
CONTEMPORARY TRENDS IN GENERAL INSURANCE - U. S. A.
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Overview

The general insurance industry in the United States has never lacked for issues or challenges. Scholars of the business can point to dozens of milestones throughout the twentieth century, each rich with its own challenges and opportunities. These include the onset of compulsory workers compensation insurance, the first million dollar personal injury jury award, the concepts of joint and several liability, major insolvencies, intrusive regulation, and the onset of right-of-access-to-insurance statutes. And there are many more. The industry always seemed to be able to cope, adjust, respond, survive and, at times, even prosper.

The late eighties have been witness to a continuation of this pattern except that the frequency and intensity of events seem to be increasing quite dramatically. In this paper a review of each of five significant events is described along with a brief discussion of the range of issues each event is likely to spawn for consumers, insurers, and regulatory agencies. The paper concludes with a brief synthesis.

Anti-Trust Exemption

For nearly fifty years the general insurance industry has enjoyed a special anti-trust exemption (The McCarran-Ferguson Act). By virtue of this exemption, insurers are able to gather industry-wide insurance statistics and

calculate industry-wide rates for nearly all lines of business. Each insurer, then, is able to "deviate" from these rates, up or down, to recognize its claim and expense requirements or any other aspect of its operation that is different from the average.

Periodically this exemption came under attack and the insurance industry always seemed to avert losing it. In the late eighties however, the assault on this exemption appears to have gained significant strength from inside and outside the legislative arena. The legislation to repeal (or at least weaken) the McCarran-Ferguson Act has been progressing through various committees of the U.S. Congress. In fact, as of this writing the legislation to repeal is further along than at any other previous attempt. Several members of Congress and a number of Washington insiders flatly and publicly predict the demise of McCarran-Ferguson.

The downstream effects of losing this exemption are nothing if not awesome. From the point of view of insurers, numerous activities which are carried out in concert will have to be modified, or curtailed altogether -- from standard policy forms, standard classification and rating plans, average industry-wide rates, to sharing of loss and expense information. As such, the cost of doing business should increase. And, not to be overlooked, the degree of expertise needed to successfully manage an insurance operation will increase dramatically.

From the consumer's point of view, the verdict is not quite as clear. One can make a case that the value of one

dollar's worth of insurance will improve. One can also make a case that the environment will be more confused and confusing for the consumer.

From the regulatory standpoint, it is not at all clear whether or not state regulation will survive, or whether the current system of state regulation will be replaced by a two-tier system of state and federal regulation; not unlike the banking industry.

On balance, if the McCarran-Ferguson Act is repealed, I believe the broad downstream issues are headed towards the following:

- The insurance business will become a riskier business for the shareholder.
- The cost of doing business will increase.
- The consumer, in the short run may not benefit; but in the long run, markets are efficient, and therefore, the consumer should ultimately benefit.
- The system of state regulation is likely to be extended to include some facet(s) of federal regulation.
- A wave of consolidations (mergers, acquisitions, retirements, etc.) is likely to follow.

The Role of Insurance Services Office

The Insurance Services Office, Inc. (ISO) is an industry organization which, for many years, has functioned, among other things, as a central statistical agent and ratemaking organization for its members and subscribers. The ISO has long been the largest ratemaking organization in the United States. It promulgated, filed, and obtained approval for rates from the appropriate regulatory authorities on behalf of its members and subscribers.

The ISO, in early 1989, announced that, effective in 1990, it plans to limit its ratemaking role to that of calculating pure loss costs which members and subscribers can in turn use to calculate their own rates.

The motivation for this decision, I am sure, rests, at least in part on the idea that this action might weaken the effort to repeal the McCarran-Ferguson Act. Just how effective this move will turn out to be in slowing down the repeal movement remains to be seen.

The full implications of the ISO action are yet to crystallize. But, on the surface, the effects of this action, to a large extent, should parallel those of losing the protection of McCarran-Ferguson. Perhaps some of the effects will be less severe but the only questions are those of degree, not of direction.

Automobile Insurance

If someone had asked ten years ago, what is likely to be

the hottest insurance issue in 1989, I doubt anyone would have picked personal automobile insurance. Well, personal automobile insurance is the hot insurance issue in the U.S.

It seems that the cost of automobile insurance has risen to the point where consumers are in "revolt." Three examples will illustrate the point:

- In the state of California, voters have passed a so called "Proposition 103," which mandates, among other things, a 20% rollback of rates. The issue had its roots in automobile insurance but the momentum carried forward so that now nearly all insurance rates are subject to this rollback.
- In the state of Nevada, a bill to rollback automobile insurance rates by 15% passed both houses of the legislature.
- In the state of New Jersey, two initiatives are on the ballot of the next election, each of which calls for a 20% rollback in rates. The initiatives are sponsored by the two opposing political parties and differ only in the "how" aspects of the same 20% rollback.

These are but three of several initiatives sweeping the U.S., all of which are aimed at mandating reductions in auto insurance rates. One may question the constitutionality of such actions but the California supreme court has ruled that nearly all parts of Proposition 103 are consti-

tutional. As a consequence, a huge administrative process has begun to sort out just how Proposition 103 will be implemented. Needless to say actuaries and economists are very heavily involved in all aspects of these proceedings.

The likely impact of this type of mandated rate rollback is multifaceted and depends to a large extent on how such actions will be implemented. For example a company which can demonstrate that its solvency is threatened by such action may be exempted from some or all of the rollbacks.

From a company standpoint, the business of automobile insurance has become riskier; access to adequate rates can no longer be taken for granted. In fact the struggle seems to be focused on warding-off mandated rate inadequacy, let alone maintaining adequacy. This issue will increase the stresses on a company's legal and actuarial staffs in that each will have yet another external force to accommodate, in addition to the usual stresses to carry out normal daily tasks.

From a consumer standpoint, this movement is almost certain to yield some short-term benefits. In the long run it may create a number of stresses in the market place; primarily reduced availability and competition, and perhaps a few insolvencies. But on a net net basis the consumer is likely to benefit; and at worst, the consumer should not be disadvantaged.

From a regulatory standpoint; the task of regulating insurance will be more difficult and will demand greater professional resources. The size of the insurance

regulatory bureaucracy will undoubtedly increase significantly; of course at the expense of taxpayers.

All in all, the automobile insurance business is likely to be a more difficult business to conduct, requiring a significantly stronger regulatory infrastructure, to the end that the consumer may derive some benefit.

Rate Regulation

For nearly 50 years, the general trend in insurance regulation has been toward deregulation. This trend developed in waves to the point where in the early eighties, with a few significant exceptions, rate regulation was carried out under the types of laws generally labeled "open rating laws." Under those laws rates could be filed on a file-and-use basis, use-and-file basis, no-file, etc. Or, if subject to prior approval, the process was generally benign.

Recently, however, there appears to have emerged a number of contra-indications. Three examples will illustrate the point:

-- The state of Florida recently passed legislation which imposes, among a number of new rules, two requirements:

- . every insurer is required to renew (re-file) all of its rate filings at least annually for each line of business, and

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- . every filing must be certified by an actuary as to the adequacy of rates.

 - The state of Maryland just returned to a modus operandi of prior approval of all rates (previous rate law was open rating).

 - The state of California has adopted a prior approval rate regulatory process and the office of insurance commissioner has become an elected office (previous rate law was no-file).

These are three populous states from three very different populations in the East, the West, and the Southeast. The implications of these emerging trends are not hard to construct:

- The task of managing an insurance company will become even more difficult. Rate adequacy will be more difficult to achieve and maintain.

- Consumers should, in the main, benefit.

- Regulators will have significant added responsibilities to implement these laws.

And in the aggregate, the insurance business will be a more complicated transaction all around, from the vantage points of the companies, consumers, and the regulatory authorities' vantage points.

Movement Away from Traditional Insurance Mechanisms

The movement away from traditional insurance mechanisms is continuing in direction and widening in scope. For at least two decades, all buyers of insurance who have had an alternative have generally exercised that option. Some examples:

- The formation of captives.
- The formation of physician-owned insurers.
- The formation of municipal liability pools.
- The emergence of self-insurance as many entities (e.g. hospitals) have become substantially self-insured.

That movement has continued. Captives continue to be formed. And recent favorable federal tax rulings will undoubtedly accelerate this movement. Municipal pools continue to be formed and expanded. Hospital-owned insurers continue to be formed. More hospitals are becoming fully 100% self-insured.

The expansion of these possibilities continues. Some examples:

- Several states have adopted enabling legislation to foster the formation of domestic captives.

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- The liability risk retention act permits, among other things, the formation of risk retention groups. These are groups of risk who band together and form a legal entity to enable them to self-insure up to a certain level then buy insurance for the higher limits of liability.

 - Purchasing groups have emerged as a force in the market place. These are groups of similarly situated buyers who band together to in order to buy insurance coverage in order to optimize the value returned on their insurance dollars.

The impact of these trends on insurers is twofold:

- To reduce the overall premium volume flowing into the traditional insurance mechanism. In fact a recent survey estimated that the volume of business (premium) handled by risk retention groups and purchasing groups is nearly \$1 billion.

- The dollars that continue to flow into the traditional insurance mechanism are subject to much increased competition, thus eroding profit margins and exerting significant pressures on expense ratios.

The insurance buyer is likely to benefit from these developments.

The regulatory role (has and) will get more complicated. For example, the question of jurisdiction (between federal and state authorities) with respect to risk retention groups is the subject of current controversy.

Once again, the insurance business is getting to be more difficult from both the company and the regulatory sides; with the expectation that the consumer will benefit.

Synthesis

A number of threads run through all of these trends:

- Managing an insurance company will be much more difficult.
- The regulatory burden is increasing.
- The consumer (has and) will continue to improve the value returned on his or her insurance dollar.

What are these developments really telling us? At the risk of terribly over-simplifying, I believe these trends are saying that American society no longer perceives insurance, as presently conducted, as a fair economic exchange, and is doing something about it. I am sure various shades of this statement can be debated, but the main thought running through is clearly supported by the trends outlined above.

From a purely actuarial standpoint, these trends are already increasing the reliance of companies, regulators, and consumers on actuaries. From an actuarial consulting standpoint, these trends have and will increasingly generate considerable need for the services of consulting actuaries. One latent characteristic in all of this is that the actuary involved in these issues will have his or her work viewed, discussed, and often critiqued in public forums; whether they be courts of law, administrative proceedings, or consumer forums.

Perhaps the best face one can put on these trends is that there is developing a very strong yearning for the absolute truth with respect to issues involving risk and risk financing, and the actuary is called forth to help define that truth. Quite a heavy responsibility and a wonderful opportunity.

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