
Carol Majors

*Introducing Insurance*

# . . . Considering the Alternative . . .

by William K. Hale

To many people, paying insurance premiums is about as much fun as paying income taxes. We are required by the state to carry liability insurance in order to register and drive our cars. When we finance our cars, we must agree to carry physical damage insurance on the cars in order to secure our loans. When we buy our houses, mortgage lenders require us to carry homeowners insurance. In many cases when we borrow money, the lender will require credit life or credit health insurance to guarantee repayment of the loan if we die or become disabled.

These requirements are understandable. The state is simply trying to guarantee that people injured on the highways will be compensated by those responsible. A lender needs to protect the property financed; otherwise, there might not be any property of any value remaining if a borrower defaults on a loan.

Most people who have dependents feel compelled to purchase life insurance in the event of an untimely demise. We also feel more secure when we know that we are adequately covered by accident or health insurance. The key word here is *security*. Although we may begrudge having to pay out money for something we may never use or see—like the cheapskate who refused to pay his utility bill because he could not actually see the electricity coming into his house—the alternative, no insurance at all, is frightening.

How many of us would take our cars out on the road if we knew that we would have to pay out of our own pockets, for a long time, to com-

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# Landmark Dates in Insurance Regulation in North Carolina

by William K. Hale

*(Ed. Note: Landmark dates concerning automobile insurance are grouped separately; see page 31.)*

**1899** Legislature established the Department of Insurance and gave it responsibility to admit, license, and generally regulate insurance companies. First commissioner elected by General Assembly, then to be appointed by the governor.

**1907** Legislature made Commissioner of Insurance an elected position, for a four-year term, beginning in 1908.

**1911** Standard policy provisions for accident and health insurance put into general statutes.

**1913** Legislature prohibited unfair discrimination in rates, required the licensing of insurance agents, and required ratemaking organizations to file information and rates with the Insurance Commissioner. The commissioner may examine rates and hold hearings upon policyholder complaints.

**1915** Insurance adjusters must be licensed;
Fire insurance companies must file rates with the commissioner, who may hold a hearing if a policyholder complains about these rates;
Standard policy provisions for fire insurance put into the general statutes.

**1929** Rates for workers' compensation began to be regulated.

**1931** Compensation Rating and Inspection Bureau established to collect data and file worker's compensation insurance rates and classifications with the commissioner.

**1935** Assigned risk plan for workers' compensation insurance established.

**1939** The Automobile Rate Administrative Office established to collect data and file automobile insurance rates and classifications with the commissioner.

**1941** Nonprofit hospital and medical service corporations (Blue Cross and Blue Shield plans) began to be regulated.

**1944** Commissioner of Insurance became a constitutional office and member of the Council of State.

**1945** Federal McCarran-Ferguson Act exempted insurance ratemaking from federal antitrust laws to extent insurance is regulated by the states;
Fire Insurance Rating Bureau established to collect data and file fire insurance rates with the commissioner.

**1947** New laws govern merger, rehabilitation, and liquidation of insurance companies.

**1949** Unfair trade practices law enacted.

**1951** For-profit accident and health insurance policies and rates began to be regulated.

**1969** Coastal and urban property insurance made available through "beach" and "FAIR" plans.

**1971** Property and Casualty Insurance Guaranty Association established to cover obligations of insolvent insurance companies;
New laws govern holding company registration and disclosure.

**1974** Life and Accident and Health Insurance Guaranty Association established to cover obligations of insolvent life and accident and health companies.

**1975** Rates and other regulatory provisions for credit life and credit health insurance written into the general statutes;
Reinsurance facility for medical malpractice established.

**1976** Malpractice legislation enacted;
N.C. Supreme Court declared the malpractice reinsurance facility law unconstitutional.

**1977** "File-and-use" system of rate regulation replaced "prior approval";
Rating bureaus for automobile, fire, and workers' compensation insurance consolidated into the N.C. Rate Bureau. Commercial insurers file their rates and classifications individually;
Health Maintenance Organizations (HMOs) began to be regulated;
Six percent annual limit on rate increases put into effect for automobile, homeowners, and workers' compensation insurance.

**1979** Readable Insurance Policies Act passed for automobile, homeowners, life, accident and health, and health maintenance organization policies;
Product liability legislation enacted;
Six percent annual limit on rate increase taken off workers' compensation rates.

**1981** Insurance Information and Privacy Protection Act passed;
Medicare Supplement Insurance (Medigap) Policies Minimum Standards Act passed;
Health Insurance Continuation and Conversion Privileges Act passed;
Six percent annual limit on rate increases taken off homeowners insurance.

**1983** Rate deviations allowed in workers' compensation insurance.

**1984** Coverage for treatment of chemical dependency (alcohol and drug abuse) must be offered in group health policies and health maintenance organization plans, effective January 1, 1985.

pensate someone we injured because of one moment of inattentiveness? Many of us would have trouble borrowing money or financing a car or home if property or credit insurance was not available to us. Without life or health insurance, none of us would be able to guarantee financial security for our dependents in the event of death or serious illness. (Metaphorically speaking, I do not mind getting older, considering the alternative.)

On a less personal and larger scale, businesses could not develop or function without insurance. Business owners and operators must carry insurance to secure credit; to protect goods, buildings, and equipment; to compensate employees for job-related injuries (a state requirement); to attract employees by offering fringe benefits such as group life and health insurance, pensions, and annuities; and to compensate persons who might be injured by defective products or by the negligence of employees. By purchasing insurance, businesses can free their working capital from the possibility of paying for losses, thus allowing entrepreneurs to venture more freely and willingly.

### Insurance—A Different Kind of Product

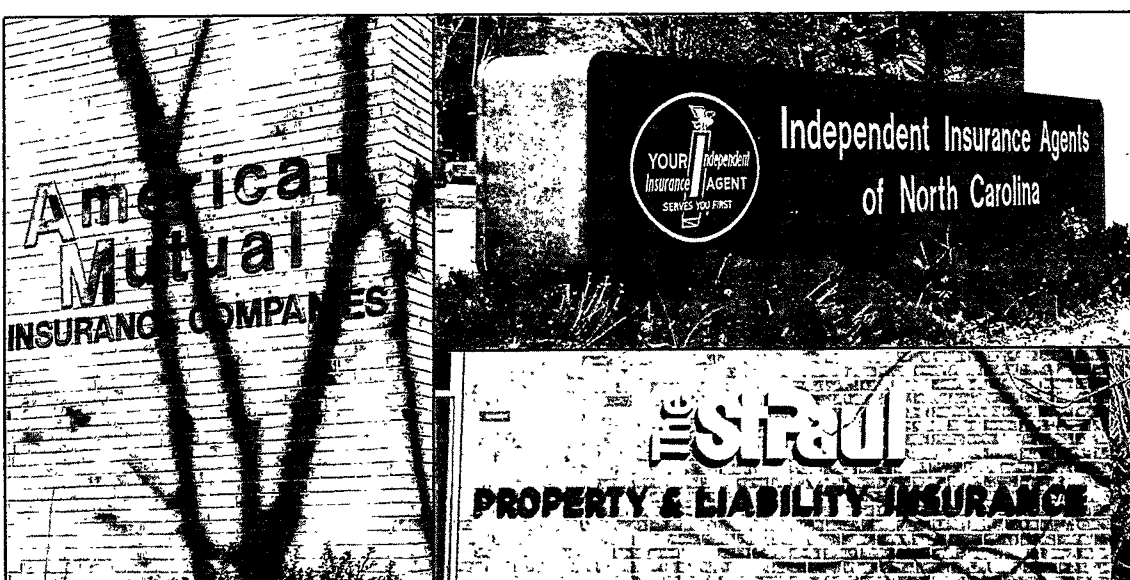
Insurance, unlike most commodities, is paid for in advance. The product or service is delivered, if at all, upon the occurrence of some unpredictable future event. Basically, insurance is: *first, the anticipation or expectation of a loss to be suffered by a portion of a group of people; and second, the redistribution of the cost of those losses to the entire group.* An insurer analyzes the loss experience for the types of risks insured, projects future losses based on this analysis, and sets the premium rates for each risk accordingly.

The concept of sharing the risk of anticipated losses is as old as commerce. The term "underwriter" originated in the most literal sense by the practices of wealthy men signing their names at the bottoms of insurance pooling agreements to cover maritime risks. The term has evolved to mean an employee or representative of an insurer who evaluates applicants for insurance and determines whether or not the insurer should provide coverage for the particular risk.

The Industrial Revolution changed the commercial world, including the natures of the risks to be insured. Developments in transportation and mass production of consumer goods meant more exposure to liability for personal injury and property damage. Over the years the concept of insurance has grown more and more complicated, leading today into such highly charged issues as the disposal of hazardous wastes and the operations of nuclear power plants. These ultrahazardous fields pervade the insurance concept and raise the big question: Who is to assume or share the risks of loss connected with these activities?

While insurance questions related to hazardous wastes still have to be answered, many insurance issues have been addressed. *People who buy this product must be assured that the insurer will be financially able to fulfill its obligations at all times.* The solvency of insurers must be carefully monitored by evaluating their assets, liabilities, investments, business structures (e.g., holding company systems), and the adequacy of their premium rates.

On the other hand, *the people who buy insurance must be protected from premium rates that are excessive* in relation to the value of the coverage, *from rates that are unfairly discrimi-*



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*natory* in that they treat similar policyholders or risks differently, and *from unethical or unfair business practices,* either in underwriting or claims processing.

Because the general public does not know or understand actuarial principles, insurance concepts, and the technical language of this business, the public has vested in its state governments the power to regulate insurance. State regulation began with requiring insurance companies only to issue periodic reports on their finances to the public. In the middle of the 19th century, states began to establish regulatory agencies and vested them with the power to enforce insurance legislation.

In 1868, state regulation was challenged in *Paul v. Virginia*, but the U.S. Supreme Court reaffirmed state jurisdiction over insurance.[1] The Court held that insurance contracts were not interstate transactions (even though the insurer and insured might be domiciled in different states) and therefore were not subject to federal law under the Commerce Clause of the United States Constitution.[2]

In 1944, this doctrine was abandoned by the U.S. Supreme Court in *United States v. South-Eastern Underwriters Association:* "No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance."[3]

Congress responded to this decision by passing the McCarran-Ferguson Act in 1945.[4] In this act, Congress, exercising its constitutional legislative power, redefined state regulatory authority. To the extent insurance is regulated by states, said McCarran-Ferguson, insurance was exempted from the federal antitrust laws (Sherman Act, Clayton Act, and Federal Trade Commission Act). Congress retained some jurisdiction over insurance, however, by providing that the intimidation, boycott, and coercion provisions of the Sherman Act still applied to insurance.

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The McCarran-Ferguson Act meant, in effect, that if a state enacted some form of insurance rate regulation, it would have jurisdiction over most insurance issues. Within a few years of the passage of McCarran-Ferguson, most states did exactly that, following in many cases a model state act prepared by the National Association of Insurance Commissioners.

Taking on the regulation of insurance was no simple matter for the states. Insurance can be purchased by several different methods and comes in different forms, as do the insurance companies themselves. A consumer can purchase insurance: 1) directly from the employees of the insurer (direct writers); 2) from persons who act as representatives of one or more insurers (agents); or 3) from persons who act as representatives of the buyer and who procure the coverage for that buyer (brokers).

Insurance companies come in three basic forms as well: stock companies, mutual companies, and nonprofit cooperatives. *Stock insurance companies* obtain operating capital by selling shares of stock. These companies declare and distribute dividends to their shareholders whenever they make a reasonable profit. *Mutual companies* result when persons participate in the insurance company by purchasing insurance policies; there is no stock per se. Mutuals declare dividends to their policyholders whenever they make a reasonable profit. A third form of insurer is the *nonprofit cooperative*, including Blue Cross and Blue Shield of N.C. and other similar medical or dental insurance plans.

The product of insurance has many forms. As regulation of the insurance industry evolved, the states generally grouped the different coverages into two broad types—*property and casualty coverage* and *life, accident, and health coverage.* This separation began with the New York General Insurance Act of 1849. Other states followed the lead of New York, apparently because of its status as a paragon of commerce and industry. Otherwise, there does not seem to be any compelling reason for segregating insurance coverages into these two categories. But such a division became a major factor in insurance regulation, affecting everything from who could write what type of coverage to the varying systems of rate regulations.

**Property and Casualty Coverage.** Property insurance is simply that—insurance on property. It can insure losses from physical damage to the property or loss of income and other expenses incurred because of damage to the property. Casualty insurance is a confusing term. If it really means any coverage for loss, due to any accident, it could describe virtually every insurance coverage in existence. By a process of

## Table 1. N.C. State Government Departments with Insurance Responsibilities

| Department/Division | Program/Responsibility |
| --- | --- |
| I. INSURANCE REGULATION | |
| *Department of Insurance* | |
| Consumer Information | Provides information on rates, policy language, etc. |
| Examination & Admissions | Inspects insurance companies' operations and licenses them to do business |
| Financial Analysis | Monitors companies for solvency and unfair trade practices. Assists other divisions with financial matters |
| Fire and Casualty | Analyzes rate filings |
| Licensing | Administers exams and regulates license renewals for agents, brokers, and adjusters |
| Life , Accident, and Health | Analyzes rate filings |
| *Department of Justice* | |
| Attorney General | Represents Dept. of Insurance in litigation |
| II. INSURANCE DELIVERY | |
| A. To the General Public | |
| *Department of Commerce* | |
| Employment Security Commission | Administers insurance and benefits system |
| Industrial Commission | Determines eligibility under Workers' Compensation Act and serves a quasi-judicial function in contested cases |
| *Department of Human Resources* | |
| Social Services | Determines eligibility for federal Social Security Disability |
| B. To State Employees | |
| *Multiple Departments*[1] | |
| Auto, liability, etc. | General coverage comparable to private sector coverage |

FOOTNOTES

[1] All state-owned motor vehicles have liability insurance protection under a master policy. The state is a self-insurer for general workers' compensation. Specialized insurance varies. The Department of Human Resources, for example, carries malpractice insurance for eight physicians who perform electro-shock treatment.

*Chart compiled by Jody George.*

elimination of other definitions, however, casualty insurance could be said to comprise automobile, burglary and theft, credit, workers' compensation, and liability (products liability, malpractice, etc.). Even accident and health could be considered a form of casualty coverage, but it usually is grouped with life insurance instead.

**Life, Accident, and Health.** Accident and health insurance is simply that—coverage of costs for personal accidents or health problems. Unlike accident and health, life insurance and annuities could rationally be singled out and separated from the other types of insurance. *Annuities,* in effect, are life insurance without the uncertainty of when the payment is made. The insured (annuitant) makes one or more payments (over a brief period) to the insurer; the amount paid in accumulates interest; and at a specified later date (usually at retirement age) the insurer makes periodic payments to the annuitant.

**Other Types.** A few types of insurance are not usually put in either category. *Marine insurance*, for example, provides coverage for goods while they are in transit, either on land (inland marine) or at sea (ocean marine). *Surety bonds* guarantee the performances of the obligations of contractors, employees, executors, public officials, and others; these bonds cover everything from negligence to outright dishonesty.

And all of this is regulated by the state, you ask? Yes, it is supposed to be. The state monitors the various forms of insurance and insurance companies, and the different ways of selling insurance. Primarily through the legislature and the Department of Insurance, the state:

- oversees the formation and operation of insurers;
- prescribes minimum financial standards for licensing and continued operations of insurers;
- regulates the premium rates insurers charge, the language in their insurance policies, and their risk classification systems;
- requires periodic financial disclosure by insurers;
- provides for audits of insurers at least every three years to monitor solvency;
- licenses and regulates agents, brokers, and claims adjusters;
- prescribes and defines what kinds of insurance may be written in the state;
- provides information to insurance consumers about their rights and responsibilities under their policies; and
- prohibits unfair and deceptive trade practices among or by insurers.

## The Issues Ahead

For the past six months, two non-partisan efforts have been underway in North Carolina to identify the most pressing insurance issues ahead for the 1985 General Assembly and the new Commissioner of Insurance: the legislature's Insurance Study Committee and this issue of

### Table 2. N.C. State Boards and Commissions with Insurance Responsibilities

| Board, Commission or Council | Established by | Purpose | Membership Appointed by |
|---|---|---|---|
| *A. Under Department of Insurance* | | | |
| 1. N.C. Health Insurance Advisory Board | NCGS 58-262.1 | To review complaints about the health insurance industry, evaluate health insurance companies, and suspend licenses of companies not operating in the public interest. | 9 - Governor[1]<br>1 - Ex-Officio Member (Commissioner of Insurance) |
| 2. Insurance Advisory Board | NCGS 58-27.1 | To set regulations for the holding of public hearings before the Insurance Commissioner on proposals to revise insurance rating schedules. | 6 - Governor<br>1 - Ex-Officio Member (Commissioner of Insurance) |
| 3. N.C. Manufactured Housing Board | NCGS 143-143.8 | To provide a framework for regulations on licensing and bonding of the mobile home industry. | 2 - Governor[2]<br>2 - Commissioner of Insurance[2]<br>4 - General Assembly [2,3]<br>1 - Ex-Officio Member (Commissioner of Insurance) |
| 4. Building Code Council | NCGS 143-136 | To adopt, amend, and interpret North Carolina State Building Code for all buildings in North Carolina. | 12 - Governor[4] |
| 5. N.C. Code Officials Qualifications Board | NCGS 143-151.9 | To establish minimum standards for officials who enforce building, plumbing, mechanical, and electrical codes on behalf of cities, counties, and the state. | 7 - Governor<br>4 - Lt. Governor<br>4 - House Speaker<br>1 - Commissioner of Insurance<br>4 - Others Making Appointments[5] |

FOOTNOTES

[1]Five members from public-at-large and 4 members from insurance industry recommended by Commissioner of Insurance.
[2]No appointees may be legislators.
[3]Upon recommendation of President Pro Tempore of the Senate and Speaker of the House of Representatives.

*North Carolina Insight.* Both studies had to consider many aspects of state regulation of insurance and ultimately had to make choices of areas of concentration.

The Insurance Study Committee decided to focus on the issue of solvency of insurance companies. Many purchasers of insurance are aware that the Commissioner of Insurance regulates premium rates and policy provisions, and licenses insurance companies and agents. The commissioner also must evaluate, regulate, and monitor the financial conditions of insurance companies—those that apply to do business here and those already operating in North Carolina. The Insurance Department must assure that those companies can fulfill their promises to pay or indemnify their policyholders—a responsibility that often goes unnoticed.

New specters loom on the horizon that affect this monitoring of insurance company solvency. Policymakers must face the challenge of protecting the public from conditions gone awry. For example, the financial services industry—banking, securities, and insurance—are becoming more integrated. This blurring of functions affects the solvency of insurers. Changes in computer science, in the federal regulation of banks, thrift institutions, and securities, and in the nature of financial services could well make the task of monitoring insurance company solvency much more difficult for the state in future years.[5]

While the Insurance Study Committee was examining issues of solvency, the N.C. Center for Public Policy Research was working to produce this primer on insurance regulation in the state. What state agencies and what boards and commissions have insurance-related responsibilities?

| Board, Commission or Council | Established by | Purpose | Membership Appointed by |
|---|---|---|---|
| ***B. Under Department of Administration*** | | | |
| 6. Public Officers and Employees Liability Insurance Commission | NCGS 143B-422 | To negotiate and acquire professional liability insurance for law enforcement officers, public officers and employees of any municipality. To act as a liaison between the company and public employees. | 6 - Governor[2,6]<br>2 - General Assembly [2,7]<br>3 - Ex-Officio Members (Commissioner of Insurance, Attorney General, and Secretary of Crime Control and Public Safety) |
| 7. Board of Trustees of the N.C. Public Employees Deferred Compensation Plan | NCGS 143B-426.24 | To establish and maintain the Deferred Compensation Plan for state employees. | 3 - Governor [2,8]<br>2 - General Assembly [2,7]<br>2 - Ex-Officio Members (Secretary of Administration, State Treasurer) |
| 8. Board of Trustees of the Teachers' and State Employees' Comprehensive Major Medical Plan | NCGS 135-39 | To supervise and monitor the company that administers the plan and modify benefit levels when appropriate. | 6 - General Assembly [2,7]<br>3 - Governor [2] |

FOOTNOTES, *continued*

[4]Members are to be registered architects, licensing contractors, registered engineers, building inspectors, public-at-large, and fire safety experts.

[5]One appointment each by: Dean, NCSU School of Engineering; Dean, NCA&T School of Engineering; Director, Institute of Government; State President of Community Colleges.

[6]Governor appoints members nominated by Independent Insurance Agents of N.C., Carolinas Association of Professional Insurance Agents, N.C. Police Chiefs Assn., N.C. Police Executives Assn., N.C. Sheriffs' Assn., N.C. League of Municipalities, and N.C. Assn. of County Commissioners.

[7]Upon recommendation by Lieutenant Governor and Speaker of the House of Representatives.

[8]Members are to have experience in taxation, finance, and investments, and one is to be a state employee.

*Chart compiled by Jim Bryan and Jody George.*

**From left, William K. Hale, Sen. Joseph E. Johnson (D-Wake), and Rep. Foyle R. Hightower Jr. (D-Anson) confer before the November 8, 1984 meeting of the legislature's Insurance Study Committee. Johnson and Hightower co-chaired the committee; Hale was staff attorney.**

What are the landmark dates in insurance regulation? The tables accompanying this article provide policymakers, the press, and the public with a quick reference guide to answer these questions.

How does the rate regulation process work? What kinds of insurance are regulated and to what extent? The next article examines the state's overall system of rate regulation, including the role of the N.C. Rate Bureau. In simple terms, rates are now determined for the "essential" lines of insurance—homeowners, private passenger automobile, and workers' compensation—through industrywide rates (with downward deviations for individual companies), filed through the Rate Bureau. Is this better than a system of "open competition," where individual companies make separate filings? A chart comparing the systems in eight selected states provides a starting point for answering this question.

This issue of *Insight* then goes beyond the primer function.

By state constitutional law, the legislature is responsible for establishing the law and public policy for insurance regulation, the Commissioner of Insurance is responsible for administering and enforcing the insurance laws, and the courts must settle disputes over the meanings and applications of the laws. During the three terms of Commissioner John R. Ingram, the N.C. Court of Appeals and Supreme Court entertained an unprecedented number of ratemaking cases in which the orders of the Commissioner had been appealed. In all but one case, which was arguably insignificant, the courts overruled the Commissioner.

On January 5, 1985, James E. (Jim) Long became the ninth person to serve as the N.C. Commissioner of Insurance. How will he cope with the Ingram legacy? And how will he balance the legislative, administrative, and judicial roles within the insurance regulatory system? In a lengthy interview with the *Insight* editors, Long answered these questions and more.

Many innovations in insurance are taking place. There are new life insurance coverages that combine death benefits with investments, such as the universal life and variable life insurance products. New health care delivery systems, such as health maintenance organizations, preferred provider organizations, and continuing care or life care centers, pose conceptual challenges to the insurance regulator, because they have some of the characteristics of health insurance yet differ in many respects. Robert Conn, a reporter covering health-related matters for two decades, identifies seven policy questions raised by the rapid growth of health maintenance organizations in North Carolina.

Perhaps the most ambitious undertaking by this issue of *North Carolina Insight* is the section on the auto insurance regulation system, designed by the *Insight* editors and free-lance writer Steve Adams. This system has not been satisfactory to motorists or insurance companies, despite periodic attempts by the General Assembly to improve it. A re-evaluation and restructuring of the entire system, including its inner workings and mechanisms, is necessary—with a view toward recreating a system that is fair, reasonable, and consistent with a clearly stated public policy.

Commissioner Long has proposed that the 1985 General Assembly establish a study committee to overhaul the property and casualty statutes by 1987. Adams, who has reported on auto insurance issues for seven years, first explains the auto insurance regulation system and then breaks the ground for the proposed overhaul.

Buying insurance may in fact be no more fun than paying taxes. But just as we keep paying taxes, we will continue buying many forms of insurance. If you are in the business of affecting the policymaking process or reporting on this process—or if you simply want to be better informed on how the state of North Carolina regulates insurance—this issue of *North Carolina Insight* should be in your hip pocket.

After all, consider the alternative. □

FOOTNOTES

[1] 8 Wall (U.S.) 168 (1868).

[2] U.S. Constitution, Article I, Section 8(3).

[3] 322 U.S. 533 (1944).

[4] 59 Stat 34 (1945), as amended, 15 USC sections 1011-1015.

[5] See "Insurance Regulation," a Report of the Legislative Research Commission, Insurance Study Committee, to the 1985 General Assembly, December 13, 1984.