

The Three Rate Regulatory Systems

- Open Competition
- File and Use
- Prior Approval

Trend One: Prior Approval of Property Casualty Rates

California Proposition 103

- Why does it matter?
- The Consumer Federation of America calls Proposition 103's prior approval rate regulatory system the "finest in the nation at protecting insureds" and continues efforts to replicate it elsewhere.

California Proposition 103

- 20% rate reduction
- Prohibits Rates that are “excessive, inadequate or unfairly discriminatory”
- Prior approval requirement

The Prohibition on Excessive, Inadequate or Unfairly Discriminatory Rates

- Facially, the standard is identical to that used by actuaries in the development of rates, and generally requires that rates be cost based

The Prohibition on Excessive, Inadequate or Unfairly Discriminatory Rates

- In practice, regulators applied the prohibition to impose formula developed rates.
- The formula is complex, but is designed to allow premium sufficient to cover:
 - Cost of insurance subject to expense caps and restrictions
 - A "fair" rate of return subject to restrictions on the equity to which the return applies

Result: The target "fair" rate of return is never achieved

The Prior Approval Requirement

- No rate can be charged until after:
 - The rate has been filed with the Commissioner
 - The public has received notice of the rate and been provided with the opportunity to contest the rate
 - The Commissioner has approved the rate

Proposition 103 Gives Consumers the Right to Participate in the Prior Approval Process

- Right to review all rate filings and to request a hearing
- Absolute right to a hearing on any rate increase over 7% in personal lines and 10% in commercial lines
- Right to participate in discussions with the insurer at all phases of the rate application process
- Right to get paid – by the insurer - for doing this

Result: The Shadow Commissioner – Consumer Watchdog

Impact of the Proposition 103 Prior Approval System: The Insurer Perspective

- Lengthy review process before implementation of new rates
 - Six months under the best of circumstances
 - Two years or more if a rate hearing
- Makes insurers reluctant to increase or decrease rates
- Danger of putting rates in play

Impact of the Proposition 103 Prior Approval System: The Consumer Perspective

- 2008 Study of State Automobile Insurance Regulation: A National Quality Assessment and In-Depth Review of California's Uniquely Effective Regulatory System
 - Conducted and published by the Consumer Federation of America

The Consumer Federation of America's Findings

- From 1989 to 2008 Proposition 103 reduced the difference between California auto rates and the National average from 36% to 2%
- From 1989 to 2008 Proposition 103 saved California auto insurance customers alone over \$62 billion in premium

The Consumer Federation of America's

Conclusion

- "Our research proves that California's system is the finest in the nation at protecting insureds."

The Impact of the Consumer Federation of America Study on other States

- The Michigan FAIR Initiative of 2010
 - Replace existing file and use system with system largely identical to Proposition 103
 - 20% rate reduction
 - Prior Approval rate system
- Did not qualify for the ballot

Trend Two: Prior Approval of Health Care Rates

Patient Protection and Affordable Care Act

- Did not include general Federal rate control authority
 - Left that task to state regulators
- Requires insurers that propose “unreasonable” rate increases to file a disclosure form justifying the rate hike

Patient Protection and Affordable Care Act

- Two issues:
 - What is an “unreasonable” rate hike
 - How do states regulate rates

Patient Protection and Affordable Care Act

- Issue One: What is an “unreasonable” rate?
 - Industry
 - Reasonable if justified by actuarial data and needed to meet solvency/reserve requirements
 - Consumers
 - Unreasonable if 10% or more
 - Unreasonable if 150% of medical inflation rate

Patient Protection and Affordable Care Act

- Issue Two: How should states regulate rates
 - Open Competition
 - File and Use
 - Prior Approval

The California Health Care Response

- The Legislative Battle
 - Health Care Industry: SB 1163
 - Effectively file and use
 - Insurers must certify rates as “actuarially sound”

The California Health Care Response

- The Legislative Battle
 - Consumer Watchdog's AB 2578: The Proposition 103 Model
 - Prior Approval of all rate increases, changes in co-payments and changes in deductibles
 - Mandatory hearings for increases over 10%
 - Full consumer participation rights

The California Health Care Response

- The Outcome: SB 1163 Prevails

The California Health Care Response

- Will SB 1163 Last?
 - Consumer Watchdog Reaction
 - "Governor Signs Bill Giving Health Insurers Carte Blanche to Raise Rates in California"
 - The Proposition 103 Modeled Bill was Sponsored by Insurance Commissioner Elect Dave Jones

Prediction: California will move to a prior approval system

Rate Regulation through the Courts and Development of the Filed Rate Doctrine Defense

Rate Regulation Through the Courts

- Direct challenges to rates
 - Excessive, inadequate, or unfairly discriminatory
 - Improving Claims Experience
 - Improving Efficiencies / Lowering Costs
 - Excessive Reserves / Excessive Profit

Rate Regulation Through the Courts

- Indirect challenges to rates (Examples)
 - Alleged use of unapproved rating factors
 - Charging of undisclosed fees
 - Inclusion of undisclosed/unrelated component to rate
 - Misrepresentation as to coverage seeking premium recovery
 - Alleged collusive price-fixing
 - Vanishing premium and/or “death spiral” litigation

Consequence of Increased Rate Regulation?

- Increased regulation of insurance rates by state agencies, particularly through prior approval, and litigation challenging/implicating reasonableness of rates is resulting in pronounced development in case law of Filed Rate Doctrine defense to rate litigation.

Filed Rate Doctrine: What is it?

- Generally, the F/R Doctrine “holds that any ‘filed rate’ - that is, one approved by the governing regulatory agency – is per se reasonable and unassailable in judicial proceedings brought by rate payers.”
 - *Wegoland Ltd., v. NYNEX Corp.* 27 F.3d 17, 18 (2nd Cir. 1994)

F/R Doctrine bars claims challenging the reasonableness of a filed rate.

Filed Rate Doctrine: Underlying Principles

- Nonjusticiability Principle
 - To prohibit courts from second-guessing a regulatory agency's determination as to the reasonableness of a rate
 - Courts are ill-suited to second-guess agency decision and lack specialized expertise to decide a reasonable rate
- Nondiscrimination Principle
 - To prohibit courts from entering a judgment that would alter rates and potentially cause rate discrimination.

Filed Rate Doctrine: Scope of Defense

- *Generally* bars direct challenges to rates.
- *Potentially* bars indirect challenges to rates.
 - Scope of F/R Doctrine depends upon the jurisdiction
 - Development of F/R Doctrine in each jurisdiction depends upon that jurisdiction's level of adoption of F/R Doctrine as historically applied to carriers / telecommunications context.

Filed Rate Doctrine: Emerging Caselaw

- Ohio: **In re Title Insurance Antitrust Cases**, 702 F. Supp. 2d 840 (N.D. OH, Mar. 31, 2010)
 - Challenged Conduct: Class action on behalf of individuals who purchased title insurance in Ohio from insurers that allegedly conspired together to fix prices for title insurance in violation of Sherman Act and Ohio's Valentine Act.
 - Title insurers allegedly charged "supra-competitive" rates that allegedly contained unlawful kickbacks and other charges unrelated with title insurance.

Filed Rate Doctrine: Emerging Caselaw

- Ohio: **In re Title Insurance Antitrust Cases**, 702 F. Supp. 2d 840 (N.D. OH, Mar. 31, 2010)
 - Holdings:
 - F/R Doctrine applicable to Ohio Title Insurance Industry
 - F/R Doctrine applies “regardless of level of agency review”
 - No “Fraud or Wrongful Act” Exception to F/R Doctrine
 - No “Improperly Filed” Exception to F/R Doctrine
 - F/R Doctrine does not necessarily preclude injunctive relief claim

Filed Rate Doctrine: Emerging Caselaw

- Illinois: **Schilke v. Wachovia Mortgage, FSB**, 705 F. Supp. 2d 932 (N.D. Ill. 2010)
 - Challenged Conduct: Putative class action on behalf of homeowners charged for lender-placed hazard insurance that allegedly included undisclosed fees (“kick-backs”) paid to lender for placement, maintenance and service of policy.

Filed Rate Doctrine: Emerging Caselaw

- Illinois: **Schilke v. Wachovia Mortgage, FSB**, 705 F. Supp. 2d 932 (N.D. Ill. 2010)
 - Holding:
 - F/R Doctrine held applicable to property insurance in Illinois.
 - F/R Doctrine barred fraud claims in that they sought partial refund of premium - barred by "*non-discrimination*" principle of doctrine.
 - Injunctive Relief not barred to the extent Plaintiff merely required disclosures of allegedly illegal fees and not alteration of rate.

Filed Rate Doctrine: Emerging Caselaw

- New Jersey: Clark v. Prudential Insurance Company of America, --- F. Supp. 2d --- (D. N.J. 2010)
 - Challenged Conduct: “*Death-Spiral*” Case – Class action against individual health insurer for fraud and breach of duty of good faith and fair dealing for various acts, including alleged failure to disclose to insureds of closure of insurance policy risk pool allegedly resulting in “death spiral.”

Filed Rate Doctrine: Emerging Caselaw

- New Jersey: Clark v. Prudential Insurance Company of America, --- F. Supp. 2d --- (D. N.J. 2010)
 - Holdings:
 - F/R Doctrine applicable to health insurance under NJ law.
 - F/R Doctrine, in that case, barred NJ claims on ground that:
 - Plaintiff sought premium refund, which interfered with rate-making process and would require determination of reasonable rate. (*Non-justiciability*)
 - Plaintiff has no fraud claim because insureds are presumed to know contents of filed rate, which included disclosure of "closure of book."

Filed Rate Doctrine: Emerging Caselaw

- New York: Roussin v. AARP, Inc., 664 F. Supp. 2d 412 (S.D. N.Y. Oct. 15, 2009), aff'd by 2nd Circuit.
 - Challenged Conduct: Class action on behalf of members of non-profit corporation (AARP) and trustees for breach of fiduciary duty and negligence in approving group health insurance premiums for members that allegedly included “double-charge” of allowance paid to AARP.

Filed Rate Doctrine: Emerging Caselaw

- New York: Roussin v. AARP, Inc., 664 F. Supp. 2d 412 (S.D. N.Y. Oct. 15, 2009), aff'd by 2nd Circuit.
 - Holdings:
 - F/R Doctrine applied though plaintiff only challenged discrete component (i.e., AARP allowance) included in the approved rate.
 - F/R Doctrine barred claims against AARP, though AARP is not an insurer and was not required to file any rates with NY DOI.
 - Focus is on the fact that a "rate" is being challenged, not the party.

Filed Rate Doctrine: Emerging Caselaw

- California: Mackay v. Superior Court, 115 Cal. Rptr. 3d 893 (Cal. App. 2nd Dist., Oct. 6, 2010)
 - Challenged Conduct: Insurer's use of persistency rating factor and method of verifying driver safety record allegedly violated Proposition 103's prohibition against use of an insured's lack of prior automobile insurance to determine premium or eligibility.

Filed Rate Doctrine: Emerging Caselaw

- California: Mackay v. Superior Court, 115 Cal. Rptr. 3d 893 (Cal. App. 2nd Dist., Oct. 6, 2010)
 - Holdings:
 - Lawsuit challenging application of rating factor and/or “underwriting rule” that affects rates can be barred if filed and approved by CDI.
 - Bar based upon statutory safe-harbor. Cal. Ins. Code § 1860.1.
 - Mackay court held, expressly for the first time, that F/R Doctrine applied to California insurance rates.

Filed Rate Doctrine Redux

- Development of F/R Doctrine still very much in flux.
- Increased regulatory scrutiny will increase the robustness of the F/R Doctrine defense to direct challenges to rates, but more importantly, indirect challenges to rates.
 - Emerging law has made clear that there is opportunity to assert F/R Doctrine principles/variants to bar claims where:
 - A total or partial refund of premium is sought;
 - Insurer is alleged to engage in an unlawful or unfair rating and/or underwriting practice that has been disclosed and approved by a regulatory agency; or
 - Insurer allegedly failed to disclose information disclosed in a filed rate.

Conclusion

Questions?