

NAIC
PROGRAM FOR STATE IMPLEMENTATION
OF
PRESIDENT CARTER'S ANTI-INFLATION PROGRAM
WITH RESPECT TO
INSURANCE INDUSTRY PRICES
Adopted December 8, 1978
as amended April 17, 1979

PREAMBLE

On October 27, 1978, the NAIC Executive Committee voted to foster insurance industry compliance with the President's anti-inflation program. The insurance business represents an important segment of this nation's economy with 1979 annual premium estimated at close to \$200 billion. The insurance industry includes at least 56 of the nation's top 400 firms which have annual sales of \$500 million or more. This evidences the fact that the insurance industry is a significant element in the effort to curb inflation. Consequently, even though some question the efficacy of wage and price restraints as the primary means to combat the fundamental causes of inflation,¹ the NAIC has concluded that state insurance commissioners and the insurance industry should render every reasonable effort to assist in implementing the President's program to assure its success. Additionally, this effort is worthwhile because inflation has a particularly adverse impact upon the insurance industry's ability to meet insurance consumers' needs.

However, this commitment by the NAIC is predicated on two conditions: (1) the basic standards to be applied are those announced in the October 31, 1978 Council on Wage and Price Stability Fact Book, as amended through April 13, 1979, and (2) the standards applied to the insurance industry are neither more nor less stringent than those applied to other industries. (This is not to say that the insurance industry does not possess some unique complexities which may require some flexibility in applying the standards. Nevertheless, the basic general pricing standards applying to all industries are similarly appropriate for the insurance industry.)

And finally, it should be noted that the NAIC effort is directed primarily at insurance prices rather than insurer wages, the latter being a question not unique to insurers or insurance regulation and hence appropriately handled by the Council on Wage and Price Stability (COWPS) along with other employers. However, under the COWPS standards, if pay deceleration exceeds a certain amount, additional price deceleration is required for compliance with the price standard. At least to this extent the insurance regulator monitoring system described below is directly concerned with insurer wage rate changes.

I. ANTI-INFLATION PROGRAM VIS-A-VIS STATE INSURANCE RATING LAWS

The NAIC commitment to implement the President's anti-inflation program is contingent upon the maintenance of the clear distinction and demarcation between state insurance rating laws and the anti-inflation effort. State insurance rating laws focus upon price changes for individual products on a local level - i.e. by line by state. The standards that rates shall not be excessive, inadequate or unfairly discriminatory are applied to individual rate changes to achieve the traditional insurance goals of reasonable price of the product to the customer, a financially secure insurance company and fair treatment as between policyholders. In contrast the President's anti-inflation program is not designed to foster these objectives nor does it focus on individual prices on a statewide basis. But rather, the President's program is designed to decelerate the rate of inflation with respect to the average price of all the company's rates on a nationwide basis. Within the parameters of the COWPS standards, it is contemplated that some price changes of individual products will exceed the standard whereas others will fall below the standard so long as on average the standard is met. The President's program clearly leaves the "mix" up to company determination.

In short, inherent in these basic differences between rate regulation and the anti-inflation program are two fundamental conclusions.

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1. There is a considerable body of expert economic opinion that the root causes and fundamental solutions are to be found in government monetary and fiscal policy.

First, the President's program, contains no suggestion that it is to be used as a means to restructure the rate regulatory mechanism. (Among other things, the pricing standards clearly do not fit the rate regulatory context.) The NAIC will vigorously resist any such distortion of the President's program in the insurance area.

Second, in at least most states, the COWPS pricing standards (with one exception noted *infra*) are irrelevant in the application of the insurance rating laws for at least two reasons. (1) The President's program is voluntary. Most, if not all, states would appear to lack statutory authority to mandate insurer compliance with federal standards under this voluntary program. This becomes especially clear when it is remembered that the COWPS itself cannot mandate compliance. (2) For a given company, COWPS standards are built upon the concept of average (not individual) price on a nationwide (not state) basis. To apply the numerical figures in the COWPS standards to the pricing of individual insurance products would be inconsistent with the federal program and would preclude company flexibility needed to encourage voluntary compliance.

However, in one sense the President's program is directly relevant to the application of state insurance rating standards. Built into insurance rate changes are trend factors which reflect an insurer's expectation as to the future rate of inflation, severity of loss and frequency of loss. The President's program is aimed at moderating the rate of inflation. Most state insurance rating laws provide that in applying the rating standards "due consideration shall be given to . . . all other relevant factors within and outside this state." Thus, the insurance regulator in applying such rating law is obligated to consider the actual and likely prospective impact of the anti-inflation program in his own state. The NAIC urges that this be done. Furthermore, in pricing the insurance product, all individual insurers, whether or not subject to state insurance rate regulation, should anticipate a moderation in the rate of inflation as to loss costs when developing their trend factors.

II. WHO IS COVERED BY THE NAIC PROGRAM?

The President's anti-inflation program applies to virtually all companies and firms. However, the President's program does not include reporting requirements for insurance firms with annual premiums less than \$50 million. Thus, the NAIC program extends to all companies or other type of organizations issuing insurance or insurance type coverages if such company or firm is subject to the supervision of the state insurance regulator(s) and if such company or firm has annual premiums of \$50 million or more. These include not only traditional insurers but also reinsurers, nonprofit hospital and medical plans, HMO's, etc. The only exceptions are those companies and firms exempted by the COWPS or whose business amounts to less than \$50 million per year both for the company individually and also consolidated with all affiliated insurers. Individual states, however may extend some or all phases of the NAIC program to companies whose business is less than \$50 million. Finally, this change in the NAIC monitoring program to exclude the smaller insurers is not to suggest that the small insurers are exempt from the COWPS program, but rather the change only the limits the scope of the NAIC monitoring activity in a manner consistent with COWPS monitoring activity.

III. MONITORING PROCEDURES TO BE EMPLOYED

In designing a monitoring mechanism, the NAIC has been mindful of the President's emphasis on the value of simplicity of government documents and the importance of not placing undue reporting burdens on the public. The monitoring mechanism consists of three categories of activities: (a) certification of compliance, (b) monitoring of compliance, and (c) publicity. The chief executive officer shall be responsible for his company's obligations under this program.

A. Certification of Compliance.

(1) The NAIC and the members of the NAIC participating in the NAIC program shall call upon insurers included under the NAIC program (see II, *supra*) doing business in the United States to notify their domiciliary insurance commissioner, with a copy to each state in which they do business, of their intention to comply with the COWPS standards. Such intention should be communicated in writing by the insurer's chief executive officer no later than January 15, 1979. If the insurer elects to comply as part of an affiliated group pursuant to the COWPS definitions, notification should be sent to the domiciliary commissioner of the parent or principal insurer of the group. If the domiciliary commissioner does not participate in this program, notification should be sent to the participating state in which the insurer (or group) writes the most premium volume.

(2) Commencing January 15, 1979, every insurer obligated by state law to file rate changes and included under the NAIC program shall in conjunction with such filings certify whether the rate change(s) will or will not cause the insurer (or the group to which it belongs) to exceed the COWPS standards.

Rating bureau filings need not contain a certification of compliance or noncompliance.² However, any rating bureau filing must be accompanied by an assurance that the bureau has given due consideration to the actual and anticipated effects of the anti-inflation program in the development of the trend factors used in the filing and to the likely impact of the filing on the compliance of its members and subscribers with the COWPS standards. Furthermore, the bureau should pledge that the bureau will inform all members and subscribers that, if they use the bureau rates, they must consider such rates in determining their individual company compliance with the COWPS standards.

(3) At the end of each six month period of an insurer's program year of the COWPS voluntary price stabilization program, each insurer included under the NAIC program (or group to which it belongs) shall certify to its domiciliary insurance commissioner, with a copy to each state in which it does business, whether or not the insurer (or the group) remains in compliance with the COWPS standards. Filing of this certification is due no later than 30 days following the end of the six month period.

(4) An insurer (or the group to which the insurer belongs) shall retain and make available on request to its domiciliary commissioner (or to the domiciliary commissioner of the parent or principal insurer in the group) a copy of any reports and certifications filed with COWPS and documentation as to how compliance was determined including the facts and methodology relied upon in reaching this conclusion.³ Such materials shall also be available to other states upon request.

B. Monitoring of Compliance.

(1) The responsibility for monitoring rests with the domiciliary commissioner (or the domiciliary commissioner of the parent or principal insurer in the group). If the domiciliary commissioner does not participate in the program, the responsibility for monitoring shall rest with the participating state in which the insurer (or group) writes the most premium volume. Such commissioner should establish a procedure deemed adequate to him for monitoring the documentation available under A.(4) supra on a random sample spot check or any other basis. Such procedures might include spot check examination of insurers based upon reasonable cause or random selection.

(2) Commencing January 1, 1979 each regular financial condition and market conduct examination should review insurer compliance, including the documentation maintained pursuant to A.(4) supra.

(3) The President and the Chairman of the Executive Committee are directed to (a) ascertain those members of the NAIC who agree to participate in and implement this NAIC program and (b) make available a list of participants to all members of the NAIC.

C. Publicity.

Because of the voluntary nature of the anti-inflation program and the fact that the program is not specifically authorized under current state law, traditional insurance regulatory sanctions are unavailable. However, the insurance regulator can use publicity as a means to encourage insurer compliance.

2. The President's anti-inflation program applies to companies for most lines of business in all states combined. In contrast, rating bureau filings are made on a by line by state basis - a situation to which COWPS standards are not tailored. Consequently, requiring a rating bureau to certify whether its rate filing complies is a meaningless exercise. At the same time, however, it should be noted that an insurer utilizing bureau rates, under the NAIC program, needs to certify whether it complies in semi-annual certification to the insurance regulator pursuant to (3) infra.

3. The basic approach used throughout this NAIC program is largely one of insurer self determination of compliance with the standards. This is consistent with the President's program which states "companies will determine for themselves how their own actions can be made to conform with these standards." COWPS Fact Book, p. 20.

The NAIC will publish periodic summaries as to the extent of certification of compliance by the insurance industry and lists of those insurers who fail to certify their compliance. These summaries shall be transmitted to the attention of COWPS and made available to other interested persons. To coordinate and prepare a compilation of these summaries, each member of the NAIC participating in the program shall furnish the NAIC at its Central Office lists of those insurers doing business in his state and included in the NAIC program who certify and fail to certify pursuant to this program.

IV. APPLICABLE STANDARDS, INTERPRETATIONS, AND CLARIFICATIONS

The standards to be applied under the NAIC implementation program are those promulgated by COWPS. The NAIC does not contemplate promulgating its own separate and distinct guidelines. Furthermore, similar to the posture assumed by COWPS, the NAIC and its members do not intend to provide advance determinations on an individual company's proposed courses of action or its methodologies as to complying with the COWPS standards.

The President's program, in using the general price standard with an alternative backup profit margin standard,⁴ recognizes that all companies in our complex economy cannot be treated identically. Thus insurers must have flexibility, within the parameters of the COWPS standards, of demonstrating and documenting their compliance.

In summary, the NAIC program to implement the federal standards places primary reliance upon insurer self determination of compliance subject to state insurance regulator monitoring and publicity consistent with a voluntary program.

V. CONTAINING THE EXTERNAL COSTS UNDERLYING THE PRICE OF INSURANCE

And finally, it must be recognized that the price of insurance, in large part, is dictated by factors outside the traditional scope of insurer activity and will not necessarily be effected by the President's anti-inflation program. In effect, an automobile insurer purchases doctors' and hospital services, legal services, automobile repair parts and labor, etc. A health insurer purchases a variety of medical goods and services. To the extent insurers cannot control their underlying costs, they are not appropriately subject to criticism.

However, to the extent the various segments of the insurance industry can control or at least influence their underlying costs and fail to do so, they render a disservice and fail to meet a publicly perceived responsibility to the insurance consuming public. All segments of the insurance industry should bring their influence to bear, separate and apart from the President's anti-inflation program, in an effort to contain or reduce the cost of those goods and services for which insurance pays.

The NAIC, in addition to the individual states, have undertaken various activities to either directly contain (or reflect on) the underlying costs of insurance or to cause insurers to do so.⁵ Furthermore, the NAIC now directs its appropriate subcommittee to develop and compile all relevant data bearing upon the trend in insurance prices, insurance costs, insurance claim frequencies and related economic indices including the trend in U.S. money supply.⁶

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4. It should be noted that the NAIC has long dealt with the measurement and monitoring of profits in the insurance industry. For example, for property and liability insurance, see (1) Measurement of Profitability and Treatment of Investment Income in Property and Liability Insurance, published by NAIC June 1970, (2) NAIC Report on Profitability (by company), published annually beginning with 1971, (3) NAIC Report on Profitability By Line and By State, published annually beginning with 1973, (4) Monitoring Competition: A Means of Regulating the Property and Liability Business, published by NAIC June 1974, (5) NAIC Report on Monitoring Competition, published 1978, and (6) NAIC Early Warning Report for Property and Liability Insurers, published annually beginning with 1971. For Life and Health insurance, see the NAIC Early Warning Report for Life and Health Insurers (tests 1 and 2), published annually beginning with 1973.
 5. E.g., the NAIC comprehensive health insurance-health care cost containment model bill program being carried out in conjunction with other state government associations.
 6. Currently the NAIC has access to a variety of information on insurance price trends including the Fast Track Reports, Monitoring Competition Reports, supporting data for rate filings, consumer price indices, etc.