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## Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection

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# Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection



Daniel Schwarcz

## ABSTRACT

Consumer protection in most domains of financial regulation centers on transparency. Broadly construed, transparency involves making relevant information available to consumers as well as others who might act on their behalf, such as academics, journalists, newspapers, consumer organizations, or other market watchdogs. By contrast, command-and-control regulation that affirmatively limits financial firms' products or pricing is relatively uncommon. This Article describes an anomalous inversion of this pattern: While state insurance regulation frequently employs aggressive command-and-control consumer protection regulation, it typically does little or nothing to promote transparent markets. Rather, state lawmakers routinely either completely ignore transparency-oriented reforms or implement them in a flawed manner. While acknowledging the limits of transparency-oriented consumer protection regulation, this Article argues that the lack of transparent insurance markets reflects a pervasive and unappreciated flaw in state insurance regulation. Despite their limitations, transparency-oriented regulatory strategies are an important complement to other more aggressive regulatory tools because they can promote consumer choice, harness market discipline, and ensure regulatory accountability in ways that more aggressive regulatory tools often cannot. In order to promote more transparent insurance markets, the Article argues that the jurisdiction of the Consumer Financial Protection Bureau should be expanded to encompass consumer protection in insurance.

## AUTHOR

Daniel Schwarcz is an Associate Professor at the University of Minnesota Law School. This Article originates out of testimony that the author gave to U.S. Senate Subcommittee on Securities, Insurance, and Investment. Thanks to Kenneth Abraham, Joe Belth, Omri Ben-Shahar, Prentiss Cox, Erik Gerding, Claire Hill, Robert Hunter, Pat McCoy, Brett McDonnell, Peter Molk, Steven Schwarcz, Daniel Sokol, and participants in faculty workshops at Cornell Law School, Rutgers Law School, University of Texas Law School, UCLA Law School, and University of Colorado Law School for helpful comments. Erin Conway, Mike Gendall, Catherine London, and Will Stancil provided excellent research assistance.

## TABLE OF CONTENTS

INTRODUCTION.....	396
I. AN OVERVIEW OF TRANSPARENCY-ORIENTED CONSUMER	
FINANCIAL PROTECTION.....	400
A. Transparency and Improving Consumer Decisionmaking .....	400
1. Summary Disclosures .....	401
2. Financial Literacy Education .....	405
3. Antifraud and Antideception Rules .....	406
4. Structuring Markets and/or Products .....	407
B. Transparency, Full Disclosure, and Market Discipline .....	409
II. INADEQUACY OF TRANSPARENCY REGULATION	
IN PROPERTY/CASUALTY INSURANCE .....	413
A. Full Disclosure of Claims Payment Practices.....	414
B. Coverage Consistent with Consumers' Reasonable Expectations.....	420
1. Improving Consumer Understanding of Coverage.....	420
2. Full Disclosure of Carriers' Coverages.....	425
C. Full Disclosure of the Availability of Insurance Products	
for Low-Income and Minority Populations.....	427
D. Improving Consumer Understanding of the Objectivity	
of Independent Insurance Agents .....	429
E. Affordable Insurance Rates and Improving Consumers' Ability	
to Comparison Shop .....	432
III. ADEQUACY OF TRANSPARENCY REGULATION IN LIFE INSURANCE	
AND ANNUITIES .....	436
A. Solvency Regulation .....	436
1. Full Disclosure.....	436
2. Summary Disclosure .....	440
B. Informing Consumers About Guarantee Fund Protection.....	441
C. Informing Consumers About Annuity Terms and Conditions .....	443
D. Improving Consumer Understanding of the Cost of Cash-Value	
Life Policies .....	448
IV. UNDERSTANDING AND BREAKING THE PATTERN.....	453
A. Understanding the Lack of Transparency in State	
Insurance Regulation .....	454
B. Towards More Transparent Insurance Markets .....	456
1. State Reform of Insurance Regulation in Response	
to Federal Scrutiny .....	457
2. Expanding the Consumer Financial Protection Bureau's	
Jurisdiction to Encompass Insurance .....	459
3. Answering Objections.....	460
CONCLUSION .....	462

## INTRODUCTION

A central goal of financial regulation is to promote markets that are more transparent for consumers and retail investors. Consumer protections in banking consequently focus predominantly on disclosures,<sup>1</sup> and securities law aims to protect retail investors principally through disclosure and antifraud rules.<sup>2</sup> Although the subprime mortgage crisis revealed important limitations to these approaches,<sup>3</sup> federal financial regulation has hardly abandoned transparency as a consumer protection priority. To the contrary, it has embraced the need for better and more empirically informed transparency initiatives, while acknowledging that these efforts must often be paired with complementary substantive restrictions.<sup>4</sup>

One domain of financial regulation, however, has consistently and repeatedly failed to embrace market transparency as a regulatory tool: state insurance regulation. In both property/casualty and life insurance—the two insurance arenas that the states predominantly regulate<sup>5</sup>—lawmakers and regulators have routinely resisted transparency-oriented consumer protections, even though

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1. See RICHARD SCOTT CARNELL ET AL., *THE LAW OF BANKING AND FINANCIAL INSTITUTIONS* 349 (4th ed. 2009).
  2. See Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1043 (2009) (describing securities law's "habitual use of the disclosure remedy for purposes of retail investor protection").
  3. See, e.g., KATHLEEN C. ENGEL & PATRICIA A. MCCOY, *THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS* 196–98 (2011); Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647 (2011).
  4. For instance, while the newly created Consumer Financial Protection Bureau (CFPB) enjoys broad regulatory authority, many of its initial efforts have focused on producing better consumer disclosures of mortgages and student loans while increasing the information available to market watchdogs. See generally Thomas P. Brown, *Disclosure—An Unappreciated Tool in the CFPB's Arsenal*, 8 BERKELEY BUS. L.J. 209 (2011). In 2009, the Credit Card Accountability and Responsibility and Disclosure Act amended the Truth in Lending Act to require credit card companies to post their contracts online and to disclose on billing statements the interest-rate costs of making only minimum payments. Truth in Lending Act of 1968, 15 U.S.C. § 1632 (2012). And healthcare reform focuses a substantial and underappreciated amount of attention on improving transparency in health insurance markets through the development of better summary disclosures, the establishment of exchanges, and the mandatory publication of claim payment information. See Karen Pollitz & Larry Levitt, *Health Insurance Transparency Under the Affordable Care Act*, HENRY J. KAISER FAM. FOUND. (Mar. 8, 2012), <http://kff.org/health-reform/perspective/health-insurance-transparency-under-the-affordable-care-act.aspx>.
  5. By virtue of the McCarran-Ferguson Act of 1945, 15 U.S.C. § 1012(b) (2012), states are the primary regulators of insurance markets when federal law does not expressly preempt this authority. See KENNETH S. ABRAHAM & DANIEL SCHWARCZ, *ABRAHAM'S INSURANCE LAW AND REGULATION* 32 (5th ed. Supp. 2010).

analogous safeguards are common in federal financial regulation.<sup>6</sup> Thus, state-regulated insurers are virtually never required to provide consumers with standardized summaries of key coverage terms before purchase.<sup>7</sup> Insurers' provision of rate information is largely unregulated, often preventing consumers from effectively comparing premiums on an apples-to-apples basis.<sup>8</sup> And state laws actually forbid insurers and their agents from informing consumers about the protections they enjoy through state guarantee funds.<sup>9</sup>

Even more importantly, state laws and regulations do remarkably little to promote broad public availability of insurance market information. For example, insurance carriers are not required to make their policies publicly accessible to anyone other than existing policyholders.<sup>10</sup> Similarly, regulators generally do not publish any company-specific information on how often individual carriers deny or delay claims, drop policyholders for making claims, rescind coverage, or charge surrender fees.<sup>11</sup> And even the financial health of insurers is actively shrouded by state regulators.<sup>12</sup>

While state insurance regulation generally shuns transparency-oriented consumer protection, it often embraces aggressive substantive regulation. For instance, states frequently (though unevenly) restrict insurers' pricing decisions,<sup>13</sup>

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6. One other commentator has noted this pattern, at least with respect to the life insurance industry. See Joseph M. Belth, *The Disclosure Approach to the Problem of Deceptive Practices in the Life Insurance Industry*, 21 INS. F. 81, 82–83 (1994) (“Insurance regulation is based on nondisclosure of material information to policyowners and prospective policyowners; the theory is that they will be protected by the regulators. In contrast, securities regulation is based on disclosure of material information to investors and prospective investors; the theory is that they will protect themselves if they are given the important information.”). Additionally, Howell Jackson has noted that state insurance regulation tends to make use of much more aggressive regulatory tools than other forms of financial regulation, a result that he attributes to the relative complexity of insurance. Howell E. Jackson, *Regulation in a Multisectoral Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319, 333–34 (1999).
  7. See *infra* Part II.B, Coverage Consistent with Consumers’ Reasonable Expectations; cf. Daniel Schwarcz, *Reevaluating Standardized Insurance Policies*, 78 U. CHI. L. REV. 1263, 1332–34 (2011) (discussing the lack of substantive information about coverage that insurers provide on a prepurchase basis).
  8. See *infra* Part III.D, Improving Consumer Understanding of the Cost of Cash-Value Life Policies.
  9. See *infra* Part III.A, Solvency Regulation.
  10. See Schwarcz, *supra* note 7; *infra* Part II.B, Coverage Consistent with Consumers’ Reasonable Expectations.
  11. See *infra* Part III.B, Informing Consumers About Guarantee Fund Protection.
  12. See *infra* Part III.A, Solvency Regulation.
  13. See Ronen Avraham et al., *Understanding Insurance Anti-discrimination Laws*, 87 S. CAL. L. REV. (forthcoming 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2135800](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2135800).

mandate specific policy provisions,<sup>14</sup> require carriers to operate unprofitable policy lines,<sup>15</sup> and insist on capital and reserve requirements that are based on uniquely conservative accounting standards.<sup>16</sup> This suite of regulatory approaches often leads observers to note that insurance is the most heavily regulated of all financial sectors.<sup>17</sup>

This inverted pattern of consumer protection regulation—aggressive command-and-control rules combined with limited market transparency—is not simply anomalous. It is dysfunctional. Transparency-oriented consumer financial protection is, despite its limitations,<sup>18</sup> a vital complement to other regulatory tools. Properly executed, transparency can help empower consumers to make better decisions about how to purchase and use financial products. Even more importantly, it can promote market discipline and facilitate “smart disclosure” to “fuel the creation of products and tools that benefit consumers.”<sup>19</sup> To be sure, these benefits will often need supplementing by various more aggressive regulatory tools. Unfortunately, transparency-based regulation is often treated as a substitute for more aggressive forms of regulation.<sup>20</sup> But this Article attempts to transcend this narrow perspective, emphasizing that transparency-based regulation is often a vital complement to effective substantive regulation.

This Article demonstrates these points in the context of state insurance regulation, showing how regulator-facilitated transparency could substantially improve the efficiency of insurance markets. In some cases, transparency-based tools could almost certainly achieve regulatory objectives more effectively at less cost than current substantive regulations. For example, enabling consumers to compare prices meaningfully would be more effective and less expensive than state rate regulation.<sup>21</sup> In most cases, though, the Article argues that enhanced market transparency would be an essential complement to substantive regulation. It could allow sophisticated consumers, advocates, and journalists to police the

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14. See Schwarcz, *supra* note 7, at 1270–71.

15. Richard A. Epstein, *Exit Rights and Insurance Regulation: From Federalism to Takings*, 7 GEO. MASON L. REV. 293, 300–08 (1999).

16. See Daniel Schwarcz, *Regulating Insurance Sales or Selling Insurance Regulation?: Against Regulatory Competition in Insurance*, 94 MINN. L. REV. 1707, 1763–64 n.256 (2010).

17. See, e.g., J. David Cummins, *Property-Liability Insurance Price Deregulation: The Last Bastion?*, in DEREGULATING PROPERTY-LIABILITY INSURANCE: RESTORING COMPETITION AND INCREASING MARKET EFFICIENCY 1 (J. David Cummins ed., 2002).

18. See Ben-Shahar & Schneider, *supra* note 3, at 723.

19. NAT'L SCI. & TECH. COUNCIL, SMART DISCLOSURE AND CONSUMER DECISION MAKING: REPORT OF THE TASK FORCE ON SMART DISCLOSURE 7 (2013), available at [http://www.whitehouse.gov/sites/default/files/microsites/ostp/report\\_of\\_the\\_task\\_force\\_on\\_smart\\_disclosure.pdf](http://www.whitehouse.gov/sites/default/files/microsites/ostp/report_of_the_task_force_on_smart_disclosure.pdf); see *infra* Part I.B, Transparency, Full Disclosure, and Market Discipline.

20. See, e.g., Ben-Shahar & Schneider, *supra* note 3, at 681.

21. See *infra* Part II.E, Affordable Insurance Rates and Improving Consumers' Ability to Comparison Shop.

marketplace in tandem with regulators, empower informed consumers to make better choices among competing products, promote better consumer usage of their policies, and prompt more effective enforcement of substantive rules.

Given the pervasive and longstanding failure of state lawmakers and regulators to promote transparent insurance markets, this Article proposes that the jurisdiction of the federal Consumer Financial Protection Bureau (CFPB) should be expanded to include insurance products. The CFPB's focus on market transparency makes it well suited to tackle the opaqueness of state insurance markets. Perhaps even more importantly, extending the CFPB's jurisdiction to insurance would motivate state insurance regulators to promote market transparency. The history of state insurance regulation strongly suggests that state regulators can, and will, act when necessary to maintain the scope of their authority.<sup>22</sup> The prospect of federal preemption by CFPB regulation would thus likely force state insurance regulators to pay attention to the behaviorally and empirically informed principles of market transparency that are at the heart of modern consumer protection.

This Article proceeds as follows. Part I provides an overview of transparency-oriented consumer protection. It argues that regulatory measures that directly seek to improve the decisions of individual consumers are an essential tool in regulators' arsenal. Even more significantly, Part I emphasizes the importance of full disclosure as a regulatory tool for promoting consumer financial protection. Such disclosure aims to make large quantities of standardized market information broadly and easily available. Its primary goal is not to directly inform consumers but rather to promote market discipline or smart disclosure by facilitating the efforts of market intermediaries.

Parts II and III then focus on the lack of transparency-oriented consumer protection in property/casualty and life/annuity insurance markets, respectively. In both cases, state insurance regulation either completely forgoes transparency-oriented approaches or relies on inadequate approaches, at least when federal law has not demanded otherwise. By contrast, federal financial regulations in banking, securities, and health insurance domains employ more effective and thoughtful strategies to promote market transparency. Parts II and III argue that similar transparency-oriented reforms could effectively complement more aggressive forms of regulatory scrutiny.

Part IV concludes by offering at least a partial explanation for why state insurance regulation has so consistently failed to develop transparency-oriented consumer protection and by describing how to remedy that failure. Although

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22. See *infra* Part III, Adequacy of Transparency Regulation in Life Insurance and Annuities.

numerous factors seem to contribute to the blind spots of state insurance regulation, Part IV concludes that this problem is amenable to a relatively simple and practical solution. Empowering the CFPB to regulate state insurance markets would almost certainly cause states to pay more attention to the need for enhanced transparency in insurance markets. And, to the extent that state efforts remain unsatisfactory, the CFPB's review and analysis of state insurance regulation would serve as an ideal precursor to a more generalized federalization of insurance regulation.

## I. AN OVERVIEW OF TRANSPARENCY-ORIENTED CONSUMER FINANCIAL PROTECTION

Transparency-oriented consumer protection can be subdivided into two categories.<sup>23</sup> The first seeks to increase awareness of relevant information by reaching consumers of insurance products directly. Subpart A describes the potential benefits and limitations of this approach, focusing on four specific strategies: summary disclosures, financial literacy education, antifraud and antideception measures, and structured products and markets. Subpart B then moves to a second, and ultimately more promising, category of transparency-oriented consumer protection: full disclosure that makes relevant information broadly and easily available to the public, reaching insurance consumers indirectly through various types of intermediaries. This form of transparency can improve the disciplining force of firm reputation and enhance the incentives of regulators to proactively identify and address market problems.

### A. Transparency and Improving Consumer Decisionmaking

Many consumer financial protections are designed to deliver relevant information to individuals in order to improve their financial decisionmaking. Unfortunately, accomplishing this is no easy task. Consumers have limited cognitive resources and background knowledge to devote to understanding complex and ever-changing financial products. Nonetheless, well-designed regulation can meaningfully improve consumer decisionmaking in a variety of settings. This Subpart describes four regulatory tools for accomplishing this goal.

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23. Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 628–29 (2005); Memorandum from Cass R. Sunstein, Adm'r, Office of Info. & Regulatory Affairs, to the Heads of the Executive Departments and Agencies, Disclosure and Simplification as Regulatory Tools (June 18, 2010), available at [http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure\\_principles.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/inforeg/disclosure_principles.pdf).



## 1. Summary Disclosures

Summary disclosure is the most familiar regulatory tool for improving consumer decisionmaking. Such disclosure highlights specific information that is particularly important for making an informed financial decision.<sup>24</sup> Most frequently, this information concerns product attributes, such as fee schedules, penalty terms, or other contract provisions.<sup>25</sup> But it can also involve other information, such as expected consumer use patterns or the obligations and incentives of the seller/intermediary.<sup>26</sup>

Historically, most attempts to mandate summary disclosures have proven ineffective.<sup>27</sup> In large part, this is because lawmakers and regulators have often embraced mandatory disclosure as a regulatory tool without paying meaningful attention to its specific design and implementation.<sup>28</sup> As a result, mandatory disclosures are often lengthy, complicated, and delivered to consumers after the point of sale, when consumers have little incentive to pay attention.<sup>29</sup> Some prominent commentators have used this record of ineffectiveness to persuasively argue for the abandonment of mandatory consumer disclosures.<sup>30</sup>

But despite their historical failings, mandatory consumer disclosures can indeed promote various specific regulatory goals if they are properly designed and executed.<sup>31</sup> Numerous examples of successful mandatory disclosure exist, including nutritional food labeling,<sup>32</sup> ATM fee disclo-

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24. See Memorandum from Cass R. Sunstein, *supra* note 23, at 3.

25. See Ben-Shahar & Schneider, *supra* note 3.

26. See Oren Bar-Gill & Franco Ferrari, *Informing Consumers About Themselves*, 3 ERASMUS L. REV. 93, 98 (2010).

27. See generally Ben-Shahar & Schneider, *supra* note 3; William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant With the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1133–34 (1984) (arguing that Truth in Lending Act (TILA) disclosures are ineffective).

28. Leonard J. Kennedy et al., *The Consumer Financial Protection Bureau: Financial Regulation for the Twenty-First Century*, 97 CORNELL L. REV. 1141, 1163–64 (2012) (describing reasons many consumers failed to use disclosures and efforts by the CFPB to resolve the issues).

29. See generally Onnig H. Dombalagian, *Investment Recommendations and the Essence of Duty*, 60 AM. U. L. REV. 1265, 1291 (2011).

30. See Kesten C. Green & J. Scott Armstrong, *Evidence on the Effects of Mandatory Disclaimers in Advertising*, 31 J. PUB. POL'Y & MARKETING 293 (2012). See generally Ben-Shahar & Schneider, *supra* note 3.

31. See generally ARCHON FUNG ET AL., *FULL DISCLOSURE: THE PERILS AND PROMISE OF TRANSPARENCY* (2007); Richard Craswell, *Static Versus Dynamic Disclosures, and How Not to Judge Their Success or Failure*, 88 WASH. L. REV. 333, 338 (2013).

32. See, e.g., John Kozup et al., *Sound Disclosures: Assessing When a Disclosure Is Worthwhile*, 31 J. PUB. POL'Y & MARKETING 313, 316 (2012) (arguing that sound disclosures, such as nutritional food labeling, can achieve regulatory objectives).

tures,<sup>33</sup> payday loan disclosures,<sup>34</sup> mortgage disclosures,<sup>35</sup> and consumer safety disclosures.<sup>36</sup> These disclosures not only promote better consumer decisionmaking but can also impact the firms' behavior by altering their decisionmaking calculus.<sup>37</sup>

To be sure, no form of summary disclosure will be perfectly effective. Indeed, even some of the comparatively successful forms of mandatory disclosure described above have been heavily criticized in recent research.<sup>38</sup> But in most of these cases, critics argue that these forms of disclosure are less effective than they could be; few commentators argue that these forms of disclosure are completely ineffective.<sup>39</sup> To the contrary, if there is one theme that permeates the vast literature on summary disclosures, it is that their effectiveness is vitally contingent on their design and implementation.<sup>40</sup>

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33. See Adam J. Levitin, *Consumer Finance: Law, Business and Policy* (2013) (textbook draft) (finding that that consumers withdraw larger amounts at automatic teller machines when they are warned that a fee will be imposed on each withdrawal).
  34. Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases, and Payday Borrowing*, 66 J. FIN. 1865, 1865–93 (2011) (finding in an experimental setting that short disclosures to payday loan consumers provided on the envelopes in which cash is disbursed can improve decisionmaking over time).
  35. James M. Lacko & Janis K. Pappalardo, *The Failure and Promise of Mandated Consumer Mortgage Disclosures: Evidence From Qualitative Interviews and a Controlled Experiment With Mortgage Borrowers*, 100 AM. ECON. REV. 516, 518–19 (2010) (finding that improved TILA disclosures can improve consumer decisionmaking).
  36. See Eli. P. Cox III et al., *Do Product Warnings Increase Safe Behavior?: A Meta-analysis*, 16 J. PUB. POL'Y & MARKETING 195, 201 (1997) (finding that product warnings can improve consumer safety).
  37. See Richard H. Thaler & Will Tucker, *Smarter Information, Smarter Consumers*, HARV. BUS. REV., Jan.-Feb. 2013, at 3, 6 (noting a study finding that after levels of trans fat were required to be disclosed on nutritional labels, food and beverage companies altered their production and advertising of products); see also Craswell, *supra* note 31, at 334 (labeling this effect, which he notes also is applicable to summary disclosure, as dynamic disclosure, because disclosure has the effect of impacting the choice sets available to consumers).
  38. See, e.g., Sophie Hieke & Charles R. Taylor, *A Critical Review of the Literature on Nutritional Labeling*, 46 J. CONSUMER AFF. 120 (2012); Daniel E. Ho, *Fudging the Nudge: Information Disclosure and Restaurant Grading*, 122 YALE L.J. 574 (2012) (arguing that the implementation of restaurant hygiene grading suffers serious flaws, including grade inflation and inconsistency).
  39. See, e.g., Craswell, *supra* note 31, at 350.
  40. See, e.g., J. Craig Andrews, *Warnings and Disclosures*, in COMMUNICATING RISKS AND BENEFITS: AN EVIDENCE-BASED USER'S GUIDE 149 (Baruch Fischhoff et al. eds., 2011); David Weil et al., *The Effectiveness of Regulatory Disclosure Policies*, 25 J. POL'Y ANALYSIS & MGMT. 155 (2006); see also, e.g., Oren Bar-Gill & Oliver Board, *Product-Use Information and the Limits of Voluntary Disclosure*, 14 AM. L. & ECON. REV. 235 (2012) (arguing that mandated disclosure of product-use information has substantial potential to improve consumer outcomes if designed effectively); Margaret C. Campbell et al., *Can Disclosures Lead Consumers to Resist Covert Persuasion?: The Important Roles of Disclosure Timing and Type of Response*, 4 J. CONSUMER PSYCHOL. 23 (2013) (reporting that properly designed disclosure can correct the nefarious impact of covert product sponsorship).

Three basic principles for designing effective mandatory disclosures can be distilled from this literature. First, disclosures must focus consumers' attention on a small number of key pieces of information directed to solving specific regulatory problems.<sup>41</sup> The reason is simple: Most consumers can or will process only a limited amount of information in a disclosure.<sup>42</sup> In some cases, disclosures can overcome this limitation by combining relevant information into a simple rating or ranking.<sup>43</sup> Examples include letter grades for restaurant cleanliness<sup>44</sup> and ratings for automobile safety and fuel efficiency.<sup>45</sup> Alternatively, product use disclosures can be embedded within product attribute disclosures so that consumers are simultaneously informed about both features when making their decisions.<sup>46</sup> Mandatory disclosures regarding automobile fuel efficiency and cigarette nicotine and tar levels fit this description.<sup>47</sup>

Although it is the most vital element of designing an effective disclosure, determining the appropriate information to include in a disclosure is often immensely difficult, particularly for inherently complicated products. Some disclosure metrics may invite gaming by firms, who seek to influence or confuse consumers by altering products in ways that change how they appear in disclosures but do not improve consumer welfare.<sup>48</sup> Other times, poorly designed disclosures can inadvertently reinforce behavioral biases by focusing consumer

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41. See Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. U. L. REV. 1089 (2007) (emphasizing the importance of using disclosure to target specific regulatory problems).
  42. See, e.g., Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 VA. L. REV. 565, 584 (2006) ("Increasing the prominence of a required disclosure may also reduce the attention consumers pay to other information . . ."); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1241–44 (2003).
  43. Of course, for these approaches to be effective, consumers must understand what the underlying metrics mean or, at the very least, how to compare ratings to determine which is purportedly better. Memorandum from Cass R. Sunstein, *supra* note 23, at 5. For example, there is evidence that many consumers do not understand what the annual percentage rate (APR) means or whether a higher or a lower APR is better. See, e.g., Jeff Sovern, *Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers*, 71 OHIO ST. L.J. 761, 776–77 (2010).
  44. See Ginger Zhe Jin & Phillip Leslie, *The Effect of Information on Product Quality: Evidence From Restaurant Hygiene Grade Cards*, 118 Q.J. ECON. 409 (2003) (finding that restaurant hygiene grades in Los Angeles cause improved restaurant hygiene and increased consumer responsiveness to restaurant). *But see* Ho, *supra* note 38 (arguing that implementation of restaurant hygiene grading suffers serious flaws).
  45. See Craswell, *supra* note 31, at 357.
  46. See Bar-Gill & Ferarri, *supra* note 26.
  47. See *id.* at 106–09.
  48. See, e.g., Ho, *supra* note 38, at 609–16 (showing how restaurants can game their ratings for hygiene and produce "grade inflation"); Langevoort, *supra* note 2, at 1049–50 (noting how mutual fund companies can frustrate cost comparisons by creating different types of fee arrangements).

attention on issues of secondary concern.<sup>49</sup> But none of these results are inevitable, particularly if regulators are attuned to these difficulties.

Second, regulators should design and test mandatory summary disclosure forms that incorporate fields for individual firms to populate with relevant product and/or consumer characteristics.<sup>50</sup> Examples include nutritional food labels and recently revamped mortgage, credit card, and health insurance disclosures. When all firms use a centrally designed disclosure template, consumers can more easily compare product features and prices across companies. Consumers are also much more likely to learn how to use uniform disclosure templates. Finally, regulators can more efficiently test standard forms for consumer comprehension.<sup>51</sup> Such testing is increasingly routine at federal agencies<sup>52</sup> and helps ensure that consumers actually understand and can act on summary disclosures.<sup>53</sup>

Third, consumers must receive consumer disclosures at the appropriate time, when they are most likely to capture consumers' attention and inform their decisionmaking.<sup>54</sup> Thus, consumers must receive disclosures intended to pro-

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49. See, e.g., Langevoort, *supra* note 2, at 1051 (noting how disclosures of past performance of mutual funds may enhance irrational trend chasing).
50. See Brenda J. Cude & Daniel Schwarcz, *Consumer Viewpoints on Effective Disclosures*, CIPR NEWSL. (Nat'l Ass'n of Ins. Comm'rs & Ctr. for Ins. Policy & Research, Kansas City, Mo.), Jan. 2013, at 26, 30, available at [http://www.naic.org/cipr\\_newsletter\\_archive/vol6\\_consumer\\_viewpoints.pdf](http://www.naic.org/cipr_newsletter_archive/vol6_consumer_viewpoints.pdf) (noting that regulator-designed disclosures create consistency across firms, making comparisons easier for consumers); Susan L. Rutledge, *Consumer Protection and Financial Literacy: Lessons From Nine Country Studies* 19–21 (World Bank Policy Research, Working Paper No. 5326, 2013), available at <http://ssrn.com/abstract=1619168>.
51. Ensuring effective consumer testing is very difficult when firms draft their own disclosures, as the number of disclosures that must be tested increases from one to the number of firms operating in the market place.
52. See generally JAMES M. LACKO & JANIS K. PAPPALARDO, FED. TRADE COMM'N, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007); see also Memorandum from Cass R. Sunstein, *supra* note 23, at 5, 7.
53. See Kennedy et al., *supra* note 28, at 1160–67 (discussing federal efforts to improve mortgage loan disclosures). Untested disclosures often prove ineffective because the experts who draft them are uniquely unsuited to determine what is comprehensible to ordinary consumers. See, e.g., Carl E. Schneider & Mark A. Hall, *The Patient Life: Can Consumers Direct Health Care?*, 35 AM. J.L. & MED. 7, 42 (2009) (noting that a large number of healthcare disclosure forms are too complex for the average American adult); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 240–41 (2002) (examining the literacy skill level required to understand consumer loan and automobile lease documents).
54. See Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law From Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627, 694 (1996); Memorandum from Cass R. Sunstein, *supra* note 23, at 3–4. But cf. Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 749–50 (2006) (describing the Home Ownership and Equity Protection Act (HOEPA) mortgage disclosures, which are designed to facilitate comparison shopping and are provided only after the opportunity to comparison shop has passed).

note comparison shopping before emotionally committing to a purchase or spending a substantial amount of time and energy learning about or applying for a product. Similarly, disclosures designed to limit overdraft fees are most likely to be effective if they are delivered at the point of sale, at the time when purchase could cause consumers to exceed their credit limit.<sup>55</sup> By contrast, disclosures intended to alter long-term consumer behavior may be most usefully provided after the point of sale,<sup>56</sup> when they are least likely to be undermined by sales people who may have incentives to downplay their relevance or importance.<sup>57</sup> Finally, mandatory summary disclosures must be provided at a time when consumers will not be overwhelmed by other disclosures.<sup>58</sup> To accomplish this, regulators should not only specify the time frames within which disclosures should be provided but also limit or prohibit providing additional disclosures to consumers at that time.

To be sure, even mandatory disclosures that meet these criteria will only be imperfectly effective: Consumers will always err. But mandatory disclosure is simply one tool in a regulator's tool kit and can generally be employed in concert with other approaches, such as minimum product requirements or regulatory preapproval. Additionally, mandatory disclosure has important advantages over other regulatory tools. First, it does not interfere with consumer choice. Second, and perhaps less fully appreciated, it can help consumers use products effectively. For instance, disclosure can encourage people to withdraw funds from automatic teller machines less frequently, to use overdraft protection only when truly needed, or to refrain from submitting insurance claims that are only slightly above one's deductible.

## 2. Financial Literacy Education

A second form of transparency-oriented consumer protection is financial literacy education, which can be defined as "education about financial concepts undertaken with the explicit purpose of increasing knowledge and the skills, confidence, and motivation to use it."<sup>59</sup> Such education is designed to empower individual consumers to make responsible financial decisions by equipping them with a core amount of financial literacy and the skills necessary to analyze individual

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55. See RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS 192 (2006).

56. See Bertrand & Morse, *supra* note 34, at 1865–93 (finding that disclosures on envelopes containing cash had a gradual effect on consumers' payday lending habits).

57. See Ben-Shahar & Schneider, *supra* note 3, at 739 (arguing that a disclosure mandate could backfire when the discloser has strategic reason to give false and biased assurances).

58. See Craswell, *supra* note 42, at 581.

59. Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 202 (2008).

financial products. It is generally provided before the point of purchase through classroom teaching, informational websites, and brochures or guides.

The evidence regarding the effectiveness of financial literacy education is generally not encouraging. Most studies report that such education has little or no effect on consumers' actual financial decisions.<sup>60</sup> And at least some of the studies that report favorable outcomes as a result of financial literacy education are subject to important methodological flaws, such as self-selection bias and data collection techniques that tend to be biased toward favorable outcomes.<sup>61</sup>

But this does not mean that financial literacy education can never promote regulatory goals: Emerging evidence suggests that financial literacy education can indeed have a positive, albeit small, effect when provided immediately before a specific financial decision that individuals are motivated to make correctly.<sup>62</sup> Indeed, in some sense, a mandatory summary disclosure is a form of highly context-specific consumer financial literacy education. It should therefore not be surprising that financial literacy education, like disclosure, can produce positive results when it is provided to consumers at the appropriate time and is otherwise well designed. By contrast, most forms of financial literacy education fail to impact consumer decisionmaking positively. Often this is because, due to various cognitive constraints, individuals fail to link such education to specific transactions about which they are motivated.<sup>63</sup>

### 3. Antifraud and Antideception Rules

Transparency-based consumer financial protection regulation almost universally includes rules prohibiting firms and individuals from making false or misleading statements. Thus, false and deceptive practices are prohibited in securities law,<sup>64</sup>

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60. See, e.g., Jean Braucher, *An Empirical Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown*, 9 AM. BANKR. INST. L. REV. 557, 577–79 (2001); Lisa J. Servon & Robert Kaestner, *Consumer Financial Literacy and the Impact of Online Banking on the Financial Behavior of Lower-Income Bank Customers*, 42 J. CONSUMER AFF. 271 (2008). But see Jonathan Fox et al., *Building the Case for Financial Education*, 39 J. CONSUMER AFF. 195 (2005).

61. Willis, *supra* note 59, at 205–07 (describing these problems in detail).

62. See Lewis Mandell & Linda Schmid Klein, *Motivation and Financial Literacy*, 16 FIN. SERVICES REV. 105 (2007) (finding that motivation of individuals significantly impacts the effectiveness of financial literacy education); Rutledge, *supra* note 50, at 2 (emphasizing that financial literacy should be provided at “teachable moments”).

63. See Daniel Fernandes et al., *Financial Literacy, Financial Education and Downstream Financial Behaviors*, MGMT. SCI. (forthcoming), available at <http://ssrn.com/abstract=2333898>.

64. 17 C.F.R. § 240.10b-5 (2013).

consumer credit law,<sup>65</sup> and insurance law.<sup>66</sup> The application of these rules to outright fraud is typically straightforward as a legal or regulatory matter. By contrast, the impact of these rules on deceptive or misleading practices depends almost entirely on how they are enforced. That is because deception is a broad and malleable standard, and hence must be defined *ex post* via application of the standard to specific cases.<sup>67</sup> The enforcement of these rules is typically most robust when individuals have a private cause of action to pursue claims of deception, as individuals often have better, or at least different, information than regulators about the existence of deceptive practices.<sup>68</sup> But traditional regulatory enforcement of antideception rules can also contribute substantially to transparent markets by limiting deceptive advertising and marketing.

#### 4. Structuring Markets and/or Products

One of the most promising regulatory strategies for directly promoting improved consumer decisionmaking is for regulators to structure markets or products to create clearer, and often more limited, choices for consumers. Perhaps the most salient examples of this approach are the health insurance exchanges that the Affordable Care Act requires to be operational in every state by 2014.<sup>69</sup> These exchanges are regulated and centralized marketplaces wherein private firms sell their products to consumers according to prespecified rules designed to facilitate consumer choice.

Available empirical evidence suggests that exchanges can be quite effective at promoting transparent markets.<sup>70</sup> All exchanges have the important virtue of reducing consumer search costs by aggregating relevant information in a single place. They also generally allow consumers to sort plans according to preferred features such as actuarial value, deductibles, copays, or whether a particular doctor is in network.

Depending on how they are structured, exchanges can also promote market transparency through more aggressive strategies. For instance, exchanges can

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65. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 753, 124 Stat. 1376, 1750 (2010).

66. See NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 880-1 (1997).

67. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 591 (1992).

68. See Jeffrey Manns, *Downgrading Rating Agency Reform*, 81 GEO. WASH. L. REV. 749, 771-73 (2013).

69. See Amy Monahan & Daniel Schwarcz, *Will Employers Undermine Health Care Reform by Dumping Sick Employees?*, 97 VA. L. REV. 125, 139-41 (2011).

70. See generally Jon Kingsdale, *Health Insurance Exchanges—Key Link in a Better-Value Chain*, 362 NEW ENG. J. MED. 2147 (2010) (using Massachusetts's Commonwealth Health Insurance Connector as an example to suggest that exchanges can successfully promote transparency).

provide a seal-of-approval function if only prescreened products are sold in the exchange.<sup>71</sup> They can also require standardization of certain product features, which promotes comparison shopping by reducing the number of relevant variables a consumer must consider.<sup>72</sup> Finally, exchanges can also function as automated “recommender systems” that match consumers with a small number of products on the basis of consumer-specified needs and preferences.<sup>73</sup> This can have a dramatic impact by limiting consumers’ “consideration sets” to a limited number of options that are more likely to be appropriate for their needs.<sup>74</sup>

Product standardization outside of an exchange is an alternative approach to promoting more transparent consumer markets. For instance, Medigap insurance policies must fit one of eleven specified benefit designs in regulations.<sup>75</sup> Product standardization can promote transparency by reducing reading costs for consumers: Rather than familiarizing themselves with numerous different product types, consumers need learn only the basic details of a few different options.<sup>76</sup> This approach is most likely to be effective when the alternatives differ on a single dimension.<sup>77</sup> Moreover, product standardization may facilitate learning from friends and family by creating a common set of choices.

A less intrusive alternative to product standardization is to require firms to offer a standardized default product but to permit opt-out through affirmative consumer action. This approach may force firms to explain how any nonstandardized products they offer depart from the standardized option.<sup>78</sup> Unfortunately, firms

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71. *Id.*

72. See, e.g., Rosemarie Day & Pamela Nadash, *New State Insurance Exchanges Should Follow the Example of Massachusetts by Simplifying Choices Among Health Plans*, 31 HEALTH AFF. 982, 982–85 (2012) (discussing how the Massachusetts exchange successfully promoted comparison shopping by standardizing products and limiting the number of health insurance options).

73. See John Lynch, *An Invitation to Research on Consumers’ Financial Decision Making* (June 6, 2010) (PowerPoint Presentation at the First Annual Boulder Summer Conference on Consumer Financial Decision Making), available at <http://129.82.41.134/MPPCWorkshop/Documents/WorkshopPresentations/Lynch%20Financial%20Decision%20Making.pdf>.

74. See Allan D. Shocker et al., *Consideration Set Influences on Consumer Decision-Making and Choice: Issues, Models, and Suggestions*, 2 MARKETING LETTERS 181, 188–92 (1991); see also Fernandes et al., *supra* note 63.

75. See *How to Compare Medigap Policies*, MEDICARE.GOV, <http://www.medicare.gov/supplement-other-insurance/compare-medigap/compare-medigap.html> (last visited Nov. 21, 2013).

76. See Abraham L. Wickelgren, *Standardization as a Solution to the Reading Costs of Form Contracts*, 167 J. INST. & THEORETICAL ECON. 30, 38–40 (2011).

77. SUSAN E. WOODWARD, URBAN INST., *A STUDY OF CLOSING COSTS FOR FHA MORTGAGES* (2008), available at [http://www.urban.org/UploadedPDF/411682\\_fha\\_mortgages.pdf](http://www.urban.org/UploadedPDF/411682_fha_mortgages.pdf) (noting that encouraging comparison heightens competition and improves consumer outcomes only in markets in which the alternatives differ on a single dimension).

78. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 90 (1989).



may be able to game certain legally required defaults by manipulating consumers to opt out of those defaults.<sup>79</sup> One potential approach to ameliorating this risk is to afford greater legal protections to sales of default options than sales of nondefault options.<sup>80</sup>

## B. Transparency, Full Disclosure, and Market Discipline

A second broad category of transparency-based consumer financial protection, which can be labeled full disclosure, provides public access to a broad set of potentially relevant market and product information. Such disclosure is generally provided through online tools. Unlike the regulatory approaches described above, the primary audience for full disclosure is not (at least initially) ordinary consumers or retail investors. Instead, the intended audience includes market intermediaries, consumer-oriented magazines, journalists, consumer advocates, academics, sophisticated consumers/investors, and government actors without direct access to the underlying information.<sup>81</sup>

The most familiar, and elaborate, example of full disclosure is the federal securities regime, which imposes exhaustive disclosure requirements on securities issuers.<sup>82</sup> Doing so protects all investors, even though only a small handful actually read these disclosures.<sup>83</sup> The core reason is that most securities are actively

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79. See Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 U. CHI. L. REV. 1155, 1220 (2013).

80. See MICHAEL S. BARR ET AL., NEW AM. FOUND., BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 7–11 (2008) (suggesting that regulators require lenders to offer plain vanilla products, but also permit them to offer more complex products, though with less protection against judicial intrusion); Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 2028–35 (2010) (suggesting a “conform or explain” approach to retail investment products).

81. See Cass R. Sunstein, *Empirically Informed Regulation*, 78 U. CHI. L. REV. 1349, 1384–85 (2011).

82. To be sure, many scholars dispute the need for so much mandatory disclosure in securities regulation. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 687 (1984); Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 421 (2003) (“Critics of mandatory disclosure argue that a company will voluntarily disclose information that investors demand in order to reduce its cost of capital and avoid any discount that the market might apply to the company’s stock price if investors think that they have too little information to evaluate the company and its securities properly or, worse yet, if investors think that the company is hiding something.”).

83. See John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 723–37, 751–53 (1984) (suggesting that mandatory disclosure is a strategy for making efficient use of securities analysts and market professionals); Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 781–82 (2006) (arguing that securities regulation, the role of which is to facilitate and maintain a competitive market for traders, benefits from mandatory disclosures because disclosures reduce costs and increase market competition).

sold on secondary markets, allowing prices to fluctuate according to new information that is traded on by sophisticated actors. Thus, even uninformed investors can be assured that securities prices are reasonably reflective of their actual worth.

Full disclosure, however, can be an important and effective consumer protection strategy even in contexts in which no secondary market exists. First, full disclosure can allow entrepreneurial market intermediaries or others, such as regulators, to design their own smart disclosure systems.<sup>84</sup> Such systems translate available raw data into tailored disclosures for consumers through mobile apps and internet sites.<sup>85</sup> These privately designed consumer information tools are particularly promising because they are mediated by market forces, thus ensuring a more nimble, evolving, and sophisticated approach to communicating useful information to consumers according to their particular needs and preferences. For these reasons, policymakers have proposed or actively implemented smart disclosure in a wide variety of settings, ranging from GPS information to 401(k) plans to credit cards contracts.<sup>86</sup> But the key ingredient in empowering entrepreneurial market intermediaries to design smart disclosure tools is data. Without standardized, easily available data, the costs to intermediaries of collecting and analyzing consumer products, use patterns, and practices can be prohibitive.<sup>87</sup>

Second, full disclosure can increase market discipline even in the absence of smart disclosure by facilitating the efforts of market intermediaries and consumer watchdogs to independently assess product quality and appropriateness and make recommendations accordingly.<sup>88</sup> This effect may have been significantly en-

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84. See, e.g., COMM. ON TECH., NAT'L SCI. & TECH. COUNCIL, CHARTER OF THE TASK FORCE ON SMART DISCLOSURE: INFORMATION AND EFFICIENCY IN CONSUMER MARKETS (2011), available at [http://www.whitehouse.gov/sites/default/files/microsites/ostp/tfsd\\_charter\\_signed.pdf](http://www.whitehouse.gov/sites/default/files/microsites/ostp/tfsd_charter_signed.pdf).

85. See *id.*

86. See RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 95–96, 145–46 (2008); Memorandum from Cass R. Sunstein, Adm'r, Office of Info. & Regulatory Affairs, to the Heads of Executive Departments and Agencies, Informing Consumers Through Smart Disclosure 3–4 (Sept. 8, 2011), available at <http://www.whitehouse.gov/sites/default/files/omb/inforeg/for-agencies/informing-consumers-through-smart-disclosure.pdf>.

87. See Thaler & Tucker, *supra* note 37, at 9.

88. See, e.g., AM. LAW INST., PRINCIPLES OF THE LAW: SOFTWARE CONTRACTS § 2.02 cmt. e, at 133 (2009) (“Transferors will also be mindful of watchdog groups that can easily access the standard form and can spread the word about the use of unsavory terms.”); Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimizing Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1, 53–54 (2004) (“Consumer-oriented groups, such as the Consumers Union, act as informers and watchdogs on behalf of consumers.”); William M. Sage, *Regulating Through Information: Disclosure Laws and American Health Care*, 99 COLUM. L. REV. 1701, 1737 (1999) (noting that full disclosure allows market intermediaries to “locate information relevant to parties they represent, analyze and distill it, and communicate it fairly

hanced in recent years by social media, which decreases the costs to market intermediaries of communicating with consumers and increases the capacity of consumers to communicate with one another.<sup>89</sup> Indeed, the mere threat of these effects may have a substantial disciplining effect on firms, deterring them from imposing new fees or hidden unfair terms.

Although the capacity of market intermediaries armed with full information to police private firms varies,<sup>90</sup> there are numerous important recent examples of this process operating effectively. For instance, the public availability of contracts has helped to prevent unfair or deceptive terms for software,<sup>91</sup> cars,<sup>92</sup> social media websites,<sup>93</sup> and cell phones.<sup>94</sup> The power of full disclosure extends to various other regulatory issues as well. For example, when the Department of Labor made broad disclosures about 401(k) plans available online, a market intermediary used this information to rate different plans, which in turn generated decreased fees and enhanced competition.<sup>95</sup> Similarly, full disclosure has proven effective in a broad range of environmental regulatory contexts.<sup>96</sup> In campaign finance law, full

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and accessibly to individual consumers”). Even Omri Ben-Shahar and Carl Schneider, the most vocal critics of disclosure-based consumer protection, seem to admit the potential importance of this type of disclosure. See Ben-Shahar & Schneider, *supra* note 3, at 732 (“There are, to be sure, areas in which disclosures are aimed directly at sophisticated intermediaries, and where the presence of such intermediaries produces a desirable effect for the nonreading populous. . . . But these contexts are few and far between.”). For one recent example of this phenomenon, consider Ian Ayres et al., *Skeletons in the Database: An Early Analysis of the CFPB’s Consumer Complaints* (John M. Olin Ctr. for Studies in Law, Econ., & Pub. Policy, Research Paper No. 475, 2013), available at <http://ssrn.com/abstract=2295157>.

89. See William McGeeveran, *Disclosure, Endorsement, and Identity in Social Marketing*, 2009 U. ILL. L. REV. 1105, 1109–16, 1156.
90. The effectiveness of full disclosure is not always clear. For instance, some argue that performance disclosure requirements for credit rating agencies have failed to reward credit rating agencies with more accurate credit ratings. See, e.g., Lynn Bai, *The Performance Disclosures of Credit Rating Agencies: Are They Effective Reputational Sanctions?*, 7 N.Y.U. J.L. & BUS. 47, 69, 101–04 (2010).
91. See, e.g., Larry Magid, *It Pays to Read License Agreements*, PC PITSTOP, <http://www.pcpitstop.com/spycheck/eula.asp> (last visited Nov. 21, 2013).
92. See, e.g., David Gilo & Ariel Porat, *Viewing Unconscionability Through a Market Lens*, 52 WM. & MARY L. REV. 133, 164 n.73 (2010).
93. See, e.g., McGeeveran, *supra* note 89.
94. See, e.g., Gilo & Porat, *supra* note 92, at 159, 164–67.
95. See Thaler & Tucker, *supra* note 37, at 5.
96. See generally Mark Stephan, *Environmental Information Disclosure Programs: They Work, but Why?*, 83 SOC. SCI. Q. 190 (2002) (noting the beneficial role that information disclosure programs have played in environmental policy and discussing theories for how and why these programs are successful). Perhaps the most well-known example is the Emergency Planning and Community Right-To-Know Act, which required companies to publicly report the amounts of hazardous chemicals they released into the environment. The result was a dramatic reduction in the release of toxic chemicals. See Sidney M. Wolf, *Fear and Loathing*

disclosure is frequently credited with deterring corruption and promoting more effective enforcement of other types of election laws.<sup>97</sup>

A third value of mandatory full disclosure is that it promotes regulatory accountability.<sup>98</sup> Market intermediaries with access to relevant data not only have the ability to convey information about product or service quality and appropriateness to consumers but they also have the capacity to identify consumer protection problems in need of a regulatory solution.<sup>99</sup> For instance, numerous studies using Home Mortgage Disclosure Act (HMDA) data have helped to identify discriminatory lending practices and prompted various initiatives to make credit more available in traditionally underserved areas.<sup>100</sup> Similarly, a recent report by the Pew Health Group reviewed online credit card contracts in an effort to demonstrate that unfair terms were still common and to influence the implementation of the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act) in 2009.<sup>101</sup> And in California, the public availability of

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*About the Public Right to Know: The Surprising Success of the Emergency Planning and Community Right-to-Know Act*, 11 J. LAND USE & ENV'T'L L. 217, 218–20 (1996).

97. See Elizabeth Garrett & Daniel A. Smith, *Veiled Political Actors and Campaign Disclosure Laws in Direct Democracy*, 4 ELECTION L.J. 295, 295 (2005) (“Those who support more extensive campaign finance regulation usually favor disclosure as a necessary component that serves the traditional objective in candidate elections of combating corruption and also provides necessary information to voters in both candidate and issue elections.”).
98. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-268, PRIVATE HEALTH INSURANCE: DATA ON APPLICATION AND COVERAGE DENIALS 2 (2011), <http://www.gao.gov/new.items/d11268.pdf>.
99. See Daniel Schwarcz, *Preventing Capture Through Consumer Empowerment Programs: Some Evidence From Insurance Regulation*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION, AND HOW TO LIMIT IT 365 (Daniel Carpenter & David A. Moss eds., 2014) (noting that public interest groups are capable of influencing and scrutinizing regulatory measures through the media and public outreach).
100. See, e.g., DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING AND FORECLOSURES 31 (2011) (finding that “low-income and minority borrowers and neighborhoods have been disproportionately impacted by foreclosures and that this reflects the higher incidence of higher-risk products received by these groups”); Jacob S. Rugh & Douglas S. Massey, *Racial Segregation and the American Foreclosure Crisis*, 75 AM. SOC. REV. 629, 644–46 (2010) (finding a higher number and rate of foreclosures in metropolitan areas where there is a large degree of Hispanic and especially black segregation); Andrew Haughwout et al., *Subprime Mortgage Pricing: The Impact of Race, Ethnicity, and Gender on the Cost of Borrowing*, BROOKINGS-WHARTON PAPERS ON URB. AFF., 2009, at 33, 33–35; Gregory D. Squires et al., *Segregation and the Subprime Lending Crisis 2–4* (Apr. 16, 2009) (Presented at the 2009 Federal Reserve System Community Affairs Research Conference), available at <http://www.kansascityfed.org/publicat/events/community/2009carc/Hyra.pdf> (concluding that racial segregation, especially among African Americans, is a significant predictor of metropolitan-level variation in the proportion of subprime lending).
101. See PEW HEALTH GRP., STILL WAITING: “UNFAIR OR DECEPTIVE” CREDIT CARD PRACTICES CONTINUE AS AMERICANS WAIT FOR NEW REFORMS TO TAKE EFFECT (2009),

health insurers' claims denial data allowed the California Nurses' Association to call attention to the fact that the state's six largest insurers rejected nearly one out of every five claims they received during the first half of 2009.<sup>102</sup> This effort, in turn, prompted the state attorney general to open an investigation into the claims payment practices of the state's largest insurers.<sup>103</sup>

To be sure, market intermediaries may be able to facilitate smart disclosure or promote market and regulatory discipline even in the absence of full disclosure by conducting independent studies or surveys.<sup>104</sup> But this is often not possible, as it may be quite costly for market watchdogs to obtain the information necessary to conduct such work. Indeed, information revealing potential market problems will often be difficult to come by precisely because firms will tend to avoid making such information easily accessible.<sup>105</sup> Simply reducing the cost of gathering information by standardizing its format and availability can have dramatic effects on the capacity of intermediaries to make use of that information.<sup>106</sup> In any event, public access to market information and data is generally most efficiently facilitated by a single regulatory body, which can specify the format, content, and location of this data.

## II. INADEQUACY OF TRANSPARENCY REGULATION IN PROPERTY/CASUALTY INSURANCE

Despite the ubiquity of transparency-oriented regulation in most consumer protection domains, such regulation is surprisingly absent or lackluster in state insurance regulation. In order to substantiate this claim, this Part focuses on five central regulatory issues in property/casualty insurance markets: (1) prompt and

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[http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit\\_Cards/Pew\\_Credit\\_Cards\\_Oct09\\_Final.pdf](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit_Cards/Pew_Credit_Cards_Oct09_Final.pdf).

102. Press Release, Cal. Nurses Ass'n/Nat'l Nurses Organizing Comm., California's Real Death Panels: Insurers Deny 21% of Claims (Sept. 2, 2009), *available at* <http://www.reuters.com/article/2009/09/02/idUS202570+02-Sep-2009+PRN20090902>. Recently, Vermont passed a similar law making claims denial information more available to the public. This, in turn, prompted media attention to disparities in claims denial rates of different carriers. See Andrew Stein, *New Disclosures Show MVP Denied 15.5 Percent of Patient Claims in 2012; Blue Cross Denied 7.6 Percent*, VTDIGGER.ORG (Mar. 20, 2013, 12:53 PM), <http://vtdigger.org/2013/03/20/new-disclosures-show-mvp-denied-15-5-percent-of-patient-claims-in-2012-blue-cross-denied-7-6-percent>.
103. Lisa Girion, *HMO Claims-Rejection Rates Triggers State Investigation*, L.A. TIMES, Sept. 4, 2009, <http://articles.latimes.com/2009/sep/04/business/fi-insure4>.
104. See Ben-Shahar & Schneider, *supra* note 3, at 731–33.
105. See Schwarcz, *supra* note 7.
106. See Thaler & Tucker, *supra* note 37, at 55 (describing how simply making available online details of 401(k) plans empowered one intermediary, Brightscope, to increase its rating efforts substantially, with dramatic impacts on 401(k) providers more generally).

accurate payment of claims, (2) coverage that is consistent with consumers' reasonable expectations, (3) availability of insurance products for low-income and minority populations, (4) objectivity of independent insurance agents, and (5) affordability of coverage. In each case, state insurance regulation either completely forgoes transparency-oriented regulatory tools or relies on clearly inadequate transparency-oriented rules. And, in each case, relatively simple transparency-focused reforms could substantially improve regulation designed to address the underlying concern. This Part also demonstrates that other spheres of financial regulation have in recent years adopted effective and targeted transparency-oriented strategies when faced with analogous problems. In advancing this final claim, this Part looks to consumer banking products—particularly mortgages, credit cards, and student loans—which raise some similar regulatory issues to property/casualty insurance. It also uses federal regulation of health insurance markets as a foil, demonstrating the remarkable disconnect between this federally dominated form of insurance regulation and the state-based regulation of property/casualty insurance.

#### A. Full Disclosure of Claims Payment Practices

One of the fundamental risks of property/casualty insurance is the prospect of insurer opportunism in claims payment. This risk arises because policyholders perform routinely by paying premiums, whereas the insurer performs by paying a claim if, and only if, a covered loss occurs.<sup>107</sup> As a result, an insurer may be able to retain premium payments even though it adopts an excessively aggressive stance on paying claims, particularly when they are very large. Moreover, the complexity and abstractness of typical property/casualty insurance policies means that it is often unclear whether a loss is indeed covered.<sup>108</sup> Consequently, policyholders may be unable to identify excessively restrictive claims practices even when they occur. Insurers who are inclined to take advantage of these facts can deny or delay payment knowing that policyholders may fail to challenge coverage denials or may be eager to settle because they have an immediate need for funds.<sup>109</sup>

For these reasons, protecting insurance consumers from unfair or delayed claims resolutions is a central goal of insurance law and regulation. Every state

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107. See, e.g., Bob Works, *Excusing Nonoccurrence of Insurance Policy Conditions in Order to Avoid Disproportionate Forfeiture: Claims-Made Formats as a Test Case*, 5 CONN. INS. L.J. 505, 578–88 (1999).

108. See KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 174, 180–81 (1986).

109. See, e.g., Daniel Schwarcz, *Redesigning Consumer Dispute Resolution: A Case Study of the British and American Approaches to Insurance Claims Conflict*, 83 TUL. L. REV. 735 (2009).

has enacted broad laws protecting consumers from opportunistic claims handling, typically using the National Association of Insurance Commissioners's (NAIC)<sup>110</sup> Unfair Claims Settlement Practices Act as a template.<sup>111</sup> Preventing insurers from unreasonably refusing to pay or delaying claims payments is also a central concern of various insurance law doctrines, particularly rules governing bad faith.<sup>112</sup>

Despite the importance of ensuring prompt and accurate claims payment in property/casualty insurance, state insurance law does not make publicly available, much less require disclosure to consumers of, any insurer-specific information regarding insurers' claims-paying reliability or promptness. This is true even though the vast majority of states currently collect data from individual automobile and homeowners insurers regarding their claims payment practices through the Market Conduct Annual Statement (MCAS).<sup>113</sup> These data elements include how often claims are paid within specified time periods, how often claims are denied, and how often policyholders sue for coverage.<sup>114</sup> The NAIC aggregates and stores this data, maintaining and updating standardized definitions for individual data elements.

The public unavailability of this or similar data is largely attributable to industry resistance. In 2008, the Market Conduct and Consumer Affairs Committee of the NAIC proposed publicly disclosing some of this data.<sup>115</sup> Organizing through numerous trade groups, the industry successfully undermined the proposal through a massive lobbying campaign.<sup>116</sup> Its primary argument was that the

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110. The National Association of Insurance Commissioners (NAIC) is a voluntary association of state insurance regulators that wields tremendous influence in insurance regulation through various mechanisms, including the drafting of model laws and regulations. See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 629–34, 667–69 (1999).

111. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 900-1 (1997), <http://www.naic.org/store/free/MDL-900.pdf>. These laws are enforced through generalized market conduct examinations as well as targeted investigations prompted by market conduct data or consumer complaints. See generally KATHLEEN HEALD ETTLINGER ET AL., STATE INSURANCE REGULATION 103 (1995) (discussing private regulation of claims activities).

112. See Alan O. Sykes, "Bad Faith" Breach of Contract by First-Party Insurers, 25 J. LEGAL STUD. 405 (1996).

113. See *Market Conduct Annual Statement Participating Jurisdictions*, NAT'L ASS'N INS. COMMISSIONERS, [http://www.naic.org/industry\\_mcas\\_states](http://www.naic.org/industry_mcas_states) (last visited Nov. 21, 2013).

114. See, e.g., NAT'L ASS'N OF INS. COMM'RS, MARKET CONDUCT ANNUAL STATEMENT: HOMEOWNERS (2011), [http://www.naic.org/documents/industry\\_mcas\\_data\\_collection\\_2011\\_homeowners.pdf](http://www.naic.org/documents/industry_mcas_data_collection_2011_homeowners.pdf).

115. See NAIC MARKET REGULATION & CONSUMER AFFAIRS COMM., PROPOSAL FOR CENTRALIZED DATA COLLECTION (2008).

116. See Chad Hemenway, *NCOIL Study Expanded to Address NAIC Market Conduct Plan*, BESTWIRE, July 11, 2008, available at <http://annuitynews.com/Article/NCOIL-Study-Expanded-to-Address-NAIC-Market-Conduct-Plan/96178>; Letter from Am. Health Ins.

underlying data should be considered confidential because it could reveal proprietary information. Formal NAIC minutes regarding the issue indicate that the NAIC agreed to spend a year to “determine whether, and to what extent, the data collected would be confidential or be available to the public.”<sup>117</sup> But since that time it has been assumed by virtually the entire regulatory community that MCAS data is confidential, and the issue has never, in fact, been revisited.

Although the NAIC does not make available any insurer-specific market conduct data, it recently began publicly releasing aggregate industry MCAS data for individual states. The data reveals that there are substantial variations among individual carriers with respect to various data elements. For instance, in Ohio, the average homeowner carrier in 2009 closed approximately 21 percent of claims without payment. But approximately 20 percent of the 150 reporting carriers closed more than 30 percent of claims without payment, including four carriers that closed more than half of their policyholders’ claims without payment.<sup>118</sup> Similarly, in Kansas, approximately 19 percent of claims associated with private automobile insurance were not paid within sixty days of being reported.<sup>119</sup> But for approximately 20 percent of the 120 reporting carriers, more than 30 percent of claims took more than sixty days to pay, with one carrier reporting that 80 percent of its claims took more than sixty days to pay, and another carrier reporting that 60 percent of its claims fell within this category. Unfortunately, consumers in these states have no ability to tell which insurers fall in which categories and thus cannot adjust their purchasing behavior accordingly.

Consumer complaint information—the only information that state insurance regulators make available to consumers that has any bearing on claims paying reliability—does very little to ameliorate these concerns. Most states, as well as the NAIC, make consumer complaint information available on their websites, though insurers need not disclose this information directly to consumers.<sup>120</sup> And

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Plans et al. to Sandy Praeger, President, Nat’l Ass’n of Ins. Comm’rs (May 27, 2008); see also Daniel Schwarcz, *Differential Compensation and the “Race to the Bottom” in Consumer Insurance Markets*, 15 CONN. INS. L.J. 723, 734 (2009). See generally James Connolly, *NAIC Insurer Conduct Data Scheme Riles Insurers*, PROP. CASUALTY 360° (Sept. 25, 2008), <http://www.propertycasualty360.com/2008/09/25/naic-insurer-conduct-data-scheme-riles-insurers> (stating “[i]ndustry representatives from major insurance trade groups . . . slammed the vote”).

117. Nat’l Ass’n of Ins. Comm’rs, *Joint Executive Committee, Plenary*, 2008 NAIC PROC. 3RD QTR., 3–1, 3–8 (Sept. 22, 2008).

118. OHIO DEP’T OF INS., MARKET CONDUCT ANNUAL STATEMENT—HOMEOWNER DATA (2009), <http://www.insurance.ohio.gov/Company/MC/2010/HORc3.pdf>.

119. KAN. INS. DEPT., 2009 PROPERTY & CASUALTY MARKET CONDUCT ANNUAL STATEMENT 1 (on file with author).

120. According to a 2010 resources report, only six states do not make this data publicly available. This data is collected by individual states and then reported and aggregated by the NAIC, which maintains an online tool allowing users to view various complaint ratios for individual carriers. See



the majority of such complaints do indeed concern claims handling.<sup>121</sup> This data, however, is generally limited and inconsistent. Most aggrieved consumers never complain to their state's insurance department. And the rate at which consumers do complain is based on numerous factors, including the willingness of companies to direct unsatisfied consumers to state insurance departments or the average affluence of policyholders, which tends to correlate with willingness to complain.<sup>122</sup> MCAS claims data are not subject to any of these limitations, though they of course have their own limitations.<sup>123</sup>

Even apart from the limitations in the underlying data, state regulators currently report consumer complaint data in a manner that substantially limits its meaning. First, consumer complaints in many states and at the NAIC are reported only if the state insurance regulator confirms them.<sup>124</sup> Among all complaints reported to the NAIC, approximately 73 percent are not confirmed and thus never publicly reported.<sup>125</sup> Second, and even more importantly, consumer complaints are reported by individual insurance companies rather than by the insurance groups with which consumers are familiar, such as Allstate and State Farm.<sup>126</sup> As a result, a consumer interested in the complaint ratio for a specific insurance group, such as Allstate, would be directed to potentially dozens of different insurance companies, all of which have different complaint numbers. Unless the searcher (1) was already a policyholder and had been assigned a specific insurance company, and (2) understood the distinction between insurance groups and companies, this information would prove almost impossible to decipher.

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*Consumer Information Source*, NAT'L ASS'N INS. COMMISSIONERS, <https://eapps.naic.org/cis> (last visited Nov. 21, 2013).

121. Schwarcz, *supra* note 109, at 751.

122. See, e.g., J.P. Liefeld et al., *Demographic Characteristics of Canadian Consumer Complainers*, 9 J. CONSUMER AFF. 73 (1975); Joseph Barry Mason & Samuel H. Himes, Jr., *An Exploratory Behavioral and Socio-Economic Profile of Consumer Action About Dissatisfaction With Selected Household Appliances*, 7 J. CONSUMER AFF. 121 (1973).

123. Market Conduct Annual Statement (MCAS) data are evidently reliable enough that regulators use them to guide their market conduct priorities. But no data are perfect; insurance regulators would indeed be well served by collecting better and more fine-grained data. In particular, state insurance regulators should move towards collecting transaction-level data, of insurance transactions rather than summary data such as the MCAS.

124. See, e.g., REASONS WHY CLOSED CONFIRMED CONSUMER COMPLAINTS WERE REPORTED AS OF SEPTEMBER 30, 2013 (2013), available at [https://eapps.naic.org/documents/cis\\_aggregate\\_complaints\\_by\\_reason\\_codes.pdf](https://eapps.naic.org/documents/cis_aggregate_complaints_by_reason_codes.pdf).

125. In using complaint information to identify market problems, regulators themselves look at both total complaints and confirmed complaints. See 1 NAIC, MARKET REGULATION HANDBOOK 25–27 (2009).

126. Each insurance group typically has numerous insurance companies, each licensed to do business in a different state. Even within a state, an insurance group may have multiple insurance companies (for example, Allstate Indemnity Company, Allstate Insurance Company, and Allstate Property and Casualty Company).

These deficiencies in consumer complaint information become even more apparent when contrasted with analogous federal regulatory efforts. First, consider the regulation of claims payment data in the federally regulated health insurance sphere. As with property/casualty insurance regulation, the vast majority of states did not make publicly available health insurers' claims payment rates before the Patient Protection and Affordable Care Act (ACA).<sup>127</sup> But even before the ACA, quasiregulatory bodies with a federal reach, such as the American Medical Association (AMA), published information on the timeliness, transparency, and accuracy of claims processing by the nation's largest health insurance companies.<sup>128</sup> Given the obvious limitations of relying on such quasiregulation, the ACA will make such disclosure a formal regulatory requirement in 2014.<sup>129</sup> This data on carriers' claims payments must be provided in plain language that consumers can readily understand and use.<sup>130</sup>

Similarly, the CFPB's database on consumer complaints for credit cards reveals the inadequacies of state consumer complaint reporting in property/casualty insurance.<sup>131</sup> In that database, consumer complaint information is reported by the brand names of credit card companies, rather than by company subsidiaries or product types. Moreover, the CFPB includes complaints in the database regardless of whether they are considered "confirmed," leaving it to the "marketplace of ideas" to determine what the data show.<sup>132</sup> As the CFPB notes, "[s]o long as consumers are aware of the limitations of the data, there is little or no reason to believe that complaint data should make the market less informed and transparent."<sup>133</sup> Shortly after the CFPB launched this database, various media outlets reported on it, noting

127. California has collected data on health-insurer claims denials since 2002. See CAL. HEALTH & SAFETY CODE § 1367.03(f)(2) (West 2008). In 2010, the Connecticut legislature approved a bill mandating the reporting of certain health-insurance claims denial data. See 2010 Conn. Acts 170–73 (Reg. Sess.).

128. *National Health Insurer Report Card*, AM. MED. ASS'N, <http://www.ama-assn.org/ama/pub/advocacy/topics/administrative-simplification-initiatives/national-health-insurer-report-card.page?> (last visited Nov. 21, 2013).

129. The Patient Protection and Affordable Care Act (ACA) will also require insurers participating in state insurance exchanges to publicly disclose "[c]laims payment policies and practices[,] . . . [d]ata on the number of claims that are denied[,] . . . [and] [o]ther information as determined appropriate by the Secretary." Patient Protection and Affordable Care Act, 42 U.S.C. § 18031(e)(3)(A) (Supp. 2011).

130. *Id.* § 18031(3)(e)(B).

131. *Credit Card Complaints*, CONSUMER FIN. PROTECTION BUREAU, <https://data.consumerfinance.gov/dataset/Credit-Card-Complaints/25ei-6bcr> (last visited Nov. 22, 2013).

132. The CFPB does, however, maintain significant controls to *authenticate* complaints. See Disclosure of Certain Credit Card Complaint Data, 77 Fed. Reg. 37,558, 37,561–62 (June 22, 2012).

133. See *id.* at 37,562.

that Capital One had the highest number of consumer complaints.<sup>134</sup> More recently, an academic analysis used this database to identify specific banks that “were significantly less timely in responding to consumer complaints than the average financial institution,” “were significantly more likely than average to dispute the company’s response to their initial complaints,” and “received more mortgage complaints relative to mortgages sold than other banks.”<sup>135</sup>

If insurance regulators invested time and resources in publicly releasing quality, carrier-specific data regarding different carriers’ claims payment practices, their regulatory efforts would be much more efficient and effective. Currently, the only publicly available information about carriers’ claims-paying practices comes from personal anecdotes and highly imperfect consumer surveys.<sup>136</sup> The public release of detailed and specific MCAS data, by contrast, would dramatically alter this landscape. Such full disclosure would empower market watchdogs to communicate more accurately to consumers the quality of different carriers’ claims practices.<sup>137</sup> Full disclosure could also improve the capacity of independent insurance agents, consumer magazines, and market intermediaries using smart disclosure to more accurately direct consumers to carriers according to the consumer’s desired mix of claims service and price.<sup>138</sup> Further, the mere threat of these forces could well alter insurers’ calculus of how best to pay claims.

Importantly, all these potential benefits would complement current regulatory and judicial efforts to prevent unfair claims practices. But rather than simply relying on occasional bad-faith cases and vastly overstretched state regulators for enforcement of these efforts, this approach would harness market forces to induce carriers to do a better job of paying claims fairly and promptly.<sup>139</sup> Moreover, un-

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134. Alwyn Scott & Rick Rothacker, *Consumer Bureau Discloses Credit-Card Complaints*, CHI. TRIB., June 19, 2012, [http://articles.chicagotribune.com/2012-06-19/business/sns-rt-us-usa-creditcards-complaintsbre85j03w-20120619\\_1\\_credit-card-complaints-complaint-database-consumer-bureau](http://articles.chicagotribune.com/2012-06-19/business/sns-rt-us-usa-creditcards-complaintsbre85j03w-20120619_1_credit-card-complaints-complaint-database-consumer-bureau) (“Making credit card complaints public will put added pressure on banks to avoid unfair practices and help consumers make more informed financial decisions,” said Pamela Banks, senior policy counsel for Consumers Union, in a statement.”).

135. For one recent example of this phenomenon, consider Ayres et al., *supra* note 88.

136. *See id.*; *see also* Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2007). Some, but not all, states do make market-conduct exams of particular companies publicly available. But accessing these reports is quite difficult, as there is no centralized location for these reports. More importantly, a substantial number of market conduct reports are not released because they are sealed pursuant to settlement between regulator and companies. This means that the exams that are released represent a biased and incomplete sample. Schwarcz, *supra*.

137. *See supra* Part I.B, Transparency, Full Disclosure, and Market Discipline.

138. Schwarcz, *supra* note 116.

139. *Cf.* Tom Baker, *Sales Stories, Claims Stories, and Insurance Damages*, 72 TEX. L. REV. 1395 (1994) (arguing “insurance companies tell stories about insurance that courts can use (and implicitly have used) as a source for the ‘unwritten’ obligations of the insurance relationship”).

like either judicial or regulatory scrutiny, this approach could facilitate consumer choice about the tradeoff between premiums and claims handling quality. Finally, it could generate pressure on regulators to better police outlier carriers who adopt particularly aggressive claims-handling practices.<sup>140</sup>

## B. Coverage Consistent with Consumers' Reasonable Expectations

### 1. Improving Consumer Understanding of Coverage

A core concern of insurance law and regulation is that consumers' actual coverage matches their reasonable expectations of that coverage. On the regulatory side, states require that carriers' policies comply with various specific coverage mandates. They also typically require that carriers' policies not be "unfair, ambiguous, unreasonable, or contrary to public policy."<sup>141</sup> In most states, enforcement of these rules in personal lines of coverage occurs through "prior approval" form review, meaning that the relevant insurance regulator must specifically approve carriers' policy documents before they are used in the market place.<sup>142</sup> Judicial doctrines also serve to promote consumers' reasonable expectations of coverage. Indeed, one of the most controversial doctrines of insurance law is specifically designed to validate consumers' objectively reasonable expectations of coverage notwithstanding policy language tending to negate those expectations.<sup>143</sup>

Despite the importance of ensuring that coverage matches consumers' reasonable expectations, state insurance law and regulation does remarkably little to promote consumers' understanding of coverage. Perhaps most strikingly, no state requires any type of summary disclosure regarding the terms of coverage to be delivered to consumers before, or at the time of, purchase. And only a small minority of states require summary disclosure of policy terms at the time of policy delivery, which is usually two-to-three weeks after purchase.<sup>144</sup> NAIC model rules or laws also do not require any form of summary coverage disclosure.<sup>145</sup>

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140. See Schwarcz, *supra* note 109.

141. See Schwarcz, *supra* note 7, at 1276.

142. See Stephen P. D'Arcy, *Insurance Price Deregulation: The Illinois Experience*, in DEREGULATING PROPERTY-LIABILITY INSURANCE: RESTORING COMPETITION AND INCREASING MARKET EFFICIENCY, *supra* note 17, at 248, 256–58.

143. See Robert E. Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970). The dominant interpretive meme of insurance law—the ambiguity rule—can also be justified at least in part as a mechanism to promote consumers' reasonable expectations of coverage. Kenneth S. Abraham, *A Theory of Insurance Policy Interpretation*, 95 MICH. L. REV. 531, 547–50 (1996).

144. Several states require insurers to disclose at the time of policy delivery (which is several weeks after purchase) that the policy contains certain exclusions, such as for damages caused by flood or

Instead, in the vast majority of states, the only description of coverage that insurers must provide to consumers is the insurance contract itself, which is typically a twenty- to forty-page document that includes various amendatory endorsements. To be sure, most states do require policies to meet a specific quantitative readability score, usually a fifty or forty on the Flesch-Kincaid Reading Ease Score.<sup>146</sup> Additionally, they often require that the policies contain a table of contents and “self-contained and independent” sections, be written in no less than ten point font, and “use everyday, conversational language.”<sup>147</sup>

But these rules are inadequate at promoting real consumer understanding of policy coverage. First, providing consumers with information several weeks after purchase—whether through a policy document itself or through a summary disclosure—will not promote the regulatory goal of ensuring coverage that consumers reasonably expect because consumers do not receive the relevant information when they actually need it.<sup>148</sup> Consumers have virtually no incentive to read these documents once they have already settled on an insurance carrier and policy, par-

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earthquake. *See* 702 DEL. CODE REGS. § 5 (LexisNexis 2013) (flood); N.J. ADMIN. CODE § 11:1-5.5 (2013) (flood); N.Y. INS. LAW § 3444 (McKinney 2007) (mudslide or flood). In Colorado, insurers issuing dwelling fire insurance, homeowners insurance, or auto insurance must have on file for public inspection a summary disclosure form that contains a simple explanation of the major coverages and exclusions of its policies, as well as a recitation of general factors considered in cancellation, nonrenewal, and increase in premium situations. COLO. REV. STAT. § 10-4-111 (2012). Delaware also requires insurers to offer various other disclosures regarding matters such as replacement cost settlement, policy limits, and nonrenewal. Alaska requires that if an auto insurance policy does not include mandated liability coverage, the insurer must disclose that fact in boldface type at the time of policy delivery. ALASKA STAT. § 21.36.465 (2012). Several states mandate some summary disclosures pertaining to rental car insurance. For instance, in Kentucky, rental vehicle insurance may not be sold unless certain disclosures are made in writing and included with the rental vehicle agreement. The disclosures must include a clear and concise description of the material terms and conditions of the coverage, including a description of exclusions and a statement that the coverage offered may be duplicative of coverage already provided by the renter’s personal automobile insurance policy. *See* KY. REV. STAT. ANN. § 304.9-509 (LexisNexis 2011). In Maine, comprehensive personal auto insurance must cover rental vehicles, and that fact must be disclosed to consumers in a notice accompanying the policy at the time of issuance. *See* ME. REV. STAT. ANN. tit. 24-A, § 2927 (West 2000). Many states do require event disclosures whereby policy terms must be disclosed on the occurrence of a certain event, such as a policy claim.

145. One exception applies when insurance is sold through an employer or affinity group, something that is very uncommon in the property/casualty context. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 710-2, § 10 (1997).
146. *See* Public Hearing on Insurance Contract Readability Standards Before the NAIC Consumer Connections Working Group for the Public Hearing on Insurance Contract Readability Standards (Mar. 2010) (testimony of Brenda Cude, Prof. of Hous. & Consumer Econ., Univ. of Ga.) (on file with author).
147. *See* NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 732-1 (1997), available at <http://www.naic.org/store/free/MDL-732.pdf>.
148. *See supra* Part I.A.1, Summary Disclosures (discussing the importance of timing disclosures correctly); *see also* Korobkin, *supra* note 42, at 1226; Schwarcz, *supra* note 109.

ticularly because switching carriers after purchase is difficult and costly.<sup>149</sup> Moreover, many consumers may have trouble recalling and making use of the basic insurance knowledge and terminology they learned when making the initial purchase several weeks earlier.<sup>150</sup>

Using the insurance policy itself as a disclosure is also inconsistent with the other two best practices of disclosure described in Part I: (1) providing limited information and (2) using a uniform and tested template. Even motivated consumers are ill-equipped to comprehend the meaning of typical property/casualty policies, which are, in many ways, uniquely impenetrable.<sup>151</sup> Flesch-Kincaid and other readability requirements do little to remedy this problem. Not only are the required scores well above the reading level of most Americans, but these scores do not reflect the length of the underlying document, its organization or formatting, or the extent to which words are put together in logical and clear sentences.<sup>152</sup>

These inadequacies are only partially mitigated by the various buyers' guides and consumer advisories that regulators produce. The NAIC maintains and makes publicly available an extensive array of consumer financial education on insurance, including buyers' guides that describe coverage in generic terms and provide some useful background and helpful questions to ask insurance agents.<sup>153</sup> Unfortunately, these attempts at financial literacy education suffer from two serious flaws, even apart from the more general inadequacies in consumer financial education.<sup>154</sup> First, not only are these materials not provided "just in time"<sup>155</sup> but most consumers never actually see them at all: Insurers and agents are not usually required to make these documents available to consumers in property/casualty markets, and they are instead buried in frequently hard-to-find links on state in-

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149. See Avery Katz, *Your Terms or Mine?: The Duty to Read the Fine Print in Contracts*, 21 RAND J. ECON. 518 (1990).

150. See *supra* Part I.A.2, Financial Literacy Education (discussing just-in-time financial education).

151. See Schwarcz, *supra* note 7. See generally Michelle E. Boardman, *Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1107 (2006) (quoting a recent South Carolina Supreme Court decision as stating that "[a]mbiguity and incomprehensibility seem to be the favorite tools of the insurance trade in drafting policies").

152. See Public Hearing on Insurance Contract Readability Standards Before the NAIC Consumer Connections Working Group for the Public Hearing on Insurance Contract Readability Standards, *supra* note 146 (testimony of Daniel Schwarcz, Brenda Cude, and Amy Bach).

153. The NAIC also runs a website, "InsureU," that aims to educate consumers about various insurance issues. See INSUREU, <http://www.insureuonline.org> (last visited Nov. 22, 2013). In addition to these efforts, various states also maintain generic descriptions of different insurance lines of coverage on their websites and in informational brochures.

154. See *supra* Part I.A.3, Antifraud and Antideception Rules.

155. See *supra* Part I.A.3, Antifraud and Antideception Rules.

surance department websites. Second, with remarkably few exceptions,<sup>156</sup> these materials are completely generic: They provide consumers with absolutely no carrier- or consumer-specific guidance. In many cases, consumers would be better off simply Google searching the desired coverage line than reading the relevant buyers' guide.

The collective inadequacy of these regulatory efforts is put into sharp relief when they are compared to federal efforts to inform consumers about the key terms of complex financial contracts. For instance, consider the CFPB summary disclosure form for mortgages.<sup>157</sup> This document is a three-page disclosure that is standardized across the industry in format, design, and information but that is personalized to the borrower's particular loan. The disclosure form provides the most important information on the first page, is written using simple and accessible words, and is given to consumers before they agree to the terms of a mortgage—at least three business days before closing on the loan.<sup>158</sup> The CFPB has extensively tested the document itself with consumers through focus groups, consumer surveys, and the broad solicitation of consumer feedback online.<sup>159</sup>

Perhaps an even more compelling comparison that reveals the inadequacies of property/casualty disclosure rules is provided by the ACA's disclosure regime for health insurance policies. ACA requires the U.S. Department of Health and Human Services (HHS), in consultation with the NAIC, to develop a uniform "summary of benefits and coverage" that would not exceed four pages, would utilize uniform definitions, and would provide consumers with a broad description of key coverage terms, cost-sharing requirements, and exclusions.<sup>160</sup> State regulators, operating through the NAIC pursuant to a federal legislative command and needing to prove themselves to federal regulators, did an admirable job of devel-

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156. The one exception is that one state, Texas, maintains a very good online tool that provides consumers with summary information regarding the content of individual carriers' homeowners policies. See Schwarcz, *supra* note 7, at 1334–35.

157. A sample of the Loan Estimate disclosure form created by the CFPB is available at *Loan Estimate*, CONSUMER FIN. PROTECTION BUREAU, [http://files.consumerfinance.gov/f/201207\\_cfpb\\_loan-estimate.pdf](http://files.consumerfinance.gov/f/201207_cfpb_loan-estimate.pdf) (last visited Nov. 22, 2013). See generally *Disclosure Comparison*, CONSUMER FIN. PROTECTION BUREAU, <http://www.consumerfinance.gov/knowbeforeyouowe/compare> (last visited Nov. 22, 2013).

158. CONSUMER FIN. PROT. BUREAU, PROPOSED RULE TO SIMPLIFY AND IMPROVE MORTGAGE DISCLOSURE FORMS (2012), [http://files.consumerfinance.gov/f/201207\\_cfpb\\_consumer-summary\\_proposed-rule-to-improve-mortgage-disclosure.pdf](http://files.consumerfinance.gov/f/201207_cfpb_consumer-summary_proposed-rule-to-improve-mortgage-disclosure.pdf) (commenting on proposed disclosures).

159. Kennedy et al., *supra* note 28.

160. 42 U.S.C. § 300gg-15 (Supp. 2011) (adding Section 2715 to the Public Health Service Act).

oping such a document.<sup>161</sup> State regulators subjected the document to extensive consumer testing and repeatedly refined it in response to the results of that testing.<sup>162</sup> As a result, it clearly communicates the central terms of a health-insurance policy in a standardized format with which consumers will become increasingly familiar and that will tend to facilitate comparison shopping and market discipline.

State regulators could easily devise an analogous document for property/casualty insurance policies. The document would likely focus consumers' attention on key exclusions for which supplemental coverage could be purchased as well as on the coverage limit, which generally must be sufficient to rebuild in the event of a total loss.<sup>163</sup> It would highlight whether claims are paid out according to actual cash value (ACV) or replacement. And it might also focus consumers' attention on exclusions that are intended to reduce moral hazard—the risk that policyholders will take insufficient care because they are insured.<sup>164</sup> Additionally, an effective disclosure would convey, in summary form, a metric of the extent to which the underlying policy was more or less generous than the presumptive industry baseline, the relevant Insurance Services Office (ISO) policy.<sup>165</sup> Except in the increasingly rare instances when consumers purchase coverage over the phone, insurers could easily provide this summary disclosure to consumers well before the purchase of the underlying coverage and maintain online access to the disclosure as well.<sup>166</sup>

Such a summary disclosure form could (albeit imperfectly) promote coverage that is more consistent with consumers' reasonable expectations if it were delivered to consumers before purchase and made widely available online. It could encourage market discipline by penalizing firms that decrease coverage to consumers in ways that their prices do not reflect. It could also better match consumers with insurance providers by allowing consumers to select intelligently among available price/coverage combinations. To be sure, how well such a document would

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161. The proposed template is available online. *Summary of Benefits and Coverage: What This Plan Covers & What It Costs*, DEPT LAB., <http://www.dol.gov/ebsa/pdf/correctedsbctemplate.pdf> (last updated May 11, 2012).

162. See CONSUMERS UNION, WHAT'S BEHIND THE DOOR: CONSUMERS' DIFFICULTIES SELECTING HEALTH PLANS (2012), <http://www.consumersunion.org/pub/pdf/Consumer%20Difficulties%20Selecting%20Health%20Plans%20Jan%202012.pdf>.

163. Kenneth S. Klein, *When Enough Is Not Enough: Correcting Market Inefficiencies in the Purchase and Sale of Residential Property Insurance*, 18 VA. J. SOC. POL'Y & L. 345, 378–82 (2011).

164. See Schwarcz, *supra* note 109.

165. See *id.*

166. The two dominant ways that consumers purchase coverage are over the Internet or in person, with an agent. See MCKINSEY & CO., AGENTS OF THE FUTURE: THE EVOLUTION OF PROPERTY AND CASUALTY INSURANCE DISTRIBUTION 6 (2013). In either case, there is simply no technical barrier to requiring that consumers receive relevant disclosure material before purchase.



accomplish these goals is an empirical question that would depend crucially on the quality of the disclosure.<sup>167</sup> But, this approach could easily be paired with current regulatory approaches to promote coverage consistent with consumers' reasonable expectations, such as coverage mandates and policy preapproval.

Additionally, better disclosure of policy terms could yield benefits that are simply impossible to replicate through the traditional command-and-control approach to ensuring adequate coverage. In particular, it could promote effective usage of insurance by consumers by limiting the risk of moral hazard: While many insurance contract exclusions are aimed at losses that are particularly likely to be the product of insufficient care, these provisions work only if policyholders are aware of them.<sup>168</sup> If these clauses fail to reduce moral hazard risk and simply shift this risk to policyholders, they produce two independent social costs: They fail to minimize costs efficiently, and they allocate those costs to the comparatively risk-averse party.

## 2. Full Disclosure of Carriers' Coverages

Not only does state insurance regulation fail to promote effective summary disclosure to consumers, but it also fails to promote full disclosure to the public.<sup>169</sup> It is currently incredibly difficult for entrepreneurial intermediaries, motivated consumers, interested academics, consumer advocates, and inquiring news outlets to acquire copies of different property/casualty insurers' policy documents.<sup>170</sup> Almost no insurers make these documents publicly available online.<sup>171</sup> Nor do state insurance regulators systematically maintain copies of different carriers' policies. The copies states happen to have on file generally must be accessed either through a freedom-of-information request or by physically visiting the regulator, locating the relevant documents, and photocopying them.<sup>172</sup> And even with respect to the small handful of states that facilitate online access to regulatory fil-

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167. See *supra* Part I.A, An Overview of Transparency-Oriented Consumer Financial Protection.

168. See Schwarcz, *supra* note 7, at 1308.

169. See *supra* Part I.B, Transparency, Full Disclosure, and Market Discipline (explaining the distinct value of full disclosure of information to the public).

170. See generally Schwarcz, *supra* note 7, at 1318–37 (emphasizing the various barriers to obtaining policy forms).

171. *Id.* at 1321 (“An information-seeking consumer might first look to insurers’ websites to access copies of policy forms. A thorough review of these websites reveals that such an effort would be fruitless: not a single one of the top twenty homeowners insurers in the nation makes their homeowners policies available online.”). Exceptions include California, Florida (property and casualty), Indiana (health and life), Pennsylvania, and Washington.

172. See Elizabeth Abbott et al., Comments of NAIC Consumer Representatives Regarding Leveraging SERFF in Support of Public Access to Product Filings (2012) (on file with author).

ings, actually using these tools to retrieve available policy forms takes many hours of effort as well as substantial technical expertise.<sup>173</sup>

Once again, these inadequacies contrast sharply with analogous efforts at transparency in the federal sphere. For instance, the Credit CARD Act requires credit card issuers to publish on the Internet their cardholder contracts.<sup>174</sup> These contracts are easily searchable on a single website that is specifically designed for ease of use.<sup>175</sup> Similarly, the ACA requires that all health insurance policies be made publicly available on the Internet, along with information about a carrier's list of network providers and drug formularies.<sup>176</sup>

There is good reason to think that making insurance policies more widely available online would meaningfully improve market transparency. In the United Kingdom, insurers' policies are widely available online, usually through the insurer's own website.<sup>177</sup> Using this information, the primary consumer-oriented magazine in the United Kingdom ranks, each year, every insurance carrier based in part on a thorough analysis of the terms of each carrier's insurance policy.<sup>178</sup> It also has developed a standardized mechanism to inform consumers of each carrier's terms, which discloses both the "[m]ost important policy elements" and, with a click of the mouse, various additional terms.<sup>179</sup> Similarly, market intermediaries in Germany provide independent product ratings of different insurers' policies.<sup>180</sup>

### C. Full Disclosure of the Availability of Insurance Products for Low-Income and Minority Populations

A major regulatory goal in the homeowners insurance arena is to ensure the availability of coverage for low-income and minority populations. The reason is

173. See Schwarcz, *supra* note 7, at 1325.

174. 15 U.S.C. § 1632 (2012) (codifying § 204 of the Credit Card Accountability Responsibility and Disclosure Act of 2009).

175. See Credit Card Accountability Responsibility and Disclosure Act of 2009, 15 U.S.C. § 1632(d).

176. Patient Protection and Affordable Care Act § 1303, Pub. L. No. 111-148, 124 Stat. 119, 168 (2010).

177. See, e.g., ECCLESIASTICAL, POLICY DOCUMENT: HOME INSURANCE (2013), <http://www.ecclesiastical.com/Images/home%20insurance%20policy%20document.pdf>; LEGAL & GEN., HOME INSURANCE: POLICY BOOKLET (2013), [http://www.legalandgeneral.com/\\_resources/pdfs/insurance/HomePolicy.pdf](http://www.legalandgeneral.com/_resources/pdfs/insurance/HomePolicy.pdf); *Home Insurance Cover*, HISCOX, <http://www.hiscox.co.uk/personal-and-home/home-insurance/details-of-cover> (last visited Nov. 22, 2013).

178. See *Home Insurance: Which? Recommended Providers*, WHICH?, <http://www.which.co.uk/money/insurance/reviews-ns/home-insurance/which-recommended-providers> (last visited Nov. 22, 2013).

179. See, e.g., *Home Insurance Reviews—Hiscox Home Insurance Review*, WHICH?, <http://www.which.co.uk/money/insurance/reviews-ns/home-insurance-reviews/hiscox-home-insurance-review> (last visited Nov. 22, 2013).

180. See Stephanie Meyr & Sharon Tennyson, Product Ratings as a Market Reaction to Deregulation: Evidence From Germany (Sept. 2013) (unpublished manuscript) (on file with author).

simple: Homeowners insurance is a practical prerequisite for homeownership because lenders require that borrowers purchase and maintain coverage. As one court succinctly put it: “No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable.”<sup>181</sup> This concern gained substantial attention several decades ago when various insurers refused to sell coverage within “redlined” low-income and minority regions.<sup>182</sup> Available evidence suggests that homeowners insurance continues to be systematically more expensive and less available in certain low-income, urban areas.<sup>183</sup> Even in the absence of discriminatory intent, facially neutral insurance practices producing these results may violate the Fair Housing Act if a less discriminatory alternative is available.<sup>184</sup>

According to a recent report, similar availability problems are common for automobile insurance.<sup>185</sup> In particular, facially neutral rating criteria—including credit score, education, and occupation—systematically make comparable insurance more expensive for low-income individuals than their wealthier counterparts. Moreover, coverage is often less available in low-income regions because of the absence of insurance agents. And in some cases, carriers simply refuse to sell coverage to low-income drivers in certain geographic regions. These findings raise distinct problems: The unavailability of automobile insurance often means that low-income individuals cannot commute to work, locate new job opportunities, or easily acquire needed goods at affordable prices.<sup>186</sup> Moreover, availability problems result in a more substantial population of uninsured drivers, which jeopardizes larger state goals of reasonable compensation for accident victims.

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181. NAACP v. Am. Family Mut. Ins. Co., 978 F.2d 287, 297–98 (7th Cir. 1992) (citing *Cartwright v. Am. Sav. & Loan Ass’n*, 880 F.2d 912 (7th Cir. 1989)).

182. See generally GREGORY SQUIRES, *INSURANCE REDLINING: DISINVESTMENT, REINVESTMENT, AND THE EVOLVING ROLE OF FINANCIAL INSTITUTIONS* (1997).

183. See generally Gregory D. Squires, *Racial Profiling, Insurance Style: Insurance Redlining and the Uneven Development of Metropolitan Areas*, 25 J. URB. AFF. 391 (2003). But see Scott E. Harrington & Greg Niehaus, *Race, Redlining, and Automobile Insurance Prices*, 71 J. BUS. 439, 456 (1998) (finding in Missouri that racial discrimination does not produce prices that are higher than expected claims costs in the context of automobile insurance).

184. Dana L. Kaersvang, Note, *The Fair Housing Act and Disparate Impact in Homeowners Insurance*, 104 MICH. L. REV. 1993, 2006–13 (2006).

185. *Auto Insurers Charge High and Variable Rates for Minimum Coverage to Good Drivers From Moderate-Income Areas*, CONSUMER FED’N AM. (June 18, 2012), <http://www.consumerfed.org/news/545>.

186. Cf. Steven Garasky et al., *Transiting to Work: The Role of Private Transportation for Low-Income Households*, 40 J. CONSUMER AFF. 64, 74 (2006) (noting that low-income respondents are more likely to report that transportation problems affected training or labor force participation because of lapses in insurance); Brian D. Taylor & Paul M. Ong, *Spatial Mismatch or Automobile Mismatch?: An Examination of Race, Residence and Commuting in U.S. Metropolitan Areas*, 32 URB. STUD. 1453, 1471 (1995) (“That commuters dependent on public transit are at a distinct disadvantage in accessing employment, especially to dispersed suburban job sites, points to policies to help carless job-seekers get access to automobiles.”).

Despite these concerns, state insurance regulation has actively resisted making publicly available any information regarding the availability and affordability of insurance in low-income and minority regions. The last survey on point found that only four states require insurers to disclose any information regarding the availability of homeowners insurance in specific geographic regions, and no state makes publicly available geography-specific loss or pricing data for individual insurers.<sup>187</sup> Similarly, the NAIC has no model laws or regulations requiring the collection and dissemination of such data, and it has repeatedly ignored advocates' efforts to promote such transparency.<sup>188</sup> Systematic data is also lacking in the automobile insurance realm. With the exception of a few states, particularly California, state laws and regulations do not require the collection or dissemination of data regarding the availability of automobile insurance to low income and minority populations.<sup>189</sup>

Full disclosure about the extent of availability and affordability problems would likely increase regulator and carrier accountability for any coverage availability problems that do exist. Currently, much of the evidence on these issues is anecdotal precisely because of the lack of relevant information. Academics, public interest groups, and journalists have been unable to document these problems systematically, allowing regulators, lawmakers, and carriers to avoid public pressure to do anything about the underlying problems to the extent they exist in the first place.<sup>190</sup> By contrast, in those states that do disclose information about the availability of coverage, public interest groups have had much more success in pressing carriers to expand the availability of coverage through Fair Housing Act lawsuits.<sup>191</sup>

Federal efforts to promote transparency in analogous domains suggest the inadequacy of state insurance law and the potential benefits of a full disclosure regime in insurance. The HMDA requires most lenders to report and make publicly available geocoded information regarding home loans, loan applications, interest rates, and the race, gender, and income of loan applicants.<sup>192</sup> The

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187. Squires, *supra* note 183, at 404.

188. See Gregory D. Squires, *Bank Reform Offers Opportunity to Address Insurance Redlining*, HUFFINGTON POST (July 13, 2010, 12:59 PM), [http://www.huffingtonpost.com/gregory-d-squires/bank-reform-offers-opport\\_b\\_644542.html](http://www.huffingtonpost.com/gregory-d-squires/bank-reform-offers-opport_b_644542.html).

189. See Comments of the Consumer Federation of America and the Center for Economic Justice on Proposed Work Plan of Joint Auto Insurance (C/D) Study Group (July 5, 2012), *available at* [http://www.naic.org/documents/committees\\_c\\_d\\_auto\\_insurance\\_study\\_group\\_exposures\\_work\\_plan\\_auto\\_study\\_group\\_cej\\_cfa\\_comments.pdf](http://www.naic.org/documents/committees_c_d_auto_insurance_study_group_exposures_work_plan_auto_study_group_cej_cfa_comments.pdf). This might include data regarding average premiums, normalized for coverage differences, for geographic areas sorted by income level.

190. See Squires, *supra* note 183, at 404.

191. See *id.*

192. See 12 U.S.C. § 2803 (2012); 12 C.F.R. pt. 203 (2013).

HMDA has promoted a richer understanding of credit availability and discrimination, helped identify discriminatory lending practices, and prompted various initiatives to make credit more available in traditionally underserved areas.<sup>193</sup>

In this instance, the inadequacy of state insurance regulation in promoting transparency proved sufficiently clear that federal lawmakers recently intervened. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) establishes a new Federal Insurance Office (FIO) and specifically charges it with “monitor[ing] the extent to which traditionally underserved communities and consumers, minorities . . . and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance.”<sup>194</sup> To do so, the FIO can “receive and collect data and information on and from the insurance industry and insurers” and “analyze and disseminate [this] data and information.”<sup>195</sup> In other words, only after state insurance law repeatedly refused to make HMDA-like data for homeowners or automobile insurance publicly available did federal lawmakers step in and insist on this level of transparency, which has long been a core feature of federal housing policy.

#### D. Improving Consumer Understanding of the Objectivity of Independent Insurance Agents

Many property/casualty policyholders purchase their coverage through an independent insurance agent. Such agents can write coverage with multiple different carriers, a fact that they claim allows them to better find a policy and company that matches consumers’ needs and preferences.<sup>196</sup> But most independent insurance agents also receive different amounts of compensation for placing consumers with different carriers.<sup>197</sup> This can create a potential conflict of interest for agents, as they may earn more by steering a policyholder to an insurer that is not the best fit for that consumer.<sup>198</sup>

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193. See sources cited *supra* note 100. Similarly, under the Community Reinvestment Act (CRA), regulators’ assessments of banks’ and thrifts’ lending records to low- and moderate-income communities and the institutions’ CRA ratings are made public. See Barr, *supra* note 23, at 601.

194. 31 U.S.C. § 313(a), (c)(1)(B) (Supp. 2011).

195. *Id.* § 313(e)(1)(A), (C).

196. See Lauren Regan & Sharon Tennyson, *Agent Discretion and the Choice of Insurance Marketing System*, 39 J.L. & ECON. 637, 642 (1996); Schwarcz, *supra* note 116.

197. Often this is a result of “contingent commissions,” which are essentially year-end bonuses to agents based on the volume and/or profitability of the business sent to the insurer. Alternatively, some carriers may simply pay higher upfront “premium” commissions.

198. See Daniel Schwarcz, *Beyond Disclosure: The Case for Banning Contingent Commissions*, 25 YALE L. & POLY REV. 289, 291 (2007).

These issues have prompted substantial regulatory scrutiny in recent years. High-profile investigations by the New York Attorney General revealed that the leading commercial-insurance broker systematically steered its sophisticated clients to more expensive coverage, at times even orchestrating phony bids to do so.<sup>199</sup> Not surprisingly, evidence suggests that similar steering (though not bid rigging) occurred at smaller independent insurance agencies as well.<sup>200</sup> Insurance agent steering undermines market discipline by focusing insurers on wooing insurance agents rather than on providing value to consumers.<sup>201</sup> It also undermines the matching of consumers with products that best suit their needs.<sup>202</sup>

Despite these concerns, state insurance regulators have consistently refused to promote disclosure to consumers about the compensation and incentives of ostensibly independent insurance agents. Most states do not currently have any rules or regulations regarding the disclosure of agent compensation. Those that do typically do not require any such disclosure unless the agent received compensation directly from the customer, which is highly atypical in most consumer transactions.<sup>203</sup> Only a single state, New York, requires that agents in ordinary consumer transactions disclose before sale that their compensation may vary depending on the carrier with which the consumer is placed.<sup>204</sup> And this disclosure violates most of the basic principles for effective summary disclosure described above: It does not require disclosure in a standardized format or template, it was not consumer tested, it does not focus consumers on the key information, and it is likely to be drowned out by other disclosures.<sup>205</sup>

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199. See Sean M. Fitzpatrick, *The Small Laws: Eliot Spitzer and the Way to Insurance Market Reform*, 74 *FORDHAM L. REV.* 3041, 3046–47 (2006).

200. See Jeffrey M. Wilder, *Competing for the Effort of a Common Agent: Contingency Fees in Commercial Insurance* 4–5 (U.S. Dep't of Justice, Antitrust Div., Econ. Analysis Grp. Working Paper No. EAG03-4, 2004), available at <http://ssrn.com/abstract=418061>.

201. *Public Hearing on Producer Compensation: Hearing Before the N.Y. Ins. Dep't & Office of the Att'y Gen.* 116 (July 25, 2008) (testimony of Don Bailey, CEO, Willis North America), available at [http://www.dfs.ny.gov/insurance/hearing/broker\\_comp\\_072008/br-cmp-tran-nyc.pdf](http://www.dfs.ny.gov/insurance/hearing/broker_comp_072008/br-cmp-tran-nyc.pdf) (testifying that Willis, a property/casualty insurance broker, does not accept contingent commissions because they pose a “clear and obvious conflict of interest”).

202. Schwarcz, *supra* note 198.

203. See Fitzpatrick, *supra* note 199, at 3063–64.

204. N.Y. COMP. CODES R. & REGS. tit. 11, § 30.3 (2010). Notably, this seemingly limited rule prompted massive outcry and resistance from the industry, including a lawsuit claiming that the rule was not within the Insurance Commissioner's authority. See *In re Sullivan Fin. Grp., Inc. v. Wrynn*, 939 N.Y.S.2d 761 (App. Div. 2012).

205. See *supra* Part I, An Overview of Transparency-Oriented Consumer Financial Protection. The disclosure should focus consumers on the fact that differential compensation creates a conflict of interest for agents in recommending different carriers. Additionally, agents should provide it when they cannot explain it away, and most importantly, such disclosure should be consumer tested.

Once again, this refusal of state regulators to embrace transparency contrasts starkly with federal regulation of analogous conflicts of interest. For instance, until the Dodd-Frank Act banned the payment of yield spread premiums to mortgage originators,<sup>206</sup> federal law required U.S. mortgage brokers to disclose these payments, as well as all other forms of compensation, to borrowers within three days of the borrower's initial application as well as at the time of closing.<sup>207</sup> Like differential compensation to insurance agents, yield spread premiums created incentives for brokers to steer mortgage applicants to costly loans.<sup>208</sup> Similarly, the Securities Exchange Act of 1934 requires investment managers to disclose any side payments that they receive from brokerage firms in the form of "soft dollars."<sup>209</sup> As above, these side payments create risks that investment managers will select brokerage firms that are not in their clients' best interests.<sup>210</sup>

To be sure, there are good reasons to be skeptical of the efficacy of transparency-based solutions to these types of regulatory problems, which Howell Jackson has labeled "trilateral dilemmas."<sup>211</sup> Indeed, federal disclosure efforts in this context have a poor record. The disclosure-based approach to yield spread premiums seems to have been a failure, a fact implicitly recognized by the Dodd-Frank Act's move to ban these payments.<sup>212</sup> And the effectiveness of soft dollar disclosures is also unclear, with the National Association of Security Dealers (NASD) Mutual Fund Task Force having recommended "enhanced disclosure in fund prospectuses to foster better investor awareness of soft dollar practices."<sup>213</sup> Moreover, empirical research suggests that disclosures of conflicts of interest can backfire, enhancing consumer trust of market intermediaries whom they credit with honesty and forthrightness and increasing the willingness of intermediaries to act on their conflicts of interest.<sup>214</sup>

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206. 15 U.S.C. § 1639b(c)(4)(a) (2012).

207. Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 305–08 (2007).

208. See Howell Jackson, *The Trilateral Dilemma in Financial Regulation*, in OVERCOMING THE SAVING SLUMP: HOW TO INCREASE THE EFFECTIVENESS OF FINANCIAL EDUCATION AND SAVING PROGRAMS 82 (Annamaria Lusardi ed., 2008).

209. See generally Lee B. Burgunder & Karl O. Hartmann, *Soft Dollars and Section 28(e) of the Securities Exchange Act of 1934: A 1985 Perspective*, 24 AM. BUS. L.J. 139 (1986).

210. See Schwarcz, *supra* note 198, at 313.

211. See Schwarcz, *supra* note 116; Schwarcz, *supra* note 198.

212. See 15 U.S.C. § 1639b(c)(4)(a) (2012).

213. MUT. FUND TASK FORCE, NAT'L ASS'N OF SEC. DEALERS, REPORT OF THE MUTUAL FUND TASK FORCE: SOFT DOLLARS AND PORTFOLIO TRANSACTION COSTS 5 (2004) [hereinafter NASD TASK FORCE REPORT], available at <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p012356.pdf>.

214. See generally JAMES M. LACKO & JANIS PAPPALARDO, FED. TRADE COMM'N, THE EFFECT OF MORTGAGE BROKER COMPENSATION DISCLOSURES ON CONSUMERS AND

But in the absence of a complete ban on differential compensation to independent insurance agents, various transparency-based approaches could indeed be partially effective. Perhaps the most promising such approach would be for insurance regulators to use insurance-based antideception rules to forbid agents who receive differential compensation from describing themselves as independent. That word, which is heavily emphasized in the marketing materials of most agents who place coverage with multiple carriers, conveys the impression that the agent will work solely in the policyholder's best interests. Differential compensation undermines this promise. By forcing agents who accept differential compensation to abandon their claims of independence, regulators could foster a market-based approach to differential compensation whereby agents seeking to appeal to consumers looking for genuine independence could disclaim differential compensation.<sup>215</sup>

#### E. Affordable Insurance Rates and Improving Consumers' Ability to Comparison Shop

A major goal of state regulation of property/casualty insurance is to promote affordable insurance rates. This goal, however, is quite controversial, with many commentators arguing that there is little risk that carriers will charge excessive rates in property/casualty markets because of market competition.<sup>216</sup> This position should be resisted for two reasons. First, carriers' actual coverage varies substantially in ways that are impossible for consumers to observe,<sup>217</sup> and so the rate per unit of coverage that any carrier charges is also difficult for consumers to observe. Second, even the nominal rate of coverage is quite costly for consumers to obtain: Unlike many products, the price that a carrier charges depends substantially on the particularities of the policyholder.<sup>218</sup> This means that insurers cannot

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COMPETITION: A CONTROLLED EXPERIMENT, at ES 1 (2004), available at [http://www.mondomundi.alta.org/govt/issues/04/ftc\\_mtgebroke\\_0227.pdf](http://www.mondomundi.alta.org/govt/issues/04/ftc_mtgebroke_0227.pdf); Daylian Cain et al., *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. LEGAL STUD. 1, 4–8 (2005).

215. See Fitzpatrick, *supra* note 199, at 3067.

216. See generally Scott E. Harrington, *Effects of Prior Approval Rate Regulation of Auto Insurance*, in DEREGULATING PROPERTY-LIABILITY INSURANCE: RESTORING COMPETITION AND INCREASING MARKET EFFICIENCY, *supra* note 17, at 285, 309–10; Harvey Rosenfield, *Auto Insurance: Crisis and Reform*, 29 U. MEM. L. REV. 69, 70 (1998).

217. Schwarcz, *supra* note 116, at 734–37.

218. Such risk-based pricing is also a feature of many credit products.



advertise a single price and that in order to obtain an accurate price quotation, consumers must engage in the time-consuming process of applying for coverage.<sup>219</sup>

To address the perceived problem of excessive insurance rates, most states maintain an extensive program of rate review. Some states require that all carriers receive preapproval from the insurance department before they change their rates, others review carriers' rate changes after they are implemented, and some states do not affirmatively review premium rates at all.<sup>220</sup> In addition to being quite costly, there is substantial evidence that, in many markets, this regulation can have unintended negative consequences, such as intensifying rate volatility and discouraging carriers from decreasing their rates.<sup>221</sup> There is even evidence that it does not, in fact, result in the suppression of rates over the long run.<sup>222</sup>

Although state insurance regulation devotes massive resources to directly regulating insurance rates, it does virtually nothing to leverage transparency-oriented tools to address the perceived risk of excessive rates. Perhaps the best way states could address affordability problems using transparency would be to structure insurance products to facilitate consumer comparison shopping.<sup>223</sup> This would eliminate the difficulty consumers currently face in comparing coverage and rates on an apples-to-apples basis. Indeed, the federal government insisted on this approach with respect to the sale of Medigap policies.<sup>224</sup> Available evidence suggests that this approach successfully promoted reduced insurance prices.<sup>225</sup> Admittedly, this strategy limits consumer choice, though it is arguably less intrusive than the aggressive rate regulation currently deployed in most states. In

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219. Such risk-based pricing may allow carriers to discriminate in the prices they charge to different customers, charging more to consumers who tend not to comparison shop, such as long-time policyholders. See OFFICE OF PUB. INS. COUNCIL, NOT SHOPPING FOR INSURANCE CAN LEAD TO OVERCHARGES, [http://www.opic.state.tx.us/images/Final\\_Failure\\_to\\_Shop\\_Report\\_-\\_7\\_26\\_12ENGLISH.pdf](http://www.opic.state.tx.us/images/Final_Failure_to_Shop_Report_-_7_26_12ENGLISH.pdf).

220. See generally Cummins, *supra* note 17.

221. See SHARON TENNYSON, NETWORKS FIN. INST., POLICY BRIEF NO. 2007-PB-03, EFFICIENCY CONSEQUENCES OF RATE REGULATION IN INSURANCE MARKETS 18 (2007), available at [http://indstate.edu/business/nfi/leadership/briefs/2007-PB-03\\_Tennyson.pdf](http://indstate.edu/business/nfi/leadership/briefs/2007-PB-03_Tennyson.pdf). But see J. ROBERT HUNTER, CONSUMER FED'N OF AM., STATE AUTOMOBILE INSURANCE REGULATION: A NATIONAL QUALITY ASSESSMENT AND IN-DEPTH REVIEW OF CALIFORNIA'S UNIQUELY EFFECTIVE REGULATORY SYSTEM (2008), [http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/state\\_auto\\_insurance\\_report.pdf](http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/state_auto_insurance_report.pdf) (arguing that rate regulation has proven uniquely successful in California).

222. See Harrington, *supra* note 216.

223. See *supra* Part I.A.4, Structuring Markets and/or Products.

224. See Thomas Rice & Kathleen Thomas, *Evaluating the New Medigap Standardization Regulations*, 11 HEALTH AFF. 194, 194 (1992).

225. See, e.g., Lauren A. McCormack et al., *Medigap Reform Legislation of 1990: Have the Objectives Been Met?*, 18 HEALTH CARE FINANCING REV. 157, 167-69 (1996); Thomas Rice et al., *The Impact of Policy Standardization on the Medigap Market*, 34 INQUIRY 106, 113-14 (1997).

any event, states could adopt less aggressive versions of this approach, such as requiring that all initial pricing of coverage take place on a standardized form but thereafter allowing carriers to offer their own personalized adjustments.<sup>226</sup>

A second, less intrusive pricing-transparency strategy that states have ignored is mimicking the ACA's approach to facilitating price competition by promoting the use of insurance exchanges.<sup>227</sup> Consumers who purchase health insurance on an exchange in 2014 will be able to comparison shop more easily among plans.<sup>228</sup> Although the impact of the ACA on rates within the exchanges is a matter of some contention, initial indications suggest that exchanges are indeed helping to promote lower prices, particularly given various other elements of the ACA—such as increased coverage requirements and adverse selection—which may push prices in the opposite direction.<sup>229</sup> State lawmakers could establish similar regulated marketplaces to facilitate consumer comparison of property/casualty policies.<sup>230</sup> They could go even further by developing pricing measures, such as actuarial value, that embed within them presumed product-use patterns. Similarly, they might embrace full disclosure of insurer product and pricing information to facilitate smart disclosure options that could recommend coverage tailored to individuals' particularized preferences.<sup>231</sup>

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226. See *supra* Part I.A.4, Structuring Markets and/or Products.

227. TIMOTHY STOLTZFUS JOST, HEALTH INSURANCE EXCHANGES AND THE AFFORDABLE CARE ACT: KEY POLICY ISSUES 15–16 (2010), available at <http://www.commonwealthfund.org/Content/Publications/Fund-Reports/2010/Jul/Health-Insurance-Exchanges-and-the-Affordable-Care-Act.aspx>. One way states could promote the development of private insurance exchanges is by better regulating commercial websites that purport to provide consumers with multiple premium quotations but in fact operate as lead generators. See NAT'L ASS'N OF INS. COMM'RS, BEST PRACTICES FOR PREMIUM COMPARISON WEBSITES (2012), [http://www.naic.org/documents/committees\\_c\\_trans\\_read\\_wg\\_exposures\\_best\\_practices.pdf](http://www.naic.org/documents/committees_c_trans_read_wg_exposures_best_practices.pdf). State lawmakers could prohibit insurance companies from advertising or soliciting business on premium comparison websites unless they operate as advertised and generate immediate premium quotes from multiple carriers. They could also require these sites to disclose the number of carriers from whom they offer quotes relative to the number of carriers in the marketplace, as well as information about commission levels that the site collects. Alternatively, states could provide this type of premium comparison information directly to consumers in the form of a regulator-provided premium comparison guide. But given the difficulties with keeping such a tool up to date and having it incorporate most rating factors, this approach is unlikely to be effective. According to a recent survey of state insurance offices, only three states maintain this type of premium comparison tool. See *id.*

228. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking.

229. See LAURA SKOPEK & RICHARD KRONICK, MARKET COMPETITION WORKS: SILVER PREMIUMS IN THE 2014 INDIVIDUAL MARKET ARE SUBSTANTIALLY LOWER THAN EXPECTED (2013), available at [http://aspe.hhs.gov/health/reports/2013/MarketCompetitionPremiums/ib\\_premiums\\_update.pdf](http://aspe.hhs.gov/health/reports/2013/MarketCompetitionPremiums/ib_premiums_update.pdf).

230. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking.

231. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking, for a discussion of recommender systems.

An alternative transparency-oriented approach that state insurance law could borrow from the ACA would be to refocus states' rate review process on communicating with consumers rather than restricting carrier rates. The ACA directs HHS, in conjunction with the states, to identify unreasonable premium increases.<sup>232</sup> But the ACA does not empower lawmakers to prohibit these rate increases; it instead requires the public posting of rate increases that are deemed unreasonable.<sup>233</sup> This approach might inform consumers about which insurers are charging unreasonable rates while avoiding some of the pitfalls of more aggressive rate review.<sup>234</sup> According to HHS, initial results suggest that this program has resulted in fewer dramatic increases in rates, though systematic evidence on this point is still not available.<sup>235</sup>

Finally, state insurance regulators could consider improving the transparency of insurance pricing by requiring carriers to disclose the rating factors they use to determine pricing for individual policyholders and the relative weight they place on those factors.<sup>236</sup> Doing this might allow consumers to narrow their searches to companies that are more likely to offer them affordable rates based on their unique characteristics.<sup>237</sup> For instance, a consumer who drives many miles but maintains an excellent credit score could target companies that place high reliance on credit score and limited reliance on miles driven.

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232. See Patient Protection and Affordable Care Act § 1003, Pub. L. No. 111-148, 124 Stat. 119, 139-40 (2010).

233. See *id.*

234. See Ctr. for Consumer Info. & Ins. Oversight, *Review of Insurance Rates*, CENTERS FOR MEDICARE & MEDICAID SERVICES, <http://www.cms.gov/CCIIO/Programs-and-Initiatives/Health-Insurance-Market-Reforms/Review-of-Insurance-Rates.html> (last visited Nov. 22, 2013) ("The Affordable Care Act brings an unprecedented level of scrutiny and transparency to health insurance rate increases.").

235. See News Release, U.S. Dep't of Health & Human Servs., Health Care Law Saved an Estimated \$2.1 Billion for Consumers (Sept. 11, 2012), available at <http://www.hhs.gov/news/press/2012pres/09/20120911a.html>; see also ROSE CHU & RICHARD KRONICK, HEALTH INSURANCE PREMIUM INCREASES IN THE INDIVIDUAL MARKET SINCE THE PASSAGE OF THE AFFORDABLE CARE ACT (2013), available at <http://aspe.hhs.gov/health/reports/2013/rateincreaseindvmt/rb.pdf>.

236. See Ctr. for Econ. Justice, Comments on Best Practices for Developing a Premium Comparison Guide (Feb. 22, 2011) (on file with author) (proposing such a disclosure and explaining in detail how it might work). Currently, it is virtually impossible for consumers to get any sense of the rating factors that different companies use, much less the relative weight that different companies place on those factors. See *id.*

237. This disclosure would provide information on the weight of rating factors for policyholders as a whole. This might allow consumers to narrow their search among the carriers most likely to offer them reasonable rates; it would not allow policyholders to determine definitively which carrier offered the lowest rates.

### III. ADEQUACY OF TRANSPARENCY REGULATION IN LIFE INSURANCE AND ANNUITIES

As with property/casualty insurance, transparency-oriented consumer protection regulation is systematically and strikingly inadequate in the life/annuity insurance domains. This Part demonstrates this claim with respect to four core regulatory issues in life/annuity markets: (1) solvency regulation, (2) guaranty fund protection, (3) annuity disclosures, and (4) price competition in cash-value life policies. Moreover, it shows how financial regulators in other domains have consistently developed more robust and thoughtful mechanisms for promoting market transparency than have state insurance regulators. Unlike in Part II, the primary, though not sole, point of comparison in this Part is federal securities law, which frequently raises many similar regulatory issues as life/annuity insurance markets, given that products in both domains aim to advance consumers' savings and investment objectives.

#### A. Solvency Regulation

##### 1. Full Disclosure

The central goal of insurance regulation is to ensure that carriers have sufficient financial resources to pay claims when they come due.<sup>238</sup> This goal, however, is particularly important in the life/annuity insurance arena because of the long-term nature of these carriers' obligations to policyholders.<sup>239</sup> The tools that regulators deploy to achieve this goal fall under the heading of solvency regulation, and they include risk-based capital requirements, reserve requirements, and investment restrictions.<sup>240</sup> Despite the central importance of solvency regulation to insurance regulation generally, and life/annuity insurance in particular, this form of regulation employs remarkably few transparency-oriented tools.

In fact, state insurance regulation affirmatively limits the availability of public information about which insurers are in tenuous financial condition. Indeed, about half of the states label it an "unfair trade practice" for anyone in the insurance business to communicate any information that is "derogatory to the financial

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238. See EMMETT J. VAUGHAN & THERESE M. VAUGHAN, *FUNDAMENTALS OF RISK AND INSURANCE* 106 (10th ed. 2008).

239. See generally ANTHONY SAUNDERS & MARCIA MILLON CORNETT, *FINANCIAL INSTITUTIONS MANAGEMENT: A RISK MANAGEMENT APPROACH* (7th ed. 2011).

240. See ROBERT W. KLEIN, *A REGULATOR'S INTRODUCTION TO THE INSURANCE INDUSTRY* 107–13, 140–67 (2d ed. 2005).

condition of an insurer,” even if that information is true.<sup>241</sup> Similarly, many states prohibit anyone in the insurance business from communicating any information about the risk-based capital level of an insurer.<sup>242</sup> Even the annual and quarterly financial accounting statements that insurers file with state regulators—which contain substantial amounts of data on the financial health of filing companies—are only made publicly available for a fee, at least when more than a few statements are downloaded.<sup>243</sup>

To be sure, bank regulators similarly limit the availability of information regarding troubled banks.<sup>244</sup> But in many ways banking rules are less extreme than insurance regulations. For instance, bank holding companies’ quarterly performance reports are publicly available, without cost, through the Federal Reserve’s National Information Center.<sup>245</sup> Moreover, gag rules in banking are actually less extensive than they are in insurance: The only such rule involves disclosure by agencies and banks of safety and soundness examination reports and grades.<sup>246</sup>

Even more importantly, though, the secrecy involved in the prudential regulation of banks does not justify comparable levels of secrecy in insurance regulation. The primary reason for the secrecy that surrounds the financial conditions of particular banks is that banks are uniquely susceptible to policyholder runs because a substantial amount of their liabilities are demand deposits that can be withdrawn in full at any time by policyholders for any reason.<sup>247</sup> As such, negative financial information about a bank can actually substantially exacerbate that bank’s financial problems by triggering a bank run.<sup>248</sup> Moreover, the vast majority of bank depositors can, and do, protect themselves from this risk by ensuring that their money is deposited in such a way that it is fully protected by Federal

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241. See, e.g., ALA. CODE § 27-12-9 (LexisNexis 2007); ARIZ. REV. STAT. ANN. § 20-445 (2002) (West); CONN. GEN. STAT. ANN. § 38a-816(3) (West 2012); IND. CODE ANN. § 27-4-1-4 (LexisNexis 1999); see also *Life Insurance: An Industry Built on Secrecy*, 31 INS. F. 45, 47–48 (2004).

242. See *Life Insurance: An Industry Built on Secrecy*, supra note 241, at 48; see, e.g., NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 312-1 (2012), available at <http://www.naic.org/store/free/MDL-312.pdf>.

243. The NAIC projects it will earn \$25.9 million in 2012 from database filing fees paid by the industry and another \$18.9 million from sales of its insurance data products. R.J. Lehmann, *FIO, FOIA and a Free Market in Insurance Data*, R ST. (Oct. 27, 2011), <http://rstreet.org/2011/10/27/fio-foia-and-a-free-market-in-insurance-data>.

244. See Geoffrey P. Miller, *Banking Regulation: The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 1 (1987).

245. *Frequently Asked Questions (FAQ's): Financial Report Questions*, FED. RES., <http://www.ffiec.gov/nicpubweb/content/help/NICFAQReport.htm> (last visited Nov. 22, 2013).

246. See generally *id.*

247. See Helen A. Garten, *The Consumerization of Financial Regulation*, 77 WASH. U. L. REV. 287, 298 (1999).

248. See *id.*

Deposit Insurance Corporation (FDIC) insurance.<sup>249</sup> Most bank depositors consequently do not need information about their bank's financial health in order to enjoy absolute security in their deposits.

By contrast, life insurers are at much less risk of a policyholder run than are banks. Many forms of life insurance and annuities do not permit policyholders to withdraw funds voluntarily.<sup>250</sup> Those that do typically charge a substantial fee that limits the desirability of this option.<sup>251</sup> Partially for these reasons, policyholders conceptualize life insurance products differently than bank accounts, considering them long-term investments rather than sources of instant liquidity. History bears these distinctions out: There has never been a run on the life insurance industry writ large, despite occasional predictions of such runs in the popular press.<sup>252</sup> And while there has once or twice been a "run" on an individual life insurer, this was only after it became clear that the insurer would not have been able to rehabilitate itself.<sup>253</sup>

Additionally, it is much harder for insurance policyholders to protect themselves against solvency risk than it is for bank depositors to do so. This is because FDIC insurance applies a separate limit to every account that an individual owns at different banks, allowing depositors with cash that exceeds the FDIC limit to simply open up accounts at multiple banks.<sup>254</sup> By contrast, state guarantee funds—which provide policyholders with some measure of protection in the event that their insurer cannot meet its financial obligations<sup>255</sup>—provide only a single limit per individual that cannot be increased by spreading protection around

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249. See CARNELL ET AL., *supra* note 1.

250. See, e.g., Richard Herring & Til Schuermann, *Capital Regulation for Position Risk in Banks, Securities Firms, and Insurance Companies*, in CAPITAL ADEQUACY BEYOND BASEL: BANKING, SECURITIES, AND INSURANCE 15, 23–24 (Hal S. Scott ed., 2005) ("Insurance companies are not reliant on first-come, first-served demand liabilities, and so they are not vulnerable to a loss of confidence and subsequent pressures to liquidate assets rapidly in order to meet the demands of creditors.").

251. See, e.g., ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 30–31 (4th ed. 2007) (noting that whole-life insurance policies include savings components from which money can be drawn at a designated interest rate).

252. See Scott E. Harrington, *Policyholder Runs, Life Insurance Company Failures, and Insurance Solvency Regulation*, 15 REGULATION 27, 30 (1992).

253. See generally Harry DeAngelo et al., *The Collapse of First Executive Corporation Junk Bonds, Adverse Publicity, and the 'Run on the Bank' Phenomenon*, 36 J. FIN. ECON. 287 (1994).

254. See *Deposit Insurance Summary*, FDIC, <http://www.fdic.gov/deposit/deposits/dis> (last updated Oct. 17, 2013).

255. See Martin F. Grace & Hal S. Scott, *An Optional Federal Charter for Insurance: Rationale and Design*, in THE FUTURE OF INSURANCE REGULATION IN THE UNITED STATES 55, 90 (Martin F. Grace & Robert W. Klein eds., 2009).

to multiple different companies.<sup>256</sup> Additionally, unlike FDIC insurance, state guarantee funds are neither prefunded nor backed by the full faith and credit of the federal government.<sup>257</sup>

For these reasons, securities law, rather than banking, provides a more appropriate basis of comparison for evaluating the transparency of carriers' financial health. Viewed against this backdrop, the lack of transparency surrounding insurers' solvency is striking.<sup>258</sup> Transparency and disclosure are, of course, the core tools of securities law.<sup>259</sup> Thus, all publicly held firms must file annual and quarterly financial statements with the U.S. Securities and Exchange Commission (SEC), which are then made publicly available without charge through the Electronic Data-Gathering, Analysis, and Retrieval system (EDGAR).<sup>260</sup> Individuals who purchase securities products must be provided with a prospectus for the product that discloses all material risks.<sup>261</sup> And regulated entities must promptly disclose any information suggesting the prospect of a deteriorating financial condition.<sup>262</sup>

A similar embrace of transparency could improve the effectiveness of insurance solvency regulation. Insurance consumers, particularly life insurance consumers, care substantially about the solvency of their carriers. This consumer preference means that there is already a great deal of market discipline with respect to insurers' solvency.<sup>263</sup> Increasing the availability of information about insurers' solvency would improve this market discipline by removing the primacy of rating agencies in intermediating this information to the marketplace. Indeed, for these very reasons, one of the three "pillars" of Solvency II, the European system for sol-

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256. See AM. COUNCIL OF LIFE INS., INSURANCE GUARANTEE ASSOCIATIONS: FREQUENTLY ASKED QUESTIONS (2010), [https://www.acli.com/Tools/Industry%20Facts/Guaranty%20Associations/Documents/c9dc45c2ea7344a6b7ac0742ae89903ffInsuranceGuarantyAssociationsFAQ\\_C1308\\_2\\_0611010.pdf](https://www.acli.com/Tools/Industry%20Facts/Guaranty%20Associations/Documents/c9dc45c2ea7344a6b7ac0742ae89903ffInsuranceGuarantyAssociationsFAQ_C1308_2_0611010.pdf).

257. Grace & Scott, *supra* note 255.

258. See Jon S. Hanson & Duncan R. Farney, *Life Insurance Companies: Their Promotion and Regulation*, 49 MARQ. L. REV. 175, 311–12 (1965) (comparing the minimal amount of risk information that must be disclosed to an individual who purchases a life insurance policy for a single premium to the significant amount that must be disclosed to an individual who invests an equivalent amount in the stock of the company).

259. Easterbrook & Fischel, *supra* note 82, at 669.

260. See generally STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* (3d ed. 2011).

261. See generally *id.*

262. See generally *id.*

263. See Scott E. Harrington, *Capital Adequacy in Insurance and Reinsurance*, in CAPITAL ADEQUACY BEYOND BASEL: BANKING, SECURITIES, AND INSURANCE, *supra* note 250, at 87.

veny regulation that is currently under construction, is transparency.<sup>264</sup> Improving transparency might also increase regulatory accountability and limit the risk of regulatory forbearance in the face of a failing insurance company.<sup>265</sup>

## 2. Summary Disclosure

An additional, though admittedly more contestable, way in which state solvency regulation wrongly eschews transparency-based regulation involves summary disclosure. State law does not require insurers to disclose in summary form to consumers any information about their financial strength.<sup>266</sup> Such a requirement could easily piggyback on the financial strength ratings that firms like A.M. Best and Moody's produce, which are generally easy to understand because they aggregate a tremendous range of information into a single metric.<sup>267</sup> While carriers with strong ratings actively advertise that fact, many consumers unknowingly purchase coverage from poorly rated carriers.<sup>268</sup> Requiring disclosure of this information could improve market discipline as well as the matching of consumers with insurers who meet their price/quality preferences.

To be sure, there are various legitimate objections to this proposal. Most importantly, the fact that the insurers who are rated are also the ones who pay rating agencies undermines the reliability of financial ratings.<sup>269</sup> The 2008 financial crisis illustrated this point well.<sup>270</sup> Additionally, entrenching the role of rating agencies in financial regulations may exacerbate the problem by enhancing their power and thus insurers' incentives to game these ratings.<sup>271</sup>

Despite these criticisms, it ultimately makes sense to mandate that insurers disclose their financial-strength ratings to consumers. The relevance of these ratings to consumers is undeniable, even though the ratings are also imperfect.

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264. THERESE M. VAUGHAN, POLICY BRIEF. NO. 2009-PB-03, THE IMPLICATIONS OF SOLVENCY II FOR U.S. INSURANCE REGULATION 6 (2009), available at [http://www.naic.org/Releases/2009\\_docs/090305\\_vaughan\\_presentation.pdf](http://www.naic.org/Releases/2009_docs/090305_vaughan_presentation.pdf).

265. *See id.*

266. *See The Need to Disclose to Consumers the Financial Ratings of Insurance Companies*, 36 INS. F. 265, 266 (2009).

267. *See supra* Part I.A, Transparency and Improving Consumer Decisionmaking. *See generally* Steven W. Pottier & David W. Sommer, *Property-Liability Insurer Financial Strength Ratings: Differences Across Rating Agencies*, 66 J. RISK & INS. 621 (1999).

268. *See The Need to Disclose to Consumers the Financial Ratings of Insurance Companies*, *supra* note 266.

269. *See* Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43, 50–51 (2004).

270. *See* ENGEL & MCCOY, *supra* note 3 (explaining how rating agencies rated securities backed by subprime mortgages as largely risk free in part because of the profitability of doing so).

271. *See* Frank Partnoy, *Historical Perspectives on the Financial Crisis: Ivar Krueger, the Credit-Rating Agencies, and Two Theories About the Function, and Dysfunction, of Markets*, 26 YALE J. ON REG. 431 (2009).



Moreover, these ratings may be harder to game than other types of financial ratings, as insurance regulators independently assess insurers' financial strength. As such, if an insurer earned a financial rating that was wildly undeserved, regulators would be able to spot this discrepancy rather easily. This, in turn, means that rating agencies in the insurance sphere are likely to be much less willing to game the system than they were in the context of specific mortgage products or for firms like Enron, whose financial health was not the subject of independent scrutiny.<sup>272</sup>

In contrast to insurance policyholders, purchasers of insurance company securities receive financial strength ratings, which are deemed material to them.<sup>273</sup> To be sure, these are provided not in summary form, but in a detailed prospectus. Although insurers are not required to provide financial-strength ratings in mandatory consumer disclosures under U.S. law, other countries do indeed have such requirements in the insurance sphere.<sup>274</sup>

## B. Informing Consumers About Guarantee Fund Protection

In addition to regulating insurers' financial capacity to pay claims, states also require insurers to be members of guarantee funds. These funds protect policyholders against the prospect that their insurer will not have sufficient funds to pay claims.<sup>275</sup> As with solvency regulation, while these guarantee funds provide an important safety net to policyholders in all lines of insurance, their importance is arguably heightened in the life insurance context because of the long-term nature of this policy line.

Despite the importance of guarantee funds to consumers, most states affirmatively restrict insurers and their agents from informing consumers of the extent of guarantee fund protection they enjoy. Indeed, the NAIC model law on the topic, which most states have adopted, prohibits advertising the existence of a state's Insurance Guaranty Association for the purpose of sales, solicitation, or inducement to purchase insurance.<sup>276</sup> The law does require policyholders receive at the time of policy delivery—several weeks after purchase—a summary disclosure describing the general purposes and limitations of the fund.<sup>277</sup>

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272. See Hill, *supra* note 269, at 75–76.

273. *The Need to Disclose to Consumers the Financial Ratings of Insurance Companies*, *supra* note 266.

274. See Martin Eling & Ines Holzmüller, *An Overview and Comparison of Risk-Based Capital Standards*, 26 J. INS. REG. 31 (2008) (reporting such a requirement in New Zealand).

275. Grace & Scott, *supra* note 255, at 90.

276. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 520-34, § 19 (2009).

277. *Id.*

Although the purpose of these gag rules is to limit moral hazard,<sup>278</sup> they have the impact of undermining the capacity of consumers to make informed decisions among competing life insurance carriers. Providing information about guarantee fund protection after policy purchase does virtually nothing to help consumers make informed decisions about their products in light of guarantee fund protection.<sup>279</sup> Yet accurate information about guarantee fund protection is vital to consumers looking to choose life insurance products that match their preferences. This is because the extent of the guarantee fund protection that life/annuities policyholders enjoy varies significantly by state and by product and is often woefully insufficient to protect even an average consumer's policy rights fully. For instance, with respect to life insurance death benefits, most states provide only \$300,000 of protection, with some states providing up to \$500,000 of protection.<sup>280</sup> In the case of life insurance cash-surrender and cash-withdrawal protection, most states cap protection at \$100,000, but some have substantially larger caps.<sup>281</sup> With respect to annuities, some states provide only up to \$100,000 of guarantee fund protection, many provide up to \$250,000 of protection, and some provide \$300,000 or \$500,000 in protection.<sup>282</sup> There is good reason to believe that consumers who are informed about these levels of protection at the time they are selecting a product will more carefully scrutinize their insurer's financial status to the extent they are not fully covered.<sup>283</sup> Alternatively, just as consumers routinely do in banking, they may alter the amount of their purchase and/or the product they purchase in order to maximize the extent of their protection.

Once again, the lack of transparency with respect to state guarantee funds is put into sharp relief when state insurance law is compared to analogous federal law. In particular, bank depositors enjoy federal protection from the risk that their bank will become insolvent through FDIC insurance. Yet banks routinely and prominently advertise this protection to depositors—something that the

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278. The moral hazard that Federal Deposit Insurance Corporation insurance creates for policyholders in the banking sphere is well understood. See Geoffrey P. Miller, *Anatomy of a Disaster: Why Bank Regulation Failed*, 86 NW. U. L. REV. 742 (1992).

279. See *supra* Part I.A, An Overview of Transparency-Oriented Consumer Financial Protection.

280. See PETER G. GALLANIS, NAT'L ORG. LIFE & HEALTH INS. GUAR. ASS'NS, THE LIFE & HEALTH INSURANCE GUARANTY ASSOCIATION SYSTEM, AND THE FINANCIAL CRISIS OF 2008–2009 (2009), available at <http://www.nolhga.com/resource/file/NOLHGAandFinancialCrisis.pdf>.

281. See *id.*

282. See *id.*

283. See Martin F. Grace et al., *Homeowners Insurance With Bundled Catastrophe Coverage*, 71 J. RISK & INS. 351, 377 (2004) (showing that consumers with homes that are more expensive than the guarantee fund protection limit are more sensitive to the financial strength of their insurance carrier).

FDIC requires them to do.<sup>284</sup> Banks also advise depositors on strategies to maximize protection, such as holding a joint account or holding an account with multiple beneficiaries. Moreover, when banks sell products unprotected by FDIC insurance they routinely warn consumers of this fact.<sup>285</sup>

### C. Informing Consumers About Annuity Terms and Conditions

Because of their complexity and variability, annuities raise a host of consumer protection problems. At their core, annuities are contracts wherein an insurer promises a policyholder a series of future payments in exchange for receiving an earlier lump sum payment, or series of payments, from the policyholder. But the details surrounding this basic framework can vary in an almost infinite set of ways. These include (1) whether insurer payouts are immediate or deferred; (2) whether policyholders contribute in a lump sum or over time; (3) the ways in which money placed in the annuity earns a return; (4) the guarantees associated with insurer payments; and (5) the existence of market-based adjustments to insurer payouts.<sup>286</sup>

This complexity raises two risks for consumers. The first is that a consumer may purchase an annuity that is not well suited to her particular needs.<sup>287</sup> The suitability of a particular annuity product depends on innumerable consumer details, including anticipated lifespan, savings, future financial needs, and retirement plans.<sup>288</sup> Second, the complexity of annuities can undermine competition across companies, resulting in excessive fees and/or poor investment performance. Indeed, according to one source, annuity fees average about 2.51 percent of one's investment, a dramatic difference from the low-cost mutual fund options that are available for fees of 0.2 percent.<sup>289</sup>

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284. See generally CARNELL ET AL., *supra* note 1.

285. See generally *id.*

286. See generally SCOTT HARRINGTON & GREGORY NIEHAUS, RISK MANAGEMENT AND INSURANCE 297–334 (2004).

287. In 2005, a class action lawsuit was filed against insurer Allianz claiming that the company sold actuarially unsuitable annuities to elderly consumers. Chris Serres, *A Split Decision in Allianz Life Annuity Lawsuit*, STAR TRIB., Oct. 13, 2009, <http://www.startribune.com/business/64089107.html>.

288. See FINRA Rule 2111: *Suitability*, FINRA.ORG, [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=9859](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859) (last updated Feb. 4, 2013).

289. Margaret Collins, *Variable Annuities: Lifelong Income, High Cost*, BLOOMBERG BUSINESSWEEK, June 23, 2011, [http://www.businessweek.com/magazine/content/11\\_27/b4235047436378.htm](http://www.businessweek.com/magazine/content/11_27/b4235047436378.htm). As one consumer-finance expert explained, experts understand the “flip side to the annuity sales pitch—including the high costs; the long surrender periods with the resulting high surrender fees; and that many annuity sales are inappropriate because more suitable low-cost investment options are available.” Mel Lindauer, *Annuities: Good, Bad or*

To address these concerns, state insurance regulation relies on two strategies. First, it requires that insurers obtain personal information from prospective customers before a sale and evaluate whether the annuity being sold is “suitable” for that particular individual.<sup>290</sup> Second, and of more direct relevance here, state law requires certain disclosures to be made to annuity consumers. This dual regulatory strategy is sensible. On one hand, disclosures are not sufficient to protect consumers because annuities are extremely complex and multifaceted products.<sup>291</sup> On the other hand, though, mandatory disclosures can provide regulatory benefits that suitability rules cannot, such as promoting competition and helping consumers ensure that an annuity is not merely suitable for their needs, but optimal.

Unfortunately, the NAIC’s annuity disclosure regime violates each of the three principles of effective disclosure described in Part I. The annuity disclosure strategy is based on an NAIC model law dating back to 1999.<sup>292</sup> Under the law, purchasers must receive both (1) a Buyer’s Guide and (2) a disclosure document. The Buyer’s Guide, created by the NAIC, describes the basic structure and general features of annuities. The disclosure document is a company-drafted form that must contain a description of specific contract terms and “emphasiz[e] its long-term nature.”<sup>293</sup> The law also includes a lengthy section placing strict guidelines on the form and the content of illustrations used to describe annuities.<sup>294</sup>

Perhaps the most central deficiency of this disclosure regime is that it does not rely on a single disclosure template used by individual firms but instead allows insurers to design their own disclosure documents. While disclosures must include certain information, this information need not be labeled in any particular way, presented in the same location on different carriers’ forms, or subjected to consumer testing. As explained in depth earlier, this inhibits consumers’ ability

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*Ugly?*, FORBES, June 4, 2010, <http://www.forbes.com/2010/06/04/variable-annuities-high-cost-surrender-fees-personal-finance-bogleheads-view-lindauer.html>.

290. See, e.g., NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 275-1 §6 (2010), available at <http://www.naic.org/store/free/MDL-275.pdf>. Only two states have not adopted this law: Mississippi and New Mexico. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 275-1 State Adoption (2010). This Article takes no position on the adequacy of the current suitability rules. See generally Kathleen C. Engel & Pat A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1316–17 (2002) (arguing for suitability rules in the mortgage context).

291. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking (describing conditions under which mandatory summary disclosure may be appropriate and effective).

292. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 245-1, § 1 (2010).

293. *Id.* § 3(B).

294. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 245-6 (2010).

to comparison shop.<sup>295</sup> One prominent industry insider sums up the result: “Say you wanted to compare five products side by side . . . Good luck.”<sup>296</sup>

The lack of any standardized disclosure document also undermines enforcement of the disclosure rules that do exist. Despite the fact that individual companies design their own unique disclosure documents, these documents are not regularly submitted to or reviewed by regulators in most states.<sup>297</sup> In fact, the only enforcement mechanism that most states employ to ensure compliance with applicable disclosure rules is market conduct exams.<sup>298</sup> But such exams vary in frequency and are incredibly broad in scope, meaning that the amount of time that can be spent reviewing disclosure documents is minimal.<sup>299</sup>

The annuity disclosure rule not only fails to provide a usable and uniform disclosure document but the information that it requires insurers to place in their disclosures is simultaneously excessive and deficient.<sup>300</sup> The disclosure document must include countless warnings and complex pieces of information about contract conditions and terms.<sup>301</sup> These requirements include information about accessing the current value of the contract, surrender fees,<sup>302</sup> tax implications of

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295. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking (describing the importance of uniform disclosure templates for mandatory summary disclosures).

296. Collins, *supra* note 289; see also Tom Lauricella, *Annuity Shopping Made Easier*, WALL ST. J., Oct. 10, 2010, <http://online.wsj.com/article/SB10001424052748704442404575542590138626652.html> (“Retirees have generally had to depend on insurance agents to get information about annuities, where the choices they offer can be influenced by incentives for recommending a certain company’s products or one kind of annuity over others. As a result, doing true comparison shopping has been a headache at best.”); *Annuity Disclosure Initiative: Frequently Asked Questions*, OHIO DEP’T INS., <http://www.insurance.ohio.gov/Company/Documents/AnnuityDisclosureFAQs.pdf> (last visited Nov. 22, 2013) (“Information contained in a contract can vary from one insurer’s annuity to another, making comparisons difficult. State disclosure laws also differ.”); Darla Mercado, *Lifetime-Income Options Pose Tough Benchmarking Puzzle*, INVESTMENT NEWS (Oct. 30, 2011, 12:01 AM), <http://www.investmentnews.com/article/20111030/REG/310309967> (“The difficulty in benchmarking lifetime-income products stems from the fact that no two are exactly alike.”).

297. This contrasts with the annuity contracts that life insurers sell, which generally must be submitted to and approved by insurance regulators before their sale.

298. Nat’l Ass’n of Ins. Comm’rs, Ch. 19—Conducting the Life and Annuity Examination, *in* MARKET REGULATION HANDBOOK (May 24, 2011) (unpublished book chapter) (on file with author).

299. See PRICEWATERHOUSECOOPERS LLP, INSURANCE MARKET CONDUCT EXAMINATION PUBLIC POLICY REVIEW pt. V (2000), available at <http://www.ncoil.org/policy/V-Summary.html> (“There is an extensive range of topics, views and activities in insurance market conduct surveillance.”).

300. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking (emphasizing the limited amount of information that can be effectively disclosed to consumers).

301. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 245-1 § 3(B) (2010).

302. *Id.* § 3(B)(3)(d)–(e).

withdrawals,<sup>303</sup> guaranteed and nonguaranteed elements of the contract,<sup>304</sup> the calculation of the initial interest rate and the guaranteed minimum rate,<sup>305</sup> and the calculation of death benefits and the operation of any riders to the contract.<sup>306</sup> Much of this information is useful only to a consumer with a relatively high degree of financial sophistication. This is particularly true of disclosures related to the calculation of rates or benefits. All this information appears alongside much more fundamental disclosures related to the basic functioning of the annuity's fees and penalties. While the NAIC rules require excessive disclosure in some areas, they contain notable omissions in others. In particular, they make no attempt to distill the various costs and interest rates of an annuity into a single figure to facilitate comparison.<sup>307</sup>

Yet another failing of the NAIC's disclosure strategy is that it does not ensure that the relevant documents find their way into consumers' hands in time to be helpful.<sup>308</sup> Delivery of the Buyer's Guide and disclosure documents can take place at any time up until the point of sale, meaning that the documents may not be delivered until a consumer has already emotionally and mentally committed to the purchase.<sup>309</sup> If the sale does not take place in a face-to-face meeting, the documents can be delivered *after* the purchase, as long as the buyer is given a fifteen-day penalty-free period to return the contract.<sup>310</sup> And in the case of online purchases, the NAIC rule requires only that the insurer take "reasonable steps" to make these documents viewable and printable from its own website.<sup>311</sup>

Disclosure efforts in comparable regulatory domains suggest the inadequacy of these efforts. Consider the SEC's work on consumer disclosures of mutual funds and variable annuities, which directly compete with state-regulated annuities.<sup>312</sup> To be sure, these efforts have been far from ideal, and they have prompted quite compelling calls for reform.<sup>313</sup> But they nonetheless are far more sensible and sophisticated than the state-based annuity disclosure regime described above.

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303. *Id.* § 3(B)(3)(g).

304. *Id.* § 3(B)(1)–(3).

305. *Id.* § 3(B).

306. *Id.* § 3(B)(3)(f), (h).

307. *See supra* Part I.A, Transparency and Improving Consumer Decisionmaking (emphasizing the importance of distilling complex information into tractable pieces of information).

308. *See supra* Part I.A, Transparency and Improving Consumer Decisionmaking (emphasizing the importance of the timing of the disclosure).

309. NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 245-4 § 5(A) (2010).

310. *Id.*

311. *Id.*

312. *See* Elizabeth F. Brown, *The Fatal Flaw of Proposals to Federalize Insurance* (Univ. of St. Thomas Sch. of Law, Legal Studies Research Paper No. 07-25, 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1008993](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1008993).

313. *See, e.g.,* Fisch, *supra* note 80.

Most notably, the SEC requires all mutual funds to provide investors with a “summary prospectus” that is at the front of the overall prospectus.<sup>314</sup> The document is limited to several pages and contains the key pieces of information that mutual fund investors should consider.<sup>315</sup> This information is written in plain English and displayed in a standardized order and format.<sup>316</sup> This layered approach to disclosure makes detailed information that may be of interest to sophisticated investors available in the larger prospectus, without burdening ordinary investors with these details.<sup>317</sup> For the last four years, the SEC has also been working on a comparable standardized summary prospectus document for variable annuities, though it has not yet released the proposal.<sup>318</sup>

Additionally, unlike state insurance regulators, the SEC requires all disclosure documents associated with either mutual funds or variable annuities to be filed with the agency.<sup>319</sup> It then reviews those documents carefully for accuracy and compliance with the SEC’s rules. As one SEC official explained: “Many of these products are very complex in their design and operation, making it very important that insurers provide clear and useful disclosure regarding how the products work and the risks of investing in them. For that reason, the Division carefully reviews these disclosures in its review of registration statements.”<sup>320</sup>

To be sure, crafting a uniform, summary disclosure of annuities is likely to be a difficult task. But there is already at least one decent model for such a document: The American Council of Life Insurers (ACLI) has released a series of universal templates for annuity disclosures.<sup>321</sup> Of course, because the ACLI tem-

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314. See SEC. & EXCH. COMM’N, RIN 3235-AJ44, ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES (2009), available at <http://www.sec.gov/rules/final/2009/33-8998.pdf>.

315. See *id.*

316. See *id.*

317. See *supra* Part I.A, Transparency and Improving Consumer Decisionmaking (emphasizing the importance of layered disclosure).

318. In 2009, the Securities and Exchange Commission (SEC) Director of Investment Management publicly endorsed the creation of a “variable annuity short form disclosure document” and the SEC’s chair acknowledged that the SEC was actively developing such a document. See INSURED RETIREMENT INST., VARIABLE ANNUITY SUMMARY PROSPECTUS HIGH IN DEMAND BY CONSUMERS: AN EXAMINATION OF CONSUMER PREFERENCES, INDUSTRY PERSPECTIVES, AND IRI INITIATIVES (2011).

319. See Andrew J. Donohue, Dir., Div. of Inv. Mgmt., Remarks at the 2010 ALI-ABA Conference on Life Insurance Company Products (Oct. 28, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch102810ajd.htm>).

320. *Id.*

321. AM. COUNCIL OF LIFE INSURERS ET AL., IMPROVING ANNUITY DISCLOSURE: A LIFE INSURANCE INDUSTRY INITIATIVE (2008), [http://www.acli.com/Issues/Documents/75fd8a4aa0c344f9983e03c1f4e042d3DisclosureTemplataesOhio\\_nva.pdf](http://www.acli.com/Issues/Documents/75fd8a4aa0c344f9983e03c1f4e042d3DisclosureTemplataesOhio_nva.pdf).

plates are building off the NAIC's previous work, they share some of the fundamental flaws of the NAIC approach—most notably, they still rely on dense text descriptions of the products in question. But they also represent a significant step toward solving the most notable problem with the NAIC law: its failure to create a standardized summary disclosure format universal to all annuities in a product class. Not only do the ACLI templates use an identical format for products of the same type, they use very similar formats for products of different types, helping consumers conduct comparisons across product classes. Unfortunately, use of the ACLI's templates is entirely discretionary.<sup>322</sup>

#### D. Improving Consumer Understanding of the Cost of Cash-Value Life Policies

Although controversy regarding appropriate disclosure of cost in life insurance markets dates back to at least the 1960s, state rules have long failed to require any simplified disclosure of price terms analogous to the ubiquitous annual percentage rate (APR) of credit products. To appreciate this issue, some background is needed. Life insurance policies can either be term or cash value. Term-life insurance is a relatively homogenous product: Carriers promise to pay a specified death benefit for a set premium over a specified period of time.<sup>323</sup> By contrast, cash-value life insurance products are extremely heterogeneous and complex.<sup>324</sup> At their core, though, these policies combine a term-life insurance policy with a savings or investment component. As the savings/investment com-

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322. Both Iowa and Ohio have adopted pilot programs to encourage use of the forms—most notably, by presuming that any insurer who uses the templates has already satisfied the states' disclosure requirements—but there has been no state or regulatory agency that has simply mandated use of the template. See, e.g., AM. COUNCIL OF LIFE INSURERS ET AL., TEMPLATES FOR IMPROVING ANNUITY DISCLOSURE: OHIO PILOT PROGRAM (2008), <https://www.acli.com/Issues/Pages/GR09-120.aspx>; OHIO DEPT OF INS., OHIO JOINS INITIATIVE TO IMPROVE ANNUITY DISCLOSURE, <http://www.insurance.ohio.gov/Company/Documents/AnnuityDisclosureFactSheet.pdf>.

323. See generally KENNETH BLACK, JR. & HAROLD D. SKIPPER, LIFE INSURANCE (11th ed. 1987).

324. The most basic cash-value policies are “whole life.” These policies generally pay a fixed death benefit and have level premiums that are paid out either for the life of the policy or for a preset number of years. As the savings component of the policy increases, the insurance component decreases in order to keep the death benefit constant. In contrast to whole-life policies, variable-life policies link the death benefit to the performance of investment options selected by the policyholder. Universal life policies, by contrast, have variable premiums that can be shifted, within various parameters, by the policyholder during the policy term. The savings component accumulates based on stated interest rates that the insurer can vary and policy expenses are deducted from the account on a monthly basis. Variable universal policies combine these features, with return on the universal policy based on the performance of policyholder-selected investment options. *Id.*



ponent of the policy grows, it increasingly funds the death benefit, thus allowing premiums to remain level as the policyholder becomes older. During his or her lifetime, the policyholder can access the savings component of the policy in various ways, including by surrendering the policy and potentially paying some penalty or by taking out a loan secured by the policy's value. If the policy is "participating," it may also pay out dividends to the policyholder.<sup>325</sup>

The combined savings and insurance components of cash-value policies make it very difficult for consumers to compare different policies. This is because the premiums of cash-value policies do not, in fact, reflect the costs of these policies. Instead, in order to evaluate cost, one must assume a specified savings rate and then extrapolate cost on that basis. Alternatively, one can specify a particular cost for the insurance component of the policy, and then measure the rate of return. Either way, though, a policy can have relatively high premiums but be quite affordable/high-return or a policy can have relatively low premiums but be quite expensive/low-return.<sup>326</sup>

Whereas markets in term-life insurance are extremely competitive, the complexity of cash-value insurance policies has impeded beneficial competition. An important Federal Trade Commission (FTC) study from the 1970s found that cash-value life insurance policies routinely paid a substantially lower rate of return than comparable savings vehicles and that price dispersion of these policies was much larger than price dispersion for similar products.<sup>327</sup> A more recent study of the life insurance industry by two prominent economists found that the price of term-life insurance policies decreased dramatically—between 8 and 15 percent—in the mid-1990s because of the development of Internet tools that easily allowed consumers to compare different policies.<sup>328</sup> By contrast, the price of cash-value policies did not fall at all during this period, and may have actually increased.<sup>329</sup> The reason, they suggest, is that Internet tools did not allow consumers to compare the prices of different cash-value policies because of their complexity and heterogeneity.<sup>330</sup>

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325. *Id.*

326. See FED. TRADE COMM'N, LIFE INSURANCE COST DISCLOSURE 70–71 (1979), <http://www.ftc.gov/be/econrpt/197907lifeinsurancecost.pdf> [hereinafter FTC REPORT].

327. *Id.* at 25–62; see also Spencer L. Kimball & Mark S. Rapaport, *What Price "Price Disclosure"?: The Trend to Consumer Protection in Life Insurance*, 1972 WIS. L. REV. 1025, 1026–27.

328. Jeffrey R. Brown & Austan Goolsbee, *Does the Internet Make Markets More Competitive?: Evidence From the Life Insurance Industry*, 110 J. POL. ECON. 481 (2002).

329. *Id.* at 493–94. One consequence of elevated insurance prices is decreased insurance protection. As Kyle Logue has described, underinsurance in the life arena is a pervasive problem. See Kyle D. Logue, *The Current Life Insurance Crisis: How the Law Should Respond*, 32 CUMB. L. REV. 1, 23–26 (2001).

330. Brown & Goolsbee, *supra* note 328, at 493–94.

The lack of price transparency in cash-value life insurance markets has also been the source of several acute consumer protection scandals in recent decades.<sup>331</sup> In one particularly high-profile and widespread scandal, consumers were sold “vanishing premium” policies on the basis of representations that the savings components of these policies would grow at a sufficiently rapid rate to cover the cost of coverage.<sup>332</sup> These growth rates were not achieved, causing policyholders to continue paying premiums well beyond the promised time horizon. Smaller-scale, but repeated, scandals have erupted at various times as it has come to light that agents frequently encourage insurance policyholders to replace a cash-value policy with a different policy.<sup>333</sup> Such replacements are often not in consumers’ interests because the cost of coverage is quite high in the first years of cash-value policies when much of the savings component of premiums is directed toward paying commissions and administrative expenses.<sup>334</sup>

Despite these problems, current regulatory rules do not require any form of standardized disclosure of the cost of cash-value life insurance policies.<sup>335</sup> This is all the more remarkable because the mechanism for making such a disclosure has been the source of study and refinement for nearly fifty years. In 1966, Joseph Belth proposed a uniform scheme for the disclosure of cost information about cash-value life insurance policies.<sup>336</sup> Shortly thereafter, U.S. Senator Phillip Hart held hearings on the topic and suggested a Truth in Life Insurance Bill that would mirror the recently enacted Truth in Lending Act.<sup>337</sup> That law requires

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331. See Dwight K. Bartlett, III, *Life Insurance Cost Disclosure: A Regulatory Viewpoint*, 13 J. INS. REG. 433, 435 (1995) (explaining that the misleading nature of net cost method has come under increased scrutiny since the 1970s); Joseph Belth, *Deceptive Sales Practices in the Life Insurance Business*, 41 J. RISK & INS. 305, 305 (1974) (asserting that deceptive life insurance sales practices are widespread enough to constitute a national scandal).

332. Tom Foley & Carolyn Johnson, *Introduction to Symposium on the Regulation of Life Cost Disclosure and Market Conduct*, 13 J. INS. REG. 398, 398 (1995).

333. For instance, in 1975, Senator Stone introduced a bill that focused on his concern about Veterans who were moving in large numbers into new life insurance policies through conversion policies. *Disclosure of Insurance Policy Information to Veterans: Hearings on S. 718 Before the Subcomm. on Hous., Ins. & Cemeteries of the S. Comm. on Veterans' Affairs*, 95th Cong. (1977). In 1984 another hearing on policy replacements was held by Congress in response to evidence that conversion policy sales accounted for one out of every two cash-value policy sales. James H. Hunt, *Life Cost Disclosure: Prospects for True Reform*, 13 J. INS. REG. 405, 407 (1995).

334. See Hunt, *supra* note 333.

335. See NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 580-1 (2005). These rules do require a policy summary to be delivered after the sale of coverage. These mandatory disclosures suffer, however, from many of the flaws described above for annuity policy summaries: They are nonstandardized, delivered after the policy is purchased, and do not contain useful information.

336. David R. Kamerschen & John J. Pascucci, *The Retail Price Structure in American Life Insurance: Comment*, 36 J. RISK & INS. 493, 493 (1969).

337. Hunt, *supra* note 333, at 412.

lenders to disclose to consumers the APR of their loans, which encompasses all of costs of borrowing, including the interest rate and fees.<sup>338</sup>

These efforts led to extensive scrutiny of life insurance cost disclosure and eventually to the NAIC, in 1976, adopting a model regulation on life insurance cost disclosure. The model required disclosure at the time of policy delivery—rather than before or at the time of sale—of various cost indices for life insurance policies.<sup>339</sup> These included a surrender index that was intended to convey the cost of a policy if it was surrendered at specified times, a payment index that provided the cost of the policy if death occurred at certain times, and an equivalent level annual dividend that was intended to show the relative importance of assumed dividends in the two indices just described.<sup>340</sup>

Although this disclosure approach was a small step in the right direction, it had numerous problems as well. Many of these problems were described in the aforementioned FTC report on life insurance cost disclosure. The FTC report noted that the NAIC approach presented consumers with “a bewildering array of numbers, most of which [were] of doubtful relevance to the average insurance consumer.”<sup>341</sup> These numbers had no intuitive benchmark to allow a consumer to discern whether a particular index number was good or bad.<sup>342</sup> Perhaps even more importantly, the indices were appropriate only for consumers comparing similar policy types: They did not allow consumers to compare different types of cash-value policies to one another or to term insurance.<sup>343</sup> Finally, the FTC report noted that the timing of the policy cost information was deficient, because it “should be provided at a time when a consumer is trying to decide which, if any, policy to buy—not after that decision has been made.”<sup>344</sup> In the face of these problems, the chairman of the FTC testified to Congress in 1979 that “no other product in our economy that is purchased by so many people for so much money is bought with so little understanding of its actual or comparative value.”<sup>345</sup>

In place of the NAIC model, the FTC suggested that consumers needed a single cost metric with which to compare different policies. It proposed the Lin-

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338. 15 U.S.C. §§ 1601–1667(e) (2012).

339. Foley & Johnson, *supra* note 332, at 399.

340. See FTC REPORT, *supra* note 326, at 130–31.

341. *Id.* at 132 (internal quotation marks omitted).

342. *Id.* at 133.

343. *Id.* at 126. The reason, from an actuarial perspective, is that it fails to control for differing amounts of risk in policies that are compared. Hunt, *supra* note 333, at 412–13.

344. See FTC REPORT, *supra* note 326, at 163.

345. See *FTC Study of Life Insurance Cost Disclosure: Hearings Before the S. Comm. on Commerce, Sci., & Transp.*, 96th Cong. 3 (1979) (statement of Michael Pertschuk, Chairman, Fed. Trade Comm'n).

ton Yield method as a mechanism to achieve this.<sup>346</sup> This single metric can be used to compare similar and different types of policies, comes with an intrinsic yardstick because it represents annual rates of return, and shows negative returns in initial years that warn consumers not to surrender a policy within that period. To be sure, the metric is not without its problems, particularly because its calculation is highly dependent on both assumed future dividends and term insurance cost, which can be manipulated.<sup>347</sup> Indeed, various alternatives to the Linton Yield index are possible and may, in fact, be superior, including a version of the metric that Belth originally proposed fifty years ago<sup>348</sup> that would calculate the expected present value of premiums paid less the expected present value of all death benefits, policy dividends, and cash values.<sup>349</sup>

Although numerous plausible approaches are possible for clearly disclosing the cost of cash-value policies to consumers, the NAIC ultimately chose to jettison any requirement of life insurance cost disclosure. In the wake of the FTC report, the industry successfully lobbied Congress to statutorily bar the FTC from investigating life insurance without a request from Congress.<sup>350</sup> Meanwhile, the NAIC refused to revisit its model law on policy costs even after the vanishing premium scandals of the early 1990s, during which time its emphasis shifted to regulating deceptive illustrations. Eventually, in 2000, now convinced that the cost disclosures it provided were indeed as useless as the FTC report had indicat-

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346. The report left open the prospect of retaining a single surrender index for comparison of similar policies if this could be combined with a reasonable benchmark. See FTC REPORT, *supra* note 326, at 97–182. This recommendation, however, was largely premised on the notion that many had already gained familiarity with this tool, and so that learning should not be dismissed. That rationale no longer applies, of course, since the tool was never adopted.

347. This method essentially measured the value of different policies by setting a cost for the term insurance component of policies, subtracting this from cash value premiums, and then calculating the average annual rate of return that would produce the cash value plus dividends that the policy pays at any point in time. *Id.* at 120.

348. See Hunt, *supra* note 333.

349. Joseph M. Belth, *The Relationship Between Benefits and Premiums in Life Insurance*, 36 J. RISK & INS. 19 (1969). Subsequent theoretical work has demonstrated that this index is far less manipulable than other indices and thus would tend to prevent insurer gaming of their policies to maximize index values. See Ralph A. Winter, *On the Choice of an Index for Disclosure in the Life Insurance Market: An Axiomatic Approach*, 49 J. RISK & INS. 513 (1982). An alternative approach is to separately disclose the cost of coverage per \$1000 of coverage and the rate of return on the savings component of the policy, in each case incorporating an assumed value for the other formula. See Belth, *supra*; see also BREADWINNERS' INS., <http://www.breadwinnersinsurance.com> (last visited Nov. 22, 2013) (proposing a different approach to summary disclosure of cash-value life insurance cost).

350. See Hunt, *supra* note 333, at 412.

ed two decades earlier, the NAIC quietly decided to eliminate any requirement that life insurers provide any cost disclosures at all.<sup>351</sup>

Ultimately, of course, any price disclosure in life insurance markets would be both imperfect and insufficient. Indeed, numerous critics of the APR measure have rightly pointed out that it is often mysterious to consumers and failed to warn them about the dangers of subprime mortgages.<sup>352</sup> At the same time, the answer to these difficulties is to improve summary disclosure metrics, recognize their limitations, and employ complementary regulatory strategies to limit the risks associated with those limitations. Instead, the NAIC chose simply to abandon all regulatory efforts to convey relevant pricing information to life insurance consumers.

#### IV. UNDERSTANDING AND BREAKING THE PATTERN

The pattern of consumer protection regulation in insurance is both anomalous and troubling. Instead of embracing disclosure and transparency, state insurance regulation actively resists it while maintaining various forms of consumer protection regulation that are much more aggressive and costly. What can explain this pattern? Subpart A of this Part considers this question, looking to the distinctive features of insurance as well as the uniquely state-based nature of its regulation. Subpart B then argues that, whatever explains the pattern in the past, there is one clear way to disrupt it in the future: the clear and credible threat of federal preemption. It argues that the most appropriate way to create this threat is by expanding the jurisdiction of the CFPB to encompass insurance.

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351. In 1993, when the NAIC was evaluating reforms to the regulation of policy illustrations, it decided not to attempt to improve these disclosures. *See id.* at 420 (“[N]one of the extensive deliberations of the LDWG over the last two years has sought to supply consumers with an effective means of comparing cash value life insurance policies either to each other or to the alternative of buying term life insurance.”). Then, in 2000, the NAIC voted to eliminate any model law requiring companies to calculate and disclose these indices to consumers. *See NAIC MODEL LAWS, REGULATIONS AND GUIDELINES 585-1, § 8 (2001)* (“When the Optional Form of the Life Insurance Disclosure Model Regulation with Yield Index was adopted, the group recommended that each time the disclosure regulation was amended the alternative with the yield index should also be amended. When the disclosure regulation was amended, all references to indices were deleted. The working group clarified its intent with regard to the alternative with the yield index by voting to recommend its deletion from the list of official NAIC models laws. 2000 Proc. 3rd Quarter 88.”).

352. *See, e.g.,* Sovern, *supra* note 43, at 761 (contending that the 2008 financial crisis was caused in part by the inadequacies of disclosure in the Truth in Lending Act).

### A. Understanding the Lack of Transparency in State Insurance Regulation

The political economy of state insurance regulation is complicated and multifaceted.<sup>353</sup> As a result, one-dimensional diagnoses or explanations of the patterns described above are not possible. At the same time, several distinctive features of state insurance regulation likely contribute to its tendency to ignore transparency-based regulation in favor of command-and-control regulation.

First, industry influence over insurance regulators and the NAIC has undoubtedly substantially limited transparency-oriented reforms in insurance. The industry has openly and vehemently resisted transparency with respect to the availability of MCAS data, the online availability of policy forms, the disclosure of price information in life insurance, and numerous other issues discussed above.<sup>354</sup> Such unified industry resistance has a substantial amount of influence on state insurance regulators and lawmakers.<sup>355</sup> The reasons are numerous. The revolving door between top insurance regulation posts and lucrative industry jobs is a large problem in insurance regulation.<sup>356</sup> In states that elect their insurance commissioners, insurance companies can also exert their influence through campaign contributions.<sup>357</sup> In addition, the industry's superior technical resources often allow it to provide and analyze information in ways that far surpass the ca-

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353. See KENNETH J. MEIER, *THE POLITICAL ECONOMY OF REGULATION: THE CASE OF INSURANCE* (1988).

354. See *supra* Part II.A, Full Disclosure of Claims Payment Practices (discussing industry resistance to MCAS disclosure); Part II.B, Coverage Consistent with Consumers' Reasonable Expectations (discussing industry resistance to online access to policy forms); Part II.C, Full Disclosure of the Availability of Insurance Products for Low-Income and Minority Populations (industry resistance to HMDA-like data collection); Part II.D, Improving Consumer Understanding of the Objectivity of Independent Insurance Agents (discussing industry resistance to disclosure of agents' conflicts of interest); Part III.B, Informing Consumers About Guarantee Fund Protection (discussing industry resistance to guarantee fund disclosure); Part III.D, Improving Consumer Understanding of the Cost of Cash-Value Life Policies (discussing industry resistance to life insurance cost disclosure).

355. See J. Robert Hunter, *A Failure of Oversight in Need of Rescue: Insurance Regulation*, GOV'T L. & POL'Y J., Winter 2011, at 6 (exploring how excessive industry influence, limited consumer empowerment, and lack of regulatory will and resources combine to produce an ineffective regulatory regime). For a recent review of regulatory capture theory, see PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE IN REGULATION, AND HOW TO LIMIT IT, *supra* note 99.

356. See Randall, *supra* note 110, at 629–34 (discussing industry influence over insurance regulators).

357. Martin F. Grace & Richard D. Phillips, *Regulator Performance, Regulatory Environment and Outcomes: An Examination of Insurance Regulator Career Incentives on State Insurance Markets*, 32 J. BANKING & FIN. 116, 121 (2008).

capacities of regulatory staff or the limited number of consumer advocates who operate in the insurance domain.<sup>358</sup>

The more difficult question is why the industry uniformly resists market transparency, given that it would presumably benefit a subset of firms already offering better products or prices. More specifically, why do insurers that offer better products, more reliable claims handling, or lower pricing fail to agitate for more robust regulatory transparency? Part of the answer may be cultural: Insurance is an industry that is almost uniquely built on proprietary information.<sup>359</sup> This arguably produces an almost knee-jerk reaction by those within the industry to resist regulatory efforts that may result in information revelation.

Alternatively, high-quality insurers might worry that transparency could expose them to adverse selection by causing high-risk individuals to prefer their coverage.<sup>360</sup> Although this concern is theoretically plausible, it is practically quite limited: Most insurance markets do not suffer from adverse selection and, in many cases, the consumers who are likely to be drawn to the most generous forms of insurance are actually relatively nonrisky, but quite risk averse.<sup>361</sup>

High-quality insurers may also resist regulatory initiatives designed to promote market accountability to the extent that they can reach their target customers without regulation through advertising campaigns and networks of intermediaries.<sup>362</sup> If so, they may have less reason to be concerned that some segment of consumers unwittingly purchases coverage from low-quality carriers. Transparency-based regulation could therefore produce limited benefits for the firm itself while increasing regulatory compliance costs and potentially even eroding their market niche by causing low-quality competitors to improve their products and their pricing.

Beyond industry influence, a second explanation for states' resistance to transparency is that state regulators want to limit their own public accountability. As described above, the complexity of insurance inevitably demands various forms of substantive consumer protection regulation.<sup>363</sup> Transparency in insurance markets provides an important disciplining force on the exercise of this

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358. See Schwarcz, *supra* note 99 (discussing the limited number of advocacy organizations that operate in the life and property/casualty insurance domains); Wendy Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1321 (2010) (discussing general phenomena of information capture).

359. See François Ewald, *Insurance and Risk*, in *THE FOUCAULT EFFECT* 197 (Graham Burchell et al. eds., 1991).

360. See TOM BAKER, *INSURANCE LAW AND POLICY* 7 (2d ed. 2008).

361. See Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223, 1264–65 (2004).

362. See Schwarcz, *supra* note 7, at 1336–38.

363. See Jackson, *supra* note 6.

regulation by allowing consumers and market intermediaries to identify its potential failings.<sup>364</sup> But while this is a social benefit that should simultaneously promote more effective regulation while reining in unnecessary regulation, it exposes state regulators to greater public scrutiny, which they may prefer to avoid.

Yet a third explanation for the inverted pattern of state insurance regulation is that state lawmakers do not have sufficient political incentives to promote transparency-based regimes. Insurance regulators tend to be quite responsive to political issues that become salient to the public.<sup>365</sup> But transparency tends not to be such an issue: Unlike substantive regulation, which directly targets regulatory problems, transparency-based reforms operate indirectly by harnessing market forces to prevent regulatory problems.<sup>366</sup> If consumers do not fully appreciate this value of transparency, state lawmakers may face limited incentives to implement such reforms.<sup>367</sup>

A final explanation is historical: Insurance regulation was originally modeled in large part on utilities regulation.<sup>368</sup> Not only was insurance viewed as a practical necessity, but it was also understood to have features of a natural monopoly because of the need for individual companies to pool and share their historic loss data in order to make accurate future projections.<sup>369</sup> Utilities regulation tends to focus predominantly on the regulation of rates, as well as various other forms of substantive regulation.<sup>370</sup> Insurance was thus originally understood to require a similar regulatory approach. From this origin, state regulators may have simply continued to rely on substantive regulation rather than transparency.

## B. Toward More Transparent Insurance Markets

Although the political economy of state insurance regulation is indeed complicated and multifaceted, one consistent force has tended to promote effective regulatory reforms. Over the last century, glaring inadequacies in state insurance regulation have tended to persist unless and until states are threatened with the risk of losing their regulatory authority. Once a credible threat of federal preemption emerges, however, state insurance regulators often prove quite capa-

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364. See *supra* Part II.B, Coverage Consistent with Consumers' Reasonable Expectations.

365. See Martin F. Grace & Robert W. Klein, *The Perfect Storm: Hurricanes, Insurance, and Regulation*, 12 RISK MGMT. & INS. REV. 81, 81–83 (2009).

366. See Schwarcz, *supra* note 7, at 1267–68.

367. This explanation is consistent with the pattern in securities law, as state blue sky laws tended to focus less on disclosure than on substantive regulation relative to federal securities regulation.

368. See Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA. L. REV. 653, 668–73 (2013).

369. See Schwarcz, *supra* note 7, at 1270–72.

370. See Abraham, *supra* note 368, at 668.



ble and effective. In lieu of a complete federal takeover of state insurance regulation, which remains unlikely, the best approach to promoting effective consumer protection regulation is to focus a bright federal spotlight on the transparency issue and back that up with a specific and credible threat of federal preemption.

### 1. State Reform of Insurance Regulation in Response to Federal Scrutiny

In a variety of regulatory domains, including banking and corporate law, state law has been consistently and dramatically influenced by the prospect that the federal government will exercise previously untapped authority.<sup>371</sup> This threat of action typically causes states to bridge the gap between their laws and those that the federal government might enact. Doing so decreases the benefits to the federal government of acting while simultaneously signaling to it that exerting its power will be politically difficult.<sup>372</sup>

Nowhere is this dynamic easier to see than in the context of state insurance regulation: The threat of federal preemption has been the primary driver of state insurance regulatory reform over the last century.<sup>373</sup> Indeed, modern state insurance regulation was largely forged in response to the *Southeastern* Supreme Court case, which opened the door to federal preemption by concluding that insurance was subject to Congress's authority to regulate commerce.<sup>374</sup> In the wake of that decision, the NAIC and the industry helped draft and pass the McCarran-Ferguson Act, which largely enshrined states as the regulators of insurance.<sup>375</sup> And in response to that Act, which limited states' antitrust exemption if they failed to regulate the business of insurance, states developed and enacted a substantial portion of modern insurance regulatory law.<sup>376</sup>

Since that time, virtually all substantial state insurance regulatory reforms can be clearly and directly traced back to acute threats of federal preemption. Consider solvency regulation, which is widely regarded to be the most important

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371. See, e.g., Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 678 (1988); see also Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 601 (2003).

372. See Roe, *supra* note 371.

373. See, e.g., Scott E. Harrington, *The History of Federal Involvement in Insurance Regulation*, in *OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES* 21, 21 (Peter J. Wallison ed., 2000) ("The history of insurance regulation is characterized by a series of perceived market or regulatory failures, followed by threats of federal regulation and subsequent changes by the states that have helped forestall federal action.").

374. See *United States v. Southeastern Underwriters Ass'n*, 322 U.S. 533, 571 (1944); see also MEIER, *supra* note 353.

375. See MEIER, *supra* note 353.

376. See *id.*

and effective element of state regulation.<sup>377</sup> The insurance solvency regime is centered on two core pillars: a risk-based capital requirement and a scheme of state accreditation, which is coordinated and enforced by the NAIC and several of its committees.<sup>378</sup> Both reforms were developed and put into place only in the early 1990s, after several insurer insolvencies prompted a highly critical congressional report and series of hearings.<sup>379</sup> Similarly, state guarantee funds were put in place in response to a proposed Federal Insurance Act, which itself was prompted by several large insurer insolvencies.<sup>380</sup>

Although state reforms in the solvency domain are the most important modern example of this process of federally triggered state insurance reform, numerous other examples exist. For instance, state regulators' numerous efforts to limit the duplicative and overlapping nature of state insurance product requirements—including the Interstate Insurance Product Regulatory Commission and State Electronic Rate and Form Filing—were directly responsive to very public campaigns by certain large property/casualty insurers and life insurers for the adoption of an Optional Federal Charter.<sup>381</sup> Similarly, recent efforts to limit the inconsistencies in state insurance producer licensing were triggered by a direct preemption threat contained within the Gramm-Leach Bliley Act, which required a national scheme for producer licensing if states did not act.<sup>382</sup> Perhaps most notably for present purposes, state lawmakers developed an excellent consumer tool for disclosing the terms of health insurance policies after the ACA delegated this responsibility to them, subject to the approval of HHS.<sup>383</sup>

377. See VAUGHAN, *supra* note 264.

378. See NAT'L ASS'N OF INS. COMM'RS, THE UNITED STATES INSURANCE FINANCIAL SOLVENCY FRAMEWORK (2010), [http://www.naic.org/documents/committees\\_e\\_us\\_solvency\\_framework.pdf](http://www.naic.org/documents/committees_e_us_solvency_framework.pdf). States have very strong reasons to maintain accreditation because of the system's ingenious design: Accredited states can only rely on the regulatory efforts of other accredited states. Failing to maintain accreditation thus risks subjecting domestic insurers to duplicative regulation.

379. SUBCOMM. ON OVERSIGHT & INVESTIGATIONS OF COMM. ON ENERGY & COMMERCE, 101ST CONG., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES (Comm. Print 1990).

380. See Brown, *supra* note 312, at 12–13.

381. See Schwarcz, *supra* note 16, at 1779.

382. Lissa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 J. CORP. L. 723, 765–66 (2000).

383. The ACA requires that Health and Human Services (HHS) consult with the NAIC in developing a Uniform Explanation of Coverage. Working through a Consumer Information Working Group, with extensive involvement from consumer groups and with consumer testing of templates, the NAIC produced a very good disclosure template, which HHS accepted without change. See Schwarcz, *supra* note 99. The template is available online. See *Summary of Coverage*, NAT'L ASS'N INS. COMMISSIONERS, [http://www.naic.org/documents/committees\\_b\\_consumer\\_information\\_soc\\_ppo\\_plan1\\_insurance\\_company1.pdf](http://www.naic.org/documents/committees_b_consumer_information_soc_ppo_plan1_insurance_company1.pdf) (last visited Nov. 22, 2013).

## 2. Expanding the Consumer Financial Protection Bureau's Jurisdiction to Encompass Insurance

All of this suggests that the path to reform of state insurance regulation ultimately lies with federal actors. If federal lawmakers do not push state lawmakers and regulators to take market transparency seriously, they will not do so. Fortunately, there is a simple and sensible way for the federal government to create an ongoing threat of preemption that depends on states making insurance markets more transparent.

Federal lawmakers could amend Dodd-Frank to extend the CFPB's jurisdiction to insurance markets.<sup>384</sup> Ideally, such a jurisdictional extension would allow the CFPB to promulgate and enforce rules that the agency reasonably deems necessary to promote more transparent insurance markets. The resulting regulatory framework would leave states as the primary insurance regulators, but it would create the prospect of preemption by the CFPB in cases in which states inadequately ensure transparency.<sup>385</sup>

The CFPB would be well situated to take on this role of promoting more transparent insurance markets. In fact, the CFPB currently devotes extensive attention to ensuring market transparency in the domain of consumer credit.<sup>386</sup> Drawing on substantial empirical testing and analysis, it has already made meaningful progress toward this goal: In the last several months, it has promulgated admirable disclosure rules for mortgages and established an online database of consumer complaints for credit card companies.<sup>387</sup> Much of this work would be directly relevant to improving the transparency of insurance markets, as many of the challenges of communicating effectively with consumers and the larger public about credit and insurance are quite similar.

Appropriately expanding the CFPB's jurisdiction to encompass insurance could place substantial and ongoing pressure on state lawmakers and regulators to promote more transparent insurance markets.<sup>388</sup> So long as the CFPB's authority to promulgate rules in the insurance domain was dependent on a preliminary deter-

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384. Currently, The Dodd-Frank Wall Street Reform Act explicitly excludes insurance from the CFPB's jurisdiction. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1002(3), Pub. L. No. 111-203, 124 Stat. 1376, 1955 (2010).

385. It would thus resemble the regulatory structure currently in place for state-regulated banks. *See id.*

386. *See* CONSUMER FIN. PROT. BUREAU, SUPERVISORY HIGHLIGHTS: FALL 2012 (2012), [http://files.consumerfinance.gov/f/201210\\_cfpb\\_supervisory-highlights-fall-2012.pdf](http://files.consumerfinance.gov/f/201210_cfpb_supervisory-highlights-fall-2012.pdf).

387. *See* Kennedy et al., *supra* note 28, at 1160–67.

388. Although numerous insurance regulators exist at the state level, they are not currently subject to meaningful regulatory competition because they have exclusive authority over insurance transactions that take place within their border. *See* Schwarcz, *supra* note 16, at 1708–09.

mination of inadequately transparent insurance markets, states would have a strong incentive to enhance market transparency proactively. Doing so would limit the risk that the CFPB would impose new rules or restrictions, both because such efforts would have less impact and because states would be better positioned to challenge them in court. So long as the CFPB's statutory grant of power were appropriately drafted, a court could strike down any attempted exercise of the CFPB's insurance authority if the agency did not, in fact, have a reasonable basis for believing its rules were necessary to promote more transparent insurance markets.

To the extent that extending the CFPB's jurisdiction to insurance failed to prompt appropriate reforms at the state level, it would serve the alternative purpose of facilitating a transition to the federalization of insurance regulation. Federalizing insurance regulation is a perennial topic of discussion among policymakers,<sup>389</sup> and many believe that Dodd-Frank took a partial step in that direction by creating a new Federal Insurance Office (FIO).<sup>390</sup> If such federalization ever were to occur completely, our recent history in the banking sphere strongly suggests that it would be appropriate to assign consumer protection responsibilities to an agency such as the CFPB, which is independent of insurers' primary prudential regulators.<sup>391</sup> Providing the CFPB with preliminary authority to study and regulate the insurance domain could thus facilitate any such transition.

### 3. Answering Objections

Various important objections can be raised against expanding the CFPB's jurisdiction to encompass insurance in particular. First, many commentators have argued that transparency-oriented consumer protections have often had the effect of crowding out more effective substantive regulations.<sup>392</sup> By embracing such regulatory approaches, lawmakers may create the appearance of having acted while preserving industry profit.<sup>393</sup> A similar point could be made here: By focusing state lawmakers on improving market transparency, the law may actually undermine important substantive regulations such as mandated policy provisions or enhanced suitability requirements.

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389. See generally OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES, *supra* note 373.

390. See Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 313(a), 502(a).

391. See Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 86–95 (2008).

392. See, e.g., Ben-Shahar & Schneider, *supra* note 3, at 651; Robert A. Hillman, *Online Boilerplate: Would Mandatory Website Disclosure of E-standard Terms Backfire?*, 104 MICH. L. REV. 837, 843–45 (2006) (worrying that online disclosure of contract terms may undermine claims of unconscionability but have little positive effect); Sovern, *supra* note 43, at 785–86.

393. See Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership From Ownership*, 95 MINN. L. REV. 1822, 1825 (2011).

Although such objections are entirely reasonable as a political matter, this Article aims to dispel the false choice between transparency and substantive regulation. Its premise is that effective consumer protection often requires both substantive regulation and transparency. There is no logical reason why these two regulatory approaches are mutually exclusive and, in fact, there are many ways in which they can be mutually reinforcing. Arguably, this fact is reflected in the most important consumer protection developments in recent years. Thus, the Credit CARD Act, the Affordable Care Act, and the Dodd-Frank Act all contain both new disclosure rules as well as meaningful substantive restrictions on firms.<sup>394</sup> At the very least, these developments demonstrate that reforms aimed at promoting market transparency need not crowd out effective substantive regulation.

A second objection is that the CFPB is not the ideal agency within which to lodge authority over insurance consumer protection. The CFPB has been mired in controversy since its genesis and has engaged in an overwhelming amount of work reforming credit markets during its limited existence. Moreover, the SEC arguably has more natural expertise in certain insurance products, as it already exercises jurisdiction over certain variable life and annuity products and focuses on promoting disclosure of firms' balance sheets, which is an important component of insurance solvency regulation.

There is little doubt that the SEC would indeed have some comparative advantages to the CFPB in promoting more transparency in insurance markets. This might be particularly true with respect to full disclosure strategies, which are much more consistent with the SEC's approach to securities regulation generally. On balance, however, the CFPB seems to present a better option than the SEC because it has devoted substantial energy to promoting both full disclosure and individual consumer understanding of complex financial products. Moreover, the CFPB's youth has certain advantages: The SEC has endured numerous turf battles with state insurance regulators that could undermine its ability to work cooperatively with them. No such history clouds the CFPB. The CFPB's youth also provides it with a distinctive amount of enthusiasm—a benefit that is particularly important given that the main goal of expanding federal authority to insurance consumer protection would be to create a credible threat of preemption that would spur state-based regulatory reform.

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394. See *supra* note 4.

### CONCLUSION

In many ways, state insurance regulation is uniquely aggressive in its approach to protecting consumers. As a result, commentators have historically overlooked the fact that state insurance regulation systematically and consistently fails to promote the most basic consumer protection of all: market transparency. The resulting pattern of state insurance regulation is both costly and ineffective. It is time for the federal government to demand that states modernize their approach to consumer protection by effectively combining market transparency with substantive regulation in ways that truly promote consumers' interests.