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SHAKEDOWN:

HOW THE INSURANCE INDUSTRY EXPLOITS A NATION IN TIMES OF CRISIS

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"Fighting to protect the right to jury trial and an independent judiciary for all Americans."

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INTRODUCTION

Ten days after the September 11, 2001 terrorist attacks, a delegation of 15 insurance executives met privately with President Bush and Commerce Secretary Donald Evans at the White House in an effort to limit insurance companies' liability exposure for future acts of terrorism.[1] A few days later, Jacques E. DuBois, an executive from Swiss Re, the world's second-largest reinsurance company[*] but to most people a virtually unknown foreign entity, walked into the White House and told officials that his company would stop providing terrorism coverage to property and casualty insurers, raising fears of a nationwide economic collapse.[2]

These executives were demanding a multi-billion-dollar insurance "backstop," essentially capping the liability of the property/casualty insurance industry, an industry worth hundreds of billions of dollars, in the event of future terrorist attacks. While similar to the demands of a host of other major industries that demonstrated their post-September 11 patriotism by asking to loot the federal treasury, this proposal stood out because the "federal safety net" the insurance executives wanted had the potential to become the most expensive bailout in U.S. history. Without a program in place by the end of 2001, the executives warned, reinsurers would stop providing coverage to property and casualty insurance companies for future terrorist attacks. Without reinsurance, they argued, insurance companies could no longer offer policies with terrorism coverage. And without terrorism insurance, they said, banks would stop lending money, new construction would grind to a halt and businesses would collapse. The blow to the U.S. economy would be crushing.

As of April 2002, a federal insurance bailout had not yet passed, the economy had not crumbled and the insurance industry has actually seen a surge in capital. In fact, by January 23, 2002, the Consumer Federation of America was reporting that the insurance industry was "more strongly capitalized than it was even before September 11," that "banks were lending money to most businesses" and that while certain large businesses and potential targets like skyscrapers and sports arenas were having difficulty getting terrorism coverage (problems that could be solved with alternatives to traditional terrorism coverage), there were "no widespread economic problems related to terrorism insurance."[3] On March 20, 2002, Assistant Secretary of the Treasury for Financial Institutions, Sheila Bair, acknowledged that there has been no "dramatic disruption" in economic activity as a result of Congress' failure to enact bailout legislation.[4]

While the doomsday predictions of September 2001 have not come to pass, the ease with which insurance executives were able to command the nation's attention with promises about the economy's imminent collapse says a great deal about the vast power and economic control that this industry exercises in the United States. History shows that property/casualty insurance

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[*] Reinsurance is insurance for insurance companies; the insurer pays the reinsurer a premium in exchange for which the reinsurer agrees to share the risk with the insurer. A U.S. insurer's willingness to offer coverage is often determined by the availability of reinsurance. Reinsurers, typically foreign companies like Swiss Re or Lloyd's of London that operate domestically with virtually no regulatory oversight, can dictate rates, terms of coverage and other matters to U.S. companies. Reinsurers also control the amount of business that primary insurers can write, since reinsurance releases funds for further underwriting that the insurer otherwise would keep in reserve to cover potential large losses. Thus, reinsurers have a substantial amount of economic power over primary insurers.

companies have repeatedly threatened to pull the rug out from under the U.S. economy to get what it wants, whether it be a bailout or limits on people's rights to sue, freely intimidating lawmakers and creating an atmosphere of "crisis" to promote its legislative agenda while at the same time escaping any meaningful public scrutiny or regulatory control.

The medical malpractice insurance "crisis" that many states are now experiencing,[†] created by the insurance industry's own pricing errors and lost investment income, is another example of how the industry uses its vast economic clout to pressure lawmakers. Doctors, like all businesses and professions that provide services, depend on adequate and reasonably priced insurance to function. Yet because of scant oversight of insurance industry activities, insurers can, in an effort to raise profits, impose rate hikes that are so astronomical that they threaten the ability of medical clinics to survive even though insurers' own mismanaged underwriting and unchecked power are to blame. Insurance companies and their foreign reinsurers announced, "Don't look at us – blame those lawyers, lawsuits and juries!" With this rhetoric in hand, the industry then uses its economic clout to drive a nationwide campaign to weaken U.S. civil liability laws, some that have protected U.S. citizens for over 200 years. And it's all done with very little scrutiny by policyholders, lawmakers, the media or the public at large.

How can this happen?

MONEY BUYS RESULTS

The property/casualty insurance industry is accountable to no federal agency but rather only to weak state agencies. Moreover, it is subject to virtually no federal regulatory laws, few federal anti-trust laws and no oversight by the Federal Trade Commission.[5] Combine this sorry state of insurance regulation and almost non-existent data disclosure requirements with the industry's massive political influence through enormous financial contributions to key lawmakers, and the result is an industry that can make extraordinary claims and demands on U.S. politicians that go nearly unchallenged.

Weak Regulation and Oversight …

To understand how the insurance industry can exercise this kind of power in the United States, it is necessary to start with one key observation: the property/casualty insurance industry is one of the least regulated and anti-competitive industries in the country. In 1944, the insurance industry strong-armed Congress into enacting the McCarran-Ferguson Act, which allows insurance companies to fix prices, an anti-competitive practice that for other industries can be punishable

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[†] In many states, as well as Congress, proposals have been introduced to restrict the rights of patients to sue doctors and hospitals for medical negligence, triggered by an insurance "crisis" – astronomical rate increases and cancelled coverage for medical malpractice insurance. As explained later in this report, the "crisis" is caused not by lawsuits but by the property/casualty insurance industry's cyclical downturn and will not be solved by restricting patients rights to sue. Despite this fact, the American Medical Association announced in March 2002 that it planned to lobby lawmakers and courts in at least 25 states for laws to cap the liability of malpracticing doctors and hospitals. On March 14, 2002, the Pennsylvania legislature became the first state this year to approve such a bill.

by jail time. Federal law also prohibits any federal regulation of insurance or Federal Trade Commission scrutiny over the industry.[6]

The job of regulating insurance companies has been left to the states. Most state insurance departments have weak or non-existent authority over insurance rates through prior approval or rejection of requests for rate increases. State insurance departments universally lack adequate investigators, auditors and other professionals, preventing them from recommending appropriate insurance rates and coverage. In other words, with few exceptions, state insurance departments have neither the authority nor the funding to exercise proper control over insurance industry pricing.

As for reinsurance, the situation is even worse. Not only is there no federal regulation, but state insurance departments do not at all regulate rates and terms of coverage in reinsurance contracts – state reinsurance regulation is focused only on assuring the solvency of the reinsurer. States do not require foreign reinsurers, like Swiss Re or Lloyd's of London, to be licensed to do business in the United States. They require only that the foreign reinsurer maintain some security in the United States to back up its obligations, such as a U.S. trust fund or a letter of credit. And states have no data collection requirements for foreign reinsurers.[7]

… Combined with Easy Access

That the executives in the above-mentioned scenario had special access to the White House should not be surprising to any close observer of the insurance industry and its recent history of political giving. Two of the visiting insurance executives, Maurice R. Greenberg, chairman and chief executive officer of the American International Group (AIG), and Robert O'Connell, chairman, president and CEO of Massachusetts Mutual Life Insurance, had been named "Pioneers" by the Bush campaign for each raising at least $100,000 towards his presidential run.[8] In addition, insurance companies had given nearly $1.7 million to the Bush campaign and over $1.1 million to underwrite his inauguration, with Greenberg's AIG, the American Council of Life Insurance and the American Insurance Association each contributing $100,000 to the inaugural fund.[9]

The fact that the insurance industry has given more than $47 million to federal political races since 1999, mostly to Republicans, certainly may have proved influential in how the Republican-controlled House of Representatives initially responded to the industry's post-9/11 demands. Indeed, on November 29, 2001, the House approved legislation on a mostly party-line vote that not only had the government underwriting potential losses from acts of terrorism but also included severe restrictions on victims' rights to sue in the event of future terrorist attacks. The bill had been sponsored by Representative Michael Oxley (R-OH), who counts the insurance industry among his top campaign contributors.[10] (As of publication, this bill has passed the U.S. House of Representatives and the administration continues to lobby heavily for its enactment.)

At the state level, the situation is no different. According to the Center for Public Integrity, an organization that studies the influence of money on government policy and politics, there are over 1,900 insurance companies or associations that lobby state legislatures, "or one lobbying interest per every three state lawmakers."[11] Moreover, data from the Center for Responsive Politics, a non-partisan campaign finance watchdog group, show that in the year 1998 alone, insurers contributed over $24 million to state political campaigns in 33 states.[12]

A HISTORY OF THREATS AND INTIMIDATION

Three times in the last 30 years, the insurance industry has created liability insurance "crises," making insurance unaffordable or, in some cases, unavailable at any price for many businesses and professions. A crisis happened in the mid-1970s, precipitating the first wave of "tort reform" in medical malpractice insurance and product liability insurance, particularly.

A more severe crisis took place in the mid-1980s, when most liability insurance was impacted. At that time, manufacturers, municipalities, doctors, nurse-midwives, day-care centers, non-profit groups and many other commercial customers of liability insurance were faced with insurance rate increases of 300 percent or more. Many could not find coverage at any price. Now, once again, in 2002, the country is experiencing what has become known as the "hard market" part of the cycle, this time impacting property as well as liability coverages, with medical malpractice lines of insurance seeing rates going up 100% or more.

What precipitates these crises is always the same. Insurers make their money from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premiums dollars to invest for maximum return. Insurers engage in severe underpricing and insure very poor risks just to get premium dollars to invest. But when investment income decreases because interest rates drop, the stock market plummets and/or cumulative price cuts make profits become unbearably low, the industry responds by sharply increasing premiums and reducing coverage, creating a "liability insurance crisis."

Each time this happens and the market turns "hard," the insurance industry tries to cover up its pricing errors by blaming lawyers and the legal system for the liability insurance price jump. Like clockwork, there are frenetic calls for legislative limits on victims' rights to sue, with state lawmakers viewing the "crisis" as an isolated problem rather than indicative of a broader national problem caused by the cyclical nature of the insurance business. They panic with fear that insurers will abandon their state and hurt the state economy unless tort restrictions are passed.

Terrorizing States – Circa 1980s

The liability insurance crisis of the mid-1980s, which led many states to enact "tort reform," was acute. Small businesses, doctors, non-profit groups and others were hit with dramatic increases in insurance premiums, reduced coverage and arbitrary policy cancellations. The situation received extensive media attention, such as *Time Magazine*'s 1986 cover story entitled, "Sorry, Your Policy is Cancelled."[13]

Numerous studies at the time, including those conducted by the National Association of Attorneys General[14] and state commissions in New Mexico, Michigan and Pennsylvania, confirmed that the crisis was not caused by the legal system but rather by the insurance cycle and mismanaged underwriting by the insurance industry.[15] Even the insurance industry admitted this internally. In 1986, Maurice R. Greenberg of American International Group told an insurance audience in Boston that the industry's problems were due to price cuts taken "to the point of

absurdity" in the early 1980s. Had it not been for these cuts, Greenberg said, "[T]here would not be 'all this hullabaloo' about the tort system."[16]

As *Business Week* magazine also explained a January 1987 editorial:

> Even while the industry was blaming its troubles on the tort system, many experts pointed out that its problems were largely self-made. In previous years the industry had slashed prices competitively to the point that it incurred enormous losses. That, rather than excessive jury awards, explained most of the industry's financial difficulties.[17]

Threats and intimidation by reinsurers were an additional driving force behind the liability insurance crisis of the mid-1980s. Evidence gathered by over a dozen state attorneys general for an anti-trust class action filed in 1988, and settled in 1995, found that a number of insurance companies had helped cause the insurance crisis by restricting coverage to commercial customers and raising prices, creating an atmosphere intended to coax states into enacting "tort reform."[18] As John J. Byrne, chairman and chief executive officer of Geico Corp., put it, "[T]he goal is to withdraw [from the market] and let the pressure for reform build in the courts and in the state legislatures."[19]

Reinsurers were in the middle of it. In fact, according to the anti-trust complaint, Lloyd's of London became the locus of meetings and discussions for a coordinated industry effort to raise commercial insurance rates, abandon certain lines of coverage, change the standard terms of coverage used by the majority of the industry and enact "tort reforms."[20] To reach these goals, reinsurers misled U.S. public officials about reasons for rate hikes and policy cancellations and their commitment to the U.S. market.

Some of the threats directed at lawmakers were quite brash. In 1985, attorney Jeff Johnson of the U.S. law firm LeBoeuf, Lamb, Leiby and MacCrae[21] – Lloyd's U.S. counsel – told Alaska state legislators:

> If you change your tort laws in Alaska, you will have a market here when the rest of the United States will not. Lloyd's is pulling out of the United States as a reinsurer – they have already pulled out of Connecticut, New York and New Jersey – and they're continuing to pull out of more states.[22]

As a result, Alaska's Director of Insurance, John George, proceeded to tell Alaska's Defense Council, "Lloyd's is threatening to pull out of the United States, in fact they are pulling out of the States one by one, but they will stay in Alaska if we enact tort reform. If we all work together we might be able to steam roller this legislation."[23] (Alaska responded by enacting a broad "tort reform" bill.)

Meanwhile, Lloyd's was also telling the U.S. Congress that America's tort system was to blame for the company's underwriting losses. U.S. Representative John LaFalce (D-NY) noted:

> Both American reinsurance companies and the foreign reinsurers, or alien reinsurers, in particular the Lloyd's of London market, argue that they were more severely hit in terms of declining profitability in 1984 and 1985, than the primary insurers. The major reason

> given by these reinsurance groups for their declining profitability, is the so-called explosion in tort litigation.[24]

Yet when a U.S. Senator sought statistics on Lloyd's payouts on U.S. claims, Lloyd's would not supply this information.[25]

Despite its threats, Lloyd's never pulled out of the United States. And, within two years, desperately in need of U.S. business, Lloyd's representatives began attempting to smooth over any evidence of withdrawal and minimize their earlier intimidation of U.S. companies and public officials.[26]

Medical Malpractice – Then and Now

Medical malpractice is one line of insurance that reinsurers historically have targeted for rate hikes. According to Director of Insurance for the Consumer Federation of America J. Robert Hunter, when he was Federal Insurance Administrator in the 1970s, a group of insurance companies in the medical malpractice line told him that Lloyd's had just doubled its reinsurance rates while supplying no data to justify this increase.[27]

The influence of reinsurers over rates has been particularly effective even over doctor-owned mutual insurance companies, which account for more than half the medical liability insurance in this country and should be independent of the profit considerations that motivate pricing decisions by the rest of the industry.

For example, in 1985 testimony before the Maryland Governor's Task Force on Maryland Mutual Society's request for a 70 percent rate increase for OB/GYNs (when a 10 percent reduction was justified), the company's president stated, "In order to keep [reinsurers'] participation on cover we had to accede to some strong suggestions from the reinsurers to beef up the rate charged to the OB's and it might be relevant to point out Med Mutual is...the only company in the state writing OB's."[28]

In 1987, after heavy lobbying by the Medical Mutual Society, Maryland's legislature passed a bill to limit collateral source payments in medical malpractice cases. According to Maryland Delegate Lawrence Wiser, in early August 1987, John Spinella, then of Medical Mutual, was asked why there was little rate reduction as a result of the new collateral source law. Spinella replied that there would not be much rate impact because Medical Mutual still had to pay the same premiums to their London reinsurers.[29]

In Arizona in April 1987, the Mutual Insurance Company of Arizona (MICA) announced medical malpractice rate increases averaging 36 percent across the board, with some as high as 50 percent, despite a whopping $38 million surplus, up 23 percent from 1985. MICA said the surplus was needed to maintain a 1:1 premium/surplus ratio, which it claimed was required by the Arizona Department of Insurance (DOI). DOI director Dave Childers, however, denied that his department had ever required such a premium/surplus ratio.[30]

Six months later, during a subcommittee hearing of the Governor's Committee in Medical Malpractice Insurance in Arizona, Woody Beckman, MICA's actuary, implicated the reinsurance industry as responsible for both the high surplus and the premium increases. According to task

force member Jim Roush, staff director of Fairness and Accountability in Insurance Reform, "There were...several legislators in attendance who remember, as I do, that it was a whole new defense of the surplus and certainly the first time any of us had heard of any linkage to the reinsurance market…."[31]

New Threats, New Fears

A few years after the mid-1980s insurance crisis, the insurance cycle flattened out, rates stabilized and availability improved everywhere. This had nothing to do with tort law restrictions enacted in particular states, but rather with modulations in the insurance cycle everywhere. However, now that the market has again turned "hard," particularly as medical malpractice insurers are once again sharply increasing medical malpractice premiums around the country, there are renewed calls for "tort reform" reflecting an intensity not seen since the mid-1980s. Legislative hearings are urgently needed to determine the reinsurers' role in manufacturing this new "crisis."

The strategy is evidently to make rates so high or coverage so unavailable that doctors threaten to leave the state or give up medicine entirely, jeopardizing the health care of citizens. Trade and business associations are conveying this message to lawmakers and the public everywhere. For example:

- The American Medical Association (AMA) announced in March 2002 that it planned to lobby lawmakers and courts in at least 25 states and mount an ad campaign that raised public support for "tort reform." In explaining the AMA's position, President Richard Corlin claimed that limits on injured patients' rights to sue were needed because "[m]any practitioners, both generalists and specialists, just can't afford the liability premiums, forcing them to retire early, limit their practice or relocate."[32]

- In January 2002, the American Association of Health Plans (AAHP) and the Physician Insurers Association of America (PIAA) announced that as co-chairs of the American Tort Reform Association's (ATRA) Medical Liability Committee they would "work at the state and federal level to educate opinion leaders on the consequences of frivolous lawsuits on health care access and quality."[33]

- ATRA announced in December 2001 that "[s]ome physicians in parts of eastern Pennsylvania have already abandoned their practices because of skyrocketing insurance premiums, opting to retire early or move to states where premiums cost much less. Pennsylvania, like other states where malpractice insurance rates have soared in the absence of meaningful civil justice reforms, is facing a physician shortage crisis. Legislators in Pennsylvania's General Assembly have promised to address liability reform in January to help keep their doctors from leaving the state."[34]

- Dave Golden, director of commercial lines at the National Association of Independent Insurers, argued: "If insurance companies can spend less defending themselves and the doctors they insure in court, the cost of doing business and practicing medicine in West Virginia can return to normal levels. Otherwise, doctors will continue to flee and turn to states where the litigation climate and insurance rates are more palatable."[35]

But are these threats real, or are they once again industry tactics meant to terrorize lawmakers into delivering whatever the insurers want? In their landmark series, "The Price of Practice," *Charleston Gazette* reporters Lawrence Messina and Martha Leonard found that despite claims from the West Virginia Medical Association that the lack of "tort reform" had caused a mass exodus of doctors from the state, the number of doctors in West Virginia had increased yearly, with the state seeing a 14.3 percent increase in its number of doctors between 1990 and 2000. This increase is at a rate about 20 times greater than the population.[36] The paper said in a March 1, 2001 editorial:

> The Medical Association has made much of the fact that Wheeling has lost all three of its neurosurgeons in the past year. But two of those neurosurgeons are near the top of the list for the number of malpractice suits brought against them. In all but one of the 19 lawsuits brought against those two doctors, the insurance company representing them settled out of court, apparently paying damages. The third neurosurgeon left town shortly after being sued for malpractice. That neurosurgeon admitted drilling into the wrong side of his patient's head during an operation, possibly leaving her permanently scarred. The same neurosurgeon lost a jury trial for $1.8 million for botching a surgery that caused multiple cerebral aneurysms and cardiac arrest. Is Wheeling really worse off for losing these doctors?[37]

Similar findings have recently been made of Pennsylvania doctors. According to a recent census conducted by the Pennsylvania Medical Professional Liability Catastrophe Loss Fund (CAT fund), the state agency that provides backup malpractice coverage for doctors and hospitals, the number of Pennsylvania doctors increased by 13.5 percent between 1990 and 2000, a period the population grew just 3.4 percent.[38] The head of the CAT fund, John H. Reed, reported not only that there was no evidence of "any major departure of physicians from the state" but also that Pennsylvania had "more doctors [in 2001] than we did five years ago or ten years ago."[39] Moreover, *Morning Call* reporter Ann Wlazelek found in her investigational series, "Examining Medical Malpractice," that in the year 2000 "Pennsylvania ranked ninth-highest nationally for physician concentration, a top-10 position it has held since 1992. There were 318 doctors for every 100,000 residents in 2000, according to the American Medical Association."[40]

Other analyses have come to similar conclusions. One recent study found that, "despite anecdotal reports that favorable state tort environments with strict…tort and insurance reforms attract and retain physicians, no evidence suggests that states with strong…reforms have done so."[41] A 1995 study of the impact of Indiana's medical malpractice "tort reforms," which were enacted with the promise that the number of physicians would increase, found that "data indicate that Indiana's population continues to have considerably lower per capita access to physicians than the national average."[42]

In sum, the insurance industry is once again using its economic power to dictate rates of commercial insurance policies, driving a nationwide campaign to change U.S. civil liability laws. They and their trade association allies mislead U.S. lawmakers and regulators about their commitment to policyholders, their financial conditions and the reasons for raising rates, creating a "crisis" atmosphere meant to intimidate lawmakers into adopting their legislative programs. And they do so with virtually no effective regulatory oversight or scrutiny.

EXPLOITING SEPTEMBER 11

"The Sky Is Falling"

After September 11, the scenario was clear – reinsurance companies planned to stop covering losses from future terrorism risks after December 31, 2001, when about 70 percent of reinsurance contracts were set to expire. Primary insurers could no longer offer to cover losses due to terrorism, banks would stop lending money, construction would stop, businesses would collapse and the economy would fall apart. Once again, the insurance industry had lawmakers up against a wall. A major economic crisis was on the horizon, they said, and the federal government had better respond exactly as instructed. Insurers wanted a severe liability cap and government guarantees to replace lost reinsurance coverage, a plan that would place the burden of terrorist-related losses directly on taxpayers. They made this clear in no uncertain terms:

- American Insurance Association President Robert E. Vagley warned in a November 2001 press release that the "lack of adequate coverage is already negatively impacting whole segments of the U.S. economy. Without adequate insurance, financiers cannot make loans; real estate cannot be bought or sold; new construction will cease...our customers are being faced with very difficult decisions about how – and indeed whether – they can continue doing business as usual."[43]

- In a letter to Senate Majority Leader Tom Daschle, the Independent Agents of America said: "It is clear that independent insurance agents and brokers and our national economy are facing a serious problem if coverage for acts of terrorism is not available after January 1…. In the aftermath of the Sept. 11th terrorist attacks, virtually all reinsurers have stated that they will no longer be able to provide insurance companies with terrorism insurance. This will create a chain reaction that will affect not just the insurance industry, but our entire economy."[44]

- The National Association of Professional Insurance Agents claimed in a press release that the "situation is urgent because a significant proportion of commercial insurance policies are scheduled for renewal before the end of the year. Since Congress has not passed a federal insurance backstop, carriers have been forced to proceed now to effect their January 2002 business decisions. Continued uncertainty caused in part by Congressional inaction/indecision fuels greater instability in the insurance markets, which will further weaken the broader economy if businesses cannot secure insurance after January 1, 2002."[45]

Other industries and business trade associations were brought in to help. For example,

- A coalition of real estate and banking trade associations ran a print ad in the Capitol newspaper *Roll Call* entitled, "Insurance – The Lubricant That Keeps America's Economic Engine Running Smoothly." The ad warned that without federal action, the "nation's economy will likely face severe disruptions because of the disappearance of

affordable, comprehensive terrorism insurance for businesses and commercial and residential properties."[46]

- Tom Donohue, President and Chief Executive Officer of the United States Chamber of Commerce, testified before the Senate Committee on Banking, Housing and Urban Affairs that "[w]ithout some sort of appropriate partnership between the insurance industry and the federal government, the looming constriction in the insurance and reinsurance market threatens to inflict serious injury to the U.S. economy. It is critical that the business community, the Administration and Congress come together before the end of this year's Congressional session to develop and implement an appropriate federal financial backstop for terrorism exposure. If such a backstop is not created, our nation's economic recovery will be seriously jeopardized."[47]

- An alliance of 60 trade associations sent a letter to President Bush urging "immediate enactment of legislation to stabilize the insurance market" that would "keep the wheels of American commerce turning without interruption."[48] The associations warned that the "terrorists who attacked America on September 11 cannot be allowed to hobble the U.S. economy." Weeks earlier, a coalition of nine major real estate groups had also warned President Bush by letter that, without federal action, "the ability to finance, buy or sell properties across the nation may be at risk."[49]

Within weeks of September 11, the White House and both houses of Congress offered proposals for a federal terrorism insurance "backstop" that would shield the industry from paying billions of dollars in another attack. Under the White House plan, the insurance industry's liability would be capped at $12 billion in 2002, $23 billion in 2003 and $36 billion in 2004.[50]

On November 29, 2001, the U.S. House Republicans enacted the "Terrorism Risk Protection Act" (H.R. 3210), which would require the federal government to temporarily pick up 90 percent of the costs of future terrorist incidents for claims above the $1 billion cap. Though the measure enjoyed bipartisan support, consensus disappeared after House Republicans, typically overreaching, inserted last-minute "tort reforms" that severely limited the ability of future terrorism victims to seek damages from insurers and other businesses in court. Insisted upon by insurers and the White House,[51] the so-called "Litigation Management" provisions eliminated punitive damages, forced all terrorism-related lawsuits into federal court, abolished joint and several liability for non-economic damages, reduced all damages awards by payments from collateral sources and capped attorneys' fees at 20 percent of any award.
The House bill passed largely along party lines. However, it immediately stalled in the Senate primarily because the House chose to pack it with tort restrictions, cruelly taking away the rights of U.S. victims of terrorism. As one Senate source put it, "[Senate Majority Leader] Daschle is open to negotiation, but said he would not allow the bill to become a vehicle for sweeping legal reforms limiting a citizen's right to sue."[52]

However, another problem has become apparent over time. Despite dire predictions and threats from insurers, the economic crisis that was promised due to the lack of a federal terrorism insurance backup has simply not materialized. As J. Robert Hunter, Director of Insurance for the Consumer Federation of America, explained recently to the *National Journal's Congress Daily*, "Proponents' inability thus far to muster concrete examples of economic damage is one reason

why the Senate is totally disinterested…. What we're not going to see is a general sweeping bill that has taxpayers on the hook for anything that may happen."[53]

"The Sky Isn't Falling"

To date, Congress has not enacted a terrorism insurance backup measure and the insurance industry is in better financial shape than it was before September 1, 2001, a fact that insurance companies have yet to publicly acknowledge. The industry continues to caution that economic disaster lies ahead. Yet the fact remains that there is no evidence that the insurance industry, much less the economy, is on the brink of collapse.

A newly-released study from the Consumer Federation of America (CFA) finds that:

> The failure of Congress to enact terrorism insurance back up has caused far fewer problems than anticipated…. [There are] several key factors for this conclusion, including lower World Trade Center losses than predicted, a new surge of capital into the industry, continued lending to businesses that have no terror coverage and insurance consumers who are adapting to changing market conditions….
>
> The real insurance costs of the attacks to most businesses should be quite low. Unfortunately, some insurers have taken advantage of the situation to extract a pound of flesh from their customers.[54]

Indeed, the insurance industry is taking advantage of September 11 in a shamefully unpatriotic way to bilk its customers.

The same turn in the industry's economic cycle, which is causing astronomic rate increases for doctors, had also led to huge rate jumps for large and mid-sized firms after September 11. These rate hikes were sped up by the terrorist attacks, collapsing two years of anticipated increases into a few months. But they were but not caused by it.[55] As CFA explains, the bulk of the increases are related to the classic economic cycle (as explained earlier in "History of Threats and Intimidation").[56]

Anecdotal evidence also shows that insurers have seized upon September 11 as an opportunity to price-gouge customers and boost profits. As one insurance brokerage executive put it, "A simple was of saying it is that adversity breeds opportunity. That's probably a little too crass. But that's the way capital looks at it."[57] For example,

- Within days of the attacks on the World Trade Center, Marsh & McLennan Cos., the world's largest insurance broker, "began planning to form a subsidiary to sell insurance to corporate customers at sharply higher rates than were common before Sept. 11. Marsh also accelerated plans to launch a new consulting unit to capitalize on heightened fears of terrorism."[58]

- Lloyd's of London told its members in a newsletter that the September 11th terrorist attacks were a "historic opportunity" to make money, adding that premiums "had shot up to a level where very large profits are possible."[59]

- Henry C.V. Keeling, the chief executive of KL Re, a Bermuda insurer, told an industry conference on that "[t]he opportunity out there is tremendous."[60]

- Commenting on predictions that premiums would probably rise over 200 percent in 2002, Chubb Corp. CEO Dean R. O'Hare said, "This business is back and is headed straight up."[61]

- Maurice R. Greenberg, chairman of American International Group, one of the world's largest insurers, "told investment analysts recently that opportunities for his 82-year-old company have never been greater."[62] This is the same Maurice R. Greenberg who descended on the White House ten days after the terrorism attacks calling for a federal bailout for the insurance industry.

- A consulting actuary with Tillinghast-Towers Perrin said, "[T]here is clearly an opportunity now for companies to price gouge – and it's happening…But I think companies are overreacting, because they see a window in which they can do it."[63]

It should be noted that specific entities like airlines, skyscrapers, malls and sports arenas, considered to be large targets and risks, are having difficulty finding terrorism insurance coverage. However, the fact that the federal government did not immediate rush to bail out the insurance industry has forced companies to adapt to the current market using, as CFA explains, a wide array of alternatives available to normal insurance. These include self-insurance, layering of coverage through the use of many insurance companies, use of captive insurance companies and risk securitization.[64] The airlines, for example, are now planning to create a company called Equitime to insure themselves against terrorism at premiums that are half of what private insurers have been charging since Sept. 11.[65] Under the proposal, there would be a much smaller, limited federal backstop. In addition, on April 4, 2002, the *Wall Street Journal* reported that six insurance companies were together forming a new company to provide terrorism coverage to "help address the shortage of terrorism-insurance capacity available in the commercial market."[66]

Additional solutions to this problem are discussed in the next section.

HOW TO FIX THE SYSTEM

For the property/casualty insurance industry, high-pressure tactics have paid off and will pay off again unless lawmakers take responsible, remedial steps to reign in the power and control the abuses of insurance companies. Otherwise, the United States will never be able to deal systematically with the tactics of this industry, which consistently looks for scapegoats to cover up its own instability and mismanagement.

1. Hearings, Investigation and Disclosure. Before Congress or state legislatures try to deal with any insurance "crises" created by the insurance industry, whether it is the lack of terrorism coverage or skyrocketing insurance rates for doctors, the solutions must be premised on data. It must not be based on alarmist, prejudicial and sometimes unsubstantiated information presented by the insurance industry or its trade association allies.

- **Terrorism Coverage.** Before Congress proceeds with any form of bailout, there should be full hearings to examine market conditions and to explore private alternatives to a federal backup.

- **The Medical Malpractice and Other Insurance Crises.** With rare exceptions, federal and state laws today do not force even licensed property/casualty insurance companies to disclose meaningful information to U.S. authorities that could substantiate or refute their allegations about the financial health of the industry or the impact of the U.S. judicial system. Nor do we understand today the covert influence that the reinsurance industry may be having on the current medical malpractice insurance "crisis," with doctors being price-gouged around the country.

  At the federal level, officials currently have no legal authority to collect data from insurance companies or even to question an insurer effectively when it shuts off the flow of insurance/reinsurance to a specific line of insurance or threatens a specific state.

  Moreover, state reporting laws typically allow insurance companies to conceal such figures as:

  - Premium income and payouts for specific sublines of insurance;
  - Reserves and the amount of losses "incurred but not reported" (IBNR) – the insurer's guess at the amount for claims that have occurred prior to the end of an accounting period but are not reported until after the end of the reporting period – for each line of insurance;
  - How much insurers pay out for different types of damages, *i.e.*, economic damages, non-economic damages and punitive damages;
  - How victims actually fare – in other words, how much insurers actually pay in settlements or verdicts that are reduced post-trial compared to victims' injuries and losses; and
  - How much insurers pay in cases involving multiple defendants (where joint and several liability may be an issue).

  In short, neither federal nor state authorities have figures to justify the property/casualty industry's huge premium increases, policy restrictions or refusals to cover.

  States need to enact laws and regulations so that public officials making policy decisions and legislative choices have information on payouts, losses, income and reserves to determine the true condition of the insurance industry and how victims are faring under the present system. Congress should set minimum disclosure standards for surplus lines and reinsurers operating in the United States and encourage states to set state-specific or stricter disclosure standards if they so choose.

2. Federal and State Action to Ensure Terrorism Coverage. To deal with the immediate problem of terrorism coverage, the Consumer Federation of America lists a number of important reforms that could immediately help businesses, including the following[67]:

- **Congress should:**

- **Create Incentives for the Development of Private Sector Alternatives.** Congress should provide incentives to encourage the fast-developing private alternatives to the overpriced insurance market. Such incentives could include: expanding the Liability Risk Retention Act (allowing small and mid-sized firms to pool their risk) to cover property insurance; determining if there are any tax disincentives for the development of captive insurance or self-insurance mechanisms, and developing proposals to encourage the securitization of risk.
- **Stop Rate Gouging in Any Bill that Passes.** Rates should be rolled back to reflect the reduced level of insurer risk that would occur if federal back-up is provided.

- **States should:**

  - **Reject Terror Exclusions for Personal Lines of Coverage.** Personal lines of coverage, such as homeowner and automobile insurance, are not at risk of major terrorism losses. Moreover, insurers never seriously attempted to get Congress to back-up personal policies in terror insurance legislation.
  - **Reject Exclusions for Commercial Lines for Small and Mid-Sized Companies.** States should not approve exclusions for smaller businesses that are not at risk of high terrorism losses. The approximately 41 states that have granted these exclusions should reconsider. New York and California should be commended for refusing to grant these broad exclusions.
  - **Require the Cost of Terror Insurance Coverage as the Line Item on the Bill.** This allows the insured to see price differences for terrorism and other coverage and would discourage insurers from jacking up costs for coverage unrelated to terrorism.
  - **Review Pricing in the Marketplace, to Prevent Price Gouging.** States should step into the current non-competitive market and assure the business insurance consumers of their states that the rates meet the "not excessive" requirements of most state statutes.

3. States Should Repeal Anti-Competitive Laws and Enact Stronger Regulation and Oversight; Commercial Lines Deregulation Should be Rejected at the State and Federal Level. With the sort of gouging and abuses that are occurring in the insurance market, now is not the time to be deregulating commercial insurance regulation.

- **Increased State Authority Over Rates.** In 1998, a New York State legislative task force concluded, "The state insurance department has failed in its job of protecting ratepayers from rate gouging [by] sitting on the sidelines while insurers pushed up rates and were realizing record profits."[68] A 1986 study by the U.S. General Accounting Office found that insurance rates were higher in the majority of states that did not require regulatory "prior approval" of insurance rates.[69]

  State insurance departments must take a far more active role in controlling insurance rates. At a minimum, departments should be given more authority to approve or reject rate requests, or to advocate the rollback of insurance rates. For example, in 1988 California voters mandated a 20% rate rollback in insurance premiums, saving consumers billions of dollars. In addition, underfunded and understaffed insurance departments must receive

increased funding for investigators, auditors, actuaries and other professionals to recommend appropriate insurance rates.

- **Repeal Anti-Rebate and Anti-Group Laws.** Many states have anti-rebate laws that prohibit insurance agents from offering discounts to policyholders. As a result, the most efficient agent cannot compete for market share by offering a discount. One federal study estimates that consumers would save 6% to 7% annually merely by eliminating "anti-rebate" laws.[70] Many state laws also prohibit group auto and homeowner insurance sales that could increase their bargaining power. These laws should be repealed.

- **Establish a State Consumer Advocate.** The few states that have a consumer advocate in the Insurance Commissioner's office to monitor insurance industry waste, inefficiencies and price-gouging have much lower premiums. According to National Association of Insurance Commissioner's data, in 1995 drivers in states without a consumer advocate paid almost 20% more in auto insurance premiums than drivers in states that had a consumer advocate.[71] In 1991, Texas established an Office of Public Insurance Counsel (OPIC), which intervenes on behalf of consumers in rate hearings and rules decisions. In 1996, OPIC reportedly saved consumers $602 million in auto insurance premiums. In 1995, it saved consumers $778 million.[72]

4. Congress Should Create Alternative Reinsurance Programs.

During cycle bottoms, reinsurance is often more difficult to find than primary insurance, particularly when reinsurers refuse to cover certain risks. And sharp rate increases by reinsurers may force insurers to drop additional risks to satisfy state premium/surplus ratios. When reinsurers hiked premium rates and reduced coverage in the mid-1980s, U.S. insurers had no effective recourse. Small businesses and other entities that may have wanted to self-insure were unable to find reinsurance.

A federal reinsurance program would ensure that primary companies and entities that self-insure can purchase reinsurance even during cycle bottoms or when other reinsurers abandon certain markets. When rates skyrocket or coverage decreases, a government reinsurance program would exert downward pressure on reinsurance rates. This in turn would enable insurers to maintain reasonable rates.

To supplement a federal reinsurance program, states could establish an interstate compact to create joint reinsurance programs. For example, as a condition of doing business in any member state, the compact could require an insurance company to contribute a small percentage of its premiums to fund a self-sustaining joint program that would write reinsurance in all member states for businesses and others that self-insure in accordance with jointly-established underwriting standards.

If efficiently run, a government reinsurance program can and should make money. Congress established a similar program to reinsure insurers against riot-caused damages when private insurers pulled out of inner-city markets in 1968. The program made a profit of $125 million while keeping insurance available in the inner cities.

5. Congress Should Repeal the Federal Anti-Trust Exemption.

Since 1944, the McCarran-Ferguson Act has allowed insurance companies to fix prices. A law repealing the federal anti-trust exemption would ensure that all domestic and foreign insurers and reinsurers that do business in the United States are subject to federal anti-trust prohibitions applicable to other industries. Such legislation would prohibit the insurance industry from acting in concert to raise prices and would prohibit tying arrangements, market allocation among competitors and monopolization. Increased competition would bring lower prices and would increase the availability of insurance for consumers.

If the McCarran-Ferguson Act were repealed, the industry-owned and controlled, for-profit Insurance Services Office, Inc (ISO) and other rating bureaus could still jointly collect, compile and disseminate past data relating to premiums and claims. However, price-fixing agreements would be illegal. Moreover, ISO would be forced to disclose to insurance buyers the documents it prepares for insurance sellers, listing both current prices major insurers charge for auto and homeowner insurance and the ISO advisory rates.

CONCLUSION

If the American people understood that a major sector of the U.S. economy, the property/ casualty insurance industry, was accountable to no federal agency, subject to virtually no U.S. regulatory laws and only limited state authority, they would have good reason to be concerned. This industry exerts significant economic power in the United States. It misleads lawmakers and regulators about its financial condition, its commitment to the U.S. market and the reasons behind the volcanic eruptions of insurance premiums and reduced coverage that lead to insurance "crises" for policyholders. Only effective insurance reforms will end these practices and stop the industry from abusing its enormous economic influence, which it uses to promote a legislative agenda that bilks the taxpayer and severely hurts the American public.

NOTES

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[6] *Ibid.*

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