuasive, at this juncture we tend to agree with Delegate Hargrove that such proposed disclosures apply across the board.

This reporting should include information about the volume of business which is reinsured and by what company, specific risks which are reinsured and/or the nature of the reinsurance contract, the level of reinsurance purchased, the cost for that protection,

and financial data on claims paid by reinsurers. In addition, we should require reinsurers who do business in Virginia to file information with the Bureau of Insurance as to the ownership of the reinsurance entity and other basic corporate information which may not presently be collected by the Bureau.

This concludes my testimony today. Thank you for the opportunity to speak on issues of importance to Virginia's consumers. I look forward to your deliberations as you develop your final recommendations and welcome any questions that you may have at this time.

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HOUSE JOINT RESOLUTION No. 382

JOINT SUBCOMMITTEE STUDYING ANTITRUST EXEMPTIONS, REINSURANCE PRACTICES AND THE AFFORDABILITY AND AVAILABILITY OF COMMERCIAL LIABILITY INSURANCE

PRESENTATION BY THE OFFICE OF THE ATTORNEY GENERAL

H. Lane Kneedler, Chief Deputy Attorney General
Edward L. Petrini, Senior Assistant Attorney General
Gail D. Jaspen, Assistant Attorney General

September 22, 1989

Mr. Chairman, members of the Joint Subcommittee:

Thank you for this opportunity to be here today on behalf of Attorney General Mary Sue Terry to address the availability and affordability of commercial liability insurance in Virginia.

As we look back over the past few years, we see that we have indeed come a long way in our efforts to ensure a stable, competitive commercial liability insurance market in the Commonwealth.

In the mid-1980s, many of Virginia's businesses, professionals, and local governments were complaining that premium increases were making their liability insurance unaffordable--when they could find it at all. Some commercial enterprises, necessary public services, and other governmental activities were curtailed or eliminated for lack of adequate liability insurance coverage.

I. 1987 LEGISLATION

As this Subcommittee well knows, in 1987 the Virginia General Assembly responded boldly and decisively to this crisis affecting commercial liability insurance. In addition to

adopting a number of measured tort system reforms, the General Assembly unanimously enacted House Bills 1234 and 1235, which encompassed an innovative program for insurance data collection and analysis and formal regulatory scrutiny of competition and rates for designated lines of insurance.

The Attorney General believes strongly in competition and the free market system. The premise of her insurance regulatory reforms, therefore, has been simple: when the insurance market is working properly, competition should regulate commercial general liability insurance rates in Virginia. But when competition is inadequate or ineffective, regulatory procedures should be in place to ensure that rates are not excessive, inadequate, or unfairly discriminatory. The 1987 insurance reforms provide a mechanism for collecting Virginia-specific insurance data, an opportunity and criteria for evaluating that data, and an overall procedure for assessing the reasonableness of requests for rate increases.

Mr. Chairman, Virginia was not alone in experiencing serious problems in commercial general liability insurance in the mid-1980s. As our Office was researching these problems and drafting our 1987 insurance regulatory reform proposals, we investigated what other states were doing to enhance reporting requirements and to promote competition in the liability insurance market. We discovered, Mr. Chairman, that Virginia was on the cutting edge of these emerging issues, and that there were few other state models to guide us in developing these legislative initiatives.

II. NATIONAL IMPACT

Mr. Chairman, it is gratifying to us that the Attorney General's insurance regulatory proposals not only have been adopted overwhelmingly by the General Assembly and implemented here in Virginia, but that they are also now serving as a model for uniform state data reporting legislation nationwide.

Attorney General Terry is currently the President-Elect of the National Association of Attorneys General ("NAAG") and the Chair of its Insurance Committee. At its summer 1989 meeting, NAAG adopted a resolution endorsing the goal of uniform data reporting by insurance companies and the framework for achieving that goal embodied in the Model Insurance Data Reporting Statute drafted by a Task Force appointed by Attorney General Terry. That Model Statute is based on data reporting statutes here in Virginia. Mr. Chairman, in endorsing the approach of the Model Statute, NAAG has asked its Insurance Committee to continue to collect comments on the Model Statute from interested parties, including the insurance industry and the National Association of Insurance Commissioners. Written comments are due by October 2. In addition, a meeting is set for October 10 at NAAG headquarters in Washington, D.C., for the purpose of receiving oral comments and discussing the Model Statute with interested parties.

III. 1988 AND 1989 LEGISLATION

As gratifying as this national interest is, Mr. Chairman, we take greater satisfaction in knowing that the insurance regulatory reforms you enacted in 1987 are beginning to bear

fruit here in the Commonwealth. Our success is due largely to the fact that the General Assembly has continued since 1987 to demonstrate its firm resolve to keep liability insurance problems from getting out of hand.

For example, in 1988, to guard against a potential crisis of unavailability in commercial liability insurance, the General Assembly passed enabling legislation authorizing the establishment of a commercial liability insurance joint underwriting association, or JUA. This stand-by JUA serves as an insurance "safety net." It is designed to meet Virginians' commercial liability insurance needs when the voluntary market does not. In addition, the last two Sessions of the General Assembly enacted several refinements to HBs 1234 and 1235 to ensure that these data reporting laws continue to operate both fairly and effectively.

Finally, but obviously of no less importance, the 1988 and 1989 Sessions of the General Assembly recognized that some of the complicated issues associated with commercial liability insurance -- and its regulation by the Commonwealth -- demand careful study. The General Assembly commissioned this Subcommittee in 1988 to examine the exemptions from antitrust laws enjoyed by insurers, the practices of the reinsurance industry, and further means for ensuring the availability and affordability of liability insurance in Virginia. Recognizing that these complex issues had not been fully resolved in the Subcommittee's first year of study, the General Assembly in 1989 extended the charge of the Subcommittee for another year.

IV. ADMINISTRATIVE IMPROVEMENTS

As I said, Mr. Chairman, Virginia is starting to reap the benefits of the insurance reforms originally proposed by the Attorney General and enacted by the General Assembly. But change has not come easily.

The members of the Joint Subcommittee will recall that last year, we provided you with a chart detailing 29 concerns about how the law was being interpreted and applied, and how we thought the situation could be improved. We told you at that time, Mr. Chairman, that most of those concerns could be resolved administratively, and did not require legislative action.

We are happy to say, Mr. Chairman, that most of those concerns have been satisfactorily resolved by administrative action taken by the State Corporation Commission ("SCC") and the Bureau of Insurance, and we are actively working with the Bureau on the remaining issues. Obviously, we haven't come to complete agreement on all the issues, but let me cite just a few examples of the progress that has been made.

1. We argued last year that the Bureau should widely disseminate its timetable for gathering data in its survey of the commercial liability insurance market. This year, the Bureau announced a schedule of public meetings and reported that it would be conducting a major telephone survey regarding the commercial liability insurance marketplace.
2. We argued that the Bureau should systematically survey insurance consumers as well as companies and agents; and

this year they have done so, in particular through their public meetings and telephone survey.

3. We urged the Bureau to conduct instructional sessions for insurers who are required to complete the Supplemental Report form. This year, the Bureau did indeed offer an instructional session. Unfortunately, only one insurance company representative attended, but he said the session was very helpful. We only wish more industry representatives had availed themselves of the opportunity. Perhaps then some of the data reporting problems which were experienced this year could have been avoided, and the Bureau would not have had to take extra time with the companies to straighten out information provided by the companies in order to get usable data.

4. We asked the Bureau to require that all companies licensed to write any of the troubled lines indicate whether they actually did write business in any of those lines. You will recall that in the first year's Supplemental Reports, there was no way to tell if an absent report was due to failure to file or simply to the fact that the company wrote no business in the troubled lines. A statutory amendment corrected this problem.

5. We urged the Bureau to impose meaningful penalties against companies that did not file complete or timely Supplemental Reports. We believe the Commissioner has done so this year.

6. In assessing the competitiveness of the various lines, the Bureau this year appears to have given consideration to all

seven factors listed in § 38.2-1905.1(E). Mr. Chairman, we may continue to disagree on the relative weight that should be given the various factors -- for example, profitability -- and on how certain information should be interpreted -- again, for example, profitability. But, unlike last year, the Bureau and our Office are much closer to being on the same track.

7. The Bureau has now clarified many of the procedures concerning when "delayed effect" filings are deemed complete and thereby "filed," and when the 60-day period for consideration of the proposed rate begins to run.

8. And finally, the Commissioner has made it clear that he will disallow expenses associated with out-of-state voter initiatives -- a concern we raised last year in light of insurance companies' lobbying expenses connected with Proposition 103 in California.

V. CASES AND HEARINGS

Mr. Chairman, it might be instructive to see how these and other changes have contributed to a significant improvement this year over last.

In 1988, the first year insurers were required to provide additional rate information, in the form of special Supplemental Reports, on the 17 lines of insurance that had been designated by the Bureau as "potentially troubled," much of the required data was submitted late. Worse, the SCC found that the quality of approximately half of that data was so poor that it was unusable

for determining whether competition in fact effectively regulated rates for the lines being reviewed. This year, however, insurers did a far better job of providing the required data. With 31 potentially troubled lines designated for review this year, compliance with the law's reporting requirements has improved significantly over last year. Some problems still remain, though. For example, we provided expert testimony at the SCC troubled lines hearing last week that there were significant problems in the way investment income was reported this year. We plan to work with the Bureau to clarify how this might be handled in the future.

A revised data reporting format, a strongly articulated intention on the part of Commissioner Foster to penalize noncomplying companies, and the efforts of Commissioner Foster and his staff to verify data, all contributed to this result. It is fair to say that we now have more complete, more comprehensive, and more useful data than ever before to evaluate the competitiveness of various lines of commercial liability insurance. Further, the SCC is making good use of the available information.

Last year, of the 17 potentially troubled lines reviewed, the SCC concluded that 11 were noncompetitive and made 7 of them subject to the special delayed effect rate filing procedures. It exempted 4 of the 11 lines because rates in those lines are for the most part individually rated, and therefore -- at least arguably -- do not lend themselves to the Code's rate review procedures. We will discuss these so-called "A-rated" lines later.

The SCC's action gave the Bureau of Insurance and our Office the opportunity to perform economic and actuarial evaluations of proposed rate changes in the 7 designated lines. Over the last year, this process has contributed to reductions in rates for a number of companies writing coverage in these lines.

Mr. Chairman, the regulatory reforms enacted by the General Assembly in 1987, and amended since then, can make a real difference for consumers throughout the Commonwealth. By way of example, let me cite a few cases that have taken place in just the past two weeks.

Last week, on September 12, the SCC issued its order following a July hearing requiring The Virginia Insurance Reciprocal, the Commonwealth's largest insurer of lawyers, to refund 16.2% of its malpractice premiums for the past year and to reduce its rates by 5.7% for the future.

Just last Friday, our Office, the Bureau of Insurance, and the Commonwealth's major medical malpractice insurer, St. Paul, reached an agreement that will save Virginia's medical professionals $5.6 million in medical malpractice insurance premiums annually. The company, which is the largest underwriter of medical malpractice insurance in the Commonwealth, originally sought in April to lower its physicians and surgeons malpractice insurance rates by 10.3%. Experts hired by the Medical Society of Virginia had argued that the rates should be reduced by 17%. However, the Office of the Attorney General and the Bureau of Insurance, after analyzing the economic data, maintained that cuts of 20% to 30% or more were warranted. Last Friday

afternoon, attorneys for the St. Paul Companies agreed to compromise at -22.4%. This agreement represents an annual savings of more than $3 million over the cut offered by the St. Paul Companies, and, as I indicated, a total annual savings of $5.6 million.

Mr. Chairman, as the members of the Subcommittee certainly know, before the enactment of HB 1235, medical malpractice insurance was the only line of commercial liability insurance that was considered noncompetitive and subject to rate review by the Commission. Along with other designated troubled lines, it is now subject to the regulatory provisions enacted in HB 1235.

Incidentally, Mr. Chairman, it appears that a significant reduction in St. Paul's insurance agents and brokers errors and omissions rates is also in the offing.

Also last Friday, Mr. Chairman, the SCC issued an order resulting from its second annual competition hearing which was held on September 13. The Bureau of Insurance last December had designated 31 commercial liability lines as potentially noncompetitive. Insurers writing those lines provided certain supplemental data this spring. That data was analyzed by the Bureau and our Office, and a hearing before the SCC was held last week. In its September 15 order, the SCC held that 14 of the 31 potentially noncompetitive lines are in fact noncompetitive and are now subject to rate review by the SCC -- twice the number subjected to rate review last year. The purpose of this review, as you know, is to make certain that newly filed rate requests are indeed reasonable. The Commission also exempted 7 so-called

"A-rated" lines from the rate filing requirements of the Code, just as it did with 4 "A-rated" lines last year.

The 14 lines found to be noncompetitive this year and subject to the delayed effect procedures include six lines that are continued from last year (coverage for insurance agents, law enforcement agencies, lawyers, health care providers, pest control agencies and real estate agents) and eight new lines (detective or investigative agencies, gas companies, public officials errors and omissions, school board errors and omissions, security and alarm systems installation, sewage treatment plants, volunteer fire departments and rescue squads, and water treatment plants).

VI. OFFICE OF THE ATTORNEY GENERAL AND BUREAU OF INSURANCE

We are pleased that a serious look at the many factors relating to the competitiveness of the insurance marketplace -- including excessive insurance company profitability -- has resulted in twice as many lines as last year becoming subject to rate review. But, as I indicated earlier, significant differences remain between the Insurance Commissioner's and the Attorney General's recommendations to the SCC, and we continue to believe that more lines -- in particular contractors' liability and products liability -- deserve to be designated as not adequately competitive, and therefore given the benefit of additional rate scrutiny.

Mr. Chairman, the Attorney General's Office and the Bureau of Insurance won't always agree on everything. We're not asking

for that. And when we have differences, we will hammer them out in the appropriate forum. In some cases that will mean roll-up-the sleeves working sessions involving staff members from both our offices. In other cases, it will mean arguing our different perspectives before the State Corporation Commission and the Virginia Supreme Court. And in some cases, it will mean coming to the General Assembly for legislative clarification and direction.

But we can safely say, Mr. Chairman, that due to the hard work and cooperation of all parties involved, the "big picture" -- at least procedurally -- is much rosier than a year ago. We trust it will continue to move in that direction over the next year.

VII. PROPOSALS

Mr. Chairman, this recaps some of the highlights of 1988 and 1989. You may take deserved pride in the fruits of your labor. But we know your interest is in what else needs to be done.

1. Ensuring Compliance with Data Reporting Laws

Mr. Chairman, last year, frustrated by insurers' failure to comply with Supplemental Report filing requirements, we suggested to the Subcommittee that it might be appropriate to increase the penalties that could be charged to companies that filed late or nonconforming data. We were concerned that even the maximum available monetary penalty failed to serve as an effective enforcement tool. Accordingly, in the Supplementary Background

Materials presented for this Subcommittee's use in 1989, we included as a suggested issue for examination, "ensuring compliance with data reporting requirements."

However, as we have already reported, and Commissioner Foster can confirm, insurers have been more responsible this year about filing timely and complete Supplementary Reports. As might be expected, among the many reports, there were some problems or questions about some of the data reported. After an extensive effort by the Bureau to confirm and correct some of this year's data, the overall quality of the Supplementary Reports significantly improved. As an aside, we are pleased to note that compliance with the claims reporting requirements of House Bill 1234 has also been quite good. Furthermore, the Bureau appears to have taken a firm stand with companies that failed to file timely reports, having sought some $150,000 in penalties in 1989 alone.

Because of these positive developments, we believe that, for the present, there is no immediate need for legislation, and we will not recommend a change in the penalty laws this year.

2. Individually-Rated Lines

Mr. Chairman, we referred earlier to the SCC's order that 14 lines of commercial liability insurance will be subject to special rate scrutiny for the next year. While we take some comfort in this result, it also concerns us that the SCC exempted certain of the potentially noncompetitive lines from the rate filing provisions of Chapter 19 of the Insurance Code. This was

done in consideration of the fact that there are reportedly no "average risks" for these lines (the so-called "A-rated" lines, as they are referred to by the Insurance Services Office ["ISO"]). For these lines, apparently, the risks may vary so much from one insured to the next that, again reportedly, a manual of rates cannot cover all the variations, and each risk must be rated individually. Mr. Chairman, we appreciate that some lines may not lend themselves to rate filing procedures and delayed effect rate scrutiny as presently set forth in the Code. But we think Virginians will benefit from the SCC's continued study of the competitiveness of such lines. If a line is noncompetitive, it should be identified as such (that in itself can be important information to consumers). It may be appropriate to determine separately whether a noncompetitive line should be exempt from rate filing laws, based on evidence as to the necessity to individually rate risks covered by such a line.

Mr. Chairman, we certainly agree that it would be inappropriate to subject rates for certain individually-rated risks to prior approval. But we have concerns about the criteria that are used for establishing a line as individually- or "A-rated." We intend to confer with Commissioner Foster about the best way in which to address these concerns, and whether there is a need for review by the Commission or statutory change.

3. Provisional Rate Reductions

Since the enactment of House Bills 1234 and 1235, the Attorney General has been sensitive to the need to modify their provisions where appropriate, and the General Assembly has been responsive to that need in both 1988 and 1989.

We have a proposed revision to suggest this year as well. As we indicated earlier, this year, unlike last year, a number of insurers applied for insurance rate reductions in noncompetitive, or "troubled," lines under the provisions of § 38.2-1912, the delayed effect rate filing statute. As with all rate filings in noncompetitive lines, the General Assembly has required that these applications still be subjected to actuarial review and be approved as "not excessive, inadequate, or unfairly discriminatory" prior to use. It is often the case that the Bureau of Insurance must seek from an applicant-insurer data in addition to the data initially provided with the rate filing. Insurance rate filings are not considered complete until all requested data has been supplied to the Bureau.

It takes time for the Bureau to determine if any additional data may be required, and it takes additional time for insurance companies to respond to any supplementary data requests. Then, after the filing is complete, an additional 90 days (a minimum of 60 days, which can be extended an additional 30 days) are allowed for review of the completed rate filing. Thus, a period of time may elapse before a rate decrease may be put into effect -- even when the insurer acknowledges from the very start that a rate reduction is appropriate.

We know of at least two major cases this year that illustrate the problem.

The first is the St. Paul physicians and surgeons professional liability insurance rate revision that Mr. Kneedler referred to earlier. In April of this year, the St. Paul Companies applied for a 10.3% decrease for this coverage effective July 1, 1989. The Bureau and the Attorney General were persuaded that an even greater rate reduction was warranted. The review process was protracted somwehat because of the need to obtain additional data and prepare for a formal hearing before the SCC. An agreement among the parties reduced rates by 10.3% while the case remained pending. Further, the difference between the agreed-to rollback and the deeper cut (-25.3%) recommended by the Bureau was placed in an interest-bearing escrow account, to allow refunds with interest if they were ordered.

Last Friday, practically on the eve of the hearing before the SCC, St. Paul entered into an agreement with the Bureau of Insurance and our Office to reduce its physicians and surgeons rates by 22.4% and to refund with interest excessive premiums it had collected since July 1, 1989. In this case, we were successful in fashioning a reasonable ad hoc solution in the interest of fairness to consumers. We believe that this case should serve as model for a general approach to implementing rate reductions in delayed effect lines.

In a second case, consumers' interests have not been as well served. Again, St. Paul applied last March for an 18.2% decrease in rates for their Insurance Agents and Brokers Errors and

Omissions coverage. The rate was to have become effective May 8, 1989. Both the Attorney General's expert and the Bureau's expert concluded that the proposed rate would still result in an excessive rate. The Bureau of Insurance requested additional data from St. Paul that was not provided until May 31. It has taken several additional months for St. Paul, as we understand it, to agree to reduce these insurance agents and brokers rates by 35%, in approximate accordance with the Bureau's and the Attorney General's recommendations. This rate, reportedly, has still not been filed. Therefore, since at least as early as this past May, insurance agents and brokers have been denied the benefits of reduced errors and omissions insurance rates from St. Paul.

This situation needs to be changed, and Commissioner Foster has indicated to us that he agrees. We propose to develop an amendment to Chapter 19 of Title 38.2 that would allow the Insurance Commissioner discretion to put into effect, "provisionally," rate reductions applied for by insurers while full review of the rate filing is pending. This would eliminate any delay in rate reductions that might result from an insurer's failure to provide additional data requested by the Commissioner, or from protracted litigation or settlement negotiations.

4. Refunds of Excessive Premiums with Interest

With regard to a related matter, but one not apparent to us at the time we developed the list of "Suggested Issues" included in your Supplementary Background Materials, we also propose to

amend Title 38.2 to require that any refunds of excessive premiums be paid with interest. This is eminently fair. When insurers have charged excessive rates, they have earned interest income on the excess premium and surplus funds that they have invested. Insurers should be required to return that interest to their policyholders.

We have only to look at recent experience to discover a perfect example of a premium refund that in fairness probably should have been ordered to be paid with interest. The case in point is the recent ruling by the SCC requiring The Virginia Insurance Reciprocal ("TVIR") to refund lawyers' malpractice premiums by an average of 16.2% for policies that went into effect between September 16, 1988 and September 15, 1989. The ruling means that consumers had been paying excessive rates for at least one year. Had the governing statute expressly given the SCC the authority to add interest to an awarded premium refund (an authority which is expressly given to them in other sections of the Code (see Va. Code § 56-238 governing utility rates)), this is a case where that interest may well have been awarded.

As with our proposal concerning provisional rate reductions, we intend to work closely with the Bureau of Insurance to develop appropriate statutory language to implement this recommendation. We, of course, also invite industry and consumer representatives to share with us their views on these subjects.

5. Periodic Evaluations of Medical Malpractice And Commercial Liability Claims Reports

Two provisions of the Insurance Code require the annual reporting of data relating to insurance claims. One, § 38.2-2228 as amended by the 1989 Session of the General Assembly at the recommendation of the SCC, requires insurers (or a health care provider if there is no insurer) to report to the SCC annually certain data relating to all medical malpractice claims opened, settled, adjudicated to judgment or closed without payment during each calendar year. Similar reporting is required of commercial liability claims pursuant to § 38.2-2228.1, which was enacted as House Bill 1234 in 1987. The purpose of both statutes is generally to provide data that may be useful in testing the appropriateness of insurer reserving practices and in assessing the influence of reforms in our tort system on insurance claims and payouts.

Mr. Chairman, we believe that systematic review of closed claim data will be revealing. Neither of the Virginia reporting statutes, however, requires the SCC periodically to examine the data and report the results. It is self-evident that the General Assembly intended that the collected data be used in conjunction with insurance regulation. Many of you will recall that the General Assembly responded with dismay when, in 1987 -- before Commissioner Foster took his present position -- it was revealed that approximately ten years' worth of accumulated medical malpractice closed claims data sat unassessed in cartons at the SCC. We therefore suggested in your background materials that this Subcommittee consider the advisability of requiring regular

evaluations of the claims data. But we are now persuaded that a statute is not required. We are very pleased, Mr. Chairman, that Commissioner Foster is developing plans to evaluate that claims data. We understand that he will address those plans in his remarks.

Assuming that this Subcommittee concurs, we do not intend to offer any statutory proposals relating to the claims reports at this time.

6. Profitability

Mr. Chairman, there is one more issue we would like to raise today, but will say in advance that we do not have a specific proposal at this time. That issue is the degree of insurer profitability in commercial liability lines. As we indicated earlier, there continue to be differences between the Bureau of Insurance and our Office in how profitability should be interpreted and how much weight should be given to profitability in the noncompetition determination by the SCC. Those differences were clearly evident in last week's noncompetition hearing before the SCC. And we have no doubt that they also will continue to be evident in any analysis of the data recently made available by Best's.

We have had only since last Friday to analyze the results of this year's SCC noncompetition hearings. And we only recently received our consultant's analysis of this year's commercial liability data from Best's. Given this timing, we have not yet had an opportunity to discuss our analysis with the Bureau of

Insurance -- or to review their analysis -- and we therefore are not in a position today to make a proposal on insurer profitability. Indeed, after discussions with the Bureau, we may decide that the SCC is the appropriate forum in which to continue the profitability debate. But we intend to continue our discussions with the Bureau on this issue and, if appropriate, Mr. Chairman, to present the results of those discussions to the Joint Subcommittee at a future time.

VIII. CONCLUSION

Mr. Chairman, the insurance regulatory reforms we have enacted in Virginia appear to be serving the citizens and businesses of the Commonwealth well. Those reforms have been aimed at balancing important, but sometimes competing objectives, such as insurance company solvency and reasonable rates for consumers. And they have been aimed at improving the environment of healthy competition in the liability insurance industry, while ensuring close scrutiny where competition fails or does not exist.

Mr. Chairman, we are confident that Virginia is on course in its approach to liability insurance regulation, and we have offered some proposals that are designed to keep it on course. We have taken a long-term approach to insurance pricing and availability problems. Our goal continues to be an insurance environment in which individuals, businesses and professionals can obtain the insurance protection they need at a price they can afford.

COMMONWEALTH OF VIRGINIA

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STATE CORPORATION COMMISSION

BUREAU OF INSURANCE

November 9, 1989

The Honorable Thomas W. Moss, Jr.
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Norfolk, Virginia 23510

Dear Tom:

Please find enclosed two additional legislative proposals which were not included in the set sent to you by the Attorney General's Office in a letter from Lane Kneedler dated November 2, 1989. The enclosed proposals are recommended by the State Corporation Commission and have been fully discussed with the Attorney General's Office and Jim Roberts. The Attorney General's Office opposes these two proposals. As far as I know, the insurance industry does not oppose these changes.

Amendment 1 would change §38.2-1912.C. to eliminate the one year limitation on the Commission rule which designates certain lines of insurance for "delayed effect." Instead of a one year limitation, the amended language would allow such a rule to run for up to twenty seven (27) months. The purpose of this amendment is to allow the Commission sufficient time to hold the hearing required under §38.2-1905.1 and issue a rule accordingly. Under the current language, the Commission must hold its hearing and render an opinion before the expiration date (12 months) of the Commission's previous year's rule. The practical result is that the Commission must hold its hearing and render a decision before September 16th of each year. The proposed change would allow the Commission sufficient time to hold its hearing in accordance with §38.2-1905.1 and render its decision.

Amendment 2 would amend §38.2-1905.1 to require the Commission to submit a report to the General Assembly and hold a hearing at least <u>biennially</u> as opposed to <u>annually.</u> Under the current statute, the Commission must submit a report to the General Assembly at least annually. In addition, the Commission must also hold a hearing <u>annually</u> for the purpose of determining whether competition is an effective regulator of rates for those lines and subclassifications designated in the Commission's report to the General Assembly.

Amendment 2 also changes §38.2-1905.1.E.5. to take into account the suggested restriction against rate service organizations filing final rates. Amendment 2 would change §38.2-1905.1.E.5. to more accurately reflect the future role of rate service organizations. As suggested in one of the joint proposals made by the Attorney General's Office and the Commission, rate service organizations would no longer be establishing final rates.

If you have any questions concerning these two additional proposals made by the Commission, please let me know. I plan to be present at the next meeting of your joint subcommittee to fully explain these proposals and answer any questions posed by members of the joint subcommittee.

Sincerely yours,

Steven T. Foster
Commissioner of Insurance

STF/kjc

Enclosures

ccs: The Honorable Lewis W. Parker, Jr.
The Honorable William T. Wilson
The Honorable W. Tayloe Murphy, Jr.
The Honorable Frank D. Hargrove
The Honorable Richard L. Saslaw
The Honorable Richard J. Holland
The Honorable J. Granger Macfarlane
The Honorable John H. Chichester
The Honorable William F. Parkerson, Jr.
John Robert Hunter, Jr.
✓H. Lane Kneedler
James C. Roberts
C. William Cramme, III

§38.2-1912. Delayed effect of rates. -- A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulator of the rates charged, (ii) a substantial number of insurers are competing irresponsibly through the rates charged, or (iii) there are widespread violations of this chapter, it may promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that class, line, subdivision, rating class or rating territory shall be filed with the Commission at least thirty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first thirty-day period expires.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of insurance, or classes of risks or combinations thereof it deems necessary for the proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than ~~one year~~ twenty seven months after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished. (1973, c. 504, §38.1-279.40; 1986, c. 562.)

Attachment 2

§38.2-1905.1. Report on level of competition, availability and affordability of certain insurance. -- A. The Commission shall submit a report or reports to the General Assembly, at least biennially ~~annually~~, concerning the lines and subclassifications of insurance defined in §§ 38.2-117 and 38.2-118, including those lines and subclassifications containing as a part thereof insurance coverage as defined in those sections, insuring a commercial entity. The report or reports shall indicate (i) the level of competition among insurers in Virginia for those lines or subclassifications, (ii) the availability of those lines or subclassifications of insurance and (iii) the affordability of those lines or subclassifications of insurance.

B. The Commission's report or reports to the General Assembly shall also designate all insurance lines or subclassifications defined in §§ 38.2-117 and 38.2-118, including those lines or subclassifications of insurance containing as a part thereof insurance coverage defined in those sections, insuring a commercial entity, for which the Commission has reasonable cause to believe that competition may not be an effective regulator of rates.

C. The report or reports to the General Assembly pursuant to this section shall be made no later than December 31 of ~~each year, the first report or reports to be made not later than December 31, 1987~~ the second year of any biennium..

D. A copy of each report made pursuant to this section shall be sent by the Commission to the Division of Consumer Counsel of the Office of the Attorney General. Each report shall be a matter of public record.

E. Those lines and subclassifications designated pursuant to subsection B of this section shall be reviewed by the Commission for the purpose of determining whether competition is an effective regulator of rates for each such designated line or subclassification. The Commission shall hold a hearing or hearings for that purpose no later than September 30 of the year immediately following the year the report or reports are submitted to the General Assembly pursuant to subsection C. of this section ~~following the due date of the supplemental reports required under § 38.2-1905.2~~ at which it shall hear evidence offered by any interested party. In determining whether competition is an effective regulator of rates for each designated line or subclassification, the Commission may consider such factors as it deems relevant to such determinations, including the following factors:

1. The number of insurers actually writing insurance within the line or subclassification.

2. The extent and nature of rate differentials among insurers within the line or subclassification.

3. The respective market share of insurers actually writing insurance within the line or subclassification, and changes in market share compared with previous years.

4. The ease of entry into the line or subclassification by insurers not currently writing such line or subclassification.

5. The degree to which rates within the line or subclassification are ~~established~~ affected by the filings of ~~rating~~ rate service organizations.

6. The extent to which insurers licensed to write the line or subclassification have sought to write or obtain new business within the line or subclassification within the past year.

7. Whether a pattern of unreasonably high rates exists within the line or subclassification in relation to losses, expenses and investment income.

8. Such other factors as the Commission deems relevant to the determination of whether competition is an effective regulator of rates within the line or subclassification.

F. Notwithstanding any designation made by the Commission pursuant to subsection B of this section, the Commission may, upon petition of any interested party, hold a hearing to determine whether, under the factors set forth in subsection E of this section, competition is not an effective regulator of rates for lines or subclassifications not so designated.

G. "Commercial entity" as used in this section shall mean any (i) sole proprietorship, partnership or corporation, (ii) unincorporated association or (iii) the Commonwealth, a county, city, town, or an authority, board, commission, sanitation, soil and water, planning or other district, public service corporation

owned, operated or controlled by the Commonwealth, a locality or other local governmental authority.

H. The Commission shall adopt such rules and regulations including provision for identification from time to time of subclassifications of insurance necessary to implement the provisions of this section. (1987, c. 697; 1989, c. 381.)

Joint Proposals of The Office of the Attorney General and The State Corporation Commission to the HJR 382 Subcommittee Studying Liability Insurance

I. ANTITRUST PROPOSALS

A. INVESTIGATIVE DEMANDS

Section 38.2-1916 of the Code of Virginia prohibits property and casualty insurers and rate services organizations from engaging in the same types of anticompetitive conduct proscribed by the Virginia Antitrust Act. State antitrust laws, however, provide the Attorney General with the power to compel testimony and the production of documents in response to pre-complaint "civil investigative demands." No such authority is presently provided to the Attorney General to assist in investigations of insurer conduct under Virginia insurance laws.

PROPOSAL: Provide equivalent of Virginia Antitrust Act's "civil investigative demands" for investigating anticompetitive conduct violative of the Insurance Code.

ADD § 38.2-1916.1 PROVIDING FOR:

1. Issuance of investigative demands by the Attorney General after notice to the SCC;

2. Compelling written or oral testimony and/or production of documents;

3. Confidentiality; and

4. Penalties for noncompliance

B. EQUIVALENT PENALTIES

When compared with the penalties for anticompetitve conduct under the Virginia Antitrust Act, the provisions for penalizing violations of § 38.2-1916 appear insubstantial and ineffective as deterrents to conduct in restraint of trade by insurers. For example, § 38.2-218 provides for a maximum penalty of only $ 5000 per violation for willful conduct in violation of the insurance laws. We propose that the penalty, damages, and attorney's fees provisions of the Antitrust Act should be incorporated into Chapter 19 of Title 38.2.

PROPOSAL: Conform penalties for anticompetitive conduct prohibited by the Insurance Code to those available under the Virginia Antitrust Act.

ADD § 38.2-1916.2 PROVIDING FOR:

1. Penalties up to $ 100,000 for each willful violation of § 38.2-1916;

2. Injunctive relief;

3. Restitution for the Commonwealth, its political subdivisions, public agencies, and other persons injured by conduct in violation of § 38.2-1916; and

4. Treble damages for willful and flagrant violations.

C. RATE SERVICE ORGANIZATIONS

Last year, this Subcommittee was asked to consider, and subsequently rejected, a proposal that would have barred rate service organizations, such as the Insurance Services Office ("ISO"), from filing advisory final rates in Virginia and, as a compromise, would also have prohibited them from filing "trended" loss factors on behalf of insurers. Since then, however, ISO, under pressure from regulators, legislatures, and consumer groups, has announced it will voluntarily cease filing advisory final rates and, instead, will provide insurers with only trended and developed historical loss data without recommended expense or profit factors. We believe such action is a step in the right direction and should be mandated by Virginia's insurance laws.

PROPOSAL: Prohibit rate service organizations from filing final rates on behalf of insurers. Instead, permit the filing of only prospective loss cost data (trended and developed data without expense and profit/contingency factors).

AMEND §§ 38.2-1901, 38.2-1905.1, 38.2-1906, 38.2-1908, 38.2-1913, 38.2-1916 AND 38.2-1923 TO:

1. Define "prospective loss costs" and "rate service organization;"

2. Eliminate the filing of final rates by rate service organizations; and

3. Authorize the filing of prospective loss costs for informational purposes only.

I. ANTITRUST PROPOSALS

A. INSURANCE INVESTIGATIVE DEMANDS

§ 38.2-1916.1. Investigation by Attorney General of suspected violations; investigative demand to witnesses; access to business records, etc. -- A. Whenever it shall appear to the Attorney General, either upon complaint or otherwise, that any person has engaged in, or is engaging in, or is about to engage in any act or practice prohibited by § 38.2-1916, the Attorney General may, consistent with his powers and duties to enforce the laws of the Commonwealth prohibiting conduct that unreasonably restrains trade, after notice to the Commission, either require or permit such person to file with him a statement in writing or otherwise, under oath, as to all facts and circumstances concerning the subject matter; require such other data and information as he may deem relevant to the subject matter of an investigation of a possible violation of § 38.2-1916; and issue an investigative demand to witnesses by which he may (i) compel the attendance of such witnesses; (ii) examine such witnesses under oath before himself or the Commission; (iii) subject to subsection (B) of this section, require the production of any documents or things that he deems relevant or material to the inquiry; and (iv) issue written interrogatories to be answered by the witness served or, if the witness served is a public or private corporation or a partnership or association or governmental agency, by any officer or agent, who shall furnish such information as is available to the witness. The above investigative powers shall not abate or

terminate by reason of any action or proceeding brought by the Attorney General or the Commission under this title. When a document or thing is demanded by an investigative demand, said demand shall not: (1) contain any requirement that would be unreasonable or improper if contained in a subpoena duces tecum issued by a court of this Commonwealth; or (2) require the disclosure of any document or thing that would be privileged, or production of which for any other reason would not be required by a subpoena duces tecum issued by a court of this Commonwealth.

B. Where the information requested pursuant to a investigative demand may be derived or ascertained from the business records of the party upon whom the interrogatory has been served or from an examination, audit or inspection of such business records, or from a compilation, abstract or summary based therein, and the burden of deriving or ascertaining the answer is substantially the same for the Attorney General as for the party from whom such information is requested, it is sufficient for that party to specify the records from which the answer may be derived or ascertained and to afford the Attorney General, or other individuals properly designated by the Attorney General, reasonable opportunity to examine, audit or inspect such records and to make copies, compilations, abstracts or summaries. Further, the Attorney General is hereby authorized, and may so elect, to require the production pursuant to this section, of documents or things before or after the taking of any testimony of the person summoned pursuant to an investigative demand, in which event, said documents or things shall be made available for

inspection and copying during normal business hours at the principal place of business of the person served, or at such other time and place, as may be agreed upon by the person served and the Attorney General.

C. Any investigative demand issued by the Attorney General under this Section shall contain (i) a citation to this statute and section, (ii) a citation to the statute and section pertaining to the alleged violation under investigation, (iii) the subject matter of the investigation, and (iv) the date, place and time the person is required to appear to produce testimony and/or documentary material in his possession, custody or control. Such date shall not be less than twenty days from the date of the investigative demand. Where documentary material is required to be produced, the same shall be described by class so as to clearly indicate the material demanded.

D. Service of an investigative demand as provided herein may be made by:

1. Delivery of a duly executed copy thereof to the person served, or if a person is not a natural person, to the principal place of business of the person to be served, or

2. Mailing by certified mail, return receipt requested, a duly executed copy thereof addressed to the person to be served at his principal place of business in this Commonwealth, or if said person has no place of business in this Commonwealth, to his principal office.

E. Within twenty days after the service of any such demand upon any person or enterprise, or at any time before the return

date specified in the demand, whichever period is shorter, such party may file with the Commission and serve upon the Attorney General a petition for an order of the Commission modifying or setting aside such demand. The time allowed for compliance with the demand, in whole or in part as deemed proper and ordered by the Commission, shall not run during the pendency of such petition in the Commission. Such petition shall specify each ground upon which the petitioner relies in seeking such relief, and may be based upon any failure of such demand to comply with the provisions of this section or upon any constitutional or other legal right or privilege of such party. The provisions of this subsection shall be the exclusive means for a witness summoned pursuant to an investigative demand under this section to challenge an investigative demand issued pursuant to subsection A of this section.

F. The examination of all witnesses under this section shall be conducted by the Attorney General, or his designee, before an officer authorized to administer oaths in this Commonwealth. The testimony shall be taken stenographically or by a sound recording device and shall be transcribed.

G. Any person required to testify or to submit documentary evidence shall be entitled, on payment of lawfullv prescribed cost, to procure a copy of any document produced by such person and of his own testimony as stenographically reported or, in the case of depositions, as reduced to writing by or under the direction of a person taking the deposition. Any party compelled to testify or to produce documents or things may be accompanied

and advised by counsel, but counsel may not, as a matter of right, otherwise participate in the investigation.

H. All persons served with an investigative demand by the Attorney General under this section, other than any person or persons whose conduct or practices are being investigated or any officer, director or person in the employ of such person under investigation, shall be paid the same fees and mileage as paid witnesses in the courts of this Commonwealth. No person shall be excused from attending such inquiry pursuant to the mandate of an investigative demand, or from producing a document or thing or from being examined or required to answer questions on the ground of failure to tender or pay a witness fee or mileage unless demand therefor is made at the time testimony is about to be taken and as a condition precedent to offering such production or testimony and unless payment thereof is not thereupon made.

I. Any natural person who shall neglect or refuse to attend and testify, or to answer any lawful inquiry or to produce documents or things, if in his power to do so, in obedience of an investigative demand or lawful request of the Attorney General or those properly authorized by the Attorney General, pursuant to this section, shall be subject to the penalty provisions of §38.2-218. Any natural person who commits perjury or false swearing or contempt in answering, or failing to answer, or in producing a document or thing or failing to do so in accordance with an investigative demand or lawful request by the Attorney General, pursuant to this section, shall be guilty of a misdemeanor and upon conviction therefor by a court of competent

jurisdiction shall be punished by a fine of not more than $5,000, or by imprisonment in jail for not more than one year, or both such fine and imprisonment.

J. In any investigation brought by the Attorney General pursuant to this chapter, no individual shall be excused from attending, testifying or producing documentary material, objects or intangible things in obedience to an investigative demand or under order of the Commission on the ground that the testimony or any document of thing required of him may tend to incriminate him or subject him to any penalty, but no testimony or other information compelled either by the Attorney General or under order of the Commission or a court or any information directly or indirectly derived from such testimony or other information, may be used against the individual or witness in any criminal case. However, he may nevertheless be prosecuted or subjected to penalty or forfeiture for any perjury, false swearing or contempt committed in answering, or failing to answer, or in producing any document or thing or failing to do so in accordance with the demand of the Attorney General or the Commission. If an individual refuses to testify or produce any document or thing after being granted immunity from criminal prosecution and after being ordered to testify or produce any document or thing as aforesaid, he may be adjudged in civil contempt by a court of competent jurisdiction and incarcerated until such time as he purges himself of contempt by testifying, producing such document or thing or presenting a written statement as ordered. The foregoing shall not prevent the Attorney General from instituting

other appropriate contempt proceedings against any person who violates any of the above provisions.

K. It shall be the duty of all public officials, both state and local, their deputies, assistants, clerks, subordinates or employees, and all other persons to render and furnish to the Attorney General, his deputy or other designated representative, when so requested, all information and assistance in their possession or within their power. Any officer participating in such inquiry and any person examined as a witness upon such inquiry who shall disclose to any such person other than the Attorney General the name of any witness examined or any other information obtained upon such inquiry, except as so directed by the Attorney General, shall be guilty of a misdemeanor and subject to the sanctions prescribed in subsection I. Such inquiry may upon written authorization of the Attorney General be made public.

L. The Attorney General may recommend rules and regulations to implement and carry out the provisions of this section. All such rules and regulations shall be subject to the approval of the Commission.

M. It shall be the duty of the Attorney General, or his designees, to maintain the secrecy of all evidence, testimony, documents or other results of such investigations until and unless formal proceedings are instituted. Violation of this subsection shall be punishable pursuant to §38.2-218. Nothing herein contained shall be construed to prevent the disclosure of any such investigative evidence by the Attorney General in his

discretion to the Commissioner of Insurance, the State Corporation Commission, or to any federal or state law-enforcement authority that has restrictions governing confidentiality similar to those contained in this subsection.

B. PROPOSAL TO INCREASE PENALTIES FOR ANTICOMPETITIVE CONDUCT

§ 38.2-1916.2. Penalties; injunctive relief; restitution. - A. Notwithstanding the provisions of § 38.2-218, any insurer, rate service organization or other person who knowingly or willfully violates any provision of § 38.2-1916 shall be punished for each such violation by a penalty of not more than $100,000 and may be subject to suspension or revocation of any license issued by the Commission.

B. Any person threatened with injury or damage to his business or property by reason of a violation of § 38.2-1916 may petition the Commission for injunctive relief pursuant to § 38.2-220.

C. The Commission may require an insurer, rate service organization or other person to make restitution in the amount of the direct actual financial loss to (i) the Commonwealth, a political subdivision thereof, or any public agency injured in its business or property or (ii) any person injured in his business or property by reason of a violation of § 38.2-1916, including any costs associated with bringing such a matter before the Commission and reasonable attorney's fees. If the Commission finds that the violation is willful or flagrant, it may increase the restitution payment to an amount not in excess of three times the actual damages sustained.

C. RATE SERVICE ORGANIZATION PROPOSAL

§ 38.2-1901. Definitions. -- As used in this chapter:

"Market segment" means any line or class of insurance or, if it is described in general terms, any subdivision of insurance or any class of risks or combination of classes.

"Prospective loss costs" means historical aggregate losses and loss adjustment expenses projected through development to their ultimate value and through trending to a future point in time. Prospective loss costs do not include provisions for profit or expenses other than loss adjustment expenses.

"Rate service organization" means any entity, including its affiliates or subsidiaries, which either has two or more member insurers or is controlled either directly or indirectly by two or more insurers, other than a joint underwriting association under § 38.2-1915, which assists insurers in ratemaking or filing by (i) collecting, compiling, and furnishing loss statistics; (ii) recommending, making or filing prospective loss costs or supplementary rate information; or (iii) advising about rate questions, except as an attorney giving legal advice. Two or more insurers having a common ownership or operating in this Commonwealth under common management or control constitute a single insurer for purposes of this definition.

"Supplementary rate information" includes any manual or plan of rates, experience rating plan, statistical plan, classification, rating schedule, minimum premium or minimum

premium rule, policy fee, rating rule, rate-related underwriting rule, and any other information not otherwise inconsistent with the purposes of this chapter required by the Commission.

"Supporting data" includes:

1. The experience and ~~judgement~~ judgment of the filer and, to the extent the filer wishes or the Commission requires, the experience and ~~judgement~~ judgment of other insurers or rate service organizations;

2. The filer's interpretation of any statistical data relied upon;

3. Descriptions of the actuarial and statistical methods employed in setting the rates; and

4. Any other relevant information required by the Commission.

§ 38.2-1905.1. Report on level of competition, availability and affordability of certain insurance. -- A. The Commission shall submit a report or reports to the General Assembly, at least annually, concerning the lines and subclassifications of insurance defined in §§ 38.2-117 and 38.2-118, including those lines and subclassifications containing as a part thereof insurance coverage as defined in those sections, insuring a commercial entity. The report or reports shall indicate (i) the level of competition among insurers in Virginia for those lines or subclassifications, (ii) the availability of those lines or subclassifications of insurance

and (iii) the affordability of those lines or subclassifications of insurance.

B. The Commission's report or reports to the General Assembly shall also designate all insurance lines or subclassifications defined in §§ 38.2-117 and 38.2-118, including those lines or subclassifications of insurance containing as a part thereof insurance coverage defined in those sections, insuring a commercial entity, for which the Commission has reasonable cause to believe that competition may not be an effective regulator of rates.

C. The report or reports to the General Assembly pursuant to this section shall be made no later than December 31 of each year, the first report or reports to be made not later than December 31, 1987.

D. A copy of each report made pursuant to this section shall be sent by the Commission to the Division of Consumer Counsel of the Office of the Attorney General. Each report shall be a matter of public record.

E. Those lines and subclassifications designated pursuant to subsection B of this section shall be reviewed by the Commission for the purpose of determining whether competition is an effective regulator of rates for each such designated line or subclassification. The Commission shall hold a hearing or hearings for that purpose no later than September 30 following the due date of the supplemental reports required under § 38.2-1905.2 at which it shall hear evidence offered by any interested party. In determining whether competition is an

effective regulator of rates for each designated line or subclassification, the Commission may consider such factors as it deems relevant to such determinations, including the following factors:

1. The number of insurers actually writing insurance within the line or subclassification.

2. The extent and nature of rate differentials among insurers within the line or subclassification.

3. The respective market share of insurers actually writing insurance within the line or subclassification, and changes in market share compared with previous years.

4. The ease of entry into the line or subclassification by insurers not currently writing such line or subclassification.

5. The degree to which rates within the line or subclassification are ~~established~~ affected by the filings of ~~rating~~ rate service organizations.

6. The extent to which insurers licensed to write the line or subclassification have sought to write or obtain new business within the line or subclassification within the past year.

7. Whether a pattern of unreasonably high rates exists within the line or subclassification in relation to losses, expenses and investment income.

8. Such other factors as the Commission deems relevant to the determination of whether competition is an effective regulator of rates within the line or subclassification.

F. Notwithstanding any designation made by the Commission pursuant to subsection B of this section, the Commission may,

upon petition of any interested party, hold a hearing to determine whether, under the factors set forth in subsection E of this section, competition is not an effective regulator of rates for lines or subclassifications not so designated.

G. "Commercial entity" as used in this section shall mean any (i) sole proprietorship, partnership or corporation, (ii) unincorporated association or (iii) the Commonwealth, a county, city, town, or an authority, board, commission, sanitation, soil and water, planning or other district, public service corporation owned, operated or controlled by the Commonwealth, a locality or other local governmental authority.

H. The Commission shall adopt such rules and regulations including provision for identification from time to time of subclassifications of insurance necessary to implement the provisions of this section.

§ 38.2-1906. Filing and use of rates. -- A. Each authorized insurer subject to the provisions of this chapter ~~and each rate service organization licensed under § 38.2-1914 that has been designated by an insurer for the filing of rates under § 38.2-1908~~ shall file with the Commission all rates and supplementary rate information and all changes and amendments to the rates and supplementary rate information made by it for use in this Commonwealth; and each rate service organization licensed under § 38.2-1914 that has been designated by an insurer for the filing of prospective loss costs or supplementary rate information under § 38.2-1908 shall file with the Commission all

prospective loss costs or supplementary rate information and all changes and amendments to the prospective loss costs or supplementary rate information made by it for use in this Commonwealth; both insurer and rate service organization as follows:

1. In cases where the Commission has made a determination under the provisions of subsection E of § 38.2-1905.1 that competition is an effective regulator of rates within the lines or subclassifications designated by the Commission, or in the case of all other lines or subclassifications subject to this chapter and not designated under subsection B of § 38.2-1905.1, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information shall be filed with the Commission on or before the date they become effective.

2. Where the Commission has made a determination pursuant to subsection E or F of § 38.2-1905.1 that competition is not an effective regulator of rates for a line or subclassification of insurance, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information for that line or subclassification shall be filed in accordance with and shall be subject to the provisions of § 38.2-1912.

3. For any line or subclassification that has been designated pursuant to subsection B of § 38.2-1905.1, insurers shall continue to file their rates in the same manner then applicable to the line or subclassification until a final determination is made by the Commission pursuant to subsection E

of § 38.2-1905.1 as to whether competition is an effective regulator of rates.

A1. Each insurer whose rate filings are subject to subdivision 2 of subsection A of this section shall submit with each rate filing, as deemed appropriate by, and to the extent directed by the Commission, the following information relating to experience in Virginia and countrywide:

1. Number of exposures;

2. Direct premiums written;

3. Direct premiums earned;

4. Direct losses paid identified by such period as the Commission may require;

5. Number of claims paid;

6. Direct losses incurred during the year, direct losses incurred during the year which occurred and were paid during the year, and direct losses incurred during the year which were reported during the year but were not yet paid;

7. Any loss development factor used and supporting data thereon;

8. Number of claims unpaid;

9. Loss adjustment expenses paid identified by such period as the Commission may require;

10. Loss adjustment expenses incurred during the year, loss adjustment expenses incurred during the year for losses which occurred and were paid during the year, and loss adjustment expenses incurred during the year for losses which were reported during the year but were not paid;

11. Other expenses incurred, separately by category of expense, excluding loss adjustment expenses;

12. Investment income on assets related to reserve and allocated surplus accounts;

13. Total return on allocated surplus;

14. Any loss trend factor used and supporting data thereon;

15. Any expense trend factor used and supporting data thereon; and

16. Such other information as may be required by rule of the Commission, including statewide rate information presented separately for Virginia and each state wherein the insurer writes the line, subline or rating classification for which the rate filing is made and which the Commission deems necessary for its consideration.

A2. Where actual experience does not exist or is not credible, the Commission may allow the use of estimates for the information required by subdivisions 1 through 15 of subsection A1 of this section and may require the insurer to submit such information as the Commission deems necessary to support such estimates.

A3. Prospective loss costs filings and supplementary rate information filed by rate service organizations shall not contain final rates, minimum premiums or minimum premium rules.

B. No insurer shall make or issue an insurance contract or policy of a class to which this chapter applies, except in accordance with the rate and supplementary rate information filings that are in effect for the insurer.

C. The Commission shall develop a uniform statement or format for requesting the information specified in subsection A1 of this section. Such statement or format shall be utilized by all insurers for all rate filings.

§ 38.2-1908 Rate making and ~~Delegation~~ delegation of ~~rate making and rate~~ filing obligation. --

A. An insurer ~~or rate service organization~~ shall establish rates and supplementary rate information for any market segment based on the factors in § 38.2-1904. A rate service organization shall establish prospective loss costs and supplementary rate information for any market segment based on the factors in § 38.2-1904. An insurer may use ~~rates and~~ supplementary rate information prepared by a rate service organization~~, with average~~ and may use prospective loss ~~factors~~ costs ~~or expense factors~~ determined by the rate service organization ~~or~~ with modification for its own expense and profit. The insurer may modify the prospective loss costs based on its own loss experience as the credibility of that loss experience allows.

B. An insurer may discharge its ~~obligations~~ obligation to file supplementary rate information under subsection A or A1 of § 38.2-1906 by giving notice to the Commission that it uses ~~rates and~~ supplementary rate information prepared and filed with the Commission by a designated rate service organization of which it is a member or subscriber. ~~Any insurer subject to the provisions of subdivision 2 of subsection A of § 38.2-1906 that files a modification to increase such rate shall comply with the~~

~~provisions of subsection A1 of § 38.2-1906.~~ The Commission may by order require an insurer to provide information in addition to that filed by the rate service organization. ~~If the proposed modification is to reduce such rates, the Commission shall determine the additional information to be required.~~ The insurer's ~~rates and~~ supplementary rate information shall be ~~those~~ that filed from time to time by the rate service organization, including any amendments to the ~~rates and~~ supplementary rate information, subject to modifications filed by the insurer.

§ 38.2-1913. Operation and control of rate service organizations. -- A. No rate service organization shall provide any service relating to the rates of any insurance subject to this chapter, and no insurer shall use the service of a rate service organization for such purposes unless the rate service organization has obtained a license under § 3S.2-1914.

B. No rate service organization shall refuse to supply any services for which it is licensed in this Commonwealth to any insurer authorized to do business in this Commonwealth and offering to pay the fair and usual compensation for the services.

C. Any rate service organization subject to this chapter may provide for the examination of policies, daily reports, binders, renewal certificates, endorsements, other evidences of insurance, or evidences of the cancellation of insurance, and may make reasonable rules governing their submission and the correction of any errors or omissions in them. This provision applies to the classes of insurance for which the rate service

organization ~~files rates pursuant to § 38.2-1908~~ is licensed pursuant to § 38.2-1914.

§ 38.2-1916. Certain conduct by insurers and rate service organizations prohibited. -- A. As used in this section, the word "insurer" includes two or more insurers (i) under common management, or (ii) under common controlling ownership or under other common effective legal control and in fact engaged in joint or cooperative underwriting, investment management, marketing, servicing or administration of their business and affairs as insurers.

B. No insurer or rate service organization shall:

1. Combine or conspire with any other person to monopolize or attempt to monopolize the business of insurance or any kind, subdivision or class of insurance;

2. Agree with any other insurer or rate service organization to charge or adhere to any rate, although insurers and rate service organizations may continue to exchange statistical information;

3. Make any agreement with any other insurer, rate service organization or other person to restrain trade unreasonably;

4. Make any agreement with any other insurer, rate service organization or other person that may substantially lessen competition in any kind, subdivision or class of insurance; or

5. Make any agreement with any other insurer or rate service organization to refuse to deal with any person in connection with the sale of insurance.

C. No insurer may acquire or retain any capital stock or assets of, or have any common management with, any other insurer if such acquisition, retention or common management substantially lessens competition in the business of insurance or any kind, subdivision or class thereof.

D. No rate service organization, or any of its members or subscribers, shall interfere with the right of any insurer to make its rates independently of the rate service organization ~~or to charge rates different from the rates made by such rate service organization.~~

E. No rate service organization shall have or adopt any rule, exact any agreement, or engage in any program that would require any member, subscriber or other insurer to utilize some or all of its services, or to adhere to its ~~rates,~~ rating plans, rating systems, underwriting rules, or policy forms, or to prevent any insurer from acting independently.

§ 38.2-1923. Person aggrieved by application of rating system to be heard; appeal to Commission. -- Each rate service organization and each insurer subject to this chapter ~~that makes its own rates~~ shall provide within this Commonwealth reasonable means for any person aggrieved by the application of its rating system to be heard in person or by an authorized representative on his written request. Any person who makes the written request shall be entitled to review the manner in which the rating system has been applied to the insurance afforded him. If the rate service organization or insurer fails to grant

or reject the request within thirty days after it is made, the applicant may proceed in the same manner as if his application had been rejected. Any person affected by the action of the rate service organization or the insurer on the request may, within thirty days after written notice of the action, appeal to the Commission. The Commission may affirm or reverse the action after a hearing held upon not less than ten days' written notice to the applicant and to the rate service organization or insurer.

Joint Proposals of
The Office of the Attorney General
and
The State Corporation Commission
to the
HJR 382 Subcommittee Studying Liability Insurance

III. AVAILABILITY-AFFORDABILITY PROPOSALS

A. REFUNDS OF EXCESSIVE PREMIUMS WITH INTEREST

The Insurance Code provides the State Corporation Commission authority to order an insurer to refund to policyholders that portion of premiums paid that are subsequently found to have been excessive. We believe that insurers should be required to pay any such refunds with interest because (1) the use of excessive rates is explicitly prohibited, and (2) insurers should not be permitted to benefit from investment income earned on excessive premiums.

PROPOSAL: Authorize SCC to require that refunds of excessive premiums be paid to policyholders with interest.

> AMEND § 38.2-1910 TO: Authorize SCC to order that an insurer found to have been using an excessive rate must refund the excessive portion of premiums paid with interest at a rate specified by the SCC.

B. PROVISIONAL RATE REDUCTIONS

The examination of a rate filing for a "troubled line" made subject to delayed effect procedures may take up to 90 days, or longer if the insurer delays in producing required data or the matter is set for a hearing. In the interests of both insurers and consumers, a procedure should be available to implement rate reductions proposed by insurers, on a provisional basis, while the full analysis of a requested rate change is pending.

PROPOSAL: Authorize the Commission, in instances in which an insurer applies for a rate reduction for some coverage deemed noncompetitive and made subject to delayed effect rate filing procedures, to implement, provisionally, the rate reduction requested while the Bureau of Insurance completes its evaluation of the insurer's rate filing and supplementary rate information. The Commission would have authority to suspend use of the provisional rate at any time and to act pursuant to the statutes governing the filing, use and disapproval of rates.

AMEND § 38.2-1912 BY ADDING A NEW SUBSECTION E PROVIDING:

1. That the Commissioner of Insurance may authorize the use, provisionally, of an insurer's requested rate reduction while a delayed effect rate filing is being evaluated by the Bureau;

2. That insurers must still submit all data required by the Commission;

3. That the Commissioner may suspend the use of the provisional rate at any time; and

4. That the use of a provisional rate reduction shall in no way interfere with the Commission's ability to examine, approve or disapprove either the pending rate request or the insurer's last rate in use.

III. AVAILABILITY-AFFORDABILITY PROPOSALS

A. REFUNDS OF EXCESSIVE PREMIUMS WITH INTEREST

§ 38.2-1910. Disapproval of rates. -- A. If the Commission finds, after providing notice and opportunity to be heard, that a rate is not in compliance with § 38.2-1904, or is in violation of § 38.2-1916, the Commission shall order that use of the rate be discontinued for any policy issued or renewed after a date specified in the order. The order may provide for rate modifications. The order may also provide for refund, with interest at a rate set by the Commission, of the excessive portion of premiums collected during a period not exceeding one year prior to the date of the order. Except as provided in subsection B of this section, the order shall be issued within thirty days after the close of the hearing or within another reasonable time extension fixed by the Commission.

B. Pending a hearing, the Commission may order the suspension prospectively of a rate filed by an insurer and reimpose the last previous rate in effect if the Commission has reasonable cause to believe that: (i) a reasonable degree of competition does not exist in the area with respect to the classification to which the rate applies, (ii) the filed rate will have the effect of destroying competition or creating a monopoly, (iii) use of the rate will endanger the solvency of the insurer, or (iv) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rates. If the Commission suspends

a rate under this provision, it shall hold a hearing within fifteen business days after issuing the order suspending the rate unless the right to a hearing is waived by the insurer. In addition, the Commission shall make its determination and issue its order as to whether the rate shall be disapproved within fifteen business days after the close of the hearing.

C. At any hearing held under the provisions of subsection A or B of this section, the insurer shall have the burden of justifying the rate in question. All determinations of the Commission shall be on the basis of findings of fact and conclusions of law. If the Commission disapproves a rate, the disapproval shall take effect not less than fifteen days after its order and the last previous rate in effect for the insurer shall be reimposed for a period of one year unless the Commission approves a substitute or interim rate under the provisions of subsection D or E of this section.

D. For one year after the effective date of a disapproval order, no rate promulgated to replace a rate disapproved under the order may be used until it has been filed with the Commission and not disapproved within sixty days after filing.

E. Whenever an insurer has no legally effective rates as a result of the Commission's disapproval of rates or other act, the Commission shall, on the insurer's request, specify interim rates for the insurer that are high enough to protect the interests of all parties. The Commission may order that a specified portion of the premiums be placed in an escrow account approved by it. When new rates become legally effective, the Commission shall order

the escrowed funds or any overcharge in the interim rates to be distributed appropriately, except that refunds to policyholders that are de minimis shall not be required.

B. PROVISIONAL RATE REDUCTIONS

§ 38.2-1912. Delayed effect of rates; provisional rate reductions. -- A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulator of the rates charged, (ii) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rate, (iii) a substantial number of insurers are competing irresponsibly through the rates charged, or (iv) there are widespread violations of this chapter, it shall promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that class, line, subdivision, rating class or rating territory shall be filed with the Commission at least sixty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first sixty-day period expires. Upon filing any rate to which this section is applicable, the insurer shall give notice to the Division of Consumer Counsel of the Office of the Attorney General that such rate has been filed with the Commission and such insurer shall so certify to the Commission in its rate filing.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of insurance, or classes of risks or combinations thereof it deems necessary for the proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than one year after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished.

E. Notwithstanding other provisions of this section, if an insurer files for a rate reduction pursuant to a rule promulgated under this section, the Commission may order the provisional use of the requested rate reduction for such period as the Commission may require to evaluate the insurer's rate filing and supplementary rate information. The implementation of such a provisional rate reduction shall not relieve an insurer of its obligation to submit such information as deemed necessary by the Commission for its consideration of the rate filing, nor shall it interfere with Commission's authority to suspend use of the provisional rate, reimpose the previous rate, consider and approve a revised rate request or otherwise exercise its authority under § 38.2-1910.

Mary Sue Terry
Attorney General

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Chief Deputy Attorney General

COMMONWEALTH of VIRGINIA

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Executive Assistant

November 7, 1989

Steven T. Foster
Commissioner of Insurance
Bureau of Insurance
State Corporation Commission
P.O. Box 1197
Richmond, Virginia 23219

HAND DELIVERED

Re: HJR 382

Dear Steve:

Last Friday I received a letter (dated October 31, 1989) and a memorandum from Tony Troy regarding our HJR 382 antitrust proposals. You are shown as having received a copy of these materials. You will recall from the October 30 meeting with Tony and Jim Roberts, that Tony alluded to this memorandum which purported to justify disparate penalties for antitrust violations under the Insurance Code. I wanted to share my thoughts with you on his letter and to reassert my strong commitment to the legislation we have proposed.

The gravamen of Tony's letter is that since he feels the elements necessary to sustain an antitrust action (in state or federal court) are stricter than those required before the Commission, lower penalties for antitrust matters reviewed by the Commission are necessitated. In short, this argument is specious. Indeed, the suggestion that there are significant differences between the antitrust provisions of the Insurance Code, § 38.2-1916 and the Virginia Antitrust Act, § 59.1-9.1 et seq. is completely without merit.

A close examination of the antitrust sections of the Insurance Code reveals that those provisions are identical in effect to the Virginia Antitrust Act. For example, the excerpted memorandum accompanying Tony's letter of October 31 states that the Insurance Code prohibition against agreements among insurers and rate service organizations which "restrain trade unreasonably" could be interpreted to be inconsistent with the language in the Virginia Antitrust Act which recites at § 59.1-9.5, "every contract, combination or conspiracy in restraint of trade or commerce of this Commonwealth is unlawful". However, a

separate provision of the Virginia Antitrust Act requires that the Act be construed "in harmony with judicial interpretation of comparable federal statutory provisions." See, § 59.1-9.17. (The federal provisions comparable to the Virginia Antitrust Act are Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2. The analysis that follows will reference federal statutes.)

Through these interpretations, the United States Supreme Court has recognized that "the legality of an agreement or regulation cannot be determined by so simple a test as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains." Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918). Consequently, since the dawn of this century, the Supreme Court has construed Section 1 to render unlawful only those restraints of trade that unreasonably restrict competition. See, e.g. Standard Oil Co. of New Jersey v. United States, 221 U.S. 1,58(1911).[1] This interpretation is identical to the condemnation of "unreasonable" restraints set forth in the Insurance Code. It is simply not credible to claim that any agreement found to "restrain trade unreasonably," would not also be deemed an "unreasonable restraint of trade."

Indeed there is no basis, and Tony sets forth none, for his apparent belief that the Commission will not be guided by the applicable case law under the Sherman Act. In fact, the Commission logically would look to federal and state precedents since the language in both the insurance and antitrust statutes is identical in interpretation. It is a well-settled rule of statutory construction that a statute is governed by the interpretation given to similar language in other statutes. See,

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[1]After reviewing the legislative history of the Sherman Act and common law rules relating to restraints of trade, the Court concluded that it was not Congress' intention to prohibit all contracts or even all contracts that caused insignificant or attenuated restraints of trade, but rather only those agreements "which were unreasonably restrictive of competitive conditions." Id. The principle that Section 1 prohibits only unreasonable restraints of trade has been repeatedly reaffirmed by the Supreme Court. See, e.g., National Society of Professional Engineers v. United States, 438 U.S. 679, 687-90 (1978); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36,49 (1977).

e.g. SUTHERLAND STAT. CONST. § 51.02 (4th ed.). Accordingly, contrary to Tony's unsupported assertion, a violation of § 38.2-1916 would constitute a violation of the Virginia Antitrust Act.

Similarly, the other provisions of the Insurance Code track judicial interpretations of the Sherman Act. Agreements among insurers and others to adhere to a rate, conspiracies to monopolize, attempts to monopolize, agreements which substantially lessen competition and concerted refusals to deal are clearly violations of the Sherman Act.

In addition, Tony's expressed concern regarding the absence of the right to a jury trial is likewise wholly lacking in merit. The Commission has authority to conduct an antitrust hearing for alleged violations of § 38.2-1916. Although no jury trial is available, the guarantees of due process are afforded. Our antitrust proposals do not impact on any existing power of the Commission. Rather, they will allow merely for additional investigatory powers and stiffer penalties. Moreover, it is beyond preadventure that the Commission has the ability to conduct an antitrust proceeding and to render a fair and impartial decision.

Finally, I would like to address one other consideration. Although Tony conceded during our October 30 meeting and during his presentation before the Subcommittee on August 21, 1989 that the most plausible interpretation of the insurance and antitrust provisions is that the Attorney General has concurrent jurisdiction to prosecute conduct proscribed under § 38.2-1916, he has also consistently stated that if our Office were to bring an action in court, he would certainly argue that only the Commission has jurisdiction to hear an antitrust action involving an insurer or rate service organization. Thus, as explained in Frank Seales' testimony before the Subcommittee, while we believe we could make a strong argument for bringing an antitrust action in court based on our role as as antitrust prosecutors, we acknowledged that because the Commission regulates the business of insurance, a potential defendant in an antitrust action could, and most assuredly would, raise a strong defense based on this issue. Further as noted by Frank, the interplay of the Insurance Code and Antitrust Act has never been addressed by the courts of this Commonwealth.

One should keep clearly in mind also that the proposal is to raise the maximum penalty so that the Commission's power to punish is equal to that of a circuit court for similar conduct.

Should the Commission move against conduct it believes to be of a less severe nature, the Commission, like state and federal courts in antitrust matters, is always free to impose penalties other than the maximum permitted. However, the point is that, much, if not all, of the core conduct covered by § 38.2-1916, e.g., price fixing, is identical to that covered under the antitrust laws and, where that conduct is pursued by the Commission, the Commission should have available significantly higher penalties which it might use in its discretion.

Of course, the focus of concern should not be on the agency that brings the action but on the conduct that is the subject of the action. I am sure we are in agreement that anticompetitive behavior should always be condemned because it adversely impacts on the Commonwealth's economic vitality, which is premised on the concept that fair competition ultimately results in the greatest efficiency, lowest prices and finest goods and services for the citizens of Virginia. Therefore, there is no logical or sound reason to vary the treatment of such conduct depending on the agency pursuing it.

In sum, I believe the concerns raised by Tony are meritless. This Office's support of the proposed amendments is still strong. We will of course be prepared to address these points from the industry if they are raised (as I expect they will be) at the meeting on November 20, but I wanted you to have some advance indication of our reaction. In the meantime, if you or any members of the Commission wish to discuss any of these matters further, please call me or Frank Seales, directly.

With kindest regards, I remain

Very truly yours,

Gail Starling Marshall
Deputy Attorney General

284-STF/268/245

REFUNDS OF EXCESSIVE PREMIUMS WITH INTEREST

§ 38.2-1910.A.

line 7 after the word "refund,"

strike: with interest at a rate set by the Commission,

and insert in line 10, after the word "order." the following sentence:

If refund is ordered, the order may provide for the payment of interest thereon at a rate set by the Commission.

Joint Proposals of
The Office of the Attorney General
and
The State Corporation Commission
to the
HJR 382 Subcommittee Studying Liability Insurance

II. REINSURANCE PROPOSALS

Reinsurance, or the practice whereby all or part of a risk under an insurance policy sold by one insurer (the "ceding insurer") is transferred to another insurer (the "reinsurer"), is virtually unregulated in Virginia. There are several traditional reasons for this: the buyers and sellers of reinsurance are themselves knowledgeable insurance professionals, the market for reinsurance is presumed to be competitive, and the international market in which reinsurance is transacted is considered too great an obstacle to effective regulation.

We believe, however, that one set of circumstances relating to reinsurance merits more serious consideration. This involves reinsurance among or between affiliated companies, i.e., those under common ownership or control, situations in which the risk exists for abuses concerning reinsurance premiums and payouts. We believe it appropriate that the State Corporation Commission have the ability to review the scope and nature of reinsurance transactions in situations of common control, where such transactions may affect the level or competitiveness of rates charged to primary insurance policyholders in Virginia. While it is generally held that the SCC has the authority to require insurers to produce any needed data, we believe it important to enact legislation that clearly puts insurers on notice that reinsurance data may be requested in particular cases.

A. FILING OF NET DATA WHEN REINSURANCE IS WITH AFFILIATE

PROPOSAL: Authorize SCC to require an insurer to provide reinsurance information when applying for a rate revision for a line of insurance deemed noncompetitive if coverage affected by the rate revision is reinsured with an affiliated company.

> AMEND § 38.2-1906 BY ADDING A NEW SUBDIVISION 16 IN SUBSECTION A PROVIDING: That the SCC may require an insurer to produce premium, loss, and expense data on a net, as well as direct, basis when applying for a rate revision for coverage both subject to delayed effect

procedures and reinsured by a company affiliated with the filing insurer.

B. CERTIFICATION IN FILING IF REINSURANCE IS WITH AFFILIATE

PROPOSAL: Require insurer to certify if coverage to which a rate filing applies is reinsured with an affiliate.

AMEND § 38.2-1912 BY ADDING A NEW SUBSECTION F PROVIDING: That insurer must so certify if coverage to which its rate filing applies is reinsured by a company affiliated with the filing insurer.

(A proposal to add a new subsection E to § 38.2-1912 is explained in the following section.)

II. REINSURANCE PROPOSALS

A. FILING OF NET DATA WHEN REINSURANCE IS WITH AFFILIATE

§ 38.2-1906: Filing and use of rates -- A. Each authorized insurer subject to the provisions of this chapter and each rate service organization licensed under § 38.2-1914 that has been designated by any insurer for the filing of rates under § 38.2-1908 shall file with the Commission all rates and supplementary rate information and all changes and amendments to the rates and supplementary rate information made by it for use in this Commonwealth as follows:

1. In cases where the Commission has made a determination under the provisions of subsection E of § 38.2-1905.1 that competition is an effective regulator of rates within the lines or subclassifications designated by the Commission, or in the case of all other lines or subclassifications subject to this chapter and not designated under subsection B of § 38.2-1905.1, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information shall be filed with the Commission on or before the date they become effective.

2. Where the Commission has made a determination pursuant to subsection E or F of § 38.2-1905.1 that competition is not an effective regulator of rates for a line or subclassification of insurance, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information for

that line or subclassification shall be filed in accordance with and shall be subject to the provisions of § 38.2-1912.

3. For any line or subclassification that has been designated pursuant to subsection B of § 38.2-1905.1, insurers shall continue to file their rates in the same manner then applicable to the line or subclassification until a final determination is made by the Commission pursuant to subsection E of § 38.2-1905.1 as to whether competition is an effective regulator of rates.

A1. Each insurer whose rate filings are subject to subdivision 2 of subsection A of this section shall submit with each rate filing, as deemed appropriate by, and to the extent directed by the Commission, the following information relating to experience in Virginia and countrywide:

1. Number of exposures;

2. Direct premiums written;

3. Direct premiums earned;

4. Direct losses paid identified by such period as the Commission may require;

5. Number of claims paid;

6. Direct losses incurred during the year, direct losses incurred during the year which occurred and were paid during the year, and direct losses incurred during the year which were reported during the year but were not yet paid;

7. Any loss development factor used and supporting data thereon;

8. Number of claims unpaid;

9. Loss adjustment expenses paid identified by such period as the Commission may require;

10. Loss adjustment expenses incurred during the year, loss adjustment expenses incurred during the year for losses which occurred and were paid during the year, and loss adjustment expenses incurred during the year for losses which were reported during the year but were not paid;

11. Other expenses incurred, separately by category of expense, excluding loss adjustment expenses;

12. Investment income on assets related to reserve and allocated surplus accounts;

13. Total return on allocated surplus;

14. Any loss trend factor used and supporting data thereon;

15. Any expense trend factor used and supporting data thereon;

16. Such premium, loss, and expense data reported on a net basis as the Commission deems necessary for its consideration of a rate filing where coverage to which the rate filing applies is reinsured by another company (i) under common management, (ii) under common controlling ownership or (iii) under other common effective legal control as defined in § 38.2-1322; and

~~16~~ 17. Such other information as may be required by rule of the Commission, including statewide rate information presented separately for Virginia and each state wherein the insurer writes the line, subline or rating classification for which the rate filing is made and which the Commission deems necessary for its consideration.

A2. Where actual experience does not exist or is not credible, the Commission may allow the use of estimates for the information required by subdivisions 1 through 15 of subsection A1 of this section and may require the insurer to submit such information as the Commission deems necessary to support such estimates.

B. No insurer shall make or issue an insurance contract or policy of a class to which this chapter applies, except in accordance with the rate and supplementary rate information filings that are in effect for the insurer.

C. The Commission shall develop a uniform statement or format for requesting the information specified in subsection A1 of this section. Such statement or format shall be utilized by all insurers for all rate filings.

B. CERTIFICATION IN FILING IF REINSURANCE IS WITH AFFILIATE

[Draft proposal that follows also incorporates amendment providing for provisional rate reductions]

§ 38.2-1912. Delayed effect of rates; provisional rate reductions; certification of reinsurance with affiliated company -- A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulator of the rates charged, (ii) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rate, (iii) a substantial number of insurers are competing irresponsibly through the rates charged, or (iv) there are widespread violations of this chapter, it shall promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that class, line, subdivision, rating class or rating territory shall be filed with the Commission at least sixty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first sixty-day period expires. Upon filing any rate to which this section is applicable, the insurer shall give notice to the Division of Consumer Counsel of the Office of the Attorney General that such rate has been filed with the Commission and such insurer shall so certify to the Commission in its rate filing.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of

insurance, or classes of risks or combinations thereof it deems necessary for the proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than one year after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished.

E. Notwithstanding other provisions of this section, if an insurer files for a rate reduction pursuant to a rule promulgated under this section, the Commission may order the provisional use of the requested rate reduction for such period as the Commission may require to evaluate the insurer's rate filing and supplementary rate information. The implementation of such a provisional rate reduction shall not relieve an insurer of its obligation to submit such information as deemed necessary by the Commission for its consideration of the rate filing, nor shall it interfere with Commission's authority to suspend use of the provisional rate, reimpose the previous rate, consider and approve a revised rate request or otherwise exercise its authority under § 38.2-1910.

F. Each insurer shall so certify in a rate filing if coverage to which the rate filing applies is reinsured by another company (i) under common management, (ii) under common controlling ownership or (iii) under other common effective legal control as defined in § 38.2-1322.

D 12/4/89 Cramme C 12/6/89 smw

SENATE BILL NO. ..... HOUSE BILL NO. .....

A BILL to amend and reenact §§ 38.2-1906 and 38.2-1912 of the Code o Virginia, relating to reinsurance practices of liability insurers.

Be it enacted by the General Assembly of Virginia:

1. That §§ 38.2-1906 and 38.2-1912 of the Code of Virginia are amended and reenacted as follows:

§ 38.2-1906. Filing and use of rates.--A. Each authorized insurer subject to the provisions of this chapter and each rate service organization licensed under § 38.2-1914 that has been designated by any insurer for the filing of rates under § 38.2-1908 shall file with the Commission all rates and supplementary rate information and all changes and amendments to the rates and supplementary rate information made by it for use in this Commonweal as follows:

1. In cases where the Commission has made a determination under the provisions of subsection E of § 38.2-1905.1 that competition is effective regulator of rates within the lines or subclassifications designated by the Commission, or in the case of all other lines or subclassifications subject to this chapter and not designated under subsection B of § 38.2-1905.1, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information shall be filed with the Commission on or before the date they become effective.

2. Where the Commission has made a determination pursuant to subsection E or F of § 38.2-1905.1 that competition is not an effective regulator of rates for a line or subclassification of insurance, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information for that line or subclassification shall be filed in accordance with and shall be subject to the provisions of § 38.2-1912.

3. For any line or subclassification that has been designated pursuant to subsection B of § 38.2-1905.1, insurers shall continue to file their rates in the same manner then applicable to the line or subclassification until a final determination is made by the Commission pursuant to subsection E of § 38.2-1905.1 as to whether competition is an effective regulator of rates.

A1. Each insurer whose rate filings are subject to subdivision of subsection A of this section shall submit with each rate filing, as deemed appropriate by, and to the extent directed by the Commission, the following information relating to experience in Virginia and countrywide:

1. Number of exposures;

2. Direct premiums written;

3. Direct premiums earned;

4. Direct losses paid identified by such period as the Commission may require;

5. Number of claims paid;

6. Direct losses incurred during the year, direct losses incurred during the year which occurred and were paid during the year, and direct losses incurred during the year which were reported during the year but were not yet paid;

7. Any loss development factor used and supporting data thereon;

8. Number of claims unpaid;

9. Loss adjustment expenses paid identified by such period as the Commission may require;

10. Loss adjustment expenses incurred during the year, loss adjustment expenses incurred during the year for losses which occurred and were paid during the year, and loss adjustment expenses incurred during the year for losses which were reported during the year but were not paid;

11. Other expenses incurred, separately by category of expense, excluding loss adjustment expenses;

12. Investment income on assets related to reserve and allocated surplus accounts;

13. Total return on allocated surplus;

14. Any loss trend factor used and supporting data thereon;

15. Any expense trend factor used and supporting data thereon;

~~and~~

16. Such premium, loss, and expense data reported on a net basis as the Commission deems necessary for its consideration of a rate filing where coverage to which the rate filing applies is reinsured by another company (i) under common management, (ii) under common controlling ownership, or (iii) under other common effective legal control as defined in § 38.2-1322; and

~~16.~~ 17. Such other information as may be required by rule of the Commission, including statewide rate information presented separately for Virginia and each state wherein the insurer writes the line, subline or rating classification for which the rate filing is made and which the Commission deems necessary for its consideration.

A2. Where actual experience does not exist or is not credible, the Commission may allow the use of estimates for the information required by subdivisions 1 through 15 of subsection A1 of this sectic and may require the insurer to submit such information as the Commission deems necessary to support such estimates.

B. No insurer shall make or issue an insurance contract or polic of a class to which this chapter applies, except in accordance with the rate and supplementary rate information filings that are in effec for the insurer.

C. The Commission shall develop a uniform statement or format fo requesting the information specified in subsection A1 of this section Such statement or format shall be utilized by all insurers for all rate filings.

§ 38.2-1912. Delayed effect of rates; certification of reinsurance with affiliated company.--A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulato of the rates charged, (ii) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rate, (iii) a substantial number of insurers ar competing irresponsibly through the rates charged, or (iv) there are widespread violations of this chapter, it shall promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that class, line, subdivision, rating class or rating territory shall be filed with the Commission at least sixty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first sixty-day period expires. Upon filing any rate

to which this section is applicable, the insurer shall give notice to the Division of Consumer Counsel of the Office of the Attorney General that such rate has been filed with the Commission and such insurer shall so certify to the Commission in its rate filing.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of insurance, or classes of risks or combinations thereof it deems necessary for the proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than one year after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished.

E. Each insurer shall so certify in a rate filing if coverage to which the rate filing applies is reinsured by another company (i) under common management, (ii) under common controlling ownership, or (iii) under other common effective legal control as defined in § 38.2-1322.

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SENATE BILL NO. ..... HOUSE BILL NO. .....

A BILL to amend and reenact §§ 38.2-1901, 38.2-1905.1, 38.2-1906, 38.2-1908, 38.2-1913, 38.2-1916, and 38.2-1923 of the Code of Virginia and to amend the Code of Virginia by adding sections numbered 38.2-1916.1 and 38.2-1916.2, relating to anticompetitiv conduct of liability insurers and rate service organizations; ir vestigations; penalties.

Be it enacted by the General Assembly of Virginia:

1. That §§ 38.2-1901, 38.2-1905.1, 38.2-1906, 38.2-1908, 38.2-1913, 38.2-1916, and 38.2-1923 of the Code of Virginia are amended and reenacted and that the Code of Virginia is amended by adding sectio numbered 38.2-1916.1 and 38.2-1916.2 as follows:

§ 38.2-1901. Definitions.--As used in this chapter:

"Market segment" means any line or class of insurance or, if it is described in general terms, any subdivision of insurance or any class of risks or combination of classes.

"Prospective loss costs" means historical aggregate losses and loss adjustment expenses projected through development to their ultimate value and through trending to a future point in time. Prospective loss costs do not include provisions for profit or expenses other than loss adjustment expenses.

"Rate service organization" means any entity, including its affiliates or subsidiaries, which either has two or more member insurers or is controlled either directly or indirectly by two or insurers, other than a joint underwriting association under §

38.2-1915, which assists insurers in ratemaking or filing by (i) collecting, compiling, and furnishing loss statistics; (ii) recommending, making, or filing prospective loss costs or supplementary rate information; or (iii) advising about rate questions, except as an attorney giving legal advice. Two or more insurers having a common ownership or operating in this Commonwealth under common management or control constitute a single insurer for purposes of this definition.

"Supplementary rate information" includes any manual or plan of rates, experience rating plan, statistical plan, classification, rating schedule, minimum premium , or minimum premium rule , policy fee, rating rule, rate-related underwriting rule, and any other information not otherwise inconsistent with the purposes of this chapter required by the Commission.

"Supporting data" includes:

1. The experience and ~~judgement~~ judgment of the filer and, to the extent the filer wishes or the Commission requires, the experienc and ~~judgement~~ judgment of other insurers or rate service organizations;

2. The filer's interpretation of any statistical data relied upon;

3. Descriptions of the actuarial and statistical methods employe in setting the rates; and

4. Any other relevant information required by the Commission.

§ 38.2-1905.1. Report on level of competition, availability and affordability of certain insurance.--A. The Commission shall submit a report or reports to the General Assembly, at least annually, concerning the lines and subclassifications of insurance defined in §

38.2-117 and 38.2-118, including those lines and subclassifications containing as a part thereof insurance coverage as defined in those sections, insuring a commercial entity. The report or reports shall indicate (i) the level of competition among insurers in Virginia for those lines or subclassifications, (ii) the availability of those lines or subclassifications of insurance and (iii) the affordability of those lines or subclassifications of insurance.

B. The Commission's report or reports to the General Assembly shall also designate all insurance lines or subclassifications define in §§ 38.2-117 and 38.2-118, including those lines or subclassifications of insurance containing as a part thereof insuranc coverage defined in those sections, insuring a commercial entity, for which the Commission has reasonable cause to believe that competition may not be an effective regulator of rates.

C. The report or reports to the General Assembly pursuant to th section shall be made no later than December 31 of each year, the first report or reports to be made not later than December 31, 1987.

D. A copy of each report made pursuant to this section shall be sent by the Commission to the Division of Consumer Counsel of the Office of the Attorney General. Each report shall be a matter of public record.

E. Those lines and subclassifications designated pursuant to subsection B of this section shall be reviewed by the Commission for the purpose of determining whether competition is an effective regulator of rates for each such designated line or subclassification The Commission shall hold a hearing or hearings for that purpose no later than September 30 following the due date of the supplemental reports required under § 38.2-1905.2 at which it shall hear evidence

offered by any interested party. In determining whether competition is an effective regulator of rates for each designated line or subclassification, the Commission may consider such factors as it deems relevant to such determinations, including the following factors:

1. The number of insurers actually writing insurance within the line or subclassification.

2. The extent and nature of rate differentials among insurers within the line or subclassification.

3. The respective market share of insurers actually writing insurance within the line or subclassification, and changes in market share compared with previous years.

4. The ease of entry into the line or subclassification by insurers not currently writing such line or subclassification.

5. The degree to which rates within the line or subclassification are ~~established~~ affected by ~~rating~~ the filings of rate service organizations.

6. The extent to which insurers licensed to write the line or subclassification have sought to write or obtain new business within the line or subclassification within the past year.

7. Whether a pattern of unreasonably high rates exists within the line or subclassification in relation to losses, expenses and investment income.

8. Such other factors as the Commission deems relevant to the determination of whether competition is an effective regulator of rates within the line or subclassification.

F. Notwithstanding any designation made by the Commission pursuant to subsection B of this section, the Commission may, upon

petition of any interested party, hold a hearing to determine wheth under the factors set forth in subsection E of this section, competition is not an effective regulator of rates for lines or subclassifications not so designated.

G. "Commercial entity" as used in this section shall mean any (i sole proprietorship, partnership or corporation, (ii) unincorporated association or (iii) the Commonwealth, a county, city, town, or an authority, board, commission, sanitation, soil and water, planning or other district, public service corporation owned, operated or controlled by the Commonwealth, a locality or other local governmenta authority.

H. The Commission shall adopt such rules and regulations including provision for identification from time to time of subclassifications of insurance necessary to implement the provis of this section.

§ 38.2-1906. Filing and use of rates.--A. Each authorized insurer subject to the provisions of this chapter ~~and each rate service organization licensed under § 38.2-1914 that has been designated by any insurer for the filing of rates under § 38.2-1908~~ shall file with the Commission all rates and supplementary rate information and all changes and amendments to the rates and supplementary rate information made by it for use in this Commonweal . Each rate service organization licensed under § 38.2-1914 that ha been designated by an insurer for the filing of prospective loss cos or supplementary rate information under § 38.2-1908 shall file with the Commission all prospective loss costs or supplementary rate information and all changes and amendments to the prospective los costs or supplementary rate information made by it for use in this

Commonwealth. Both insurer and rate service organization shall file as follows:

1. In cases where the Commission has made a determination under the provisions of subsection E of § 38.2-1905.1 that competition is an effective regulator of rates within the lines or subclassifications designated by the Commission, or in the case of all other lines or subclassifications subject to this chapter and not designated under subsection B of § 38.2-1905.1, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information shall be filed with the Commission on or before the date they become effective.

2. Where the Commission has made a determination pursuant to subsection E or F of § 38.2-1905.1 that competition is not an effective regulator of rates for a line or subclassification of insurance, such rates, supplementary rate information, changes and amendments to rates and supplementary rate information for that line or subclassification shall be filed in accordance with and shall be subject to the provisions of § 38.2-1912.

3. For any line or subclassification that has been designated pursuant to subsection B of § 38.2-1905.1, insurers shall continue to file their rates in the same manner then applicable to the line or subclassification until a final determination is made by the Commission pursuant to subsection E of § 38.2-1905.1 as to whether competition is an effective regulator of rates.

A1. Each insurer whose rate filings are subject to subdivision 2 of subsection A of this section shall submit with each rate filing, as deemed appropriate by, and to the extent directed by the Commission, the following information relating to experience in Virginia and

countrywide:

1. Number of exposures;

2. Direct premiums written;

3. Direct premiums earned;

4. Direct losses paid identified by such period as the Commission may require;

5. Number of claims paid;

6. Direct losses incurred during the year, direct losses incurred during the year which occurred and were paid during the year, and direct losses incurred during the year which were reported during the year but were not yet paid;

7. Any loss development factor used and supporting data thereon;

8. Number of claims unpaid;

9. Loss adjustment expenses paid identified by such period as the Commission may require;

10. Loss adjustment expenses incurred during the year, loss adjustment expenses incurred during the year for losses which occurred and were paid during the year, and loss adjustment expenses incurred during the year for losses which were reported during the year but were not paid;

11. Other expenses incurred, separately by category of expense, excluding loss adjustment expenses;

12. Investment income on assets related to reserve and allocated surplus accounts;

13. Total return on allocated surplus;

14. Any loss trend factor used and supporting data thereon;

15. Any expense trend factor used and supporting data thereon; and

16. Such other information as may be required by rule of the Commission, including statewide rate information presented separately for Virginia and each state wherein the insurer writes the line, subline or rating classification for which the rate filing is made and which the Commission deems necessary for its consideration.

A2. Where actual experience does not exist or is not credible, the Commission may allow the use of estimates for the information required by subdivisions 1 through 15 of subsection A1 of this section and may require the insurer to submit such information as the Commission deems necessary to support such estimates.

A3. Prospective loss costs filings and supplementary rate information filed by rate service organizations shall not contain final rates, minimum premiums, or minimum premium rules.

B. No insurer shall make or issue an insurance contract or policy of a class to which this chapter applies, except in accordance with the rate and supplementary rate information filings that are in effect for the insurer.

C. The Commission shall develop a uniform statement or format for requesting the information specified in subsection A1 of this section. Such statement or format shall be utilized by all insurers for all rate filings.

§ 38.2-1908. Rate making and delegation of filing obligation.--A. An insurer ~~or rate service organization~~ shall establish rates and supplementary rate information for any market segment based on the factors in § 38.2-1904. A rate service organization shall establish prospective loss costs and supplementary rate information for any market segment based on the factors in § 38.2-1904. An insurer may use ~~rates and~~ supplementary rate

information prepared by a rate service organization ~~,--with-average-loss-factors-or-expense-factors-~~and may use prospective loss costs determined by the rate service organization ~~or~~-with modification for its own expense and profit. The insurer may modify the prospective loss costs based on its own loss experience as the credibility of that loss experience allows.

B. An insurer may discharge its ~~obligations~~ obligation to file supplementary rate information under subsection A ~~or A1~~ of § 38.2-1906 by giving notice to the Commission that it uses ~~rates and~~ supplementary rate information prepared and filed with the Commission by a designated rate service organization of which it is a member ~~or~~ , subscriber , or service purchaser . ~~Any insurer subject to the provisions of subdivision 2 of subsection A of § 38.2-1906 that files a modification to increase such rate shall comply with the provisions of subsection A1 of § 38.2-1906.~~ --The Commission may by order requi an insurer to provide information in addition to that filed by the rate service organization. ~~If the proposed modification is to reduce such rates, the Commission shall determine the additional information to be required.~~ --The insurer's ~~rates and~~ supplementary rate information shall be ~~these~~ that filed from time to time by the rate service organization, including any amendments to the ~~rates and~~ supplementary rate information, subject to modifications filed by the insurer.

§ 38.2-1913. Operation and control of rate service organizations.--A. No rate service organization shall provide any service relating to the rates of any insurance subject to this chapter, and no insurer shall use the service of a rate service organization for such purposes unless the rate service organization

has obtained a license under § 38.2-1914.

B. No rate service organization shall refuse to supply any services for which it is licensed in this Commonwealth to any insurer authorized to do business in this Commonwealth and offering to pay the fair and usual compensation for the services.

C. Any rate service organization subject to this chapter may provide for the examination of policies, daily reports, binders, renewal certificates, endorsements, other evidences of insurance, or evidences of the cancellation of insurance, and may make reasonable rules governing their submission and the correction of any errors or omissions in them. This provision applies to the classes of insurance for which the rate service organization ~~files rates pursuant to § 38.2-1908 is~~ licensed pursuant to § 38.2-1914.

§ 38.2-1916. Certain conduct by insurers and rate service organizations prohibited.--A. As used in this section, the word "insurer" includes two or more insurers (i) under common management, or (ii) under common controlling ownership or under other common effective legal control and in fact engaged in joint or cooperative underwriting, investment management, marketing, servicing or administration of their business and affairs as insurers.

B. No insurer or rate service organization shall:

1. Combine or conspire with any other person to monopolize or attempt to monopolize the business of insurance or any kind, subdivision or class of insurance;

2. Agree with any other insurer or rate service organization to charge or adhere to any rate, although insurers and rate service organizations may continue to exchange statistical information;

3. Make any agreement with any other insurer, rate service

organization or other person to restrain trade unreasonably;

4. Make any agreement with any other insurer, rate service organization or other person that may substantially lessen competiti in any kind, subdivision or class of insurance; or

5. Make any agreement with any other insurer or rate service organization to refuse to deal with any person in connection with the sale of insurance.

C. No insurer may acquire or retain any capital stock or assets of, or have any common management with, any other insurer if such acquisition, retention or common management substantially lessens competition in the business of insurance or any kind, subdivision or class thereof.

D. No rate service organization, or any of its members or subscribers, shall interfere with the right of any insurer to make its rates independently of the rate service organization ~~or to charge rates different from the rates made by such rate service organization~~.

E. No rate service organization shall have or adopt any rule, exact any agreement, or engage in any program that would require any member, subscriber or other insurer to utilize some or all of its services, or to adhere to its rates, rating plans, rating systems, underwriting rules, or policy forms, or to prevent any insurer from acting independently.

§ 38.2-1916.1. Investigation by Attorney General of suspected violations; investigative demand to witnesses; access to business records, etc.; penalties.--A.1. Whenever it appears to the Attorney General, either upon complaint or otherwise, that any person has engaged in, or is engaging in, or is about to engage in any act or

practice prohibited by § 38.2-1916, the Attorney General may, consistent with his powers and duties to enforce the laws of the Commonwealth prohibiting conduct that unreasonably restrains trade, after notice to the Commission:

a. Either require or permit such person to file with him a statement in writing or otherwise, under oath, as to all facts and circumstances concerning the subject matter;

b. Require such other data and information as he may deem relevant to the subject matter of an investigation of a possible violation of § 38.2-1916; and

c. Issue an investigative demand to witnesses by which he may (i) compel the attendance of such witnesses; (ii) examine such witnesses under oath before himself or the Commission; (iii) subject to subsection B of this section, require the production of any documents or things that he deems relevant or material to the inquiry; and (iv) issue written interrogatories to be answered by the witness served or, if the witness served is a public or private corporation or a partnership or association or governmental agency, by any officer or agent, who shall furnish such information as is available to the witness.

2. The investigative powers authorized shall not abate or terminate by reason of any action or proceeding brought by the Attorney General or the Commission under this title. When a document or thing is demanded by an investigative demand, that demand shall not (i) contain any requirement that would be unreasonable or improper if contained in a subpoena duces tecum issued by a court of this Commonwealth; or (ii) require the disclosure of any document or thing that would be privileged, or production of which for any other reason

would not be required by a subpoena duces tecum issued by a court of this Commonwealth.

B. Where the information requested pursuant to an investigative demand may be derived or ascertained from the business records of the party upon whom the interrogatory has been served or from an examination, audit, or inspection of such business records, or from a compilation, abstract, or summary based therein, and the burden of deriving or ascertaining the answer is substantially the same for the Attorney General as for the party from whom such information is requested, it shall be sufficient for that party to specify the records from which the answer may be derived or ascertained and to afford the Attorney General, or other individuals properly designated by the Attorney General, reasonable opportunity to examine, audit, or inspect such records and to make copies, compilations, abstracts, or summaries. The Attorney General is authorized, and may so elect, to require the production pursuant to this section, of documents or things before or after the taking of any testimony of the person summoned pursuant to an investigative demand, in which event, those documents or things shall be made available for inspection and copying during normal business hours at the principal place of business of the person served, or at such other time and place as may be agreed upon by the person served and the Attorney General.

C. Any investigative demand issued by the Attorney General under this section shall contain (i) a citation to this statute and section, (ii) a citation to the statute and section pertaining to the alleged violation under investigation, (iii) the subject matter of the investigation, and (iv) the date, place, and time the person is required to appear to produce testimony or documentary material in h

possession, custody or control. Such date shall not be less than twenty days from the date of the investigative demand. Where documentary material is required to be produced, it shall be described by class so as to clearly indicate the material demanded.

D. Service of an investigative demand as provided in this section may be made by:

1. Delivery of a duly executed copy thereof to the person served or, if a person is not a natural person, to the principal place of business of the person to be served; or

2. Mailing by certified mail, return receipt requested, a duly executed copy therof addressed to the person to be served at his principal place of business in this Commonwealth, or if that person has no place of business in this Commonwealth, to his principal office.

E. Within twenty days after the service of any such demand upon any person or enterprise, or at any time before the return date specified in the demand, whichever period is shorter, such party may file with the Commission and serve upon the Attorney General a petition for an order of the Commission modifying or setting aside such demand. The time allowed for compliance with the demand, in whole or in part as deemed proper and ordered by the Commission, shall not run during the pendency of such petition in the Commission. Such petition shall specify each ground upon which the petitioner relies in seeking such relief, and may be based upon any failure of such demand to comply with the provisions of this section or upon any constitutional or other legal right or privilege of such party. The provisions of this subsection shall be the exclusive means for a witness summoned pursuant to an investigative demand under this

section to challenge an investigative demand issued pursuant to subsection A of this section.

F. The examination of all witnesses under this section shall be conducted by the Attorney General, or his designee, before an officer authorized to administer oaths in this Commonwealth. The testimony shall be taken stenographically or by a sound-recording device and shall be transcribed.

G. Any person required to testify or to submit documentary evidence shall be entitled, on payment of lawfully prescribed cost, to procure a copy of any document produced by such person and of his own testimony as stenographically reported or, in the case of depositions, as reduced to writing by or under the direction of a person taking the deposition. Any party compelled to testify or to produce documents or things may be accompanied and advised by counsel, but counsel may not, as a matter of right, otherwise participate in the investigation.

H. All persons served with an investigative demand by the Attorney General under this section, other than any person or persons whose conduct or practices are being investigated or any officer, director, or person in the employ of such person under investigation, shall be paid the same fees and mileage as paid witnesses in the courts of this Commonwealth. No person shall be excused from attending such inquiry pursuant to the mandate of an investigative demand, from producing a document or thing, or from being examined or required to answer questions, on the ground of failure to tender or pay a witness fee or mileage, unless a demand therefor is made at the time testimony is about to be taken and is made as a condition precedent to offering such production or testimony and unless payment is not made.

I. Any natural person who neglects or refuses (i) to attend and testify, (ii) to answer any lawful inquiry, or (iii) to produce documents or things, if in his power to do so, in obedience of an investigative demand or lawful request of the Attorney General or those properly authorized by the Attorney General, pursuant to this section, shall be subject to the penalty provisions of § 38.2-218. Any natural person who commits perjury, false swearing, or contempt in answering or failing to answer, or in producing a document or thing or failing to do so in accordance with an investigative demand or lawful request by the Attorney General, pursuant to this section, shall be guilty of a misdemeanor and upon conviction therefor by a court of competent jurisdiction shall be punished by a fine of not more than $5,000 or by imprisonment in jail for not more than one year, or both.

J. In any investigation brought by the Attorney General pursuant to this chapter, no individual shall be excused from attending, testifying or producing documentary material, objects, or intangible things in obedience to an investigative demand or under order of the Commission on the ground that the testimony, document, or thing required of him may tend to incriminate him or subject him to any penalty. No testimony or other information compelled either by the Attorney General or under order of the Commission or a court or any information directly or indirectly derived from such testimony or other information, may be used against the individual or witness in any criminal case. However, he may be prosecuted or subjected to penalty or forfeiture for any perjury, false swearing, or contempt committed in answering or failing to answer, or in producing any document or thing or failing to do so in accordance with the demand of the Attorney General or the Commission. If an individual refuses to

testify or produce any document or thing after being granted immunity from criminal prosecution and after being ordered to testify or produce any document or thing as authorized by this section, he may found to be in civil contempt by a court of competent jurisdiction and incarcerated until such time as he purges himself of contempt by testifying, producing such document or thing, or presenting a written statement as ordered. Such finding of contempt shall not prevent the Attorney General from instituting other appropriate contempt proceedings against any person who violates any of the provisions of this section.

K. It shall be the duty of all public state and local officials, their employees, and all other persons to render and furnish to the Attorney General or his designee, when so requested, all information and assistance in their possession or within their power. Any officer participating in such inquiry and any person examined as a witness upon such inquiry who discloses to any person other than the Attorney General the name of any witness examined or any other information obtained upon such inquiry, except as so directed by the Attorney General, shall be guilty of a misdemeanor and subject to the sanctions prescribed in subsection I of this section. Such inquiry may upon written authorization by the Attorney General be made public.

L. The Attorney General may recommend rules and regulations to implement and carry out the provisions of this section. All such rules and regulations shall be subject to the approval of the Commission.

M. It shall be the duty of the Attorney General, or his designees, to maintain the secrecy of all evidence, testimony, documents, or other results of such investigations until formal

proceedings are instituted. Violation of this subsection shall be punishable pursuant to § 38.2-218. Nothing contained in this section shall be construed to prevent the disclosure of any such investigative evidence by the Attorney General in his discretion to the Commissioner of Insurance, the State Corporation Commission, or to any federal or state law-enforcement authority that has restrictions governing confidentiality similar to those contained in this subsection.

§ 38.2-1916.2. Penalties; injunctive relief; restitution.--A. Notwithstanding the provisions of § 38.2-218, any insurer, rate service organization or other person who knowingly or willfully violates any provision of § 38.2-1916 shall be punished for each such violation by a penalty of not more than $100,000 and may be subject to suspension or revocation of any license issued by the Commission.

B. Any person threatened with injury or damage to his business or property by reason of a violation of § 38.2-1916 may petition the Commission for injunctive relief pursuant to § 38.2-220.

C. The Commission may require an insurer, rate service organization, or other person to make restitution in the amount of the direct actual financial loss, including any costs associated with bringing such a matter before the Commission and reasonable attorney's fees, to (i) the Commonwealth, a political subdivision thereof, or any public agency injured in its business or property or (ii) any person injured in his business or property by reason of a violation of § 38.2-1916. If the Commission finds that the violation is willful or flagrant, it may increase the restitution payment to an amount not in excess of three times the actual damages sustained.

§ 38.2-1923. Person aggrieved by application of rating system to be heard; appeal to Commission.--Each rate service organization and

each insurer subject to this chapter ~~that makes its own rates~~ shall provide within this Commonwealth reasonable means for any person aggrieved by the application of its rating system to be heard in person or by an authorized representative on his written request. Any person who makes the written request shall be entitled to review the manner in which the rating system has been applied to the insurance afforded him. If the rate service organization or insurer fails to grant or reject the request within thirty days after it is made, the applicant may proceed in the same manner as if his application had been rejected. Any person affected by the action of the rate service organization or the insurer on the request may, within thirty days after written notice of the action, appeal to the Commission. The Commission may affirm or reverse the action after a hearing held upon not less than ten days' written notice to the applicant and to the rate service organization or insurer.

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Appendix 10

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SENATE BILL NO. ..... HOUSE BILL NO. .....

A BILL to amend and reenact §§ 38.2-1910 and 38.2-1912 of the Code of Virginia, relating to the availability and affordability of liability insurance.

Be it enacted by the General Assembly of Virginia:

1. That §§ 38.2-1910 and 38.2-1912 of the Code of Virginia is amended and reenacted as follows:

§ 38.2-1910. Disapproval of rates.--A. If the Commission finds, after providing notice and opportunity to be heard, that a rate is not in compliance with § 38.2-1904, or is in violation of § 38.2-1916, the Commission shall order that use of the rate be discontinued for any policy issued or renewed after a date specified in the order. The order may provide for rate modifications. The order may also provide for refund of the excessive portion of premiums collected during a period not exceeding one year prior to the date of the order. <u>If a refund is ordered, the order may provide for the payment of interest thereon at a rate set by the Commission.</u> Except as provided in subsection B of this section, the order shall be issued within thirty days after the close of the hearing or within another reasonable time extension fixed by the Commission.

B. Pending a hearing, the Commission may order the suspension prospectively of a rate filed by an insurer and reimpose the last previous rate in effect if the Commission has reasonable cause to believe that: (i) a reasonable degree of competition does not exist in

the area with respect to the classification to which the rate applies, (ii) the filed rate will have the effect of destroying competition or creating a monopoly, (iii) use of the rate will endanger the solvency of the insurer, or (iv) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rates. If the Commission suspends a rate under this provision, it shall hold a hearing within fifteen business days after issuing the order suspending the rate unless the right to a hearing is waived by the insurer. In addition, the Commission shall make its determination and issue its order as to whether the rate shall be disapproved within fifteen business days after the close of the hearing.

C. At any hearing held under the provisions of subsection A or B of this section, the insurer shall have the burden of justifying the rate in question. All determinations of the Commission shall be on the basis of findings of fact and conclusions of law. If the Commission disapproves a rate, the disapproval shall take effect not less than fifteen days after its order and the last previous rate in effect for the insurer shall be reimposed for a period of one year unless the Commission approves a substitute or interim rate under the provisions of subsection D or E of this section.

D. For one year after the effective date of a disapproval order, no rate promulgated to replace a rate disapproved under the order may be used until it has been filed with the Commission and not disapproved within sixty days after filing.

E. Whenever an insurer has no legally effective rates as a result of the Commission's disapproval of rates or other act, the Commission shall, on the insurer's request, specify interim rates for the insurer

that are high enough to protect the interests of all parties. The Commission may order that a specified portion of the premiums be placed in an escrow account approved by it. When new rates become legally effective, the Commission shall order the escrowed funds or any overcharge in the interim rates to be distributed appropriately, except that refunds to policyholders that are de minimis shall not be required.

§ 38.2-1912. Delayed effect of rates; provisional rate reductions.--A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulator of the rates charged, (ii) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rate, (iii) a substantial number of insurers are competing irresponsibly through the rates charged, or (iv) there are widespread violations of this chapter, it shall promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that class, line, subdivision, rating class or rating territory shall be filed with the Commission at least sixty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first sixty-day period expires. Upon filing any rate to which this section is applicable, the insurer shall give notice to the Division of Consumer Counsel of the Office of the Attorney Genera that such rate has been filed with the Commission and such insurer shall so certify to the Commission in its rate filing.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of insurance,

or classes of risks or combinations thereof it deems necessary for the proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than one year after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished.

E. If an insurer files for a rate reduction pursuant to a rule promulgated under this section, the Commission may order the provisional use of the requested rate reduction for such period as the Commission may require to evaluate the insurer's rate filing and supplementary rate information. The implementation of such a provisional rate reduction shall not relieve an insurer of its obligation to submit such information as deemed necessary by the Commission for its consideration of the rate filing, nor shall it interfere with the Commission's authority to suspend use of the provisional rate, reimpose the previous rate, consider and approve a revised rate request, or otherwise exercise its authority under § 38.2-1910.

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SENATE BILL NO. ..... HOUSE BILL NO. .....

A BILL to amend and reenact §§ 38.2-1905.1 and 38.2-1912 of the Code of Virginia, relating to competition hearings and reports on certain lines or subclassifications of liability insurance.

Be it enacted by the General Assembly of Virginia:

1. That §§ 38.2-1905.1 and 38.2-1912 of the Code of Virginia are amended and reenacted as follows:

§ 38.2-1905.1. Report on level of competition, availability and affordability of certain insurance.--A. The Commission shall submit a report or reports to the General Assembly, at least ~~annually~~ biennially, concerning the lines and subclassifications of insurance defined in §§ 38.2-117 and 38.2-118, including those lines and subclassifications containing as a part thereof insurance coverage as defined in those sections, insuring a commercial entity. The report or reports shall indicate (i) the level of competition among insurers in Virginia for those lines or subclassifications, (ii) the availability of those lines or subclassifications of insurance and (iii) the affordability of those lines or subclassifications of insurance.

B. The Commission's report or reports to the General Assembly shall also designate all insurance lines or subclassifications defined in §§ 38.2-117 and 38.2-118, including those lines or subclassifications of insurance containing as a part thereof insurance coverage defined in those sections, insuring a commercial entity, for which the Commission has reasonable cause to believe that competition

may not be an effective regulator of rates.

C. The report or reports to the General Assembly pursuant to th section shall be made no later than December 31 of ~~each year, the first report or reports to be made not later than December 31, 1987~~ the second year of any biennium .

D. A copy of each report made pursuant to this section shall be sent by the Commission to the Division of Consumer Counsel of the Office of the Attorney General. Each report shall be a matter of public record.

E. Those lines and subclassifications designated pursuant to subsection B of this section shall be reviewed by the Commission for the purpose of determining whether competition is an effective regulator of rates for each such designated line or subclassificatior The Commission shall hold a hearing or hearings for that purpose no later than September 30 ~~following the due date of the supplemental reports required under § 38.2-1905.2~~ of the year immediately following the year the report or reports are submitted to the General Assembly pursuant to subsection C of this section at which it shall hear evidence offered by any interested party. In determining whethe competition is an effective regulator of rates for each designated line or subclassification, the Commission may consider such factors it deems relevant to such determinations, including the following factors:

1. The number of insurers actually writing insurance within the line or subclassification.

2. The extent and nature of rate differentials among insurers within the line or subclassification.

3. The respective market share of insurers actually writing

insurance within the line or subclassification, and changes in market share compared with previous years.

4. The ease of entry into the line or subclassification by insurers not currently writing such line or subclassification.

5. The degree to which rates within the line or subclassification are ~~established~~ affected by ~~rating~~ the filings of rate service organizations.

6. The extent to which insurers licensed to write the line or subclassification have sought to write or obtain new business within the line or subclassification within the past year.

7. Whether a pattern of unreasonably high rates exists within the line or subclassification in relation to losses, expenses and investment income.

8. Such other factors as the Commission deems relevant to the determination of whether competition is an effective regulator of rates within the line or subclassification.

F. Notwithstanding any designation made by the Commission pursuant to subsection B of this section, the Commission may, upon petition of any interested party, hold a hearing to determine whether, under the factors set forth in subsection E of this section, competition is not an effective regulator of rates for lines or subclassifications not so designated.

G. "Commercial entity" as used in this section shall mean any (i) sole proprietorship, partnership or corporation, (ii) unincorporated association or (iii) the Commonwealth, a county, city, town, or an authority, board, commission, sanitation, soil and water, planning or other district, public service corporation owned, operated or controlled by the Commonwealth, a locality or other local governmental

authority.

H. The Commission shall adopt such rules and regulations including provision for identification from time to time of subclassifications of insurance necessary to implement the provisions of this section.

§ 38.2-1912. Delayed effect of rates.--A. If the Commission finds in any class, line, or subdivision of insurance, or in any rating class or rating territory that (i) competition is not an effective regulator of the rates charged, (ii) Virginia loss experience and other factors specifically applicable to the Commonwealth have not been properly used to determine the rate, (iii) a substantial number of insurers are competing irresponsibly through the rates charged, or (iv) there are widespread violations of this chapter, it shall promulgate a rule requiring that any subsequent changes in the rates or supplementary rate information for that clas line, subdivision, rating class or rating territory shall be filed with the Commission at least sixty days before they become effective. The Commission may extend the waiting period for thirty additional days by written notice to the filer before the first sixty-day period expires. Upon filing any rate to which this section is applicable, the insurer shall give notice to the Division of Consumer Counsel of the Office of the Attorney General that such rate has been filed with the Commission and such insurer shall so certify to the Commission in its rate filing.

B. By this rule the Commission may require the filing of supporting data for any classes, lines or subdivisions of insurance, or classes of risks or combinations thereof it deems necessary for th proper functioning of the rate monitoring and regulating process.

C. A rule promulgated under this section shall expire no later than ~~one-year-twenty-seven months~~ after issue. The Commission may renew the rule after a hearing and appropriate findings under this section.

D. If a filing is not accompanied by the information the Commission has required under subsection B of this section, the Commission shall within thirty days of the initial filing inform the insurer that the filing is not complete, and the filing shall be deemed to be made when the information is furnished.

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