THE McCARRAN-FERGUSON ACT PASSES 75 YEARS

A Look at the Law That Provides the Foundation of State-Based Regulation

by Paul Tetrault

This article, the second in a two-part series, examines the history of the McCarran-Ferguson Act and its role in providing a legal foundation for the state-based system of insurance regulation. A previous Insights *article considered more fully the United States Supreme Court case that necessitated the act. Picking up on the narrative with the passage of the law a little over 75 years ago, this article considers the meaning of the text of the legislation and threats to its delegation of insurance regulation to the states.*

Imagine that the most fundamental manner in which the insurance industry functions was declared illegal.

Insurance professionals in 1944 did not have to imagine, because that is what happened when the United States Supreme Court ruled, in *United States v. South-Eastern Underwriters Association*, that insurance is interstate commerce and therefore subject to federal laws, including antitrust statutes inherently in conflict with the way insurance was priced and sold.

For decades, the industry had been operating outside the scope of any kind of federal oversight—including, most significantly, antitrust laws—because a previous Supreme Court case, *Paul v. Virginia*, decided in 1869, had stated that insurance was not in fact "commerce" and therefore was not subject to the authority of Congress to regulate interstate commerce under the U.S. Constitution.

The *South-Eastern Underwriters* decision prompted swift congressional action, resulting in passage of the McCarran-Ferguson Act in 1945. That statute established the framework for the state-based system of insurance regulation that exists in the U.S. today. And while its underpinnings have been challenged in several instances, the act's fundamental premise—that insurance should be regulated primarily at the state level—has prevailed more than 75 years later.

A High-Profile Case

The Supreme Court case was extremely high profile and followed closely by the industry, as evidenced by a review of trade journals from the time, including *National Underwriter*, *Rough Notes*, and *The Standard*.

In fact, the legislative process ultimately resulting in passage of the act was set in motion well before the court decision was made. As early as May 1944, the Senate Judiciary Committee, headed by Sen. Pat McCarran of Nevada, was moving forward with legislation to affirm the power of states to regulate insurance, while Sen. Homer S. Ferguson of Michigan expressed an intent to amend the bill so that it did not affect the pending case.

Members of both the industry and the insurance regulatory community watched the case closely. The National Association of Insurance Commissioners (NAIC) established the Subcommittee on Federal Legislation, reporting to the organization's executive committee, in October 1943 to monitor the case and prepare a response.

The decision was described by one insurance commissioner as "the bombshell which exploded in our midst on June 5, 1944."[1] McCarran would observe, four years after his co-sponsored law's passage, that "the problem presented by that decision was not a problem for the industry alone, but was a problem for the Congress, and for the several States."[2]

NAIC Resolution of Support

The full NAIC had already been scheduled to meet in Chicago on what ended up being just 10 days after the McCarran-Ferguson decision was handed down. The case and how to respond quickly became the focus of attendees' attention.

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At that meeting, the organization adopted a resolution supporting the continued state regulation of insurance. In part, this resolution stated, "The interests of the insuring public can best be served by proper supervision on the part of State Governments, and in keeping with constitutional limitations as defined by the United States Supreme Court over the past seventy-five years."[3]

Through its president and the Massachusetts insurance commissioner, the NAIC proposed legislation in Washington by introducing the organization's proposal to members of Congress.[4] The resulting bill was not adopted before the end of the congressional session and ultimately was not adopted completely by the full Congress in the next session. But all was not lost.

A summary prepared for the NAIC Subcommittee on Federal Legislation shows:

> "A comparison of the bill as it was finally enacted with the text of the original Commissioners' proposal of November, 1944, as well as references to the Congressional debates, establishes clearly that the Commissioners' draft was used as a foundation for the bill. In drafting the bill, Congress used almost verbatim those portions of the Commissioners' proposal relating to the doctrine of Congressional silence and the affirmative expression of the Congressional will in so far as they affect state regulation and taxation."[5]

Key Provisions

The McCarran-Ferguson Act is codified at 15 U.S. Code § 1011, *et. seq.* The following are among its key provisions:

- "Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States."
- "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."
- "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance…"

State Regulation: The Finer Points

The text of the statute clearly and unequivocally specifies that the states, not Congress and the federal government, regulate the business of insurance. However, it is important to note two things about the law's designation of the states as the regulators of insurance.

One, because the McCarran-Ferguson Act is an act of Congress, it can be repealed or amended by Congress. Consequently, Congress has the ability to take over the regulation of insurance at any time. To date, 75 years have passed, and it has not seen fit to do so. Occasionally in insurance public-policy debates, some will refer to a states' rights concept, but nothing in the U.S. Constitution requires insurance regulation to be the province of the states.

Two, the statutory text allows for federal laws to supersede state laws regulating insurance if they "specifically relate…to the business of insurance." This means that, even short of full repeal of the McCarran-Ferguson Act, the act's reverse preemption does not come into play for any federal law that specifically relates to insurance. This would be a dispositive issue in the 1996 U.S. Supreme Court case *Barnett Bank of Marion County, N. A. v. Nelson*, 517 U.S. 25, a significant case that allowed banks to sell insurance.

Reverse Preemption

Normally, a conflict between a state and federal law will result in a win for the federal law because of the U.S. Constitution's Supremacy Clause. When this occurs, the federal law is said to preempt the state law. The McCarran-Ferguson Act, however, creates reverse preemption, a unique situation in U.S. law, under which a conflict between a state law regarding insurance regulation and a federal law that might invalidate, impair, or supersede the state law will be resolved in favor of the state law.

An important phrase from the statute regarding reverse preemption refers to state laws enacted "for the purpose of regulating the business of insurance." A state law passed for some other reason, generally applicable to businesses, for instance, will not result in reverse preemption. Additionally, the preemption is applicable only to industry activities that are subject to state regulation.

This aspect of the law led to a "flurry of activity at the NAIC and in the states"[6] to strengthen the states' regulatory framework through the adoption of model laws related to insurance rates and pricing. The emphasis put on state law would cement the NAIC's role in the fabric of state insurance regulation over time.

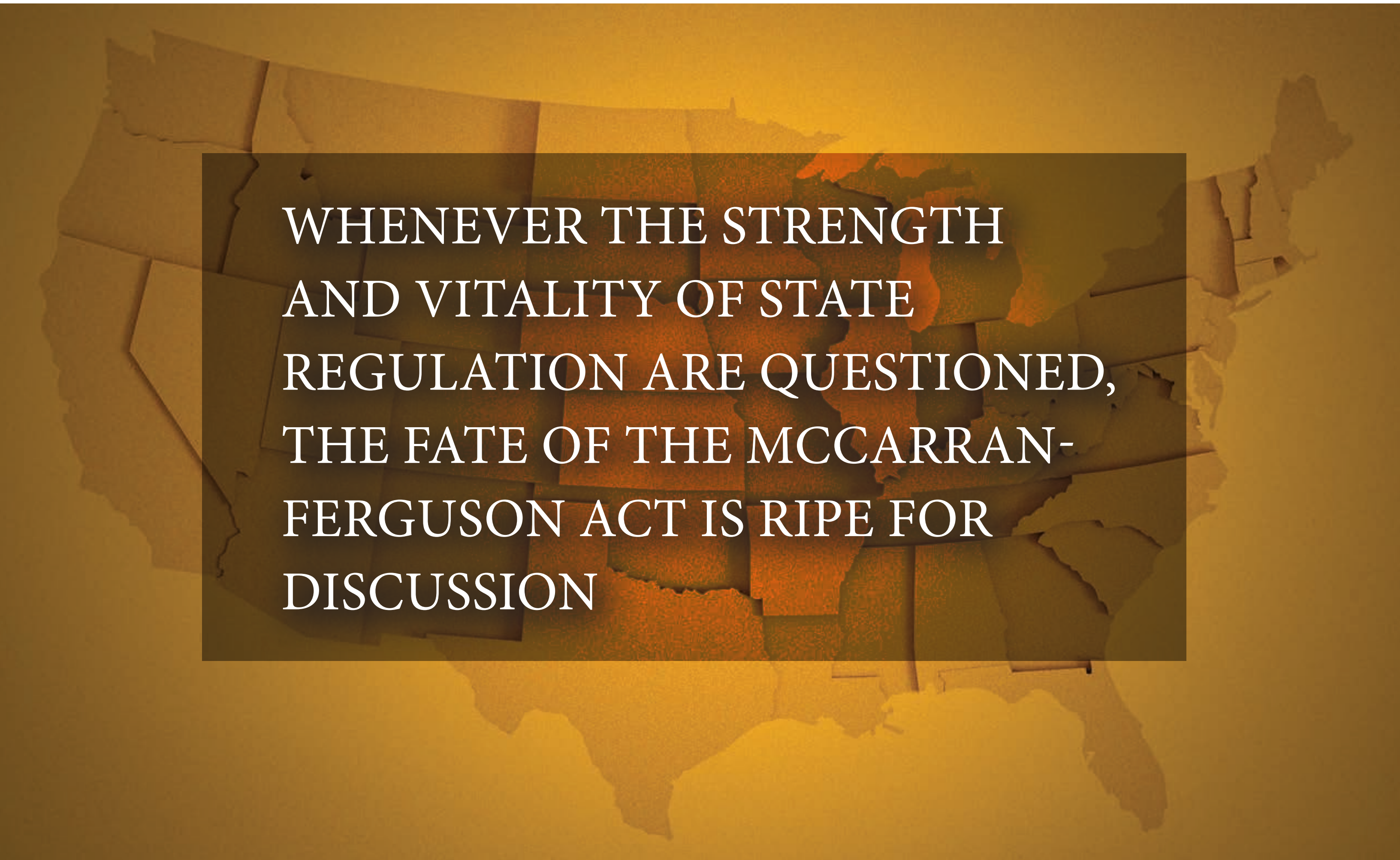
Threats to the Act

A quiet existence ensued for decades after the law's passage, with just a few cases questioning its provision of an exemption from federal antitrust laws.[7] In more recent years, however, several developments have called into question the law's delegation of insurance regulation to the states. It is fair to say, in fact, that whenever the strength and vitality of state regulation are questioned, the fate of the McCarran-Ferguson Act is ripe for discussion.

The liability insurance crisis of the 1980s, when the subject of insurance availability and affordability was pivotal enough to merit the cover of *Time* magazine, was certainly a time for reevaluation of all things related to insurance, including insurance regulation.

Relatedly, perhaps the most perilous time for continuation of the law came in the early 1990s, following a rash of insolvencies of several large insurers, when Congressman John Dingell of Michigan set his sights on state regulation.

Dingell was chairman of the U.S. Senate Energy and Commerce Committee's Subcommittee on Oversight and Investigations, which, after a series of hearings, published a damning report titled "Failed Promises: Insurance Company Insolvencies." The report



WHENEVER THE STRENGTH AND VITALITY OF STATE REGULATION ARE QUESTIONED, THE FATE OF THE MCCARRAN-FERGUSON ACT IS RIPE FOR DISCUSSION argued for congressional takeover of insurance regulation based on the premise that states were simply not up to the task of protecting consumers from insolvencies.

That report, and the threat to state regulation that it represented, led the NAIC to develop its accreditation program, formally known as the Financial Regulation Standards and Accreditation Program, under which states must demonstrate that they have the laws, regulations, and authority considered necessary to conduct proper financial oversight of insurers.

Another direct threat to the McCarran-Ferguson Act came in the wake of Hurricane Katrina, which resulted in some controversy regarding whether catastrophic losses were largely attributable to storm surge (and therefore not covered) or to wind (which is covered).

Senate Majority Leader Trent Lott of Mississippi found himself on the adverse end of a coverage decision, a development that prompted him to take direct aim at the law providing insurers with a limited exemption to federal antitrust laws. In testimony submitted to the Senate Judiciary Committee in 2007, Lott stated, "I trully [sic] believe that the McCarran-Ferguson Act's antitrust exemption has allowed insurers to engage in anticompetitive conduct, and I can find no justification to exempt the insurance industry from federal government oversight."

Influences From the Legislative Landscape

On at least three occasions over the past couple of decades, major legislative efforts could have materially altered McCarran-Ferguson's allocation of insurance regulation to the states. First, the Gramm-Leach-Bliley Act (GLB), also known as the Financial Services Modernization Act of 1999, represented a major restructuring of the federal regulation of financial services firms—with insurers fully considered when it was being developed.

GLB eliminated certain merger and affiliation restrictions that had been in place since the Great Depression and paved the way for one-stop shopping for financial services products. It was also the first federal financial law to establish privacy standards for consumer information. In this respect, it did not exempt insurers from the standards it set, but rather established a system of "functional regulation" under which the federal standards would be enforced not by a federal regulator but by state regulators already overseeing insurers.

Then, in the mid-1990s, a significant push for Optional Federal Charter legislation accompanied national insurers' increasing frustration with having to deal with more than 50 individual state regulators when it came to licensing and other compliance matters. Proponents of state-based regulation feared that the legislation, to give insurers the option of getting a single license to do business in every state, would put a large dent in the system of state regulation and could lead to a mostly federalized system over time.

The momentum for an Optional Federal Charter bill was halted by the financial crisis and ensuing legislative response, as the environment had shifted to one in which more requirements and regulation were likely.

This leads to the third piece of legislation: the Dodd-Frank Wall Street Reform and Consumer Protection Act. Developed as a response to the financial crisis, Dodd-Frank could have done much to sweep insurance regulation under federal oversight, but it did not. House Financial Services Committee Chairman Barney Frank of Massachusetts commented on several occasions that Congress had little interest in dealing with some of the issues raised by insurance regulation. The law did, however, establish the Federal Insurance Office (FIO) within the U.S. Treasury, with the power to collect information and issue reports—but it made it clear that the FIO was not a regulator.

At this time, more than 75 years after its adoption, the McCarran-Ferguson Act appears to be on stable ground and unlikely to be substantially altered in the near term. As one veteran insurance regulator and NAIC leader has commented, "The McCarran-Ferguson Act is as relevant today as it was when it was adopted. It is brilliant in its simplicity. It solved a problem created by a significant court case and demonstrated the flexibility of our democracy."[8] ■

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1. NAIC Proceedings, Seventy-Sixth Session, 1945, p. 13.
2. Pat McCarran, "Insurance as Commerce—After Four Years," *Notre Dame Law Review*, vol. 23, Issue 3, 1948, p. 300.
3. NAIC Proceedings, Seventy-Fifth Session, 1945, pp. 98-99.
4. NAIC Proceedings, Seventy-Fifth Session, p. 156.
5. NAIC Proceedings, Seventy-Fifth Session, pp. 157-158.
6. Eric Nordman, "The Relevance of the McCarran-Ferguson Act," CIPR newsletter, August 2017, p. 17.
7. Alan M. Anderson, "Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond," *William & Mary Law Review*, vol. 25, Issue 1, 1983.
8. Nordman, "The Relevance of the McCarran-Ferguson Act," p. 13.