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Insurance Classification: Too Important to be Left to the Actuaries

Leah Wortham

Columbus School of Law, Catholic University of America

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INSURANCE CLASSIFICATION: TOO IMPORTANT TO BE LEFT TO THE ACTUARIES†

Leah Wortham*

War is much too important to be left to the generals.

Georges Clemenceau¹

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* Assistant Professor of Law, Columbus School of Law, Catholic University of America. B.A., 1970, Macalester College; J.D., 1973, Harvard University.

1. "La guerre! C'est une chose trop grave pour la confier à des militaires," attributed by G. Suarez to Clemenceau. N. GUTERMAN, A BOOK OF FRENCH QUOTATIONS 332 (1963).

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Intense debate in both state and federal governments has focused on the question: should government restrict insurers' use of classifications² such as sex or zip codes, in deciding whom to insure, how much to charge, and what coverage to offer? Two perspectives, the traditional fair discrimination approach, taken by most insurers and insurance regulators, and the antidiscrimination perspective, grounded in civil rights law concepts, have dominated the controversy.³ Regrettably, the former perspective has received undue deference⁴ and the latter, while useful, obscures other important considerations for regulation of insurance classification.⁵ Two additional perspectives must be added to the debate to ensure that sound public policy choices are made.⁶

One overlooked perspective is an appreciation that insurance is a necessity for most Americans. Public choices have heightened that necessity while looking to the private insurance system to meet it. As a result, government should assume greater responsibility for selection of classifications, both from a concern for their perceived legitimacy and because of their relation to insurance availability.

The second overlooked perspective is an understanding that a significant form of competition in the insurance market, selection competition, possesses limited utility from both the public policy and the free market viewpoints. Selection competition, sellers competing through the choice of buyers for the product, deflects public attention and competitive pressure on insurers away from forms of competition that might achieve the ends for

2. Underwriters and market strategists are more likely than actuaries to be responsible for the classifications this Article criticizes, although actuaries commonly are perceived to be responsible. *See infra* note 373.

3. *See infra* notes 41-110 and accompanying text.

4. *See infra* notes 111-249 and accompanying text.

5. *See infra* notes 93-103, 347-69 and accompanying text.

6. *See infra* notes 250-346 and accompanying text.

which competition is revered: reduced overhead, improved service, and innovative products of high quality. Today's relatively unfettered selection competition emphasizes deciding who should not be sold insurance, with serious consequences for perceived fairness and availability, while allowing the perpetuation of numerous market inefficiencies.

The proposal that Congress has considered most actively takes an antidiscrimination approach to classification reform.⁷ Those raising fair discrimination and superficial pro-competition arguments staunchly oppose this proposal. Much of the debate in the states has been along similar lines. This debate's limited parameters have obscured consideration of three areas in which action is needed: acceptance of government responsibility for the criteria upon which classifications should be based, availability of insurance coverage, and the encouragement of desirable competition.

Government responsibility for classification and concern for availability should result from the critical place insurance plays in today's society. The people of the United States comprise about five percent of the world's population⁸ but buy almost half of the private insurance sold in the world.⁹ In 1983, American expenditures on insurance amounted to almost twelve percent of the nation's disposable income.¹⁰

For a family with even modest assets to protect, the personal lines of insurance are necessities. Personal lines are those that individuals usually carry: automobile, homeowner's or renter's, health, life, and disability insurance. An automobile accident or an injury in one's home can lead to expensive litigation with expensive consequences. Therefore, liability coverage in automobile and homeowner's policies, through which the insurer undertakes to provide the defense and pay the cost of damage awards up to policy limits, has become a necessity for many Americans.

7. S. 372, 98th Cong., 1st Sess. (1983) [hereinafter cited as S. 372]; H.R. 100, 98th Cong., 1st Sess. (1983) [hereinafter cited as H.R. 100]. For further discussion, see *infra* notes 59-62 and accompanying text. For citation to previous introductions of these bills, see *infra* note 59.

8. In 1983, the United States' population was about 234,193,000 while the world's population was about 4,722,000,000. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 856, 857 (1984).

9. Figures for 1979 from the North American Reinsurance Corporation show that the United States pays 44.7% of the world's insurance premiums (excluding government programs). A. TOBIAS, *THE INVISIBLE BANKERS* 22 (1982).

10. *Competition in the Insurance Industry: Oversight Hearings Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 98th Cong., 2d Sess. 371 (1984) (testimony of Robert Hunter, National Insurance Consumer Organization) [hereinafter cited as *House Oversight Hearings*].

Automobile insurance is a condition of registering a car in about half the states.¹¹ Lenders require physical damage insurance as a condition for financing the purchase of a vehicle. Obtaining a home mortgage requires the fire and casualty coverages of home owner's insurance.¹² Even those who own their homes free of debt often would lack personal savings sufficient to repair extensive fire or storm damage. Homeowners with reachable assets, like car owners, must fear the economic consequences of a personal injury suit.

Technological advances have increased vastly the medical profession's capacity to heal and prolong life, but technology is expensive. The costs of both basic medical care and extraordinary procedures have spiralled in recent years.¹³ A patchwork of federal programs provides publicly funded medical care or health insurance to some Americans, primarily poor people, the aged, Native Americans, the military, and veterans.¹⁴ Other Americans must look to private health insurance to assure access to quality medical care and to protect against the financial catastrophe that could result from serious illness.

Social security benefits for dependents of a deceased or disabled worker are modest and subject to various restrictions.¹⁵

11. In 1979, the General Accounting Office reported that 25 states required such insurance. U.S. GENERAL ACCOUNTING OFFICE, ISSUES AND NEEDED IMPROVEMENTS IN STATE REGULATION OF THE INSURANCE BUSINESS 75 (1979) [hereinafter cited as GAO REPORT]. For other inventories of such legal requirements, see the authorities cited by Austin, *The Insurance Classification Controversy*, 131 U. PA. L. REV. 517, 520 n.9 (1983).

12. *Dunn v. Midwestern Indem. Mid-Am. Fire & Casualty Co.*, 472 F. Supp. 1106, 1111 (S.D. Ohio 1979); MEETING THE INSURANCE CRISIS OF OUR CITIES: A REPORT BY THE PRESIDENT'S NATIONAL ADVISORY PANEL ON INSURANCE IN RIOT-AFFECTED AREAS 1 (1968) [hereinafter cited as HUGHES PANEL REPORT] (calling insurance the "cornerstone of credit").

13. See *infra* notes 285-86 and accompanying text.

14. The major programs reaching poor people are Medicaid, 42 U.S.C. §§ 1396-1396p (1982) and the Public Health Service, 42 U.S.C. §§ 201-300z-10 (1982). Older people and social security disability recipients can purchase Medicare insurance. 42 U.S.C. §§ 1395-1395xx (1982). The Indian Health Service provides care for many Native Americans. 25 U.S.C. §§ 1601-1680 (1982). Health care is provided for those on active duty by the various military services. 10 U.S.C. §§ 1071-1092 (1982). Veterans receive some care through the Veteran's Administration. 38 U.S.C. §§ 601-664 (1982). Most of these programs are subject to qualifying requirements and limits on coverage. Some other programs also provide federally funded medical care or insurance, such as care for inmates in federal institutions. 18 U.S.C. §§ 4005, 4082, 4251 (1982). The federal government contributes to the cost of health insurance for federal civilian employees in the same manner as many other employers. 5 U.S.C. §§ 8901-8913 (1982).

15. For a worker and his dependents or survivors to qualify for social security disability benefits, he must be unable to engage in *any* "substantial gainful activity" because of an impairment that is expected to result in death or to last at least twelve months. 42 U.S.C. § 423(1)(A) (1982). A different standard applies to blind workers. 42 U.S.C. § 423(d)(1)(B) (1982). This means that a worker who can perform some job, even a much

Therefore, Americans at or above the middle-income level must consider purchasing life and disability insurance to meet the needs of their families.

Today's mobile, urban society does not provide the same kinship and community support networks that once met some of these insurance needs.¹⁶ Even if these ties still were strong, the expense and complexity of the safety net required for those who wish to preserve assets and a life style above the poverty line rarely could be maintained by extended family and community help alone. Some nations have opted for government-administered programs to meet similar needs of their citizens,¹⁷ but American public policy generally has relied on private insurance carriers to provide individual financial security.¹⁸

Private carriers have considerable discretion regarding how various insurance coverages and their costs will be distributed among the population. How much one pays, what coverage one

less remunerative one than his previous one, cannot qualify. Also, there is no coverage for disabilities that may last less than a year, although such a disability may result in substantial loss of income not covered by employer-paid sick leave.

Another restriction, beginning April 1985, is that children 18 or over of deceased parents cannot continue to receive social security benefits while attending post-secondary school. DEPARTMENT OF HEALTH AND HUMAN SERVICES, SOCIAL SECURITY HANDBOOK § 412, at 61 (1984). Thus, the worker who wishes to ensure adequate income for a child's college or vocational training must look to savings or life insurance.

Assume a worker whose monthly earnings averaged \$36,744 per year over his working lifetime as adjusted for changes in the cost of living by the Social Security Administration. The maximum benefit for his family is \$18,645.60 per year upon his death or retirement, or \$15,987.60 upon his disability. These figures are calculated from data in STAFF OF HOUSE COMM. ON WAYS AND MEANS, 98TH CONG., 2D SESS., BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 39 (Table 15) (Comm. Print 1984). Lower earnings would mean proportionately lower benefits.

16. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471, 480 (1961); Gardner, *Insurance and the Anti-Trust Laws—A Problem in Synthesis*, 61 HARV. L. REV. 246, 273 (1948). R. GRANT, INSURANCE REFORM: CONSUMER ACTION IN THE PROGRESSIVE ERA 6 (1979), attributes the gargantuan growth of the insurance industry after the Civil War to the move from the "self sufficiency of the agrarian-based extended-family unit" to urban workers dependent on the wage system.

17. Some countries have comprehensive health insurance schemes that reach all citizens. See S. KAMERMAN & A. KAHN, ESSAYS ON INCOME TRANSFERS AND RELATED PROGRAMS IN EIGHT COUNTRIES (1983) for descriptions of health programs in Sweden (4-6), France (86-88), and Canada (468-88). See also Soderstom, *The Canadian Experience*, 33 ACAD. POL. SCI. PROC. 224 (1980) for more detail on the Canadian system.

Some nations rely more heavily on government programs in compensating automobile accident victims. See *infra* note 264 and accompanying text. A few American states considered government-sponsored programs in fire and life in the early twentieth century but ultimately opted for private insurance schemes. See *infra* notes 278-83 and 297-303 and accompanying text.

18. See *infra* notes 264-303 and accompanying text.

can purchase, and whether one can buy insurance at all are determined in large part by how an individual is classified by insurers. This Article refers to these choices as the rating, coverage, and underwriting decisions.¹⁹

Insurers have guarded jealously their discretion to make classification decisions.²⁰ They generally have been successful in this regard, but their exercise of this discretion has not been without controversy.

Many commentators have claimed that territorial rating, usually based on zip code of residence, is a disguised form of racial discrimination that works to the detriment of blacks in property and automobile insurance.²¹ They also have charged that racial

19. Classification refers to treating an individual as a member of a class based on an individual trait such as gender, residential zip code, driving record, history of cancer, and so forth. For a review of commonly used classifications, see generally R. HOLTOM, *RESTRAINTS ON UNDERWRITING* (1979). Rating is the process of transforming classifications into prices for insurance. An example of rating is charging drivers under age 25 higher rates than older drivers. *Id.* at 25-26. Rating also includes the process of defining the basic charge for insurance. Issues in setting base rates, however, are not of concern in this Article.

Classification may play a role in coverage as well as in rating and underwriting. In the past, for example, disability coverage often required longer waiting periods for women than men and then provided them with lower benefits. *See, e.g., Stern v. Mass. Indem. & Life Ins. Co.*, 365 F. Supp. 433, 1973 (E.D. Pa. 1973); *Reichardt v. Payne*, 396 F. Supp. 1010 (N.D. Cal. 1975), *aff'd, in part, remanded sub nom.* *Life Ins. Co. of N. Am. v. Reichardt*, 591 F.2d 499 (9th Cir.), *modified*, 485 F. Supp. 56 (N.D. Cal. 1979).

Underwriting refers to the decision whether to offer insurance to an individual at all as when individuals with more than a specified number of traffic violations are refused auto insurance. *See* R. HOLTOM, *supra* note 19, at 5-7, 12-15. Underwriting guidelines may be adopted formally by companies and exist in formal manuals, or they may be lists of unacceptable risks passed informally from underwriter to underwriter. To insurers, the term underwriting may refer also to setting policy conditions (here referred to as the "coverage decision") and assignment of premiums (here referred to as "rating"). *See* Comment, *Gender Classifications in the Insurance Industry*, 75 COLUM. L. REV. 1381, 1383 n.13 (1975), which develops definitions similar to those used in this Article.

Classification also may play a role in marketing. Insurers may direct their advertising at a particular segment of the population and choose agents who are likely to sell only to particular groups. For example, former Pennsylvania Insurance Commissioner Herbert Denenberg has said that many insurers avoid non-white markets. He cites as support an American Academy of Actuaries study. *Insurance Competition Improvement Act: Hearings on S. 2474 Before the Senate Subcomm. on Antitrust, Monopoly, and Business Rights of the Senate Comm. on the Judiciary*, 96th Cong., 2d Sess. 153 (1980) [hereinafter cited as *Senate Hearings on S. 2474*,]; *see also* Lamel, *State Regulation of the Insurance Industry*, 1978 INS. L.J. 336 (containing similar comments of a Deputy New York Insurance Commissioner).

20. One commentator who made an extensive study of reform efforts in property insurance has referred to underwriting prerogative as "an important political symbol." Works, *Whatever's Fair—Adequacy, Equity and the Underwriting Prerogative in Property Insurance Markets*, 56 NEB. L. REV. 445, 479 (1977).

21. *Dunn v. Midwestern Indem. Mid-Am. Fire & Casualty Co.*, 472 F. Supp. 1106 (S.D. Ohio 1979). For five studies of alleged insurance redlining, *see Rights and Remedies of Insurance Policyholders, Part 1: Discrimination by Property and Casualty In-*

classification still is used covertly in some underwriting decisions through means other than territorial rating.²² Controversies have erupted periodically with regard to the role of territory, age, and gender in insurer decisions in automobile insurance.²³ Young men in urban areas, who usually pay more for automobile insurance than their older, female, or suburban counterparts, have argued that high rates effectively render insurance unavailable to them.²⁴ Advocates for physically and mentally impaired people have convinced some state legislatures to restrict insurer discretion with regard to such impairments generally or with regard to a specific disability.²⁵ Much of the controversy about classification in the last two decades has focused on gender classification.²⁶ Automobile classification schemes have been criticized for

urance Companies: The Fairness in the Coverage and Cost of Insurance: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary, 95th Cong., 2d Sess. 223-351, 352-409, 410-51, 452-87, 634-748 (1978) [hereinafter cited as Senate Oversight Hearings on Discrimination in Property and Casualty Ins.].

22. See, e.g., *Sims v. Order of United Commercial Travelers of America*, 343 F. Supp. 112 (D. Mass. 1972) (concerning a fraternal benefits association's refusal of a black member when membership was necessary to buy life insurance).

23. *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 8-12.

24. *Id.* at 81. The General Accounting Office contrasts a 24-year-old male driver with no accidents living in East Boston who would have to pay \$2,512 for car insurance on a three-year-old Chevrolet Malibu with an elderly resident of Deerfield, Massachusetts who would pay \$160 for the same car and same coverages even if the Deerfield man had two accidents in the previous year. GAO REPORT, *supra* note 11, at 104.

25. Bailey, Hutchison & Narber, *The Regulatory Challenge to Life Insurance Classification*, 25 DRAKE L. REV. 779, 794 (1976); see *infra* notes 84-87 and accompanying text.

26. Five sets of congressional hearings have been held on a bill introduced by Senators Hatfield and Packwood and Representative Dingell that would prohibit classification on the basis of race, color, religion, sex, and national origin. Most of the testimony from the opponents and proponents has focused on gender classification. See, e.g., *Fair Insurance Practices Act: Hearings on S. 372 Before the Senate Comm. on Commerce, Science, and Transportation, 98th Cong., 1st Sess. (1983)* [hereinafter cited as *Senate Hearings on S. 372*]; *Fair Insurance Practices Act: Hearings on S. 2204 Before the Senate Comm. on Commerce, Science, and Transportation, 97th Cong., 2d Sess. (1982)* [hereinafter cited as *Senate Hearings on S. 2204*]; *Nondiscrimination in Insurance Act: Hearings on S. 2477 Before the Subcomm. on Antitrust, Monopoly, and Business Rights of the Senate Comm. on the Judiciary, 96th Cong., 2d Sess. (1980)* [hereinafter cited as *Senate Hearings on S. 2477*]; *Nondiscrimination in Insurance Act of 1983: Hearings on H.R. 100 Before the Subcomm. on Commerce, Transportation, and Tourism of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. (1983)* [hereinafter cited as *House Hearings on H.R. 100, 98th Cong.*]; *Nondiscrimination in Insurance Act of 1981: Hearings on H.R. 100 before the Subcomm. on Commerce, Transportation, and Tourism of the House Comm. on Energy and Commerce, 97th Cong., 1st Sess. (1981)* [hereinafter cited as *House Hearings on H.R. 100, 97th Cong.*]. See cases cited *infra* note 57. At the most recent of these hearings, Senator Packwood commented, "although there are five categories . . . [covered by the bill] . . . only the one of sex seems to bother the companies." *Senate Hearings on S. 372, supra*, at 323.

favoring those with higher socio-economic status.²⁷ Underwriting decisions about occupations and life styles have been attacked as based on stereotypes and irrational prejudices.²⁸

Much of the academic commentary on classification has focused on gender and the questions before the Supreme Court in *City of Los Angeles Department of Water & Power v. Manhart*²⁹ and *Arizona Governing Committee v. Norris*.³⁰ These cases presented the issue of whether federal employment discrimination law bans gender classification in employer-sponsored fringe benefits and whether banning such classification is sound policy. Commentary has concentrated on the specific classification and line of insurance considered in those cases, gender classification in annuities, or somewhat more generally on gender classification in the lines of insurance commonly sponsored by employers, these being life, health, and disability insurance as well as pensions and annuities.³¹ Other writers on classifica-

27. Austin, *supra* note 11, at 534-48; *see also* Order of the New Jersey Insurance Commissioner, Apr. 9, 1981, *reprinted in House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 1064-65 [hereinafter cited as *N.J. Order*, with page cites to *House Hearings on H.R. 100, 98th Cong.*].

28. Excerpts from the Homeowners Insurance Underwriting Manual of the Continental Insurance Cos., *reprinted in Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 89-93. Included in the list of occupations considered to have a higher than average frequency of loss were: antique dealer, professional athlete, actors and actresses, junk and secondhand dealers, and waiters and waitresses. *Id.* Excerpts from the Hartford Personal Lines Underwriting Manual, *reprinted in id.*, at 728-36, contain similar material with statements on considerations such as "[t]he psychological makeup of a person likely to be drawn to this occupation, e.g., a banker versus a carnival employee." *See also* Statement of Senator Metzenbaum, 126 CONG. REC. 6529 (1980) (criticizing the classification practices with examples from his subcommittee's hearings).

29. 435 U.S. 702 (1978).

30. 463 U.S. 1073 (1983).

31. Most notable in the comment spawned by *City of Los Angeles Dep't of Water & Power v. Manhart*, 435 U.S. 702 (1978), is one of the longest running dialogues in law review history, a septology spawned by the debate between Professors Kimball and Benston, on the one hand, and Professor Brilmayer and her colleagues, on the other: Kimball, *Reverse Sex Discrimination: Manhart*, 1979 AM. B. FOUND. RESEARCH J. 83 [hereinafter cited as Kimball, *Reverse Sex Discrimination*]; Brilmayer, Hekeler, Laycock & Sullivan, *Sex Discrimination in Employer-Sponsored Insurance Plans: A Legal and Demographic Analysis*, 47 U. CHI. L. REV. 505 (1980) [hereinafter cited as Brilmayer, *Sex Discrimination*]; Kimball, *Reprise on Manhart*, 1980 AM. B. FOUND. RESEARCH J. 915; Laycock & Sullivan, *Sex Discrimination as "Actuarial Equality": A Rejoinder to Kimball*, 1981 AM. B. FOUND. RESEARCH J. 221; Benston, *The Economics of Gender Discrimination in Employee Fringe Benefits: Manhart Revisited*, 49 U. CHI. L. REV. 489 (1982) [hereinafter cited as Benston, *Economics of Gender Discrimination*]; Brilmayer, Laycock & Sullivan, *The Efficient Use of Group Averages as Nondiscrimination: A Rejoinder to Professor Benston*, 50 U. CHI. L. REV. 222 (1983); Benston, *Discrimination and Economic Efficiency in Employee Fringe Benefits: A Clarification of Issues and a Response to Professors Brilmayer, Laycock, and Sullivan*, 50 U. CHI. L. REV. 250 (1983).

See also Bernstein & Williams, *Sex Discrimination in Pensions: Manhart's Holding v.*

tion also have tended to limit themselves to specific classifications in the context of particular lines of insurance.³² With a few important exceptions,³³ commentary has focused on whether

Manhart's *Dictum*, 78 COLUM. L. REV. 1241 (1978); Bernstein & Williams, *Title VII and the Problem of Sex Classification in Pension Programs*, 74 COLUM. L. REV. 1203 (1974); Gold, *Of Giving and Taking: Applications and Implications of City of Los Angeles, Department of Water and Power v. Manhart*, 65 VA. L. REV. 663 (1979); Hager & Zimbleman, *The Norris Decision, Its Implications and Applications*, 32 DRAKE L. REV. 913 (1983); Jacobs, *The Manhart Case: Sex-Based Differentials and the Application of Title VII to Pensions*, 31 LAB. L.J. 232 (1980); Key, *Sex-Based Pension Plans in Perspective: City of Los Angeles Department of Water and Power v. Manhart*, 2 HARV. WOMEN'S L. J. 1 (1979); Lines, *Sex-Based Fringe Benefits—Annuities and Life Insurance*, 16 J. FAM. L. 489 (1977); Rutherglen, *Sexual Equality in Fringe-Benefit Plans*, 65 VA. L. REV. 199 (1979); Note, *Title VII and the TIAA-CREF Annuity System: An Analysis of the Spirit and Wayne State Decisions*, 47 ALB. L. REV. 1230 (1983) [hereinafter cited as Note, *TIAA-CREF Annuity System*]; Note, *Title VII's Applicability to Arizona's Deferred Compensation Plan*, 24 ARIZ. L. REV. 1032 (1982); Note, *Sex Discrimination and Sex-based Mortality Tables*, 53 B.U.L. REV. 624 (1973); Note, *Title VII and the McCarran Act: Sex Discrimination in Retirement Benefits by Third-Party Insurers*, 68 GEO. L.J. 1285 (1980); Note, *Norris v. Arizona: A Move Toward Unisex Insurance*, 45 LA. L. REV. 149 (1984); Note, *The Premiums on Longer Life: Gender Based Pension Benefits Violate Civil Rights Act*, 13 STETSON L. REV. 673 (1984); Note, *Equal Protection, Title VII, and Sex-Based Mortality Tables*, 13 TULSA L.J. 338 (1977); Note, *Gender-Based Determination of Retirement Benefits: Arizona v. Norris*, 19 TULSA L.J. 755 (1984); Note, *Discrimination in Insurance: The Unisex Issue*, 24 WASHBURN L.J. 78 (1984); Note, *Sex Discrimination—Pensions—The Court Takes a Stand: Arizona v. Norris*, 30 WAYNE L. REV. 1329 (1984); Note, *Sex Discrimination in Employee Fringe Benefits*, 17 WM. & MARY L. REV. 109 (1975); Note, *Challenges to Sex Based Mortality Tables in Insurance and Pensions*, 6 WOMEN'S RTS. L. REP. 59 (1980); Comment, *Gender Classifications in the Insurance Industry*, 75 COLUM. L. REV. 1381 (1975); Comment, *An Additional Expense in the Quest for Equality: A Comment on Arizona v. Norris*, 19 NEW ENG. L. REV. 671 (1984); Comment, *Sex Stereotyping and Statistics—Equality in an Insurance Context*, 7 U. PUGET SOUND L. REV. 137 (1983).

32. See, e.g., Badain, *Insurance Redlining and the Future of the Urban Core*, 16 COLUM. J.L. & SOC. PROBS. 1 (1980) (commenting on territorial classification in property/casualty insurance); De Wolfe, Squires & De Wolfe, *Civil Rights Implications of Insurance Redlining*, 29 DE PAUL L. REV. 315 (1980) (same); Note, *Insurance Redlining and Fair Housing: The Lost Opportunity of Mackey v. Nationwide Insurance Company*, 34 CATH. U.L. REV. 563 (1985) (same); Comment, *Application of Title VIII to Insurance Redlining*, 75 NW. U.L. REV. 472 (1980) (same); Abramoff, *Rating the Rating Schemes: Application of Constitutional Equal Protection Principles to Automobile Insurance Practices*, 9 CAP. U.L. REV. 683 (1980) (concerning gender classification in automobile insurance); Kesner, *Auto Insurance Rating: A Question of Equal Protection*, 32 FED'N INS. COUNS. Q. 165 (1982) (same). A recent antidiscrimination Article looks at the gender classification debate across the various lines of personal insurance. Jerry & Mansfield, *Justifying Unisex Insurance: Another Perspective*, 34 AM. U.L. REV. 329 (1985).

33. The author acknowledges an intellectual debt to four important Articles introducing other insights. The first is Austin, *supra* note 11, which is a conceptual critique of the classification debate from a Critical Legal Studies perspective. Professor Austin argues that the classification schemes commonly used in automobile and property insurance reflect and reinforce the status hierarchy of society. *Id.* at 543-48. That analysis is drawn upon here as part of the critique of the claim that traditional fair discrimination is a neutral, scientific enterprise with great fairness to the public. See *infra* notes 138-48 and accompanying text.

Critical Legal Studies theorists generally reject approaches to reform that involve gov-

particular classifications should be forbidden from an antidiscrimination perspective.³⁴ This Article takes a broader, conceptual approach, looking across classifications and lines of insurance.

This Article classifies most of the public debate about classification as coming from one of two perspectives labeled traditional fair discrimination³⁵ and antidiscrimina-

ernment regulation because they favor solutions evolving from "organic groups" . . . characterized by face-to-face co-existence and by multipurpose organization." *Id.* at 581; see authority cited in n.372. See generally *Critical Legal Studies Symposium*, 36 STAN. L. REV. 1 (1984) (presenting the general approach of Critical Legal Studies). These groups have voluntary membership and are free from domination. Austin, *supra* note 11, at 581. With regard to the classification controversy in property insurance, it is proposed that such groups could engage "in important economic and social tasks relevant to the control of risks and the provision of support and resources for the victims of accidents and losses." *Id.* The example cited is municipal fire or property insurance: a local jurisdiction would market group homeowner's insurance to residents through a master policy written by a private carrier, with safety and maintenance inspections conducted by local fire fighting personnel. *Id.* at 582. There probably are other examples of voluntary groups that might provide insurance in a manner more desirable than that afforded by present classification schemes, but the provision of insurance through these groups is likely to be limited.

The second Article is Kemp, *Insurance and Competition*, 17 IDAHO L. REV. 547 (1981), which focuses on the unique features of competition in the insurance market, including their interplay with classification. The two other Articles are Underwood, *Law and the Crystal Ball: Predicting Behavior with Statistical Inference and Individualized Judgment*, 88 YALE L.J. 1408 (1979), which considers insurance classification as one case raising issues of legitimacy in public decisions based on statistical prediction, and Works, *supra* note 20, which emphasizes the limits of the antidiscrimination perspective and the manner in which it can obscure availability issues.

Abraham, *Efficiency and Fairness in Insurance Risk Classification*, 71 VA. L. REV. 403 (1985), appeared recently. Although this author has some differences with Professor Abraham, he provides a most useful and lucid attempt to bring conceptual and theoretical discipline to the classification debate.

Law and Economics scholars have entered the debate as well. See Professor Benston's Articles cited *supra* note 31. Professor Brilmayer and her colleagues note correctly that Professor Benston's work, while cast in Law and Economics terms, does not differ significantly in perspective from that of Professor Kimball who argues the "traditional fair discrimination" perspective. See Kimball, *Reverse Sex Discrimination*, *supra* note 31, and *infra* notes 41 & 43 and accompanying text discussing the work; Brilmayer, Laycock & Sullivan, *supra* note 31, at 223.

34. The Articles by Professor Brilmayer and her colleagues, *supra* note 31, probably contain the most influential development of the antidiscrimination perspective.

35. The term "traditional" excludes a few state insurance commissioners who have introduced other values, including some shared by the antidiscrimination perspective, into classification reform without abandoning the rhetoric of fair discrimination. Florida, Louisiana, Massachusetts, New Jersey, North Carolina, and Pennsylvania insurance commissioners all have banned sex as well as some other classifications in automobile insurance. See *supra* note 27 (N.J. order) & *infra* note 149 (Mass. order). Courts overturned the Florida, Louisiana, and North Carolina rulings. *Dep't of Ins. v. Insurance Servs. Office*, 434 So. 2d 908 (Fla. Dist. Ct. App. 1983), *petition denied*, 444 So. 2d 416 (Fla. 1984); *Insurance Servs. Office v. Commissioner of Ins.*, 381 So. 2d 515 (La. Ct. App.), *cert. denied*, 382 So. 2d 1391 (La. 1979); *State ex. rel. Commissioner of Ins. v.*

tion.³⁶ Proponents of the status quo in classification and its regulation justify that status quo as fair discrimination. They argue that fair discrimination is both desirable and a reflection of a long-standing public policy judgment embodied in state law.³⁷ Part I finds the assertion that fair discrimination is fair wanting in theory and even more deficient in practice, and rejects the contention that state law reflects a requirement or even a judgment about the wisdom of this approach.

Part I develops two alternative perspectives that should receive prominence in the classification debate: the vital importance of the personal lines of insurance to many Americans and the way competition actually functions in the insurance market. These perspectives provide additional bases of support for the ban of race, color, religion, sex, and national origin classification advocated by the antidiscriminators. They also expose the limits of antidiscrimination as a single perspective on classification reform.

Part II proposes three objectives for classification regulation: perceived fairness of the system and legitimacy of classifications used; promotion of overall loss control; and encouragement of price and service competition. The legislative initiatives described in Part III address these objectives.

The initiatives recommended are in three areas that have not been included in the legislative proposals actively considered. The first legislative proposal would judge all classifications against articulated standards.³⁸ The second initiative is a study of the ability of individuals to buy insurance coverage to see who cannot get insurance because it is too expensive. This study would provide the data necessary to consider whether govern-

North Carolina Automobile Rate Admin. Office, 23 N.C. App. 475, 209 S.E.2d 411 (1974), *cert. denied*, 286 N.C. 412, 211 S.E.2d 219 (1975). North Carolina later banned sex classification in automobile insurance by statute as it has been banned in four other states. See *infra* notes 77-78 and accompanying text. The failure of the New Jersey and Wyoming attempts are discussed in Austin, *supra* note 11, at 528-30. For discussion of the court decisions upholding the Pennsylvania decision, see *infra* notes 223-26, 241-42, and accompanying text. Because unfair discrimination statutes were the authority for their action, commissioners could not abandon fair discrimination rhetoric.

36. Any attempt to place the views of diverse scholars, regulators, legislators, and advocates into categories provides ample ground for disagreement and alternative formulations. Another conceptualization of the classification debate characterizes the positions regarding automobile and property insurance as those "of a competitive market regulated pursuant to a widespread consensus that promotes individual mobility," called the "individualist mode," and those "of a market controlled by social welfare considerations determined by a political process that is responsive to intergroup unity and intergroup conflict," labeled the "collectivist mode." Austin, *supra* note 11, at 549.

37. See *infra* notes 41-43 and accompanying text.

38. See *infra* notes 395-404 and accompanying text.

ment intervention to broaden availability is warranted for a particular coverage and what method of intervention would be best.³⁹ The third recommendation is the need for legislation to encourage desirable forms of competition in the insurance market, the most important being provision of readily available and understandable consumer information.⁴⁰ Public debate in which only the fair discrimination and antidiscrimination perspectives are recognized obscures the need for these legislative proposals.

I. PERSPECTIVES ON GOVERNMENT INTERVENTION IN INSURANCE CLASSIFICATION

Most classification reforms that have taken place or have been proposed have been from an antidiscrimination perspective. This Part outlines such judicial and legislative reforms.

The status quo is termed here as traditional fair discrimination. The argument that it is fair to the public and required, or urged, by the history of state unfair discrimination laws or their judicial interpretation is challenged.

Two alternative perspectives to classification are presented. First, each of the personal lines of insurance is a necessity for many Americans. Society has chosen to meet this need through private insurers. From those facts should flow a concern for the perceived legitimacy of classifications used and insurance availability.

Second, competition in the insurance market often is not the price and service competition so revered. Classification itself becomes a form of competition that does not produce the same beneficial results. Complex products, lack of useful information about the multiplicity of products, and the possibility for agents to act in their own economic interest rather than that of consumers all impede competition reducing price and encouraging better service. Classification restriction may enhance desirable competition, and other measures to enhance such competition should be taken as well.

A. *Dominant Perspectives in the Classification Debate*

Most insurers and insurance regulators, as well as some schol-

39. See *infra* notes 405-06 and accompanying text.

40. See *infra* notes 407-14 and accompanying text.

ars, argue that the goal of insurance classification should be fair discrimination. In the words of a distinguished academic proponent of this view, insurers should seek "to measure as accurately as is practicable the burden shifted to the insurance fund by the policyholder and to charge exactly for it, no more and no less. To do so is "fair" discrimination Not to do so is unfair discrimination."⁴¹

Some assert that the traditional fair discrimination perspective is fair because each insured pays according to what he receives rather than being subsidized by others.⁴² The perspective also is said to be consistent with the mandate of state unfair discrimination statutes, thus reflecting a long-standing public policy judgment.⁴³

The antidiscrimination perspective rejects the traditional fair discrimination approach from a perspective grounded in civil rights law concepts.⁴⁴ This view opposes the use of certain classifications, particularly those restricted by civil rights laws governing other activities or enterprises.

Insurers' discretion to practice traditional fair discrimination in their classification of insureds has been circumscribed to a considerable degree by the antidiscrimination perspective. The Supreme Court in *City of Los Angeles Department of Water & Power v. Manhart*⁴⁵ and *Arizona Governing Committee v. Norris*⁴⁶ held that if an employer sponsors a fringe benefit plan,⁴⁷ the plan must not treat employees differently with regard to cost or benefits on the basis of any classification forbidden by Title

41. Kimball, *Reverse Sex Discrimination*, *supra* note 31, at 105; see also Bailey, Hutchison & Narber, *supra* note 25, at 781-82; Gerber, *The Economic and Actuarial Aspects of Selection and Classification*, 10 FORUM 1205, 1207 (1975) (espousing the same view).

42. See *Senate Hearings on S. 372*, *supra* note 26, at 215 (testimony of John Filer, Chairman, Aetna Life and Casualty).

43. Kimball, *Reverse Sex Discrimination*, *supra* note 31, at 105.

44. See *supra* notes 31-32. The best statement of the antidiscrimination perspective is Brillmayer, *Sex Discrimination*, *supra* note 31.

45. 435 U.S. 702 (1978).

46. 463 U.S. 1073 (1983).

47. The employer need not contribute funds to fall within the ambit of *Norris*. It was considered sufficient there that Arizona invited insurance companies to submit bids, selected the companies who would participate, entered into contracts governing the benefit terms, gave employers time off to attend meetings to learn about benefit options, limited the employee's choice of plans to those selected by the state, and deducted and forwarded the payroll contributions. 463 U.S. at 1075-79, 1088-89 (1983). Hager & Zimleman, *supra* note 31, at 932-33 (predicts extensive litigation on the requisite degree of employer involvement and lists criteria authors believe relevant to determine whether *Norris* applies).

VII of the Civil Rights Act of 1964,⁴⁸ namely, race, color, religion, sex, and national origin.⁴⁹ In so doing, the Court rejected the argument that sex-segregated tables should be permitted because they accurately reflect differences in longevity: “‘Even a true generalization about [a] class’ cannot justify class-based treatment.”⁵⁰

Because Title VII addresses only employment discrimination, *Norris* and *Manhart* extend only to employer-sponsored insurance plans. Nevertheless, these cases will have a considerable impact on the annuity, health, disability, and life insurance industries generally because these coverages largely are provided by employers on a group basis.⁵¹ On the other hand, *Norris* and *Manhart* probably will have little direct effect on homeowner's or automobile insurance because there is little employer-sponsored group coverage in these lines.⁵²

Race or color classification in insurance that is not employer-sponsored might be reached by the Civil Rights Acts of 1866⁵³ and 1870.⁵⁴ One district court has held⁵⁵ that the racial impact

48. 42 U.S.C. §§ 2000e to 2000e-17 (1982).

49. *Manhart* concerned retirement benefits from a state-run pension plan with no private carrier involved. 435 U.S. 702 (1978). *Norris* concerned a deferred compensation plan that provided annuities under terms negotiated with private carriers. 463 U.S. 1073 (1983). Both schemes were found to be “compensation,” “terms,” or “conditions” of employment as to which there could be no discrimination under Title VII of the Civil Rights Act of 1964. 42 U.S.C. § 2000e-2(a)(1) (1982). Under these two decisions, any employer-sponsored insurance benefit would fall within the requirements and prohibitions of Title VII.

50. *Norris*, 463 U.S. at 1084-85 (quoting *Manhart*, 435 U.S. at 708).

51. For example, the President of the American Academy of Actuaries has testified that 85% of private hospital/medical insurance issued to those under 65 is on a group basis. *Senate Hearings on S. 372, supra* note 26, at 290. See Hager & Zimpleman, *supra* note 31, at 940-42, on *Norris*'s application to fringe benefits other than pensions and annuities.

52. *Senate Hearings on S. 372, supra* note 26, at 290.

53. 42 U.S.C. § 1982 (1982) guarantees the right to all citizens that is “enjoyed by white citizens . . . [to] purchase . . . personal property.” *Sims v. Order of United Commercial Travelers*, 343 F. Supp. 112 (D. Mass. 1972), held § 1982 applicable to insurance. *Ben v. General Motors Acceptance Corp.*, 374 F. Supp. 1199 (D. Colo. 1974), reached the same conclusion in a case concerning insurance rating for Native Americans. See also dictum in *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419 (4th Cir. 1984), which denied standing to an insurance agent to challenge alleged discriminatory practices but indicated that black insurance applicants who claimed discrimination would be able to sue under §§ 1981 and 1982.

54. 42 U.S.C. § 1981 (1982) guarantees to all persons in the United States the rights enjoyed by white citizens “to make and enforce contracts.” See *Sims v. Order of United Commercial Travelers*, 343 F. Supp. 112, 114-15 (D. Mass. 1972); *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 420-22 (4th Cir. 1984); *Bailey, Hutchison & Narber, supra* note 25, at 779 n.150 (suggesting that §§ 1981 and 1982 might not reach rating decisions).

55. *Dunn v. Midwestern Indem. Mid-Am. Fire & Casualty Co.*, 472 F. Supp. 1106 (S.D. Ohio 1979). In *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419 (4th Cir. 1984), the

of territorial classification in property insurance may be scrutinized under the Fair Housing Act.⁵⁶ Civil rights challenges to classifications other than race or color, however, have failed for lack of state action.⁵⁷ There also has been debate about whether classification challenges based upon civil rights statutes are barred by the McCarran-Ferguson Act.⁵⁸

Fourth Circuit rejected *Dunn's* reasoning and held that the Fair Housing Act, 42 U.S.C. §§ 3601-3631 (1982), does not reach insurance practices. 724 F.2d at 424. *See also* *Badain, supra* note 32, at 34-46; Note, *supra* note 32; Comment, *supra* note 32.

56. 42 U.S.C. §§ 3601-3631 (1982).

57. 42 U.S.C. §§ 1981, 1982 reach only race and color-based discrimination. Although claims of sex discrimination may be reached under the Civil Rights Acts of 1871, 42 U.S.C. §§ 1983, 1985 (1982), such claims have failed in the insurance context for want of state action. *Reichardt v. Payne*, 396 F. Supp. 1010 (N.D. Cal. 1975), *rev'd sub nom.* *Life Ins. Corp. of N. Am. v. Reichardt*, 591 F.2d 499 (9th Cir.), *modified*, 485 F. Supp. 56 (N.D. Cal. 1979); *Broderick v. Associated Hosp. Serv. of Philadelphia*, 536 F.2d 1 (3d Cir. 1976); *Jackson v. Associated Hosp. Serv. of Philadelphia*, 414 F. Supp. 315 (E.D. Pa. 1976), *cert. denied*, 434 U.S. 832 (1977); *Madison v. Keystone Ins. Corp.*, No. 77-2559 (E.D. Pa. filed Sept. 21, 1978) (cited in *Key, supra* note 31, at 42); *see also* *Freier v. New York Life Ins. Corp.*, 679 F.2d 780 (9th Cir. 1982) (finding state insurance regulation insufficient to constitute state action). *Stern v. Massachusetts Indem. & Life Ins. Corp.*, 365 F. Supp. 433 (E.D. Pa. 1973), found the state activity in insurance regulation sufficient under §§ 1983 and 1985, but the Supreme Court's subsequent decision in *Jackson v. Metropolitan Edison Corp.*, 419 U.S. 345 (1974), caused the courts in the previously cited cases to find state action wanting. *Reichardt* also held that *Great Am. Fed. Sav. & Loan Ass'n v. Novotny*, 442 U.S. 366 (1979), required that the substantive right protected under § 1985(3) be a federal one. *Reichardt* reasoned that if a § 1983 claim was barred for want of state action, there was no substantive federal right on which to base a sex discrimination claim.

58. 15 U.S.C. §§ 1011-1015 (1982) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance", 15 U.S.C. § 1012(b) (1982)). Justice Powell, dissenting in *Norris*, argued that the majority's decision would make Title VII supersede state unfair discrimination laws. 463 U.S. at 1099-1100 (1983). This, said Powell, was precisely the kind of result *McCarran-Ferguson* was intended to prevent. *Id.* The majority responded that because Arizona had abandoned the claim, it should not be addressed, but went on to say that state law was not superseded because the decision addressed employment practices rather than insurance practices. 463 U.S. at 1087-88 n.17.

At least two district courts have rejected the contention that *McCarran-Ferguson* would bar a claim brought under a civil rights act. *Ben v. General Motors Acceptance Corp.* questioned the intent and constitutional authority to do so if it were to "deprive a citizen of access to the Federal Courts to obtain redress for violations of his civil rights and require him to resort to the state courts as the sole forum of redress." 374 F. Supp. 1199, 1203 (D. Colo. 1974). *Women in City Gov't United v. City of N.Y.* questioned the "indiscriminate" application of *McCarran-Ferguson* to legislation with a purpose that is "not the regulation of commerce but the protection of other important federal interests . . ." 515 F. Supp. 295, 303 (S.D.N.Y. 1981). A number of other cases that have considered the application of civil rights statutes to insurance discrimination have not discussed *McCarran-Ferguson*. *Broderick v. Associated Hosp. Serv. of Philadelphia*, 536 F.2d 1 (3d Cir. 1976); *Jackson v. Assoc. Hosp. Serv. of Philadelphia*, 414 F. Supp. 315 (E.D. Pa. 1976); *Reichardt v. Payne*, 396 F. Supp. 1010 (N.D. Cal. 1975), *rev'd sub nom.* *Life Ins. Corp. of N. Am. v. Reichardt*, 591 F.2d 499 (9th Cir. 1979), *modified* 485 F. Supp. 56 (N.D. Cal. 1979); *Stern v. Mass. Indem. & Life Ins. Corp.*, 365 F. Supp. 433 (E.D. Pa. 1973); *Sims v. Order of United Commercial Travelers*, 343 F. Supp. 112 (D.

Federal legislation that would extend the antidiscrimination principles of federal civil rights laws to all personal lines of insurance has been proposed in the past three Congresses by Senator Hatfield, Senator Packwood, and Representative Dingell.⁵⁹ The Hatfield-Packwood-Dingell bill would prohibit insurers from differentiating on the basis of race, color, religion, sex, or national origin in underwriting, coverage, and rating.⁶⁰ It would provide a private right of action to aggrieved persons⁶¹ and would empower the Attorney General to sue if the denial of rights "raises an issue of general importance."⁶² The proposal is a relatively simple one that bans classifications, enumerates covered practices, and describes enforcement procedures and remedies.

In summary, current federal law forbids classification by race, color, religion, sex, or national origin in employer-sponsored in-

Mass. 1972). See Jordan, *Property Insurance and Fair Housing*, 18 FORUM 223 (1982); Note, *Title VII and the McCarran Act: Sex Discrimination in Retirement Benefits by Third Party Insurers*, 68 GEO. L.J. 1285 (1980); Note, *Title VII Clashes With McCarran-Ferguson in the Pension Arena*, 41 U. PITT. L. REV. 859 (1980).

59. Senator Hatfield and Representative Dingell introduced identical bills in the 96th Congress. Senator Packwood joined Senator Hatfield in introducing a revised version of the bill in the 97th and 98th Congresses. Although Senator Hatfield was the principal sponsor in all three Congresses, the bill is also associated with Senator Packwood because he chairs the committee that has considered it. The introductions of the bill have been: H.R. 1793, 99th Cong., 1st Sess. (1985); S. 372, *supra* note 7; S. 2204, 97th Cong., 2d Sess. (1982); S. 2477, 96th Cong., 2d Sess., 126 CONG. REC. 6536-39 (1980) [hereinafter cited as S. 2477]; H.R. 100, 98th Cong., 1st Sess. (1983); H.R. 100, 97th Cong., 1st Sess. (1981); H.R. 100, 96th Cong., 1st Sess. (1979). For citations to the five sets of hearings that have been held on this legislation, including texts of the bills for those sessions of Congress, see *supra* note 26. For a discussion of the legislation, see Comment, *Banning "Actuarially Sound" Discrimination: The Proposed Non-Discrimination in Insurance Act*, 20 HARV. J. ON LEGIS. 631 (1983); Note, *Ending Sex Discrimination in Insurance: The Nondiscrimination in Insurance Act*, 11 J. LEGIS. 457 (1984).

The Senate bill was reported from the Committee on Commerce, Science, and Transportation in the 97th Congress, S. REP. NO. 671, 97th Cong., 2d Sess. (1982). The House bill was reported from the Committee on Energy and Commerce in the 98th Congress, but it was so altered by amendments that its proponents abandoned support for it in that form. *Opponents Rewrite Unisex Insurance Bill*, CONG. Q., Mar. 31, 1984, at 706, 707.

The text of the bill also has been introduced in the past three Congresses as Title III of a proposed "Economic Equity Act," an omnibus bill of proposals addressed to sex equity. S. 1169, 99th Cong., 1st Sess. (1985); H.R. 2472, 99th Cong., 1st Sess. (1985); S. 288, 98th Cong., 1st Sess. (1983); H.R. 2090, 98th Cong., 1st Sess. (1983); S. 888, 97th Cong., 1st Sess. (1981); H.R. 2090, 97th Cong., 1st Sess. (1981).

This legislation appears to be well within the power of Congress under the commerce clause. U.S. CONST. art I, § 8, cl. 3; *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).

60. S. 372, *supra* note 7, § 4, reprinted in *Senate Hearings on S. 372*, *supra* note 26, at 6-8.

61. *Id.* § 6, reprinted in *Senate Hearings on S. 372*, *supra* note 26, at 11-12.

62. *Id.* § 7, reprinted in *Senate Hearings on S. 372*, *supra* note 26, at 12-13.

insurance plans.⁶³ The Hatfield-Packwood-Dingell measure would extend this ban to insurance plans in all the personal lines of insurance, whether or not they are employer-sponsored.⁶⁴ Other federal civil rights statutes also may support a ban on race or color classification in insurance policies, whether employer-sponsored or not, but there apparently is no federal remedy for alleged discrimination regarding other classifications such as sex.⁶⁵

Some state statutes ban race classification in insurance.⁶⁶ They do so more frequently in life insurance than in property insurance.⁶⁷ A few states instituted the race classification ban after the Civil War.⁶⁸ Most, however, did not, and race was a commonly used classification, at least in life insurance, through the 1950's.⁶⁹ Some state statutes also ban religious and national origin classification.⁷⁰

Today, insurers claim not to use race, color, religion, or national origin classification.⁷¹ Even if these classifications play no role in underwriting, rating, or coverage, a statute banning their use could have an effect on current practices if it were interpreted to reach other classifications that have an adverse impact

63. See *supra* notes 45-52 and accompanying text.

64. See *supra* notes 59-62 and accompanying text.

65. See *supra* notes 53-58 and accompanying text.

66. Authorities cited in *Senate Hearings on S. 372, supra* note 26, at 224 n.8 are: ARIZ. REV. STAT. ANN. § 20-283, sub. 2 (West 1980); ARK. STAT. ANN. §§ 66-3005(7g) (1979); CAL. INS. CODE §§ 10140, 10141 (West 1972); CONN. GEN. STAT. ANN. § 38-61(10) (West 1972); ILL. ANN. STAT. § 73-1031, sub. 3 (Smith-Hurd 1980); KY. REV. STAT. § 304.12-085 (1971); MD. ANN. CODE §§ 482-234A, sub. (a), (b), 48A-234AA, sub. (a), (c); MASS. ANN. LAWS § 175:122 (1979); MICH. COMP. LAWS ANN. § 500.2082 (West 1983); MONT. CODE ANN. §§ 33-18-210; N.D. CENT. CODE ANN. § 26-30-04(11) (1972 & 1981 Supp.); N.J. STAT. ANN. § 17.29B-4, sub. (c), (d) (West 1973); N.Y. INS. LAW § 40(10) (McKinney 1966); OHIO REV. CODE ANN. tit. 39, § 3911.16; R.I. GEN. LAWS §§ 42-62-11, 42-62-14 (1977); WASH. REV. CODE ANN. §§ 40.60.175, 40.60.178 (West 1962).

67. The complaint in property insurance often concerns geographical classifications that have considerable impact on racial or ethnic minorities. The refusal to insure based on geographical classification alone is referred to as "redlining." For a description of state legislative approaches to redlining, see Badain, *supra* note 32, at 23-31.

68. See, e.g., MASS. GEN. LAWS ANN. ch. 175, § 122 (West 1977) (first passed in 1884); MICH. COMP. LAWS ANN. § 500.2082 (West 1983) (first passed in 1869).

69. See authorities cited in Jerry & Mansfield, *supra* note 32, at 351 n.135, 352 n.139.

70. ARIZ. REV. STAT. ANN. § 20-384 (Supp. 1984-1985); CAL. INS. CODE § 10140 (West 1972); FLA. STAT. ANN. § 626.9541 (West 1984); ILL. REV. STAT. ch. 73, § 1031 (Smith-Hurd Supp. 1984-1985); KY. REV. STAT. § 304.12-085 (1981); MD. ANN. CODE art. 48-A, § 234AA (1979); MONT. CODE ANN. § 40-3512 (Supp. 1975); N.H. REV. STAT. ANN. § 417:4 (1983); N.J. STAT. ANN. § 17B:30-12(a) (West 1970); N.Y. INS. LAW § 2609 (McKinney 1985); PA. STAT. ANN. tit. 40, § 1171.5 (Purdon Supp. 1984-1985); WASH. REV. CODE ANN. § 48.44.220 (1984).

71. *Senate Hearings on S. 2477, supra* note 26, at 25; see also authorities cited in Comment, *supra* note 59, at 631 n.8.

on individuals within the banned classifications.⁷² For example, residence zip code, commonly used in automobile and property insurance, often has an adverse impact on minority racial groups.⁷³

Major public opposition to *Norris, Manhart*, the Hatfield-Packwood-Dingell proposal, and state legislation has focused on sex classification.⁷⁴ Unlike race, color, religion, and national origin, insurers use sex classification in rating in health, disability, life, annuity, and automobile insurance.⁷⁵ Many states restrict the use of sex classification in underwriting and coverage,⁷⁶ but there are few such restrictions regarding rating even though significant rate differentials can have the same effect as a refusal to underwrite if the rate is, or is perceived by consumers to be, unaffordable. Four states—Hawaii, Michigan, Massachusetts, and North Carolina—have recently banned sex classification in rating, as well as in automobile insurance underwriting and coverage.⁷⁷ Only Montana extends this ban to all the personal lines of insurance.⁷⁸

Some state statutes that restrict the use of classifications with antidiscrimination language do not do so entirely. Some prohibit only classification without actuarial justification,⁷⁹ or only different treatment based “solely” on the specified classification.⁸⁰

72. See *infra* notes 350-59 and accompanying text; *House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 1017-23 (memorandum to Rep. Dingell from N.Y. State Sen. Donald Halperin).

73. See studies cited *supra* note 21.

74. See *supra* note 26.

75. See *infra* notes 131-40 and accompanying text.

76. Much of the impetus for these provisions came from a Model Regulation to Eliminate Unfair Sex Discrimination developed by the National Association of Insurance Commissioners (NAIC). See Note, *Challenges to Sex-Based Mortality Tables in Insurance and Pensions*, 6 *WOMEN'S RTS. L. REP.* 59, 67 nn.68-69 (1980) (listing states that have adopted the regulation); see also *Senate Hearings on S. 2477, supra* note 26, at 49 (text of NAIC Model Regulation), 313-15 (listing states that have adopted same). For other compilations of states adopting the regulation, see *House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 690-91; *Senate Hearings on S. 372, supra* note 26, at 336.

77. HAWAII REV. STAT. §§ 294-33 (1976); MASS. GEN. LAWS ANN. ch. 175, §§ 22E, 24A (West 1983 & Supp. 1985); MICH. COMP. LAWS ANN. § 500.2027(c) (West 1983); N.C. GEN. STAT. § 58-303 (1982 & Supp. 1985); see Austin, *supra* note 11, at 528 n.57 (citing N.Y. Times, Mar. 23, 1983, at D2, col. 1) (regarding failed attempts in Florida, Louisiana, New Jersey, and Wyoming).

78. MONT. CODE ANN. § 49-2-309 (1985). Insurance industry lobbyists have been seeking repeal or evisceration of the law. *Montana Debates Sex-Blind Insurance Law*, N.Y. Times, Feb. 17, 1985, at A33, col. 1.

79. See, e.g., CAL. INS. CODE § 10144 (West Supp. 1985) (prohibiting classification based on blindness, partial blindness, or a physical or mental impairment); COLO. REV. STAT. § 10-3-1104(1)(f)(III) (Supp. 1984) (prohibiting classification based on marital status or sex).

80. See, e.g., ARK. STAT. ANN. § 66-3005(7)(g) (Supp. 1985) (prohibiting classification

The first category seems to do no more than the unfair discrimination statutes that exist in all states and require that classifications be supported by valid data showing a statistical difference in loss.⁸¹ The meaning of the second is unclear, but it may require little more than the first.⁸² Other statutes attempt to formulate a standard for heightened scrutiny that is less than a ban but more than mere statistical association with loss.⁸³

A number of state statutes take an antidiscrimination approach in banning classifications beyond race, color, religion, sex, or national origin. Some statutes proscribe classifications based generally on physical⁸⁴ or mental impairment,⁸⁵ a specific disability,⁸⁶ or a genetic trait.⁸⁷ A federal proposal would proscribe blindness as a classification.⁸⁸ State statutes have proscribed the use of such other classifications as marital status,⁸⁹

based on race, color, creed, or sex); FLA. STAT. ANN. § 626.9705 (West 1984) (prohibiting classification based on severe disability).

81. See *infra* notes 115-16, 213 and accompanying text.

82. See State Dep't of Ins. v. Insurance Servs. Office, 434 So. 2d 908 (Fla. Dist. Ct. App. 1983), *petition denied*, 444 So. 2d 416 (Fla. 1984) (including extensive discussion in the dissent of possible interpretations of such language).

83. See, e.g., ILL. ANN. STAT. ch. 73, § 848 (Smith-Hurd Supp. 1985) (requiring that no life insurer "shall make or permit any distinction or discrimination against individuals with handicaps or disabilities . . . unless the rate differential is based on sound actuarial principles and a reasonable system of classification and is related to actual or reasonably anticipated experience directly associated with the handicap or disability"); MINN. STAT. ANN. § 72A.20(8) (West Supp. 1985) (requiring that no life insurer shall refuse to issue or discriminate in the issuance of a policy "on the basis of a disability . . . unless the claims experience and actuarial projections and other data establish significant and substantial differences in class rates because of the disability").

84. ARK. STAT. ANN. § 66-3005(7)(f) (Supp. 1985); CAL. INS. CODE § 10144 (West Supp. 1985); FLA. STAT. ANN. § 627.644 (West 1984); MD. ANN. CODE art. 48-A, § 223 (Supp. 1985); MASS. ANN. LAWS ch. 175, § 193T (Michie/Law. Co-op. Supp. 1985); OR. REV. STAT. § 746.015 (1983); WASH. REV. CODE ANN. § 48.30.300 (1984).

85. ARK. STAT. ANN. § 66-3005(7)(f) (Supp. 1985); CAL. INS. CODE § 10144 (West Supp. 1985); FLA. STAT. ANN. § 626.9705 (West 1984); MASS. ANN. LAWS ch. 175, § 120A (Michie/Law. Co-op. 1977); WASH. REV. CODE ANN. § 48.30.300 (1984).

86. COLO. REV. STAT. § 10-3-1104 (Supp. 1984); FLA. STAT. ANN. § 626.9705 (West 1984); ILL. ANN. STAT. ch. 73, § 848 (Smith-Hurd Supp. 1985); LA. REV. STAT. ANN. § 22:652.1 (West Supp. 1985); ME. REV. STAT. ANN. tit. 24-A, § 2159-A (Supp. 1985-1986); MD. ANN. CODE art. 48-A, § 226 (Supp. 1985); MINN. STAT. ANN. § 72A.20(8) (West Supp. 1985); R.I. GEN. LAWS § 27-4-1 (1979).

87. CAL. INS. CODE § 10143 (West Supp. 1985); LA. REV. STAT. ANN. § 22:652.1 (West Supp. 1985); MD. ANN. CODE art. 48-A, § 223 (Supp. 1985); N.C. GEN. STAT. § 58-195.5 (1982).

88. S. 1290, 99th Cong., 2d Sess. (1985); S. 2775, 98th Cong., 2d Sess., 130 CONG. REC. S7646-48 (daily ed. June 19, 1984).

89. ARK. STAT. ANN. § 66-3005(7)(e) (Supp. 1985); COLO. REV. STAT. § 10-3-1104 (Supp. 1984); FLA. STAT. ANN. § 626.9541 (West 1984); N.H. REV. STAT. ANN. § 417:4(VIII)(e) (1983); N.Y. INS. LAW § 2067 (McKinney 1985); PA. STAT. ANN. tit. 40, § 1171.5 (Purdon Supp. 1985); VA. CODE § 38.1-381.6 (Supp. 1985); WASH. REV. CODE ANN. § 48.30.300 (1984).

occupation,⁹⁰ and military service.⁹¹ Many of these statutes involve less than a complete ban of the classifications.⁹²

Use of race, color, religion, sex, and national origin, the "special five" classifications, should be banned in insurance even if they are statistically associated with loss. A federal prohibition on the use of these classifications, as proposed by the Hatfield-Packwood-Dingell bill, should be imposed. A ban of these classifications is warranted on grounds that have been advanced by some of those arguing from an antidiscrimination perspective.

These special five classifications have been banned in other areas of law.⁹³ This in itself reflects a social judgment about their legitimacy that should warrant a ban on their use in insurance as well.⁹⁴ This social judgment reflects the immutable and ascriptive character of these classifications as well as their long history of abuse.⁹⁵ One could debate whether these factors ex-

90. FLA. STAT. ANN. § 626.9541 (West 1984); ILL. ANN. STAT. ch. 73, § 755.24 (Smith-Hurd Supp. 1984-1985); N.H. REV. STAT. ANN. § 417:4 (1983); PA. STAT. ANN. tit. 40, § 1171.5 (Purdon Supp. 1984-1985); VA. CODE § 38.1-381.6 (Supp. 1985).

91. FLA. STAT. ANN. § 626.9541 (West 1984); VA. CODE § 38.1-381.6 (Supp. 1985).

92. See *supra* note 83 and accompanying text.

93. See, e.g., 42 U.S.C. §§ 2000e to 2000e-17 (1982) (banning special five's use in employment); 15 U.S.C. §§ 1691-1691f (1982) (credit); 20 U.S.C. §§ 1681-1686 (1982) (banning special five's use in some aspects of education). The Supreme Court has interpreted Title VII to ban the special five classifications with regard to employer-sponsored insurance. See *supra* notes 45-50 and accompanying text. See also Jerry & Mansfield, *supra* note 32, at 334 n.28 for citations to Supreme Court cases extending equal status to women with regard to other federal statutes.

94. Jerry & Mansfield, *supra* note 32, at 345-54, 359-62. The disparity in treatment created by the ban on the special five classifications in employer-sponsored plans has been advanced as a justification for extending the ban to insurance that is not employer-sponsored. Comment, *supra* note 59, at 643 & n.69.

95. Professor Brilmayer, Professor Laycock, and their colleagues have observed that these two characteristics are common to the classifications banned by employment discrimination law. They also identify a third characteristic that they call "irrelevance." Irrelevance means that the characteristic itself is of no legitimate interest to an employer but that its supposed statistical association with some legitimate characteristics is what is really on his mind.

The Brilmayer-Laycock group then finds two implications in such irrelevance. First, the special five classifications are likely to be overly inclusive. Some people who should qualify for the job, or by analogy for insurance, would be disqualified. For example, refusing to hire women because a job requires lifting heavy objects likely will disqualify some women who could lift the weight required. Similarly, charging men more for life insurance because as a group they do not live as long as women as a group disadvantages the men with long life expectancies. Second, the statistical association may be a spurious one that obscures intervening variables, which are the confusion of correlation and causation. For example, sex mortality differences between men and women may be explained by behavior patterns such as smoking, drinking, military service, automobile driving frequency, and career pursuit rather than a genetic factor. Comment, *supra* note 59, at 637 n.39 (citing Lewis & Lewis, *The Potential Impact of Sexual Equality on Health*, 297 NEW ENG. J. MED. 863, 865 (1977)). Professor Brilmayer and her colleagues devote a substantial portion of their Article to examining evidence that suggests sex may

plain the proscription of these classifications,⁹⁶ but they provide a justification in any event.

This justification can be criticized.⁹⁷ The legal protections regarding sex, though stronger than protections regarding some other classifications,⁹⁸ are not so absolute as for race, color, religion, and national origin.⁹⁹ The lower level of legal protection for sex arguably could justify a different treatment for sex than the other special classifications in insurance. Additional classifications such as age and handicap also have received legal protections. What level of legal protection in other areas should justify a ban on their use in insurance classification? A disabling birth defect may be immutable, and disability has been subject to historical abuse. This Article proposes criteria for judging all classifications¹⁰⁰ that would likely result in banning the use of the birth defect as a classifier but would not ban it *per se* as with the special five.

Sex should be treated like race, color, religion, and national origin in insurance.¹⁰¹ Regardless of the persuasiveness of the antidiscrimination argument for elimination of sex classification in insurance, a ban should flow as well from consideration of the perspectives of the importance of insurance and competition in the insurance market.¹⁰² Classifications beyond the special five also should be scrutinized, and at least some should be restricted after testing against criteria tailored to the function insurance

mask differences attributable to life-style. Brilmayer, *Sex Discrimination*, *supra* note 31, at 526-33. Professor Laycock has discussed further the immutability, historical abuse, and irrelevance criteria. Laycock, *Taking Constitutions Seriously: A Theory of Judicial Review* (Book Review), 59 *TEX. L. REV.* 343, 382-88 (1980).

This Article addresses the issues concerned in the Brilmayer-Laycock group's second implication of irrelevance in the context of criteria that an insurance classification system should meet. *See infra* notes 149-51, 156-63 & 399-404 and accompanying text.

96. One might argue that these bans result from political strategies or clout of minority groups and women that have little to do with rational analysis of underlying theory. It has been suggested that the ban on sex discrimination in employment resulted in part from a southern representative's attempt to kill the employment discrimination title of the Civil Rights Act of 1964. Sirota, *Sex Discrimination: Title VII and the Bona Fide Occupational Qualification*, 55 *TEX. L. REV.* 1025, 1027 (1977). *See also* Note, *TIAA-CREF Annuity System*, *supra* note 31, at 1233 n.19, and authorities cited therein, for documentation of this bit of Title VII history.

97. *See* Laycock, *supra* note 95, at 382-88.

98. *See, e.g.*, the discussion of the protections with regard to age in Jerry & Mansfield, *supra* note 32, at 347-57.

99. For a discussion of the difference in treatment for race and sex in employment law, see Rutherglen, *supra* note 31, at 224-31.

100. *See infra* notes 399-404 and accompanying text.

101. For an argument that race and sex should be considered differently in constitutional law, see Rutherglen, *supra* note 31, at 205-12.

102. *See infra* notes 250-346 and accompanying text.

plays in society and the specific goals for classification proposed in this Article. Such criteria are outlined in Part III.¹⁰³

In 1980, Senator Metzenbaum introduced the Insurance Competition Improvement Act.¹⁰⁴ This Article advocates some of the features of the Metzenbaum bill as proposed and other features with some changes. Like the Hatfield-Packwood-Dingell bill, the Metzenbaum bill would have banned the use of race, color, religion, sex, and national origin in underwriting, coverage, and rating.¹⁰⁵ In addition, it would have banned the use of marital status, personal living habits, appearances, marital history, political activities, and, in some instances, occupation.¹⁰⁶ It also presented a list of criteria against which all other classifiers proposed in rating would be judged as well as limiting criteria for which underwriting could be refused. It included provisions directed toward enhancing desirable competition in insurance including provision of information that consumers could use to comparison shop.¹⁰⁷ The Metzenbaum bill was limited to property/casualty insurance,¹⁰⁸ while the Hatfield-Packwood-Dingell bill would apply to all personal lines of insurance.¹⁰⁹ The reform package advocated by this Article¹¹⁰ would govern all personal lines of insurance.

B. Traditional Fair Discrimination Examined

This Section outlines why traditional fair discrimination, as practiced and sanctioned by most state regulators, is not the model of fairness to the public that is claimed. State unfair discrimination statutes are interpreted to permit any rating classifier for which a statistical difference between groups can be shown, while ignoring other issues.

Underwriting classifications usually are not reviewed at all. Most states do no independent review of rating classifications.

103. See *infra* notes 395-404 and accompanying text.

104. S. 2474, 96th Cong., 2d Sess., 126 CONG. REC. 6529-36 (1980) [hereinafter cited as S. 2474].

105. S. 2474, *supra* note 104, at § 6(a)(1), 126 CONG. REC. at 6530-31.

106. The ban on occupational classification would have excepted situations when the discharge of occupational duties "directly and demonstrably causes increased exposure to loss." *Id.*

107. See *infra* notes 407-09 and accompanying text.

108. S. 2474, *supra* note 104, at § 6 and definitions in § 4.

109. S. 372, *supra* note 7, § 3, reprinted in *Senate Hearings on S. 372, supra* note 26, at 4.

110. See *infra* notes 395-414 and accompanying text.

The motivation for and consequence of selection by insurers among possible classifiers is not considered. Possible cross-subsidization between lines is not investigated. The variation in loss prediction among group members is masked by the group average test. The multiplicative effect of classifiers exacerbates the rates of those falling in several high-risk classifications. Expenses often are apportioned arbitrarily as a percentage of premium rather than actual cost. The causal plausibility of classification is ignored.

This Section also reviews the history and judicial interpretation of state unfair discrimination statutes. Neither supports a conclusion that such statutes require, or even urge, refined classification. Their dominant concern is treatment of equals equally, not differentiation when possible.

1. *Does fairness to the public demand it?*— The deference regulators, legislators, and courts have given traditional fair discrimination has left reform proposals with a heavy and unwarranted burden of justification. Insurers argue that fair discrimination is fair because each insured pays according to what he receives rather than being subsidized by others. It even has been argued that for an insurer to redistribute policyholders' resources without their consent would be "immoral."¹¹¹

The traditional fair discrimination perspective purports to emphasize the value of each paying his own way. One could argue that altruism rather than rugged individualism should be encouraged as a social value¹¹² and that emphasis on division in society is undesirable.¹¹³ This Article's recommendations for immediate action do not depend for their acceptance on the adoption of one or the other set of values. The short-term recommen-

111. Williams, *Unfair Discrimination in Property and Liability Insurance*, in INSURANCE, GOVERNMENT, AND SOCIAL POLICY: STUDIES IN INSURANCE REGULATION 209, 221 (S. Kimball & H. Denenberg eds. 1969) (quoting D.L. MACDONALD, CORPORATE RISK CONTROL 82 (1966)).

112. Austin, *supra* note 11, at 581, so argues although her proposal for community fire insurance would still permit some classification. Under her proposal, properties that failed to meet certain safety standards would not be insured. *Id.* at 582. Those who believe in altruism as a value generally are still willing to put some limits on insurability. Where those lines should be drawn should vary with the type of insurance. The fewest limits would be appropriate in health insurance where access to insurance may be tantamount to access to health care, which in turn may be the difference between life and death. See *infra* notes 308-10 and accompanying text.

113. In *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 143, Carl Levin, a U.S. Senator, then Detroit City Council President, said: "I think the broader the rating, the better. In this society if we want to be one society—and I know this doesn't agree with much other testimony—but if we want to be one society it seems to me we've got to share a lot of risks."

dations would continue considerable classification but give greater emphasis to perceived legitimacy. Statistical association with risk would remain a permissible consideration but would not be the only one. An insurance availability study is advocated for the express purpose of stimulating public debate in the longer term on how broadly particular risks should be spread.¹¹⁴

Even if one accepts each paying his own way as the preferable social value, current insurance classification and its regulation do not achieve the neutral, scientific ends that their proponents and many others assume. The following outlines the biases and irrationalities in the classification process as it actually functions.

a. The minimal standards required by state unfair discrimination statutes— According to the General Accounting Office, most states require only that classifiers “reasonably reflect differences in loss experience and that the data be credible.”¹¹⁵ This test requires only that the average loss of groups so classified shows a reasonable difference.¹¹⁶ Meeting this group average test is not an adequate measure of fairness to the public, principally because the test does not ensure, or come close to ensuring, that each pays his own way.¹¹⁷

Generally, rating classification schemes must be submitted to state insurance authorities for review. Although “unfair discrimination” usually is prohibited with regard to underwriting and coverage decisions as well as rating, insurers are not required, as they are with regard to rating, to submit the criteria used in underwriting to regulatory authorities.¹¹⁸ Little empirical work on what state regulators actually do in reviewing rating classifica-

114. See *infra* notes 305-11, 405-06 and accompanying text.

115. GAO REPORT, *supra* note 11, at 127. This definition is that said by the General Accounting Office to reflect the legal criteria for automobile insurance rating classifications. *Id.* The GAO defined credibility to mean “that there be enough cases for the data to be statistically valid in predicting the class average of a primary driver class or territory separately—but not any particular one of the myriad subcells taken individually.” *Id.* at 127 n.1. In other words, there must be a statistically significant difference in loss for the class of all drivers under 25, but the expected loss need not reflect actual experience for subclasses such as single men under 25 with no prior accidents or tickets who live in a particular urban area.

116. *Senate Hearings on S. 2474, supra* note 19, at 24.

117. For an example of a classification accepted by a court without statistical justification, see *infra* note 248 and accompanying text.

118. The General Accounting Office surveyed state insurance departments on their authority with regard to underwriting guidelines. Only 12 of the 43 state regulators responding said they could forbid particular guidelines. GAO REPORT, *supra* note 11, at 149-50. The GAO concluded that “it appears that few State insurance departments review or even collect the underwriting guidelines used by insurance companies in their states.” *Id.* at 50.

tions is available.¹¹⁹ A 1979 General Accounting Office (GAO) study conducted fieldwork on state insurance regulation in seventeen states.¹²⁰ The GAO found that no state systematically performed independent actuarial analysis of the statistical relationships on which insurance companies based classifications.¹²¹ Few reported cases discuss standards for classification review.¹²²

b. *Choice among classifiers*— Even if all classifiers used met the group average test, the resulting scheme would not avoid all subsidy so that each would pay his own way. For any insured in any line of insurance, there are a number of possible classifications with a statistical association to risk. One example is the newborn, black male in South Carolina for whom sex, race, state of birth, and national residence all might be used as predictors of life expectancy. Depending on which of these classifications is used, the baby's life expectancy varies from 58.33 to 70.75 years.¹²³ For an insured seeking homeowner's insurance, there will be a number of possible classifiers, each of which might produce a different group average loss record. For fire coverage alone, these might include residence zip code, presence of smoke alarms, distance from the nearest fire house, combustibility of the material of which the house is constructed, whether the people in the house smoke, and myriad others.

Insurers choose among possible classifications. State review, if

119. The pioneering effort on the functioning of insurance regulation was E. PATTERSON, *THE INSURANCE COMMISSIONER IN THE UNITED STATES* (1927). Almost all the subsequent work has been done by Spencer Kimball and those collaborating with him. Kimball's comparison of regulation in Wisconsin and Utah in 1968 shows that most of the regulatory emphasis is on the base rate rather than the classification. Kimball & Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 MICH. L. REV. 545, 557-66 (1958). For further discussion of regulation in Wisconsin and Utah, see Kimball & Hansen, *The Utah Insurance Commissioner: A Study of Administrative Regulation in Action* (pts 1 & 2), 5 UTAH L. REV. 429 (1957), 6 UTAH L. REV. 1 (1958); S. KIMBALL, *INSURANCE AND PUBLIC POLICY* (1960).

120. GAO REPORT, *supra* note 11.

121. *Id.* at 130.

122. For the method I used to find state cases, see *infra* note 207. Some state decisions are discussed in the text accompanying notes 207-49. In one case, a court permitted the use of a classification despite the absence of statistical evidence. A Florida intermediate court overturned the state insurance commissioner's rejection of the use of the "good student discount," for which "no insurance company submitted any actuarial data linking scholastic achievement to accident avoidance" and which Allstate, the nation's second largest automobile insurer, had said was "indefensible actuarially." *State Dep't of Ins. v. Insurance Servs. Office*, 434 So. 2d 908, 913 n.8, 930 (Fla. Dist. Ct. App. 1983), *petition denied*, 444 So. 2d 416 (Fla. 1984). In justification, the court said only that "there was testimony that there are differences in expected loss experience between those who qualify for scholastic achievement discount and those who do not." *Id.*

123. This example is taken from Brilmayer, *Sex Discrimination*, *supra* note 31, at 512 n.32:

there is any, focuses only on whether the chosen classifiers meet the group average test. If other classifiers that are not used would provide different answers about individual risk, one cannot accurately say that subsidy in fact has been avoided. For example, insurers argue that sex classification in life insurance avoids subsidy because women as a group live longer than men as a group. Until recently, when smoking began to be used widely as a classifier in life insurance, one could say that non-smoking men subsidized women who smoked.¹²⁴

If pressed, insurers will admit that there are myriad classifiers and that they make choices among them. Insurers still defend fair discrimination as they practice it by saying that the criteria used for selecting among the potential classifiers are inherently fair. Three such criteria commonly cited are significance, stability, and practicality of use.¹²⁵ For example, gender is argued to meet these criteria. It is said to have significance because it is statistically associated with risk in life, health, disability, and automobile insurance, stability because it ordinarily does not change over time,¹²⁶ and practicality of use because it is cheap to determine and difficult to misrepresent. Even if all agreed that such criteria were fair, and insurers actually used them alone, it still would not be accurate to say that a classification system using only some of the possible classifiers avoids subsidies and as-

EXPECTATION OF LIFE AT BIRTH
(Selected Categories, 1969-1971)

	United States	South Carolina
All persons	70.75	67.96
All males	67.04	63.85
All non-whites	64.95	62.64
Non-white males	60.98	58.33

SOURCE: Greville, *Some Trends and Comparisons of United States Life-Table Data: 1900-1971*, in 1 NATIONAL CENTER FOR HEALTH STATISTICS, DEP'T OF HEALTH, EDUCATION & WELFARE, U.S. DECENNIAL LIFE TABLES FOR 1969-71, no. 4, Table 4, at 4-10 (1975).

Works, *supra* note 20, at 460, calls the "selection of class-defining risk indicia . . . inevitably imperfect and value laden." He quotes Alfred Kahn's remarks about classifications in another context: "[A]ll involve complex distributional effects; all will be economically imperfect, and all will inevitably raise noneconomic questions about what is fair, politically acceptable, and so on." *Id.*

124. GAO REPORT, *supra* note 11, at 124, makes a similar point about cross-subsidies by linking them to homogeneity of groups.

125. Kimball, *Reverse Sex Discrimination*, *supra* note 31, at 108.

126. The proposition that sex is a stable predictor has been challenged. See Brilmayer, *Sex Discrimination*, *supra* note 31, at 542-56, marshalling evidence that the relationship of sex to longevity has changed over time and varied among cultures. Disputes with their position and their response are found in other Articles in the septology cited in that footnote.

tures that each pays his own way. Anything short of use of all possible classifiers with statistical significance will lead to some subsidy. The most insurers can claim for the classifiers they use is that meeting criteria such as significance, stability, and practicality does what is feasible and provides perceived legitimacy. They usually claim far more.

In fact, these three criteria are not the only ones used in choosing classifiers. Insurers also make choices among classification based on their utility in marketing.¹²⁷ Insurers acknowledge that one motivation for starting to use sex in life insurance classification was the perception of women as a growing market.¹²⁸ Some disability insurance companies have started eliminating sex difference for occupations at the top of the income scale.¹²⁹ Some classifiers used in automobile and homeowner's insurance parallel socioeconomic status and are designed to attract customers likely to buy multiple coverage and policies.¹³⁰

When one looks at the history of male versus female classification, one wonders if it might be better explained by a perception of men as more valued customers than women than as a neutral, statistical exercise.¹³¹ Women generally pay more than men for

127. *New Jersey Dep't of Ins. Automobile Insurance Rate Classification: An Overview of Findings, Conclusions and Remedies* 1063 (1981), reprinted in *House Hearings on H.R. 100, 98th Cong., supra* note 26, at 1057-1171 [hereinafter cited as *N.J. Overview*, with page cites to the *House Hearings on H.R. 100, 98th Cong.*].

128. See *Senate Hearings on S. 372, supra* note 26, at 218 (testimony of Robert N. Houser, Chairman of the Board, Banker's Life Insurance, and John H. Filer, Chairman, Aetna Life and Casualty); Kiesel, *A Matter of Policy: Sex Bias in Insurance, Attacked, Defended*, 67 A.B.A. J. 875, 876 (1983).

129. See *Senate Hearings on S. 372, supra* note 26, at 276 (testimony of Elizabeth S. Morrison, Vice-President and manager of an actuarial benefits and compensation consulting firm).

130. Austin, *supra* note 11, at 535 n.101 (citing *N.J. Overview, supra* note 127 and G. GLENDENNING & R. HOLTOM, *PERSONAL LINES UNDERWRITING* 73 (1977)).

131. A past President of the Society of Actuaries, E. Paul Barnhart, has testified that "[h]istorically, the insurance industry has been quick to recognize areas where women's costs are higher than men's and to charge more; slow to recognize areas where women's costs are lower and to charge less." *Senate Hearings on S. 372, supra* note 26, at 355. The remedy Barnhart supports is closer relation in pricing to statistical differences rather than abolition of sex classification.

Each of the five sets of hearings on Hatfield-Packwood-Dingell, *supra* note 26, has included representatives of women's and civil rights groups testifying about a litany of differences in treatment between men and women. For example, the most recent Senate hearings included testimony from the Women's Equity Action League, National Organization for Women, National Federation of Business and Professional Women's Clubs, American Association of University Women, American Association of Retired Persons, National Association for the Advancement of Colored People, National Council of Jewish Women, American Nurses Association, and others. *Senate Hearings on S. 372, supra* note 26. The sources for many of the examples in all five hearings is a survey by the Women's Equity Action League, WOMEN'S EQUITY ACTION LEAGUE, SEX DISCRIMINATION

individual health and disability insurance.¹³² Until recently, women's policies usually were subject to more restrictions and provided less coverage.¹³³ Insurers justify cost differences in health and disability insurance with group average statistical differences in loss between men and women.¹³⁴ At the same time, the rates for women over forty-five do not reflect statistics showing fewer medical expenses and periods of disability for women than men in this age group.¹³⁵ Medicare supplemental insurance for those over sixty-five generally is provided on a unisex basis, even though statistical differences in loss would justify cheaper policies for women.¹³⁶

Women pay less in life insurance, but until recently their rates commonly were based on a three-year setback from men's tables when the actual gap in life expectancy was six to nine years.¹³⁷ At the same time, annuities, for which women paid more, reflected the full gap in life expectancy.¹³⁸ Some large employers used integrated tables for life insurance when women would

IN INSURANCE, A GUIDE FOR WOMEN [hereinafter cited as WEAL STUDY] reprinted in *Senate Hearings on S. 2477*, *supra* note 26, at 224-87. Perhaps in response to the controversy generated by Hatfield-Packwood-Dingell, to similar efforts in the states, and to litigation, some of the practices enumerated in the WEAL STUDY seem to have changed. *Senate Hearings on S. 372*, *supra* note 26, at 335-46 (comments of the Alliance of American Insurers, American Council of Life Insurance, American Insurance Association, Health Insurance Association of America, Insurance Services Office, and National Association of Independent Insurers).

132. *Senate Hearings on S. 2477*, *supra* note 26, at 233-40 (WEAL STUDY). Testimony of various witnesses at the five hearings on Hatfield-Packwood-Dingell, *supra* note 26, provided other examples. See, e.g., *Senate Hearings on S. 372*, *supra* note 26, at 42, 52 (testimony of Kathy Wilson, Chair, National Women's Political Caucus).

133. *Senate Hearings on S. 2477*, *supra* note 26, at 233-40 (WEAL STUDY). Testimony of various witnesses at the five hearings on Hatfield-Packwood-Dingell, *supra* note 26, provided other examples. See, e.g., *Senate Hearings on S. 372*, *supra* note 26, at 42, 52 (testimony of Kathy Wilson, Chair, National Women's Political Caucus).

134. *Senate Hearings on S. 372*, *supra* note 26, at 343 (testimony on behalf of the insurance industry in response to Senate Commerce Comm. Rep. on S. 2204).

135. E. Paul Barnhart, a past President of the Society of Actuaries, has testified that women over 45 pay more than statistics indicate. *Senate Hearings on S. 372*, *supra* note 26, at 362. He says that at "age 60, [women] should be paying no more than 70 to 80 percent as much as men, but in the rate manuals of too many companies the female age 60 rate is still as high as 90 to 98 percent of the corresponding male rate." *Id.*

136. E. Paul Barnhart says that women of the age eligible for the Medicare supplement have 30 to 35% lower costs than men of the same age. He projects that if Medicare supplemental were sex differentiated, women would pay 15% less and men 20% more. *Senate Hearings on S. 372*, *supra* note 26, at 362.

137. *House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 232; see *Senate Hearings on S. 372*, *supra* note 26, at 335, 341 (insurance industry response on changed practices).

138. *House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 232; see *Senate Hearings on S. 372*, *supra* note 26, at 335, 341 (insurance industry response on changed practices).

have benefited from sex segregation while using separate tables for annuities when women would suffer a disadvantage with their use.¹³⁹ Women pay less than men for automobile insurance only up to age twenty-five, even though a statistical difference in loss between men and women exists throughout life.¹⁴⁰

So long as classifications are permitted, some classifications that create groups with different average expected losses necessarily will be used while others will be discarded. The proposal here is not to prohibit a classification because it is useful as a sales device for insurers, but rather to demonstrate the fallacy of the notion that introduction by government of values other than statistical association with loss would do violence to what is now a neutral, scientific process.¹⁴¹

c. *Cross-subsidization among lines of insurance*— The measure of each paying his own way in property and casualty insurance also can be criticized if underwriting losses and investment income in one line are used to offset lower profits in another line and because the measure of each paying his own way generally ignores profits from investment income. It has been suggested that personal insurance lines subsidize commercial lines in property/casualty insurance. High profits in commercial property/casualty insurance in the late 1970's attracted new entrants to the market and generated vigorous price competition.¹⁴² To gain or hold market share, many insurers apparently priced their commercial products below cost¹⁴³ as evidenced by the commercial property and casualty industry's underwriting losses of thirty-four billion dollars from 1979 to 1983.¹⁴⁴ It has been charged that investment income and underwriting profits earned in personal automobile and homeowner's insurance may have been used by companies to subsidize commercial losses.¹⁴⁵ In any

139. Examples include the City of Los Angeles and the University of Chicago. Brilmayer, *Sex Discrimination*, *supra* note 31, at 530 nn.116-17.

140. See *House Hearings on H.R. 100, 98th Cong.*, *supra* note 26, at 1070-71.

141. See, e.g., *Senate Hearings on S. 372*, *supra* note 26, at 175 (statement of T. Lawrence Jones, President of the American Insurance Association) ("Probability mathematics and its application to natural events is the very foundation of our industry.").

142. *Insurers are Scrambling to Break Their Losing Streak*, *Bus. Wk.*, Dec. 3, 1984, at 144 [hereinafter cited as *Insurers are Scrambling*].

143. *Id.*; *Higher Insurance Rates for Autos, Homes Seen as Insurers' Costs Rise on Other Lines*, *Wall St. J.*, Jan. 13, 1983, at 18, col. 2 [hereinafter cited as *Higher Insurance Rates*].

144. *Insurers are Scrambling*, *supra* note 142, at 144.

145. See *infra* note 148. *Higher Insurance Rates*, *supra* note 143, contrasts insurers' acceptance of substantial rate increases recommended by rating bureaus for personal lines of insurance with insurers' adoption of very small increases for commercial lines. The *Wall Street Journal* reported that "[i]nsurers staunchly deny they are using profits

event, high interest earned on invested premiums generated by these personal lines offsets much of the industry's commercial losses.¹⁴⁶ The majority of state regulators do not take investment income into account in judging profitability for ratemaking in automobile and homeowner's insurance.¹⁴⁷ If they do, they do not look at issues of cross-subsidy between lines of insurance.¹⁴⁸

d. Additional problems— There are several other problems with saying that traditional fair discrimination, as practiced by insurers and as permitted by most regulators, is fair to the public. Massachusetts and New Jersey are unique in the degree of scrutiny they have given to automobile insurance classifications.¹⁴⁹ Studies in both states focused on homogeneous versus heterogeneous groups in examining the fairness of using group average alone as a justification for a particular classification.¹⁵⁰ A group half of whose members have losses of \$90 and half of whom have losses of \$10 will have a group average loss of \$50, as will a group half of whose members have losses of \$45 and half losses of \$55. The latter group, though, is far more homogene-

from personal insurance to subsidize commercial customers. But they do say that these personal lines, particularly automobile insurance, have become big money makers for them." *Higher Insurance Rates*, *supra* note 143. This Article suggests cross-subsidies might be possible because the markets for the personal lines of insurance are uncompetitive. On competitiveness in the industry, *see infra* notes 312-46 and accompanying text.

146. *Higher Insurance Rates*, *supra* note 143, at 18, col. 2-3.

147. *See generally* 1 R. HUNTER, TAKING THE BITE OUT OF INSURANCE: INVESTMENT INCOME IN RATEMAKING (1980). According to this study, only 17 states take investment income into account in private passenger car ratemaking. This study shows that the method used in 13 of those states "seriously understates the impact of investment income as it relates to the ratemaking process." *Id.* at 1-2. Hunter also quotes the Insurance Services Office, the major ratemaking bureau relied upon in states, as reporting that only four states require investment income to be taken into account in homeowner's insurance ratemaking. *Id.* at 12.

148. At least partly in response to the Study of R. HUNTER (sponsored by the National Insurance Consumers Organization (NICO)), *supra* note 147, the National Association of Insurance Commissioners (NAIC) appointed a task force to consider investment income issues. NICO asked NAIC to study whether "unfair discrimination was occurring . . . as a result of insurer's practice [sic] of using some of the investment income from personal lines to cross-subsidize commercial lines." *NICO (National Insurance Consumer Organization) Newsletter*, July/Aug. 1984, at 5 (emphasis in original). The NAIC Advisory Committee for the study refused to consider that issue. *Id.*

149. *See* DIVISION OF INSURANCE, COMMONWEALTH OF MASSACHUSETTS, OPINION, FINDINGS AND DECISION ON 1978 AUTOMOBILE INSURANCE RATES (1977), *reprinted in Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 488-553 [hereinafter cited as *Mass. Opinion*, with page cites to the Senate hearings]; background papers published in DIVISION OF INSURANCE, COMMONWEALTH OF MASSACHUSETTS, AUTOMOBILE INSURANCE RISK CLASSIFICATION: EQUITY AND ACCURACY (1978) [hereinafter cited as *Mass. Background Papers*]; *N.J. Order*, *supra* note 27; *N.J. Overview*, *supra* note 127.

150. *See Mass. Background Papers*, *supra* note 149, at 74-109; *N.J. Order*, *supra* note 27, at 1087-89; *N.J. Overview*, *supra* note 127, at 1099-1103, 1124-25, 1161-65.

ous. Both state studies concluded that a concern for unfair discrimination should include a concern that classifications create groups that are relatively homogeneous rather than heterogeneous.¹⁵¹ Because I favor broader risk sharing for at least some coverages, this Article's proposed criteria for judging classifications do not include homogeneity. Nonetheless, the existence of heterogeneous groups is one of the refutations that the value of each paying his own way is furthered in a system requiring that classifications meet only a group average test.

The Massachusetts and New Jersey studies also identified a multiplicative effect in the way automobile risk classifications were used.¹⁵² The New Jersey Insurance Commissioner found that a policyholder from a territory with twice the average claim cost and whose driver classifications, such as age and sex, were three times the average was charged six times the statewide average rate.¹⁵³

In addition, both states found to be unfair the practice of apportioning expenses to policyholders in proportion to their expected claims.¹⁵⁴ Under this practice, policyholders in higher rated classifications pay more money for expenses than those in lower rated classifications even though the costs of servicing their accounts do not differ in the same magnitude.¹⁵⁵

Classifications such as sex also have been criticized as masking the real causes of statistical difference in loss. A scientific or statistical theorist would assert that causation can never be known.¹⁵⁶ In their terms, a causal theory might be seen only as a

151. See *Mass. Background Papers*, *supra* note 149, at 74-109; *N.J. Order*, *supra* note 27, at 1087-89; *N.J. Overview*, *supra* note 127, at 1099-1103, 1124-25, 1161-65.

A background paper to the Massachusetts's Commissioner's Order developed a methodology for determining the degree of undercharging and overcharging in a particular group to assess the relative homogeneity of the group. Ferreira, *Identifying Equitable Insurance Premiums for Risk Classes: An Alternative to the Classical Approach*, in *Mass. Background Papers*, *supra* note 149, at 74-121.

152. See Chang & Fairley, *An Estimation Model for Multivariate Insurance Rate Classification*, in *Mass. Background Papers*, *supra* note 149, at 25-55; *N.J. Order*, *supra* note 27, at 1083-84; *N.J. Overview*, *supra* note 127, at 1154-56.

153. *N.J. Order*, *supra* note 27, at 1083-84. An alternate method was developed in the Massachusetts proceeding. See Chang & Fairley, *supra* note 152, for an explanation.

154. *Mass. Opinion*, *supra* note 149, at 542-46; *N.J. Order*, *supra* note 27, at 1084-87; *N.J. Overview*, *supra* note 127, at 1156-61.

155. *Mass. Opinion*, *supra* note 149, at 542-46; *N.J. Order*, *supra* note 27, at 1084-87; *N.J. Overview*, *supra* note 127, at 1156-61.

156. See, e.g., C. HEMPEL, ASPECTS OF SCIENTIFIC EXPLANATION 347-54 (1945) & K. POPPER, THE LOGIC OF SCIENTIFIC DISCOVERY 56-62 (1968) (cited in Underwood, *supra* note 33, at 1445 n.94). For efforts to deal with causation in the law, see G. CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 294-95 (1970); H.L.A. HART & A. HONORE, CAUSATION IN THE LAW 1-7 (1959) (cited in Underwood, *supra* note 33, at 1445 n.94).

working hypothesis.¹⁵⁷ Fair discriminators point to the theoretical impossibility of determining causation to justify correlation as sufficient reason for ignoring whether or not a classification is supported by a causal explanation.¹⁵⁸

Classifiers that do not seem grounded in a causal explanation, however, draw considerable criticism.¹⁵⁹ Given the vital nature of the personal lines of insurance,¹⁶⁰ there should be a perception of legitimacy regarding classifications that determine who can purchase insurance, what it will cost, and what coverage can be bought. Plausible theories of causation are important to such a perception. Thus, this factor is an appropriate value in a scheme for classification regulation despite the limitations on definitively determining causation.¹⁶¹

In addition, a causal theory suggests qualifications to the predictive value of a classification.¹⁶² If the mortality differences between men and women are thought to be genetic, they would not be expected to change over time. If a more plausible causal answer is, say, differences in alcohol or tobacco use, this may suggest that the pattern will change as behavior changes. Also, publication of this factor may lead to behavioral changes that could result in overall loss reduction.¹⁶³

Finally, at least some of the classification variables currently used in the personal lines of insurance are not particularly powerful predictors of future loss. A study of automobile classifica-

157. C. HEMPEL, *supra* note 156.

158. See, e.g., Freed & Polsby, *Privacy, Efficiency, and the Equality of Men and Women: A Revisionist View of Sex Discrimination in Employment*, 1981 AM. B. FOUND. RESEARCH J. 583, 626. Benston, *Economics of Gender Discrimination*, *supra* note 31, at 514, says it is "preferable" that the postulated relationships be grounded in a causal theory that would predict whether the relationship would continue in changed circumstances but "this is not necessary if past relationships have been stable and previous predictions accurate."

159. Underwood, *supra* note 33, at 1444. The substance of this point is drawn from Professor Underwood's article. Professor Brilmayer and her colleagues, *supra* note 31, make a similar point, but they state the desire for causal variables as more a value in itself than important to achieving perceived legitimacy and providing hypotheses about the continued stability of classification variables as argued here.

160. See *supra* notes 11-16 and *infra* notes 250-311 and accompanying text.

161. Austin criticizes the argument for causal connection as a criterion for selection of permissible classifiers. Austin, *supra* note 11, at 559-63. As she argues, a search for causal connection does not provide an objective, neutral criterion or eliminate value judgments. Underwood's rationale for a concern for causal connection is a more modest one. She argues that there is more perceived legitimacy in criteria that offer an intuitively sensible causal explanation than in those that do not. Causal explanations also suggest the limitations of the usefulness of the criteria and may suggest behavior changes that could lead to greater overall risk control. See Underwood, *supra* note 33, at 1444-47.

162. Underwood, *supra* note 33, at 1446-47.

163. *Id.*

tion by the Stanford Research Institute found that the schemes commonly predict no more than thirty percent of losses.¹⁶⁴ There has been considerable debate about that finding's meaning and its implications.¹⁶⁵ It only is cited here as further evidence that the illusion of a statistical, scientific system that is a model of fairness because each pays his own way, is somewhat removed from reality.

2. *Does state law require it?*— Proponents of unfettered insurer discretion do not stop with saying that fair discrimination as practiced by insurers is in fact fair. Some also argue that the use of such classifications is required by state unfair discrimination statutes.¹⁶⁶ Available evidence suggests that this is incorrect.

The history of state unfair discrimination statutes indicates that consumers who supported them sought to promote equal treatment of individuals with a *permissible* basis for differentiation in statistical association with loss.¹⁶⁷ Traditional fair discriminators suggest that unfair discrimination statutes *require*, or at least *promote*, classifications that differentiate between individuals. This clash in interpretation can be phrased as whether the unfair discrimination statutes merely forbid the use of classifiers not statistically associated with loss, or whether they require, or at least urge, more and more refined classifications, constrained only by the financial and administrative limitations on their use.

Typical wordings of state unfair discrimination laws do not require, or even reflect, policy judgments encouraging the use of classifications.¹⁶⁸ Case law in several states supports this inter-

164. STANFORD RESEARCH INSTITUTE FINAL REPORT, 49 (cited in GAO REPORT, *supra* note 11, at 116-17).

165. GAO REPORT, *supra* note 11, at 117-19.

166. See, e.g., Kimball, *Reverse Sex Discrimination*, *supra* note 31, at 105 n.53. For a discussion of whether state public accommodation laws might prohibit sex classification, see Sharp, *Insurance as a Public Accommodation: Challenging Gender-Based Actuarial Tables at the State Level*, 15 COLUM. HUM. RTS. L. REV. 227 (1984).

167. See *infra* notes 181-249 and accompanying text. The goals of many insurers, agents, and regulators in supporting such statutes had little to do with concern for anything regarding treatment of consumers. See *infra* notes 190-206 and accompanying text.

168. The New Jersey Insurance Commissioner has emphasized this point. *N.J. Order*, *supra* note 27, at 1068. Three exceptions exist. FLA. STAT. ANN. § 627.0651(6) (West 1984) (stating that in automobile insurance, “[o]ne rate shall be deemed unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the differences in expected losses and expenses”); S.D. COMP. LAWS ANN. § 58-24-6.1 (Supp. 1985) (defining unfair discrimination as “failure of rates to reflect differences in expected losses and expenses”); CAL. INS. CODE § 790.03f (West Supp. 1985) (stating that sex classification in rates mandated where they are “substantially supported by valid pertinent data segregated by sex in life insurance and annuities”).

pretation.¹⁶⁹ Most¹⁷⁰ decisional suggestions to the contrary either have been dictum,¹⁷¹ have involved miscitation of previous cases,¹⁷² or have been subsequently repudiated.¹⁷³

All American jurisdictions have statutes that forbid unfair discrimination in at least some of the personal lines of insurance.¹⁷⁴ State statutory schemes governing property and casualty insurance, including homeowner's and automobile insurance, usually include a general standard that rates "not be excessive, inadequate or unfairly discriminatory."¹⁷⁵ Often, an additional statute prohibits unfair discrimination "between insureds or property having like insuring or risk characteristics"¹⁷⁶ or other such language. Although some states have moved to open competition and have curtailed their rate regulatory authority,¹⁷⁷ state rate approval was the common pattern in property and casualty insurance for many years.¹⁷⁸

The regulatory framework for life, health, and disability is different because states do not have rate regulation authority in those areas.¹⁷⁹ A common formulation in unfair discrimination

169. See *infra* notes 207-49 and accompanying text.

170. Only two cases revealed by my research expressed a "fair discrimination" philosophy as a basis for decision that was not expressly or impliedly repudiated by a later decision. One of these cases did not claim to base its view on an interpretation of the statutory unfair discrimination requirement but rather an analogy to public utility law. *Blue Cross of Kansas, Inc. v. Bell*, 227 Kan. 426, 607 P.2d 498 (1980); see *infra* notes 231-35 and accompanying text.

The second involved a Florida statute with unique wording and was accompanied by a strong dissent. *State Dep't of Ins. v. Insurance Servs. Office*, 434 So. 2d 908 (Fla. Dist. Ct. App. 1983), *petition denied*, 444 So. 2d 416 (Fla. 1984). See *supra* note 168 and accompanying text (unique wording of the Florida statute) and *infra* notes 243-49 (commentary on the case).

171. *Century Cab, Inc. v. Commissioner of Ins.*, 327 Mass. 652, 100 N.E.2d 481 (1951), discussed *infra* text accompanying notes 214 & 215; *Insurance Dep't v. City of Philadelphia*, 196 Pa. Super. 221, 173 A.2d 811 (1961), discussed *infra* text accompanying notes 217-18 & 225-26.

172. *Century Cab, Inc. v. Commissioner of Ins.*, 327 Mass. 652, 100 N.E.2d 481 (1951), discussed *infra* text accompanying notes 214-15.

173. See *infra* text accompanying notes 215-16 & 222-26.

174. A compilation of 128 state statutes is on file with U. MICH. J.L. REF. Individual state codes often contain multiple references to unfair discrimination. See, e.g., NEB. REV. STAT. §§ 44-363, 44-365, 44-366, 44-749, 44-1525(7)(a)-(c) (1984).

175. See, e.g., ARIZ. REV. STAT. ANN. § 20-356(1) (1975 & Supp. 1984).

176. See, e.g., ALASKA STAT. § 21.36.090(c) (1984).

177. U.S. DEP'T OF JUSTICE, *THE PRICING AND MARKETING OF INSURANCE* 27-35 (1977) [hereinafter cited as DOJ REPORT].

178. *Id.* at 15-27.

179. *Id.* at iii-v, 22-35. As described in more detail later, preferential treatment of larger and favored types of customers in the rate structure was a source of complaint in fire insurance. See *infra* notes 195-96, 198, 204 and accompanying text. This was one of the pushes to rate regulation. In life insurance, the concern was more preferential treatment of individuals in rebating which was addressed by anti-rebate statutes. See *infra*

statutes governing these lines prohibits "discrimination between individuals of the same class and equal expectation of life"¹⁸⁰ as part of unfair trade practice codes governing insurance.

Secondary evidence calls into question the traditional fair discriminators' argument that the intent of statutes prohibiting unfair discrimination was to bring about more and more refined classifications.¹⁸¹ Consumer concern in urging passage of such statutes seems to have been that people be treated the same, not that more and more sophisticated methods be developed so that people could be treated differently.¹⁸²

notes 186-94, 197-200 and accompanying text. Life rates may have been perceived to be controlled adequately by reserve requirements and competition. See *infra* note 201 and accompanying text.

In the late 1940's and early 1950's, state rate regulation in fire and casualty insurance spread to all states through passage of model laws tailored to oust Sherman Act jurisdiction against concerted ratemaking. See *infra* notes 205-06 and accompanying text. Joint ratemaking was not common in life, health, and accident insurance, so those industries saw no reason to fear the Sherman Act and resisted a move to state rate regulatory authority in a model law. Mertz, *The First Twenty Years—A Case-Law Commentary on Insurance Regulation Under the Commerce Clause*, 1984 A.B.A. PROC. NEG. AND COMP. §§ 153, 163. Unfair discrimination prohibitions governing life, health, and disability insurance were part of a separate model act enacted by states in the same period. *Id.* at 171-72. Their purpose was to oust the Robinson-Patman Act. *Id.* at 168-73.

180. See, e.g., ALA. CODE § 27-12-11(a) (1975).

181. To gather primary evidence sufficient to make definitive statements on this point would require research into state legislative archives, biographical material on participants, and contemporaneous press accounts. Historian H. Roger Grant used such material in writing *INSURANCE REFORM: CONSUMER ACTION IN THE PROGRESSIVE ERA* (1979), a study of life and fire insurance reforms in New York, Wisconsin, Missouri, Kansas, and Texas from 1885 to 1915. One of my research assistants performed a 50-state survey of anti-rebate and unfair discrimination statutes, but state codes often do not provide accurate information on the date of original enactment of such statutes. J. STALSON, *MARKETING LIFE INSURANCE* (1941), provides some information on the history of anti-rebate and unfair discrimination statutes for life insurance. S. KIMBALL, *supra* note 119, studies Wisconsin legislative and judicial action from 1835 through 1959 in detail. E. PATTERSON, *supra* note 119, comprehensively analyzes insurance regulation at the time through his book's publication in 1927. Williams, *supra* note 111, also contains some information on the history of unfair discrimination statutes.

182. Writing in the mid-1920's, E. PATTERSON, *supra* note 119, at 307-10, catalogued the alleged evils sought to be remedied by forbidding rebating and unfair discrimination. The first was to prevent someone from acquiring a broker's license just to insure his own property, although Patterson commented that "[t]he precise evil of such a practice is not clear." *Id.* at 307. The second was inadequate rates, but he argued that "in life insurance, where the reserve is not measured by the premium charge, a company which maintains this reserve is solvent even if it rebates in order to gain new business." *Id.* at 308. The third perceived evil identified was unfair competition, i.e., that the agent who offered rebates would divert business from the one who did not. He then asked, "But why is this 'unfair' to the latter, in a competitive system?" *Id.* at 309. Patterson then argued:

It is believed that two social ideals are at the bottom of the anti-rebate and anti-discrimination laws. The "one-price" idea, firmly rooted in the retail marketing traditions of the American people, is one The second ideal is that of equality. All insured persons should be treated the same under like circumstances. It

a. *The development of unfair discrimination statutes*—Unfair discrimination prohibitions were enacted in a number of states in the late nineteenth and early twentieth centuries.¹⁸³ The background of the prohibitions for life insurance is somewhat different from that for fire insurance. Life and fire insurance were the major lines of personal insurance in that era. Health insurance was not yet in use.¹⁸⁴ Automobiles were just being invented. The multiple coverage package of homeowner's insurance was not developed until the 1950's.¹⁸⁵

In life insurance, rebating was a common practice. Agents offered to rebate a portion of their commission to potential customers or to give some other valuable consideration as an inducement to sale.¹⁸⁶ The practice was widespread and well-known.¹⁸⁷ It infuriated a number of consumers,¹⁸⁸ and their ire was one of the pressures for enactment of statutes prohibiting rebates and forbidding different treatment of people in the same class and with the same life expectancy.¹⁸⁹

Agents and insurers also were influential in the passage of anti-rebate and unfair discrimination statutes in life insur-

is unfair to make one man pay more for a thing than another.

Id. at 309. He went on to cite prohibitions on race or color discrimination "regardless of whether the mortality experience shows an actuarial basis for charging negroes a higher premium than whites" as an extreme example of this ideal, one "probably motivated by post bellum sentimentality, though they have their justification in the general tendency toward 'mutualizing' life insurance—that is, abolishing all distinctions between risks except age and normal health." *Id.* at 309-10.

The General Accounting Office has commented that "most state laws affecting classification were enacted long before the classification plans became so sophisticated and before premiums became so high." GAO REPORT, *supra* note 11, at 128.

183. See *infra* notes 197-98 and accompanying text.

184. See Richardson, *The Origin and Development of Group Hospitalization in the United States, 1890-1940*, 20 U. MO. STUD., 15-18 (1945); Hedinger, *The Social Role of Blue Cross as a Device for Financing the Costs of Hospital Care*, HEALTH CARE RESEARCH SERIES, No. 2, Iowa, 6-9 (1966); R. EILERS, REGULATION OF BLUE CROSS AND BLUE SHIELD PLANS 8-9 (1963) (all three pieces cited in S. LAW, BLUE CROSS, WHAT WENT WRONG? 6 nn.18-19 (1974)).

185. FEDERAL INSURANCE ADMINISTRATION, U.S. DEP'T OF HOUSING AND URBAN DEVELOPMENT, FULL INSURANCE AVAILABILITY 21-23 (1974) [hereinafter cited as FIA].

186. H. GRANT, *supra* note 181, at 8-10, 77, 104; S. KIMBALL, *supra* note 119, at 123-26; J. STALSON, *supra* note 181, at 535; E. PATTERSON, *supra* note 119, at 311-21. These Articles describe some of the variety of inducements termed rebating.

187. Grant quotes an insurance trade journal in the 1880's as saying that rebating in life insurance "had become 'so general that it may almost be said to be common to all companies and a majority of agents.'" H. GRANT, *supra* note 181, at 9. He also quotes a state insurance commissioner as having said in 1905, "No agency could singularly refuse to grant rebates and long remain in a competitive position . . ." *Id.*

188. *Id.*

189. See *supra* notes 175-76 and accompanying text.

ance.¹⁹⁰ Some agents may have found such practices offensive for the same reasons as did their customers. Others desired something to defuse consumer anger.¹⁹¹ It also was claimed that abolition of rebating would professionalize the job of the insurance agent.¹⁹² Finally, agents probably realized that pressure to rebate was, in effect, pressure to lower their incomes.¹⁹³ Insurers may have shared some of these concerns, but they also disliked the lack of control of the sales process that the rebate entailed.¹⁹⁴

Rebating was practiced in fire insurance too, but more resentment seemed to focus on rate structures that favored larger consumers with greater bargaining power.¹⁹⁵ Such rates sometimes were combined with rebates to favored customers.¹⁹⁶

Unfair discrimination statutes were enacted more quickly in life insurance than in fire. By 1895, twenty-five states had life anti-rebate statutes in place,¹⁹⁷ as compared with only four fire statutes by 1910.¹⁹⁸ The difference might be explained by the organized lobbying effort of life underwriters and insurers.¹⁹⁹ The perceived abuses also seem to have been more widespread in life insurance.

In life insurance, the major concern was the individual dis-

190. In May 1888, the Life Underwriters Association adopted a memorial to all firms urging them to curb rebating. H. GRANT, *supra* note 181, at 12. At the Association's insistence, John A. McCall, president of New York Life and the former New York Superintendent of Insurance, drafted a life insurance anti-rebate bill. *Id.* The New York legislature passed it in 1889. *Id.* The Wisconsin Life Insurance Agents Association was instrumental in securing passage of an anti-rebate statute in 1891. *Id.* The bill was strongly supported by the powerful Northwestern Mutual Life Insurance Company of Milwaukee. *Id.* at 13-14. The National Association of Life Underwriters endorsed a bill in 1891 that was the model for many state statutes. *Id.* at 12. "Association members played an active role in the adoption of virtually all such legislation." *Id.*

191. Grant quotes a Missouri agent as having given a "common response" when he said: "Frankly my clients' anger with the present rebate situation . . . frightens me. Some mornings I expect to see a mob with clubs outside my office." H. GRANT, *supra* note 181, at 11.

192. H. GRANT, *supra* note 181, at 12.

193. Kimball says that rebating was only a symptom of the problem of excessive commissions. S. KIMBALL, *supra* note 119, at 124. He argues that "antidiscrimination laws were helping to shore up a marketing system that in many situations was uneconomic." *Id.*

194. H. GRANT, *supra* note 181, at 9. Grant also describes insurers' support for reform as a desire for a "more orderly and rational business enterprise." *Id.* at 14.

195. H. GRANT, *supra* note 181, at 77-80, 104, 107.

196. H. GRANT, *supra* note 181, at 77, 104, 107.

197. Williams, *supra* note 111, at 228.

198. Williams says that the first statute prohibiting unfair personal discrimination was a Louisiana fire insurance statute passed in 1886. *Id.*

199. See *supra* note 190.

crimination present in rebating rather than the rate structure.²⁰⁰ A leading authority writing in the 1920's said that life rates generally were perceived as held in check by legal reserve requirements and competition.²⁰¹ The greater concern in fire was group discrimination in the rate structure.²⁰² Until the Kansas rate regulatory statute was enacted in 1909,²⁰³ most states used anti-compact statutes, antitrust-type statutes prohibiting ratemaking agreements, to regulate fire rates.²⁰⁴ Unfair discrimination prohibitions were added later as part of rate regulation schemes.

A burst of state legislative activity in the late 1940's and early 1950's brought unfair discrimination prohibitions to all states.²⁰⁵ This resurgence of interest, however, seems to have been motivated not so much by consumer concern about insurance practices as by the desire of the insurance industry and state regulators to occupy the field of insurance regulation sufficiently to avoid application of the federal antitrust laws under the McCarran-Ferguson Act.²⁰⁶

200. E. PATTERSON, *supra* note 119, at 270.

201. *Id.*

202. *Id.*

203. Williams, *supra* note 111, at 229. The Kansas statute, the first of its kind, was upheld by the U.S. Supreme Court against a challenge on substantive due process grounds. *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389 (1914). For comments in *German Alliance* about the role of insurance in American society, see *infra* text accompanying notes 250-58.

204. E. PATTERSON, *supra* note 119, at 269.

205. Mertz, *supra* note 179, at 170-71.

206. Until 1944, insurance generally was thought not to be commerce and thus not subject to regulation under the antitrust laws. In 1944, the Supreme Court decided *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), holding insurance to be commerce and thus subject to federal antitrust laws. Congress responded quickly with prompt passage of the McCarran-Ferguson Act, ch. 20, § 1, 59 Stat. 33 (1945) (codified at 15 U.S.C. §§ 1011-1015 (1982)). The Act exempts the business of insurance from the reach of federal laws so long as insurance is regulated by state law in such a manner that the federal law would "invalidate, impair, or supersede" this state law. 15 U.S.C. § 1012(b) (1982). The National Association of Insurance Commissioners and industry representatives immediately formed an All-Industry Committee "to aid in the formulation of a legislative program to strengthen existing state laws within the meaning of section 2b of the McCarran Act." Brook, *Public Interest and the Commissioners—All Industry Laws*, 15 LAW & CONTEMP. PROBS. 607, 608 n.14 (1950).

Model laws resulted that were enacted by every state. Passage of the model fire and casualty rating law extended unfair discrimination prohibitions, as part of a general rate regulation statute, to all states that did not already have such a plan. The model rating bill was considered necessary to oust the federal Sherman Act, 15 U.S.C. §§ 1-7 (1982). The life insurance industry resisted rate regulation. Life and health insurance were made subject to the model "Act Relating to Unfair Methods of Competition and Deceptive Acts and Practices in the Business of Insurance," which included unfair discrimination prohibitions. Mertz, *supra* note 179, at 171-72. This legislation was considered necessary to oust the Robinson-Patman Act, 15 U.S.C. §§ 13, 13a, 13b & 21a (1982). *Id.* at 168-73.

b. *Judicial interpretation of unfair discrimination statutes*— State courts have touched only occasionally upon the objectives of unfair discrimination statutes and the principles that should guide classification regulation.²⁰⁷ Massachusetts and Pennsylvania courts are relatively unique because they have considered these issues several times.²⁰⁸ In some early opinions, each state's courts seemed to interpret unfair discrimination language as mandating or encouraging refined classification to avoid perceived subsidy. These opinions, however, did not provide much analysis of the basis for this interpretation. The most recent decisions in both states have said that other values properly may supersede statistical association with loss in a classification scheme.²⁰⁹

In *Brest v. Commissioner of Insurance*,²¹⁰ decided in 1930, insureds argued that territorial classification in automobile insurance violated the nondiscrimination standard in the Massachusetts statute. The Supreme Judicial Court rejected that interpretation, stating classification was permissible if statistical evidence supported it.²¹¹ Five years later in *Schlabach v. Commissioner of Insurance*,²¹² an insured who lived in the Boston Navy Yard argued that reclassification of the Yard so it was rated with the city of Boston violated the statutory nondiscrimination standard. The Massachusetts high court held that such

207. LEXIS searches were conducted using "discrim! w/7 class! or rate w/9 insurance and unfair," "class! w/8 risk or rate w/seg insurance w/15 discrim!," and "actuarial! w/15 sound or justif! w/seg insurance and discrim!" using the federal and state reporter libraries. Through December 1984, this produced 373 citations, with some duplication of cases. Additional searches were conducted in the Commerce Clearing House Automobile Reporter, Fire and Casualty Reporter, and Life and Health Reporter, which checked "cancellation," "classification," "definitions," "discrimination," "rate," "refusal," "renewal," "risk," and "selection." A research assistant also used the West state and federal digests extensively, but there is no record of the key numbers checked. In addition, cases cited in other cases and in law review articles were checked. Though many cases were reviewed, few included any discussion of construction of the unfair discrimination statutes or standards for approval of classifications.

208. See *infra* notes 210-26 & 236-39 and accompanying text. There also has been extensive litigation on the insurance commissioner's authority in North Carolina, but the issues of concern here have not been discussed during North Carolina's litigation in any detail. See Note, *Insurance Law—Changes in Automobile Rate Regulation and the Role of the Insurance Commissioner in North Carolina*—State ex. rel. Commissioner of Insurance v. North Carolina State Bureau, 17 WAKE FOREST L. REV. 822 (1981). There also have been several Florida cases, the most recent of which is discussed *infra* text accompanying notes 243-49.

209. For the development of case law in Massachusetts, see *infra* text accompanying notes 210-16 & 238-39. For the development of case law in Pennsylvania, see *infra* text accompanying notes 217-26.

210. 270 Mass. 7, 169 N.E. 657 (1930).

211. 270 Mass. at 18, 169 N.E. at 661.

212. 290 Mass. 585, 195 N.E. 887 (1935).

reclassification was permissible even if the Navy Yard had a more favorable loss record.

Brest is consistent with interpreting unfair discrimination statutes to require that classifications used have a statistical association with loss.²¹³ Nothing in *Brest* or *Schlabach* said there was an affirmative duty on the Commissioner, who was actually setting the rates in Massachusetts, to seek classification that measured differences in loss as precisely as possible. In *Schlabach*, the court rejected the claim that classification had to reflect all available information about differences in loss.

Unfortunately, in 1951 the Massachusetts Supreme Judicial Court cited *Brest* and *Schlabach* as support for language suggesting an affirmative duty in the Commissioner to seek classifications such that each pays his own way. The court in this case, *Century Cab, Inc. v. Commissioner of Insurance*, said that state law required that risks "be equitably adjusted and proportioned among the classes with the respective losses which reasonably are to be anticipated,"²¹⁴ citing *Brest* and *Schlabach* with no explanation as to how this conclusion was drawn from these cases. The holding of *Century Cab* was only that it was permissible to use average rates for some taxicab owners and experience rates based on individual experience for others. The comment on the statute's intent was dictum and considerably expanded the holdings of *Brest* and *Schlabach*.

In 1981, the Massachusetts high court said that it was reaffirming the previously quoted language but went on to approve a state commissioner's order that held other values to outweigh statistical association with loss.²¹⁵ The state rating bureau challenged the allocation of losses in the state reinsurance pool among *all* state insureds rather than fixing rates in the pool purely on the experience of the insureds *within* it. The court said the Commissioner could do so because his mandate included ensuring reasonableness in rates as well as nondiscrimination. Thus, he could consider the "legislative policy of making motor vehicle insurance available to all, including high risk drivers," in allocating losses among the classifications.²¹⁶

Pennsylvania appellate courts' first experience with a classification case produced some language reflecting a traditional fair discrimination interpretation of the unfair discrimination stat-

213. See *supra* text accompanying notes 115-16.

214. 327 Mass. 652, 663, 100 N.E.2d 481, 488 (1951).

215. *Massachusetts Auto Rating Bureau v. Commissioner of Ins.*, 384 Mass. 333, 424 N.E.2d 1127 (1981).

216. 384 Mass. at 346, 424 N.E.2d at 1135.

utes. In 1961, in *Insurance Department v. City of Philadelphia*, Philadelphia challenged the state Commissioner's approval of a rate filing raising the rates for property insurance in the city.²¹⁷ The superior court said that the rate increase was needed to rectify unfair discrimination in favor of Philadelphia residents and against those elsewhere in the state.²¹⁸

Thirteen years later, the commonwealth court considered a case in which the Commissioner had disapproved a flat one dollar charge for the first month's premium in an industrial health policy regardless of the risk insured.²¹⁹ Although the Commissioner seemed to have been concerned primarily with the potential bait and switch nature of the scheme, he had held that it was unfair discrimination to charge the same rates to "persons in different rating classifications."²²⁰ The court upheld this determination saying it was discriminatory to charge equal rates for diverse policies sold to diverse risks.²²¹

In two more recent decisions, however, the Pennsylvania courts have joined Massachusetts in holding that other values may outweigh statistical association loss. In *Capitol Blue Cross v. Commonwealth Insurance Department*,²²² Blue Cross and Blue Shield failed in a challenge to the Commissioner's requirement that supplemental policies for those over sixty-five include a community rating factor rather than having rates depend on the experience of that classification alone. In 1982, the commonwealth court considered the Commissioner's prohibition of gender as a factor in automobile insurance.²²³ The court stated: "*Capitol Blue Cross*, by holding that actuarial soundness cannot be the sole test of validity of a rate, established that actuarial justification does not operate without limit."²²⁴ The court dismissed the fair discrimination language of *Insurance Department v. City of Philadelphia*,²²⁵ stating that the case "does not stand for any contrary proposition by virtue of the dictum therein, that continuation of the old rates favoring Philadelphia

217. 196 Pa. Super. 221, 173 A.2d 811 (1961).

218. 196 Pa. Super. at 229, 235, 242, 173 A.2d at 815, 818, 821.

219. *Physicians' Mutual Ins. Co. v. Denenberg*, 15 Pa. Commw. 509, 327 A.2d 415 (1974).

220. 15 Pa. Commw. at 516, 327 A.2d at 419.

221. *Id.*

222. 34 Pa. Commw. 584, 383 A.2d 1306 (1978). Community rating refers to the original philosophy of Blue Cross plans that all hospital insurance be offered at two uniform rates, one for individuals and one for families. S. LAW, *supra* note 184, at 12.

223. *Hartford Accident & Indemn. Co. v. Insurance Comm'r*, 65 Pa. Commw. 249, 442 A.2d 382, *aff'd*, 505 Pa. 571, 482 A.2d 542 (1984).

224. 65 Pa. Commw. at 255-56, 442 A.2d at 385.

225. 196 Pa. Super. 221, 173 A.2d 811 (1961).

could have violated an 'unfairly discriminatory' standard. The principal thrust of that case was to affirm the Commissioner's exercise of discretion under the statute'²²⁶

Two other states have rejected challenges analogous to the one raised in *Schlabach*, namely that unfair discrimination statutes reflect a concern that all classifications having a statistical association with loss should be used. In 1932, the Alabama Supreme Court held that unfair discrimination statutes permitted Aetna Life Insurance to charge a flat rate for credit life insurance to all borrowers between twenty-one and fifty-nine despite their different life expectancies.²²⁷ The court held that the unfair discrimination statute required only that people of the same age be treated the same, not that people of different ages be treated differently.²²⁸

The highest Virginia court upheld the state Commissioner's rejection of a company's request for a twenty-five percent reduction from Bureau property insurance premiums for policies written for druggists.²²⁹ Although not questioning the contention that the druggists might have a better loss ratio, the Commissioner and the court refused to permit the lower rate. This case exemplifies the anticompetitive effects of rigid rejection of deviations from Bureau rates,²³⁰ but it supports the argument that unfair discrimination statutes were not meant to require that each pay his own way.

A Kansas case offers support for the traditional fair discriminators' interpretation of unfair discrimination statutes.²³¹ The court based its opinion, however, not on the text or legislative history of the statute but merely on the court's view of desirable public policy. On facts similar to those in *Capitol Blue Cross v. Commonwealth Insurance Department*,²³² the Kansas Insurance Commissioner had denied Kansas Blue Cross and Blue Shield's proposal to eliminate the community rating factor previously used in supplemental coverage for Medicare and Medicaid recipients and to make them self-sustaining. The court quoted a stan-

226. 65 Pa. Commw. at 256, 442 A.2d at 385-86.

227. *Greer v. Aetna Life Ins. Co.*, 225 Ala. 121, 142 So. 393 (1932).

228. 225 Ala. at 123, 142 So. at 395.

229. *American Druggists' Ins. Co. v. Commonwealth*, 201 Va. 275, 110 S.E.2d 509 (1959); see Dirlam & Stelzer, *The Insurance Industry as a Case Study in the Workability of Regulated Competition*, 107 U. PA. L. REV. 199, 210-11 (1958).

230. See Comment, *The McCarran-Ferguson Act: A Time for Procompetitive Reform*, 29 VAND. L. REV. 1271, 1295 (1976).

231. *Blue Cross of Kansas, Inc. v. Bell*, 227 Kan. 426, 607 P.2d 498 (1980).

232. 34 Pa. Commw. 584, 383 A.2d 1306 (1978); see *supra* text accompanying note 222.

dard that had been applied to public utility rates: "[T]he rule that one class of consumers shall not be burdened with costs created by another class."²³³ The court continued: "We believe this same philosophy should be applied in fixing rates for different groups of health care subscribers . . ."²³⁴ Although this reflects an endorsement of the each pay his own way philosophy, the court did not claim that its decision was based on an interpretation of an insurance unfair discrimination statute. The court cited a treatise on public utility ratemaking and simply said that this principle should apply in insurance as well.²³⁵

Courts also periodically have addressed whether the unfair discrimination statutes should be read to require *more* than statistical association with loss as a condition for permitting a classification based on some considerations such as causality. As long ago as 1930, insureds complained that only causal classifications should be permitted.²³⁶ In *Brest v. Commissioner of Insurance*,²³⁷ the petitioner argued that the place of garaging was not the cause of the accidents and thus should not be a permissible classification for rating purposes.²³⁸ The court said that the unfair discrimination statute did not require that a classification be the cause of loss, but only that the two be statistically associated.²³⁹ On the other hand, in 1953 the Wisconsin Supreme Court considered causality extensively in a case challenging race as a proper classification for the state life insurance program.²⁴⁰ The court ruled that race could not be used because it did not offer a causal explanation for the mortality difference between blacks and whites.

The Pennsylvania Supreme Court recently considered the issue of causality and rejected the insurer's contention that the legislature was concerned only with statistical association with loss in the unfair discrimination statutes.²⁴¹ The court quoted with approval from a National Association of Insurance Commissioners (NAIC) Task Force Report on automobile rating, which was never approved by the NAIC, stating: "[P]ublic pol-

233. 227 Kan. at 439, 607 P.2d at 508.

234. *Id.*

235. *Id.*

236. *Brest v. Commissioner of Ins.*, 270 Mass. 7, 169 N.E. 657 (1930).

237. 270 Mass. 7, 169 N.E. 657 (1930).

238. 270 Mass. at 16, 169 N.E. at 660.

239. *Id.*

240. *Lange v. Rancher*, 262 Wis. 625, 56 N.W.2d 542 (1953). For discussion of the Wisconsin state life insurance plan, see *infra* notes 297-301 and accompanying text.

241. *Hartford Accident & Indem. Co. v. Insurance Comm'r*, 505 Pa. 571, 579, 482 A.2d 542, 546 (1984).

icy considerations require more adequate justification for rating factors than simple statistical correlation with loss; . . . such as causality, reliability, social acceptability and incentive value in judging the reasonableness of a classification system.' ”²⁴²

A Florida court took a contrary view on causality, rejecting the state insurance Commissioner's ban on the use of sex, marital status, and scholastic achievement as automobile insurance rating factors.²⁴³ The Insurance Department had rejected these rating factors, stating that they had no direct or indirect causal connection to expected loss.²⁴⁴ The court held that the fairness and equity of a classification must be judged by predictive accuracy alone.²⁴⁵ A lengthy dissent argued that this was an overly narrow view of the Commissioner's discretion²⁴⁶ and that the Insurance Department should be able to employ “normative standards of ‘fairness’ to sharpen its scrutiny into the claimed predictive accuracy of the suspect classifications.”²⁴⁷ Interestingly, the court stated that the evidence regarding the actuarial soundness of these factors was “overwhelming” even though there was no statistical evidence in the record regarding scholastic achievement.²⁴⁸ The decision turned on the Florida statute's particular language and legislative history. It should be of limited interest to other jurisdictions because Florida is one of only three states with a statute encouraging classification rather than merely prohibiting classifications not statistically associated with loss.²⁴⁹

In summary, examination of traditional fair discrimination in theory and practice reveals it not to be particularly fair to the public, nor generally required or encouraged by state unfair discrimination laws. With its customary justification thus eroded, traditional fair discrimination presents a far less formidable obstacle than commonly assumed to arguments that values other than statistical association with loss should be considered in regulating insurance classification. To the degree to which statistical association with loss remains a value, a more precise defini-

242. 505 Pa. at 584, 482 A.2d at 548.

243. *Dep't of Ins. v. Insurance Servs. Office*, 434 So. 2d 908 (Fla. Dist. Ct. App. 1983), *petition denied*, 444 So. 2d 416 (Fla. 1984).

244. 434 So.2d at 912.

245. *Id.* at 912-13.

246. *Id.* at 914.

247. *Id.* at 924.

248. *Id.* at 913.

249. See *supra* note 168 for the citation to and the text of the Florida statute as well as the wording of the other two state statutes that suggest an encouragement of classification. See *supra* notes 175-76 and accompanying text for statutory language common in other states.

tion than group average should be required.

C. *An Alternative Perspective: The Importance of Insurance in American Society*

Case law, commentary, and public dialogue on insurance often refer to the industry's special nature and a consequent public interest. In 1913 in *German Alliance Insurance Co. v. Kansas*,²⁵⁰ the United States Supreme Court upheld a state's right to regulate fire insurance rates by finding insurance "affected with a public interest."²⁵¹ The Court's exploration of the "peculiar relation to the public interest"²⁵² of insurance identified several grounds to justify the regulation.

First, the Court reasoned that the long history and pervasive nature of state government regulation of insurance was itself evidence of a strong public interest.²⁵³ Second, the Court took notice of insurance's function to distribute loss as widely as possible, which lessens the burden of catastrophes on particular individuals and communities.²⁵⁴ Third, the role of fire insurance in protecting the nation's wealth was cited.²⁵⁵ Fourth, the Court called insurance "practically a necessity to business activity and enterprise" because of its relation to credit.²⁵⁶

Finally, specifically justifying rate regulation, the Court suggested that rate setting by "councils of underwriters" was akin to a monopolistic process with no opportunity for bargaining by insureds.²⁵⁷ The Court went on to say that the public should be protected from "arbitrary terms," as was the case with regard to

250. 233 U.S. 389 (1914).

251. *Id.* at 408.

252. *Id.* at 411.

253. *Id.* at 412; see E. PATTERSON, *supra* note 119, at 513-37 app. (setting forth history of insurance regulation in Europe and the United States). Professor Patterson cites insurance legislation in Genoa in the last quarter of the 14th century, *id.* at 514 n.10, a comprehensive insurance code in Barcelona in 1435, *id.* at 515 n.14, and an administrative body to regulate insurance in Florence in 1523, *id.* at 515 n.16. The Florentine body was empowered to fix premium rates "provided they conform themselves to equitable regulation in the matter." *Id.* at 515. Patterson said over half a century ago that "modern rate-making statutes have added but little to this formula in the way of exactness." *Id.* Little if any more has been added since 1927. See *supra* notes 115-65 and accompanying text on the minimal standards required by state law and *supra* notes 207-49 and accompanying text on the small number of cases interpreting the requirements of unfair discrimination statutes.

254. 233 U.S. at 412-13.

255. *Id.* at 413.

256. *Id.* at 414.

257. *Id.* at 416.

common carriers, public accommodations, and weights and measures.²⁵⁸

The notion of a special public interest in insurance was invoked by life insurers in the early twentieth century to claim that they should be exempt from taxation.²⁵⁹ Some commentators have argued that the law should consider insurance a public utility, but have failed to offer comprehensive discussions of this treatment's basis or implications.²⁶⁰

Although allusions to the special nature and public interest in insurance are relatively frequent, legal commentary offers little in terms of a theoretical framework for the nature of the insurance enterprise and the considerations that should govern its regulation.²⁶¹ Although such a framework is needed, an endeavor of that scope is not attempted here. This Article develops a perspective on insurance classification that arises from the role of the personal lines of insurance in American society and government choices that have affected that role. It then argues that there should be a resulting public obligation to be concerned

258. *Id.* at 417.

259. Grant quotes a 1908 editorial in the insurance journal, the *Spectator*:

The beneficent work accomplished by life . . . insurance companies should entitle them to the most liberal possible consideration at the hands of legislators; for the encouragement of such insurance is one of the surest means of avoiding public expense for almshouses, jails, etc. Surely, a tax upon insurance is a tax upon thrift; and, having a tendency to make insurance unduly expensive, operates to discourage prudence and forethought on the part of the citizens of our country.

H. GRANT, *supra* note 181, at 69.

260. See, e.g., Denenberg, *Meeting the Insurance Crisis of Our Cities: An Industry in Revolution*, 1970 *INS. L.J.* 205, 210-11; Comment, *Insurance Rate Regulation in Pennsylvania: Does the Consumer Have a Voice?*, 81 *DICK. L. REV.* 297, 303-06 (1977); *Senate Hearings on S. 372, supra* note 26, at 169 (testimony of Tom O'Day, Assistant Vice President of the Alliance of American Insurers, disputing the appropriateness of an analogy to public utilities); H. GRANT, *supra* note 181, at 128-29 (referring to modified rate control legislation drafted by a Wisconsin state legislative committee based on the concept of fire insurance as a public utility); Kimball & Boyce, *supra* note 119, at 546 (commenting on insurance rate regulation as "much less sophisticated and thorough than public utility rate regulation"); see also Lamel, *State Regulation of the Insurance Industry*, 1978 *INS. L.J.* 336, 341 (arguing that a balance should be struck between the "total supervision" of a public utility and "permitting latitude for private enterprise to make its own business decisions"); Works, *supra* note 20, at 478 & n.73 (commenting that contrary to the approach with regard to public utilities, "availability traditionally has not been made an official member of the spectrum of primary regulatory values").

261. The best such commentary is Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 *MINN. L. REV.* 471 (1961). Insurance law scholar Robert Keeton has offered objectives for regulation that he says are suggested by government-sponsored programs of insurance. R. KEETON, *CASES & MATERIALS ON BASIC INSURANCE LAW* 1022-29 (1977). Keeton's definition of government sponsorship includes coercing the use of private insurers to provide insurance. *Id.* at 1022.

with legitimacy of classifications²⁶² used by insurers and availability of insurance.²⁶³

1. *The needs insurance fills and public choices about how to meet those needs*— Government-sponsored social insurance plays an important role in compensating the victims of automobile accidents in some other countries.²⁶⁴ Although many states have changed from a fault based to a no-fault system, the United States has maintained its reliance on the private insurance system as a way to recompense damage caused by automobiles. Japan and Western Europe use private insurers as well but do not use a refined classification scheme like that found in the United States.²⁶⁵

About half the states require liability insurance indemnifying the driver in case of suit by injured parties.²⁶⁶ The potential cost of a damage award makes liability insurance a necessity for anyone concerned about preservation of assets. Collision insurance protecting the insured's own vehicle is a requirement for obtaining a loan secured by the vehicle being purchased.

More legislation has restricted classification discretion in automobile insurance than in any other personal line of insurance.²⁶⁷ Most states have developed a method to insure those who cannot buy insurance in the private market.²⁶⁸ The Michi-

262. As a stimulus to thinking about the concept of "legitimacy" in classification, the author acknowledges Underwood, *supra* note 33.

263. The author acknowledges the excellent Article by Works, *supra* note 20, for help in developing her thoughts concerning availability.

264. R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM 189-219 (1965).

265. FIA, *supra* note 185, at 69-72.

266. See *supra* note 11 and accompanying text.

267. Four states have banned the use of gender classification in auto insurance, while only one has done so in all lines. See *supra* notes 77-78 and accompanying text. Men benefit from prohibiting gender classification in auto and life insurance while women benefit in health, disability, and annuities. Although one is tempted to ascribe the regulatory enthusiasm regarding automobile insurance to the benefits men receive from the elimination of gender classification, there are probably a number of other factors as well. The primary concern in automobile insurance is not the insured but liability to third parties. The fact that automobile insurance is often required has been considered important. See *infra* note 269 and accompanying text. Many states have more elaborate state code provisions concerning automobile insurance than other lines.

268. Austin, *supra* note 11, at 522 n.23, outlines and explains the three methods generally used: assigned risk plans, reinsurance facilities, and joint underwriting associations. She says that insurers cooperated in the formation of such schemes because they "[f]ear[ed] restrictions on their profit-maximizing practices or competition from rival state-run schemes subsidized by tax revenues." *Id.* at 521 & n.21 and authorities cited. The cost of such methods may be quite high. A study by the Federal Insurance Administration published in 1974 found that rates for insureds in assigned risk plans averaged 45% higher than similar drivers insured in the voluntary market. FIA, *supra* note 185, at 3.

gan Supreme Court has reasoned that the requirement of automobile insurance as a condition of automobile registration imposes constitutional limits on the use of classifications.²⁶⁹

German Alliance found one basis for a public concern regarding fire insurance in its requirement for extension of credit.²⁷⁰ Fire insurance is still a condition for obtaining a mortgage.²⁷¹ In 1968, the President's National Advisory Panel on Insurance in Riot-Affected Areas documented the relation of unavailability of insurance in urban areas to the decline of the urban core.²⁷² This concern prompted federal legislation.

The Urban Property Protection and Riot Reinsurance Act of 1968 authorized urban riot reinsurance, then much desired by the insurance industry, if states would set up pools of insurance companies, called FAIR plans, to provide insurance to those denied by the private market.²⁷³ FAIR plans proved important not only for those in the inner city but also for people in rural areas and areas with low property values who had difficulty obtaining property insurance.²⁷⁴ This legislation has now been allowed to lapse,²⁷⁵ although many states have maintained FAIR plans.²⁷⁶

269. *Shavers v. Attorney General*, 402 Mich. 554, 267 N.W.2d 72 (1978), *cert. denied*, 442 U.S. 934 (1979) (criticized in Austin, *supra* note 11, at 531-33).

270. See *supra* text accompanying note 256.

271. See Austin, *supra* note 11, at 520 n.10 (citing the requirements of property insurance for loans guaranteed by the Veterans Administration and the Department of Housing and Urban Development).

272. See HUGHES PANEL REPORT, *supra* note 12, at 115 app.

273. Pub. L. No. 90-448, §§ 1211-1224, 82 Stat. 476, 558-63 (1968) (codified at 12 U.S.C. § 1749bbb-3 to § 1749bbb-10 (1982)). FAIR is an acronym for fair access to insurance requirements. 12 U.S.C. § 1749bbb-3(a) (1982). In most states, the insurance through such pools was similar in cost to that available to insureds with similar properties. A few states had places where rates were dramatically higher in such pools. Concern with such arrangements lead to passage of the "Holtzman Amendment," which provided that rates in FAIR plans could not be higher than the rates established by state rating bureaus for the voluntary market. Pub. L. No. 95-557, 92 Stat. 2097 (1978) (amending 12 U.S.C. § 1749bbb-3(b)(11) (Supp. V 1981)), *repealed*, Pub. L. No. 97-35, tit. III, § 342(b), 95 Stat. 420 (1981) (codified at 12 U.S.C.A. § 1749bbb-3(b)(11) (West Supp. 1985)). The property/casualty industry was violently opposed to this amendment. Eleven states opted to forgo federal reinsurance rather than comply. Allstate Insurance and the Continental Insurance Group, two of the nation's largest insurers, pulled out of FAIR plans in states in which participation was not required. See Austin, *supra* note 11, at 527 & nn. 49-50 and authorities cited therein.

274. *Housing and Community Development Amendments of 1978: Hearings Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance, and Urban Affairs*, 95th Cong., 2d Sess. 1131-32 (1978).

275. The riot reinsurance program terminated on Nov. 30, 1983. Pub. L. No. 98-181, § 452(b)(1), 97 Stat. 1153, 1230 (codified at 12 U.S.C.A. § 1749bbb(b)(1) (West Supp. 1985)).

276. Robert Hunter, Director of the National Insurance Consumer Organization, estimates that half the states still have such programs. Telephone interview with Robert Hunter (Feb. 22, 1985).

The federal government took a direct action to assure some availability of insurance against burglary in some urban areas in passage of the Federal Crime Insurance Act.²⁷⁷

In the late nineteenth and early twentieth centuries, there was support in some states²⁷⁸ for government-run fire insurance resembling municipal insurance schemes in Germany²⁷⁹ as an alternative to the publicly regulated private company system that evolved instead.²⁸⁰ Insurance companies vigorously opposed such initiatives with cries of "socialistic" and "harmful to society."²⁸¹ No government fire schemes were enacted,²⁸² although a number of mutuals patterned on German and Scandinavian models were organized.²⁸³

Development of health insurance generally did not begin until the 1920's.²⁸⁴ The need for such protection has increased as costs have accelerated. In 1983, health expenditures were \$355.4 billion, 10.8% of the gross national product.²⁸⁵ This compares to \$103.4 billion, 7.8% of the gross national product, ten years earlier.²⁸⁶

The United States has rejected schemes to guarantee universal health care or health insurance. In response to calls for a national health scheme, the National Association of Insurance Commissioners drafted a Model Act establishing a reinsurance pool administered by private carriers to provide coverage for

277. 12 U.S.C.A. § 1749bbb-10a (West 1980 & Supp. 1985).

278. Grant describes efforts in Missouri, Wisconsin, and Kansas. H. GRANT, *supra* note 181, at 78-79, 94-96, 122-24, 142. He describes concerns for high rates in Missouri. *Id.* at 78-79, 122-24. Wisconsin initiatives seem to have grown from a concern for stability evinced by company failures after the great Chicago fire of 1871. *Id.* at 94-96. Kansas Insurance Commissioner Webb McNall favored state-operated fire insurance because he believed it would lower costs and keep financial resources in the state. *Id.* at 142.

279. *Id.* at 78.

280. Many states ultimately enacted rate regulation schemes similar to the Kansas statutes upheld by the Supreme Court in *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389 (1914). See *supra* notes 203-06 and accompanying text.

281. H. GRANT, *supra* note 181, at 95.

282. Wisconsin enacted a scheme of self-insurance for public buildings but did not pass a public scheme for insuring private property. *Id.* at 95-96.

283. *Id.* at 96. Many of these mutuals ultimately grew to be huge concerns with much control by policyholders. See generally *Rights and Remedies of Insurance Policyholders, Pt. 2: The Role of the Policyholder in Mutual Insurance Companies: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary*, 95th Cong., 2d Sess. (1978) [hereinafter cited as *Role of the Policyholder*].

284. See S. LAW, *supra* note 184, at 6.

285. Gibson, Levit, Lazenby & Waldo, *National Health Expenditures, 1983*, HEALTH CARE FINANCING REV., Winter 1984, at 1, 3 (Table 1) [hereinafter cited as Gibson].

286. *Id.*

those who would not be covered voluntarily.²⁸⁷ As of 1978, only Connecticut, Hawaii, and Minnesota had adopted such schemes although they permit rates considerably higher than those for people insured by insurers voluntarily.²⁸⁸ Health benefits are funded by the federal government through Medicaid, the Public Health Service and other programs for poor people, the Defense Department for active military personnel and the Veteran's Administration for retired military personnel, the Indian Health Service for Native Americans, and Medicare for those receiving social security retirement and disability benefits.²⁸⁹ For most other Americans, public policy choices have encouraged an employer-provided system of health care.

The tax system allows employers to deduct from their taxable income all moneys contributed to employee health benefits, and employees do not have to pay taxes on these funds.²⁹⁰ Health benefits are an attractive way of providing compensation. Employers bear three-quarters of the cost of health insurance premiums in the United States.²⁹¹

Those in employer-provided health plans benefit in ways other than through the tax advantage. Group insurance is cheaper than similar benefits in an individual policy because the cost of selling multiple policies is eliminated and because employers often take up some of the cost of processing claims. Classifications usually are not used in employer-sponsored plans. All eligible employees are accepted regardless of characteristics such as age, sex, and health.²⁹²

One could criticize the existing system because it ties people

287. Okin, *Preemption of State Insurance Regulation by ERISA*, 13 FORUM 652, 664 & n.67 (1978). The Model Act is addressed to those "uninsurable" in the private market. If costs were not subsidized externally or shared broadly among the state's insureds, high rates could make insurance from such pools unaffordable for many. See *supra* note 268 regarding the high cost of automobile insurance in residual market mechanisms.

288. Okin, *supra* note 287, at 664.

289. See *supra* note 14 and accompanying text.

290. See 26 U.S.C. § 162(a) (1982) (allowing for deduction of ordinary and necessary business expenses); 26 U.S.C. § 106 (1982) (allowing exclusion from employee's gross income of contributions by employers to accident and health plans).

291. Gibson, *supra* note 285, at 5.

292. The only common restrictions regard coverage of some services such as treatment of pre-existing illnesses, psychiatric counseling, and cosmetic surgery. The controversy over exclusion of pregnancy coverage from employer-sponsored plans led to the decisions in *Geduldig v. Aiello*, 417 U.S. 484 (1974) and *General Electric Co. v. Gilbert*, 429 U.S. 125 (1976). After the Supreme Court's decision in *Gilbert*, which held that such a practice was not sex discrimination, Congress passed the Pregnancy Discrimination Act of 1978, Pub. L. No. 95-555, 92 Stat. 2076, amending the definition of sex discrimination in Title VII to include discrimination on the basis of pregnancy. 42 U.S.C. § 2000e(k) (1982).

to employers if they wish to ensure the availability of health insurance and health care.²⁹³ This Article's concern, however, is for those who do not have access to an employer-sponsored plan. These people include the unemployed, the self-employed, and those with employers too small or unwilling to provide health benefits.²⁹⁴

It has been charged that the third-party system for health insurance, at least in part, caused the spiralling cost of health care.²⁹⁵ If this is true, the person without access to an employer-sponsored plan is disadvantaged in yet another way. She does not receive the same tax subsidies for her health insurance as someone insured in an employer-sponsored plan. She has to buy an individual policy that is more expensive than a group policy. She is more likely to find it difficult to buy insurance or to be subject to coverage restrictions. If she chooses or is compelled by price to be uninsured, she faces health care costs inflated by a third-party payment system in which health care consumers and health care providers have little incentive to contain costs.

Social security serves some of the same functions as private life and disability insurance. Social security survivors and disability benefits provide income for qualified dependents, but the income provided is modest and there are a number of restrictions on coverage.²⁹⁶ Those who wish to preserve a middle-class life style for their families in the event of the breadwinner's death or disability still need private life and disability insurance.

As in fire insurance,²⁹⁷ there were efforts to institute government-run life insurance in the late nineteenth and early twentieth centuries.²⁹⁸ Wisconsin was the only state to enact such a scheme.²⁹⁹ It did so despite the same claims of socialism and drastic predictions about the consequences to society³⁰⁰ that de-

293. From the left, it might be criticized for encouraging people to be capitalist wage slaves. From the right, it might be criticized for dampening incentives for striking out on one's own with an entrepreneurial venture.

294. This assumes that such people do not have insurance coverage through another family member and are not eligible for the government-provided programs included in *supra* note 14. A citizens' committee headed by Arthur Flemming, former Secretary of Health, Education, and Welfare, has estimated recently that 33 million Americans lack access to public or private health insurance. *U.S. Is Faulted on Health Care*, Wash. Post, Oct. 18, 1984, at A18, col. 3 [hereinafter cited as *Faulted on Health Care*].

295. Gibson, *supra* note 285, at 5. Unnecessary surgery, tests, and other procedures are likely to be responsible as well.

296. See *supra* note 15 and accompanying text.

297. See *supra* notes 278-83 and accompanying text.

298. H. GRANT, *supra* note 181, at 60-64.

299. *Id.* at 63.

300. *Id.*

feated publicly sponsored fire insurance.³⁰¹ Massachusetts established a semi-public Savings Bank Life Insurance System in 1907.³⁰² It still exists but has modest coverage limits.³⁰³

2. *Implications that should flow from insurance as a necessity and public choice to use private insurance to meet this need*— The personal lines of insurance fulfill vital needs for the majority of Americans. Public choices have been made to meet these needs through the private insurance mechanism. Public choices also have had significant effects on the distribution of insurance availability from private insurers throughout the population. This combination of necessity and public choice creates an obligation on behalf of society to be concerned about the legitimacy of the classification schemes used by insurers to decide who can buy insurance, how much it will cost, and who will be covered. The antidiscrimination perspective provides powerful answers to questions about the legitimacy of some classifications but fails to offer a sufficient framework for evaluating all classifications.³⁰⁴

Consideration of the role of insurance in society, as well as the public choices that have shaped that role, leads one not only to a concern for perceived legitimacy of classifications but also to the more important issue of availability of coverage: Can people buy the insurance they need?

A national study should be made of who cannot obtain insurance because a policy cannot be purchased at any price (an underwriting decision), the price is unaffordable (a rating decision), or the particular coverage is unobtainable or unaffordable (a coverage decision).³⁰⁵ On occasion, public attention has focused on availability with regard to a particular group of people and a particular line of insurance. In the late 1960's, the Hughes Commission directed attention to property insurance for inner-city residents.³⁰⁶ In the 1981-83 recession, there was discussion of a public solution for those who lost their health insurance along with their jobs.³⁰⁷ The specificity of such foci obscures consideration of the general limitations of the private insurance mecha-

301. See *supra* note 281 and accompanying text.

302. H. GRANT, *supra* note 181, at 63.

303. See *infra* note 333 and accompanying text.

304. See *supra* notes 93-103, *infra* notes 347-60 and accompanying text.

305. See *infra* notes 405-06 and accompanying text.

306. See *supra* note 12.

307. In 1983, the House of Representatives passed a bill, H.R. 3021, 98th Cong., 1st Sess. (1983), to aid unemployed workers in obtaining health insurance and health care, but the bill did not pass the Senate. *Backing for Jobless Health Insurance Wanes*, 39 CONG. Q. ALMANAC 405 (1983).

nism as it operates in this country. It also allows society to ignore an important question: Whom is society willing to leave uninsured?³⁰⁸

Focusing only on ways to increase availability, such as restricting classification, allows society to avoid confronting what insurance unavailability it will tolerate. The choice of ways to address unavailability should consider the amount of cost redistribution involved in broader pooling of risks, attitudes about the specific classification, and perceptions about the importance of the line of insurance and the coverage in question.

If the cost shifts of restricting classification are relatively minor, this becomes a more palatable alternative. For example, if eliminating residence zip code as a classifier would cost each insured in a state only a few dollars more, it is reasonable to take this step if it makes insurance available to some who otherwise could not buy it at all.³⁰⁹ Because the classification process is sufficiently imprecise, eliminating a classifier does not necessarily do great violence to a scientific process.

Whether society is willing to require that particular insureds be included in pools may depend on its views about the classification. Thus, it may seem unfair to restrict the ability of disabled people to buy insurance but acceptable to require that smokers pay the higher costs justified by their self-destructive behavior. Conversely, if society perceives health insurance as sufficiently important, we may determine that offering health insurance to smokers only at a prohibitive cost goes too far. It may be concluded that some higher cost is all right but not the full cost differential that might be suggested by use of the smoking classifier alone if that differential would result in unaffordability for many. At the same time, refusing to sell automobile insurance to people with three moving traffic violations may be palatable even though past violations are limited in their predictive validity about future accidents.

Once a decision is made that a gap in availability should be closed, there are at least three approaches to doing so. Classification discretion can be limited by placing the additional cost of

308. See Works, *supra* note 20, at 524, on the avoidance of the issue of minimum standards for insurability in the design of the federal FAIR plan schemes.

309. In the late 1970's, New York, unlike most other states, administered its FAIR Plan so that rates were based on the losses of those properties in the plan. J. Com., Sept. 15, 1978, at 1, col. 3. It was estimated that a proposal to bring those rates to market rates would add only \$2.50 to a \$150 insurance policy. See letter from Francis V. Reilly, Federal Insurance Administration, to the Author (Aug. 4, 1977) (copy on file with U. MICH. J.L. REF.).

insuring those who would otherwise be uninsured on the pool of those buying insurance. In other words, the insurance pool is broadened. Another choice leaves insurance classification discretion unfettered but subsidizes the extra cost for some insureds from public funds.³¹⁰ A third choice assures that all can purchase insurance but allows all or most of the cost of those perceived to be higher risk to fall on that group. In other words, classification is restricted in underwriting and coverage but not in rating. Many assigned risk pools take this approach and therefore have much higher rates than the private market. Within any one of these three approaches, how much might be done through private insurers and what role government might play could vary considerably.

It is beyond the scope of this Article to suggest in which lines of insurance, and for which classifications, availability gaps should not be permitted and to suggest precisely how to bridge those gaps. Some classification restriction is proposed but not primarily because of its impact on availability. The availability study proposal would look at availability both before implementation of the suggested classification restrictions and after two years of experience with them.³¹¹

D. Another Alternative Perspective: Competition in the Insurance Market

The other overlooked perspective on the classification debate is the possible salutary effect on competition of restricting insurers' discretion in classification. Competition supposedly creates "reasonable prices based on the cost of rendering the services; efficiency in which the services are rendered at the lowest possible cost; and innovation in which new or improved products or services and methods of distribution are utilized."³¹² Writings about government intervention affecting classification generally have ignored the almost unique nature of competition in the insurance market and the consequence which those unique fea-

310. See, e.g., Benston, *Economics of Gender Discrimination*, *supra* note 31, at 512 (so argues even with regard to race classification). *Contra*, Austin, *supra* note 11, at 521 (suggests that insurers have cooperated with state regulators in residual market mechanisms for automobile insurance from a fear of greater government regulation and of competition from subsidized schemes).

311. See *infra* notes 405-06 and accompanying text.

312. DOJ REPORT, *supra* note 177, at 2-3.

tures might have for decisions about appropriate regulation.³¹³

One notable exception outlines four possible kinds of competition that can take place among insurers.³¹⁴ Economists and those interested in efficiency in public policy revere the first type, competition by adjustment of price and service. Product differentiation, which can result in a proliferation of minor differences in product, is a second possibility.³¹⁵ Product differentiation as a mode of competition, of course, is not unique to insurance. Product differentiation as a mode of competition may allow sellers to meet discrete needs and establish good will in their products. At the same time, it can substitute for beneficial price competition and confuse customers. Product differentiation is more common and prone to more negative consequences in the insurance industry than in some others because of the difficulty of making price and quality comparisons about insurance.³¹⁶ The insurance product is presented to the public as a complex written document. Most people have difficulty ascertaining the differences among insurance policies and more difficulty understanding their implications. Quality judgments about insurance would relate to a company's financial stability and claims settlement practices, but this information is not readily available to a consumer.

The third kind of competition occurs among insurers for loyalty and diligence of sales intermediaries. Independent agents sell much insurance. Insurers can compete by offering better commissions to agents.³¹⁷ Because the product is very complicated to understand, agents can convince people to buy a product that offers the most beneficial commission to the agent as opposed to the best buy for the customer.³¹⁸

313. For example, Dirlam & Stelzer, *supra* note 229, at 205, say that "[c]ompetition in insurance, as in all types of businesses, may take three forms: (1) service, (2) product (policy), and (3) price (premium rates)." They do not mention selection competition. See also Brainard & Dirlam, *Antitrust, Regulation, and the Insurance Industry: A Study in Polarity*, 11 ANTITRUST BULL. 235, 236 (1966) (commenting on "paucity of research" on competition in insurance markets and review of past studies).

314. Kemp, *supra* note 33.

315. *Id.* at 555.

316. See Williams, *supra* note 111, at 216 (stating that the problems of price and product proliferation are "more serious problems in insurance than in other businesses because price and quality comparisons are more difficult to make") (quoting the observation of F. CRANE, AUTOMOBILE INSURANCE RATE REGULATION 82 (1962)). See also sources cited in Brilmayer, *Sex Discrimination*, *supra* note 31, at 531 n.125.

317. This is also referred to as "reverse competition." Kemp, *supra* note 33, at 563-64.

318. At the 1980 Senate Hearings on the Metzenbaum bill, J. Robert Hunter, a former Deputy Federal Insurance Administrator who is now head of the National Insurance Consumer's Organization, gave the example of a leading automobile insurance writer's

Risk selection, the attempt to enhance competitive position by choosing more good risks than one's competitor, is the fourth type of competition.³¹⁹ Insurance and credit are among the rare enterprises that compete by selection of customers.³²⁰ Concentration on risk selection encourages the insurance industry to spend considerable resources on risk classification and deflects scrutiny from other possible ways to compete.³²¹

The selection competition feature probably causes people to most immediately make the analogy of insurance and credit classifications to civil rights laws. Those unable to purchase the product can easily see themselves as "discriminated" against. The federal government has seen fit to forbid the use of race, religion, sex, marital status, and national origin classification in credit.³²²

It sometimes is argued that the market will correct for overly conservative decisions in risk selection because a smart competitor will change his classification system to reduce costs to the overcharged group.³²³ This is not as likely to happen in insurance as in other industries.³²⁴ The incentives in insurance under-

policy offered in the District of Columbia at \$200 more than the assigned risk plan. Hunter said that, despite the price, this policy was purchased by many people because agents steered customers to it despite its greater expense. *Senate Hearings on S. 2474*, *supra* note 19, at 11.

319. Kemp, *supra* note 33, at 555, 563; REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL OF THE NAT'L COMM. FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES 240-43 (1979) [hereinafter cited as NAT'L COMM.]; *N.J. Overview*, *supra* note 127, at 1063-67; *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 214-22 (testimony of J. Robert Hunter, Deputy Federal Insurance Administrator).

320. Professor Works comments that "a large service industry that insists on selecting to whom it will sell at the consumer level is not a familiar phenomenon." Works, *supra* note 20, at 456-57.

321. The president of a major insurance brokerage firm used a personal anecdote to illustrate this phenomenon. He recounted having turned in a paper on "Underwriting the Expense Dollar" in a night course on Large Commercial Risk Underwriting given by the College of Insurance. The company for which he worked tried to make a five percent profit in the liability business by keeping losses to 47% of premiums, and expenses to 48%. In his paper, he questioned "the logic of training underwriters to spend 100% of their effort trying to forecast losses, which are unknowable in any event, and zero time trying to assess expenses on an individual risk basis, even though they accounted for the larger dollar outlay and were not only knowable but controllable." His comment on the attitude of the industry was: "Obviously I earned a grade of 'D' for the course, along with the comment that the paper constituted impertinent criticism, while failing to demonstrate any assimilation of what had been taught." (Speech by Robert Clements, President of Marsh and McLennan, Inc., before the Casualty Actuarial Society (May 12, 1980) *reprinted as Risk in a Complex Society*, 1980 *Ins. L.J.* 392, 392).

322. 15 U.S.C. §§ 1691-1691f (1982).

323. Benston, *Economics of Gender Discrimination*, *supra* note 31, at 529; *see also* authorities cited in Austin, *supra* note 11, at 553 n.228.

324. Works suggests several explanations for the failure of the property insurance

writing are for avoiding loss, not for taking risks on insureds about whom there is some question.³²⁵ An insurer's ratemaking depends on the assumption that he is insuring homogeneous risks whose loss record will approximate the loss record of the sample for whom loss data is available. Picking out a new subclass raises uncertainty about their losses, an uncertainty insurers usually seek to avoid.³²⁶

Competition has not been successful in minimizing the cost of delivering the insurance product. In testimony before a Senate Judiciary Subcommittee in 1980, former Deputy Federal Insurance Administrator J. Robert Hunter reviewed statistics on the property and casualty insurance industry from 1958 to 1977.³²⁷ They showed that for every dollar of cash income received: forty-eight cents went to benefits, thirty-four cents for expenses, and eighteen cents for positive cash flow into investments as reserves.³²⁸ Hunter pointed out that this equaled a cost of seventy cents to deliver each dollar of benefits.³²⁹

The history of insurance regulation reveals a number of examples of resistance to proposals to increase competition in a way that would pressure reduction of overhead costs. Insurance agents' concern about pressure to reduce commission levels probably was a factor in the passage of anti-rebate legislation.³³⁰ Such legislation is still on the books in every state with regard to insurance,³³¹ although pressure to negotiate and offer discounts

industry to reach a market-clearing equilibrium that eliminates availability problems: "inadequacies of regulatory and rating practices inherited from an era of cartelization and as yet only partially accommodated to the new realities of competitive insurance markets"; "intrinsic limitations of the insurance technique when practiced by competing insurers in an unruly world of heterogeneous property risks of uncertain independence and questionable spread"; and "normal consequences of the uncertainty, transaction costs, and incomplete information that characterize real markets unprotected by the simplifying assumptions necessary for the elegant mechanics of economic theory." Works, *supra* note 20, at 457. This is not to say that all insurers classify identically. There often is substantial variation. It only is to suggest that there are incentives for the variation to be less than otherwise might be assumed.

325. *Id.* at 467-69.

326. *Id.* at 459, 465-66.

327. *Senate Hearings on S. 2474, supra* note 19.

328. *Id.* at 23.

329. *Id.*

330. *See supra* note 193 and accompanying text.

331. A compilation of 121 statutes from all fifty states, the District of Columbia, and Puerto Rico is on file with U. MICH. J.L. REF. An individual state may have multiple anti-rebate statutes referring to various lines of insurance. *See, e.g.,* ME. REV. STAT. ANN. tit. 24A, §§ 2160, 2162, 2163, 4139 (1974).

A Florida intermediate court recently held that the state's anti-rebate statute violated the due process clause of the Florida Constitution as an unjustified exercise of the police power because it bore no rational relation to a legitimate state interest. Dade County

to the consumers is accepted in most other industries.³³² The sale of life insurance through savings banks offers a cheap delivery technique, but only three states permit it and coverage limits are low.³³³ Insurers and agents have opposed recent efforts of banks to get into life insurance underwriting.³³⁴ Fictitious group legislation, which severely limits what can be considered a group, restricts the use of mass marketing in automobile and property insurance.³³⁵

A comprehensive analysis of anticompetitive features in state insurance regulation schemes and the pros and cons of a change in each is beyond the scope of this Article.³³⁶ The point here is that far too much insurer and regulator attention has been devoted to selection of insureds as opposed to other features that could lead to an overall reduction in the cost of delivering the product.

Rather than favoring rate reduction, the industry is structured to favor accumulation of capital beyond that needed to serve as a reserve for losses.³³⁷ Insurers argue that investment income on premiums is not properly a consideration in ratemaking in the states in which government has regulatory authority for automobile and property insurance rates, and states generally have accepted that contention.³³⁸ State methods for regulating rates often have allowed an administrative expense factor that carries forward the overhead of the least efficient carriers.³³⁹ Insurance accounting practices allow the industry to report millions of dollars in "losses" when their profits in investment income still

Consumer Advocate's Office v. Department of Ins., 457 So. 2d 495 (Fla. Dist. Ct. App. 1984).

332. The Robinson-Patman Act, 15 U.S.C. §§ 13-13b, 21a (1982), forbids anticompetitive discounts to intermediaries. Individual discounts are forbidden in regulated industries.

333. Savings bank life insurance is sold in Connecticut, Massachusetts, and New York. Coverage is limited to \$10,000, \$53,000, and \$30,000, respectively. A. TOBIAS, *supra* note 9, at 238, 273.

334. *Upheaval in Life Insurance*, Bus. Wk., June 25, 1984, at 58, 60.

335. J. WILSON & R. HUNTER, INVESTMENT INCOME AND PROFITABILITY IN PROPERTY/CASUALTY RATEMAKING: AN INDEPENDENT REPORT TO THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS TASK FORCE ON PROFITABILITY AND INVESTMENT INCOME 52-53 (1983); DOJ REPORT, *supra* note 177, at 72-84.

336. See *infra* notes 408-14 and accompanying text. Most heavily debated is whether to repeal the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1982). For its major provisions, see note 58.

337. A recent book explores reasons for this in life insurance. R. KESSLER, THE LIFE INSURANCE GAME 154-82, 249 (1985).

338. See R. HUNTER, *supra* note 147; J. WILSON & R. HUNTER, *supra* note 335, at 21-38 (discussing state case law).

339. This phenomenon is a common characteristic of cartels and any regulated industry in which rates are determined through collusive action.

leave them with a substantial margin of gain.³⁴⁰ Many insurance companies are mutuals with no real control of officers, and no effective pressure to distribute dividends, which are supposed to be the mechanism for rate reduction.³⁴¹

Promoting desirable competition requires not only eliminating barriers in the regulatory structure but also sufficient market information to enable insurance consumers to comparison shop.³⁴² Insurance contracts are notorious for incomprehensibility. Automobile and property insurance have undergone standardization, which helps consumers to make price comparisons,³⁴³ but these comparisons are difficult even in those lines.³⁴⁴ The multiplicity of product differentiation and the complexity of figuring out exactly what is being offered is most pronounced in life insurance.³⁴⁵ A reform effort should seek better market information to encourage consumer comparison of products and should scrutinize statutory barriers to competition as well as restrict selection competition through classification.

Procompetition rhetoric deflects attention from practices that leave many Americans without needed insurance. This is particularly troublesome because the procompetitive rhetoric also shields from scrutiny a number of anticompetitive market conditions.³⁴⁶

340. A. TOBIAS, *supra* note 9, at 58, quotes a 1980 press release issued by the Insurance Information Institute saying the property/casualty insurance industry suffered a \$3.04 billion underwriting loss and the J. COM.'s observation that "despite the underwriting loss there was a \$7.51 billion profit." He also cites a 1979 National Underwriter headline about a loss of \$985 million for a period when the investment income was \$4.3 billion.

341. See generally *Role of the Policyholder*, *supra* note 283 (on the way mutual companies actually function).

342. DOJ REPORT, *supra* note 177, at 41-42.

343. Day, *Changing Attitudes About Insurance Regulation*, 14 FORUM 744, 750-51 (1979).

344. A Massachusetts study found that no more than 20% of agents and companies contacted regarding property casualty insurance gave price information on the phone. J. WILSON & R. HUNTER, *supra* note 335, at 59. Wilson and Hunter also discuss other studies of available consumer information. *Id.* at 53-62.

345. See generally *Cost Disclosure in Life Insurance: Hearings Before the Subcomm. on Antitrust, Monopoly, and Business Rights of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. (1979) [hereinafter *Cost Disclosure Hearings, 96th Cong.*]; R. KESSLER, *supra* note 337.

346. See testimony of Robert Hunter, then Deputy Federal Insurance Administrator, in *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 215, arguing that the focus should be shifted from selection competition to competition based on "lower price, better coverage, superior service, or a combination thereof."

II. FROM PERSPECTIVES TO OBJECTIVES

The antidiscrimination perspective makes a valuable contribution to the debate on insurance classification by focusing on the use of race, color, religion, sex, and national origin as classifiers.³⁴⁷ Once the use of these classifications is forbidden, however, difficult questions remain: Should classifications other than these, but having an adverse impact on the banned classifications, also be restricted? Are there additional classifications that should be restricted as well? Should the treatment of questionable classifications other than race, color, sex, religion, or national origin be subject to less than an absolute ban?³⁴⁸ In other words, should a permissible defense exist?

Two of the discrimination theories developed in fair employment law have been discussed in relation to insurance. The first is the disparate treatment theory, which refers to the treatment of people in a protected classification differently from the way others are treated.³⁴⁹ The second is the adverse impact theory, which refers to practices that have a discriminatory effect and disqualify members of a protected group at a substantially higher rate than others without a showing that the requirement imposed is job-related or a necessity.³⁵⁰

The adverse impact theory was articulated by the Supreme Court in *Griggs v. Duke Power Co.*,³⁵¹ which held that when Congress prohibited race and color classification, it also intended to prohibit classifications with an adverse impact on blacks if such classifications could not be justified as a matter of business necessity or relationship to job performance.³⁵² Confusion exists in fair employment law about whether business necessity and job relatedness are different standards and what they require in justification.³⁵³ Job relatedness may require only

347. See *supra* notes 93-101 and accompanying text.

348. For examples of state statutes imposing less than a complete ban, see *supra* notes 79-83 and accompanying text.

349. B. SCHLEI & P. GROSSMAN, *EMPLOYMENT DISCRIMINATION LAW* 13 (2d ed. 1983). 42 U.S.C. § 2000e-2(e)(1) (1982) provides a bona fide occupational qualification exception with regard to sex, religion, and national origin, but not for race or color discrimination.

350. B. SCHLEI & P. GROSSMAN, *supra* note 349, at 82-84, 91-92.

351. 401 U.S. 424 (1971).

352. "[Title VII] proscribes not only overt discrimination but also practices that are fair in form, but discriminatory in operation. The touchstone is business necessity. If an employment practice which operates to exclude Negroes cannot be shown to be related to job performance, the practice is prohibited." *Id.* at 431, quoted in B. SCHLEI & P. GROSSMAN, *supra* note 349, at 112.

353. B. SCHLEI & P. GROSSMAN, *supra* note 349, at 112-14.

that the criterion reasonably measures job performance,³⁵⁴ while business necessity has been interpreted to require a test essential to the employer's goals of safety and efficiency.³⁵⁵

Problems arise when one considers appropriate analogies to these tests in insurance. Intuitively, some classifications with an adverse impact seem better than others. Convictions for driving under the influence of alcohol or drugs might have an adverse impact on male drivers, but it seems appropriate for these classifications to be used in automobile insurance. Residence zip code, which often adversely affects racial minorities, is a considerably more controversial automobile insurance classification than alcohol or drug-related convictions.³⁵⁶

If an analogy to job relatedness meant only that the classification be statistically justifiable, it would require no more than the current unfair discrimination statutes.³⁵⁷ Such a classification might be subject to other charges of perceived unfairness such as offering no plausible causal explanation.³⁵⁸ An appropriate analogy for business necessity in the insurance context is difficult to draw.

The alternative proposed here would not use adverse impact analysis or an antidiscrimination approach to consider other classifications beyond race, color, religion, sex, or national origin. Rather than focusing on how bad a classification might be, proposed classifications would be judged against a set of criteria that they affirmatively should meet.³⁵⁹ Of course, in a sense, deciding whether a classification is good enough is the same as deciding whether it is too bad, but the affirmative criteria proposed by this Article have been formulated in specific relation to values for an insurance classification scheme rather than abstract considerations about a classification outside the insurance context. Considerations such as relation to overall loss reduction and available alternatives to the coverage are introduced. Such criteria encompass consideration for values other than discrimination.

Requiring that classifications used affirmatively meet certain criteria means that insurance classification would be treated more stringently than classifications in other areas such as employment and housing. In those areas of law, the primary tools

354. *Id.* at 113.

355. *Id.*

356. *See supra* notes 21-24 & 27 and accompanying text.

357. *See supra* notes 115-16 & 176 and accompanying text.

358. *See supra* notes 115-65 and accompanying text.

359. *See infra* notes 398-404 and accompanying text.

restricting the decisionmaker's choice are the antidiscrimination prohibitions of specified classifications. Generally, once banned classifications and any others reached under an adverse impact theory are avoided, the employer or landlord may apply whatever arbitrary or discriminatory criteria he or she pleases. If one wishes to refuse to rent an apartment to people who ride motorcycles or sell antiques, one may do so.³⁶⁰

I have argued in this Article that there should be a special concern for the perceived legitimacy of classifications in insurance because of the necessity of the product and the public choices to meet that need through the private sector.³⁶¹ The necessity of insurance and the public decision to meet the need through private insurance, however, do not explain why an approach that is more stringent than that taken in employment or housing discrimination law should be used. Employment and housing are certainly as important to people as insurance.

An approach to classifications that is more stringent in insurance than employment or housing has several justifications. First, classifications in insurance already are treated more stringently, reflecting a previously made social judgment. Such restriction occurs in the unfair discrimination statutes.³⁶² Some insurance commissioners have tried to argue that most of the criteria proposed by this Article³⁶³ can be applied through interpretation of the term unfair discrimination.³⁶⁴

Another justification lies in the much greater likelihood that all insurers will use the same classification than that all employers or all landlords will do so. There usually are many more employers, landlords, or house sellers than insurers offering a particular coverage in a particular locale.

Third, the insurance industry's antitrust exemption³⁶⁵ permits insurers to pool statistical data on loss and to use a central rate bureau's classification plan.³⁶⁶ Insurers also frequently ask if an applicant has been turned down or "rated up" by another car-

360. Discretion in rentals is sometimes limited by rent control statutes as well as by fair housing laws.

361. See *supra* notes 250-311 and accompanying text.

362. See *supra* notes 174-80 and accompanying text.

363. See *infra* notes 398-99 and accompanying text.

364. See the decision of Massachusetts Insurance Commissioner James Stone, *supra* note 149, the decision of New Jersey Insurance Commissioner James Sheeran, *supra* note 27, and cases overruling decisions of Florida, Louisiana, and North Carolina Commissioners cited in *supra* note 35.

365. 15 U.S.C. §§ 1011-1015 (1982) (McCarran-Ferguson Act).

366. J. WILSON & R. HUNTER, *supra* note 335, at 54-57. For information on how the property/casualty industry is organized and functions, see generally DOJ REPORT, *supra* note 177.

rier. An affirmative answer often leads to a repetition of the previous treatment.³⁶⁷

Finally, insurers are concerned that their sample of insureds reflect the same distribution of risks as the sample of risks for whom loss data is available. This discourages taking different approaches to classification.³⁶⁸ The incentives for agents and underwriters are to avoid loss rather than to discover people who have been refused wrongly or charged too much by other insurers.³⁶⁹

Three possible objectives for regulation of classification are:³⁷⁰ perceived fairness of the system and legitimacy of classifications used, promotion of overall loss control, and encouragement of desirable competition.³⁷¹

Almost all discussions of goals in insurance regulation begin with solvency.³⁷² Although no scheme for classification regulation should threaten solvency, however, classification regulation

367. *Senate Hearings on S. 2474, supra* note 19, at 3.

368. *See supra* notes 323-26 and accompanying text.

369. *Id.*

370. For the perspective of an insurance trade association on objectives for a risk classification system, see *Senate Oversight Hearings on Discrimination in Property and Casualty Ins., supra* note 21, at 102.

371. In *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970), Guido Calabresi posits goals and subgoals for judging a system of accident law and attendant compensation systems. His concern is with accident law generally, with private insurance as a part of some of the alternative schemes considered, rather than risk classification alone, but the following shows some parallels in his concerns and those described here.

Calabresi's primary goals for a system of accident law are reduction of accident costs and justice. *Id.* at 24-33. Reduction of accident costs is divided into three subgoals. The primary subgoal, reduction in number and severity of accidents, parallels the loss control goal described here. *Id.* at 26-27. The secondary subgoal is reducing the societal cost of accidents, as distinguished from their number and severity, which he says could be accomplished through risk spreading or in placing costs on those most able to pay. *Id.* at 27-28. The optimal type and degree of risk spreading for particular coverages are not addressed in this Article although more risk spreading and cost reduction through competitive pressures on administrative costs rather than risk selection are advocated. Government action with regard to particular coverages should be considered in light of the results of the proposed availability study, the available alternatives to the coverage, and incentives for overall loss reduction in various schemes. Calabresi's tertiary subgoal is "efficiency cost reduction," whether particular methods of achieving other subgoals are worth their administrative cost. *Id.* at 28. I argue that concentration on risk selection as a mode of competition has obscured inefficiencies in the delivery of insurance protection.

Calabresi treats justice as a constraint or check, "a final test which any system of accident law must pass," rather than as an initial consideration for a system of accident law. *Id.* at 24-26. He does so because he sees difficulty in recognizing justice and greater ease in recognizing injustice. *Id.* at 24 n.2. The goal proposed here for classification regulation is perceived fairness and legitimacy rather than a particular definition of justice. The reforms advocated are designed to shift responsibility for classification into the public debate and to assign government responsibility for final decisions on classifications.

372. J. DAY, *ECONOMIC REGULATION OF INSURANCE IN THE UNITED STATES* 2 (1970).

is not a tool for achieving the goal.³⁷³

The first objective proposed for classification regulation is that classification systems be perceived as fair and that classifications used be perceived as legitimate. This does not mean abandoning statistical association with loss as a consideration in insurance classification, because it has a strong perception of fairness and legitimacy associated with it. In fact, insurance regulators should be more aggressive about scrutinizing whether proposed classifications are associated with loss on the basis of valid data,³⁷⁴ but the inquiry should not end there. The question of statistical accuracy should require more than the mere presence of a difference in averages among groups that insurers have defined. The statistical separation of the groups created from the rest of the population is important as well.³⁷⁵

Perceived fairness and legitimacy also suggest that there be a perceived plausible causal linkage.³⁷⁶ In mathematical and scientific theory, causation can never be known.³⁷⁷ At the same time, the perception that causation is plausible is important. Furthermore, plausible causal explanations provide hypotheses about how loss can be avoided.³⁷⁸

Social acceptability is another measure of perceived legitimacy and fairness. Race, color, religion, sex, and national origin score badly on it.³⁷⁹ Including social acceptability in the definition of perceived fairness and legitimacy for insurance classification focuses on how bad a classification is in the manner for which the antidiscrimination perspective has been criticized. Here, how-

373. See Testimony of J. Robert Hunter, then Deputy Federal Insurance Administrator, now Director of the National Insurance Consumer Organization, *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 219:

As an actuary I believe that any plan can be actuarially sound in terms of achieving the end result which is a reasonable profit for insurers . . . [Y]ou can eliminate age, sex, and even territory and take a map of the State and compile the number of dollars you want to collect at various levels and do it through merit rating or whatever approach you want to use.

Of course, almost any plan is actuarially sound. The actuaries did not create most of the classification slots in use today anyway. They were created by underwriters based in many cases on prejudgments.

In 1977 the Department of Justice recommended that a federal system with a uniform system of solvency regulation emphasizing early detection and prompt removal of weak companies would be preferable to the common state approach of "keeping every insurer afloat." DOJ REPORT, *supra* note 177, at ix. It recommended a guaranty fund, like the Federal Deposit Insurance Corporation, to provide policyholder security. *Id.*

374. See *supra* note 121 and accompanying text.

375. See *supra* notes 149-51 and accompanying text.

376. See *supra* notes 156-63 and accompanying text.

377. See *supra* note 156 and accompanying text.

378. See *supra* notes 162-63 and accompanying text.

379. See *supra* notes 93-100 and accompanying text.

ever, social acceptability is one of several criteria against which classifications are to be judged. The other criteria have been established specifically with regard to the nature of the insurance enterprise.

The second objective for judging a classification system is the relationship of classification to an overall system of loss control.³⁸⁰ If a classification creates incentives to reduce losses, all insureds can gain in life, health, and disability insurance. A non-smokers' classification creates incentives not to smoke. Less illness and fewer premature deaths can reduce the cost of health, disability, and life insurance for everyone. In contrast, sex classification creates no incentives because there are no measures one can take to be classified differently.

The third objective is the stimulation of desirable competition. Government should act to encourage a shift from selection competition toward competition that will create pressure for lower overall price levels, better service, and more valuable products.³⁸¹ The focus should not be on competition as an end in itself but on its ability to produce these desirable ends.

Availability does not appear on the list of objectives. Given the critical nature of insurance, availability should be a more important concern than the three listed objectives. The omission occurs because perceived fairness and legitimacy, encouraging loss control, and promotion of desirable competition are proposed as short-term reforms for a system of insurance *classification* regulation, not a long-term approach to insurance regulation generally.³⁸² In a longer term scheme, society might decide to close availability gaps with mechanisms that de-emphasize one of the previously stated objectives such as competition.

The antidiscrimination perspective, although important for other reasons,³⁸³ deflects attention from availability by its concentration on restricting the use of particular classifications. Restriction of classification discretion usually will lead to greater availability for some people. If sex classification in automobile insurance is forbidden, one can expect that at least some young men will pay less for insurance. This presumably means that

380. Denenberg has suggested this as an appropriate criterion. Denenberg, *supra* note 260, at 216; *see also* Underwood, *supra* note 33, at 1437-42 (discussing appropriateness of "predictors that induce, reward, and punish"); G. CALABRESI, *supra* note 371, at 26-27.

381. *See supra* notes 312-46 and accompanying text.

382. The inclusion of "the alternatives to private insurance coverage available to potential insureds" as a consideration in my suggested criteria for classifiers assigns some weight to availability. *See infra* notes 398-400 and accompanying text.

383. *See supra* notes 93-96 and accompanying text.

some for whom insurance was previously unaffordable will now be able to purchase it. At the same time, the cost probably will go up for some young women. If the increase is substantial, it may render insurance unaffordable to them.

Estimating the redistribution of cost and the changes in availability likely to result from restricting the use of a particular classification is complicated, because the cost shifts may be moderated considerably if alternative classifications are used.³⁸⁴ If gender classification is banned in automobile insurance and no other classification is substituted, there will be a considerable redistribution in cost and probably in availability.³⁸⁵ On the other hand, it has been argued that there would be little change if mileage were to be substituted.³⁸⁶

Classification restriction is only one way to change availability patterns.³⁸⁷ External public subsidies or rate adjustments that distribute the cost among the group perceived to be a higher risk are other alternatives. These general approaches can be combined in addressing a specific availability issue. There are a host of variations in how such schemes might work, including variations in the roles government and private insurers play.

III. FROM OBJECTIVES TO REFORMS

The ban on race, color, religion, sex, and national origin classification found in both the Hatfield-Packwood-Dingell and the Metzenbaum bills should be enacted by Congress for all the personal lines of insurance. Congress should act in three additional areas as well.

First, the crucial place of insurance in the society³⁸⁸ and the ways risk selection can deflect pressure from price and service competition should dictate a public role in approval of *all* classifications used in rating, underwriting, and coverage.³⁸⁹ This Article proposes criteria against which rating classifications should be judged. These would be combined with limitations on underwriting and coverage discretion. Written findings on whether a

384. GENERAL ACCOUNTING OFFICE, ECONOMIC IMPLICATIONS OF THE FAIR INSURANCE PRACTICES ACT 19-23 (1984).

385. *Id.* at 21.

386. *House Hearings on H.R. 100, 98th Cong., supra* note 26, at 403; *Senate Hearings on S. 372, supra* note 26, at 184.

387. *See supra* text accompanying notes 308-11.

388. *See supra* notes 251-311 and accompanying text.

389. *See supra* notes 312-46 and accompanying text.

prior rating classification meets the criteria would be made by state officials after an administrative process open to public comment. Consumers denied insurance would be entitled to written notice of reasons, with appeal rights to a state administrative agency.

Second, a national study of insurance availability in the personal lines should be conducted to determine who is uninsured, why, and whether there are coverage alternatives for such people. The results of this study would provide data and focus national attention on whether there should be public initiatives to increase availability. Such initiatives might include further restrictions on classification or might take another approach such as public subsidy.

Third, reforms should be enacted to enhance desirable competition. Federal requirements for the production and distribution of consumer information on policy prices and terms should be set. As a stimulus to service competition, state regulators also should be required to make available data on consumer complaints about insurer practices, such as claims settlement and their disposition. In addition to enhancing consumer information, laws regulating insurance should be scrutinized for anticompetitive features.

All of these steps should be taken by Congress even though state insurance regulators would retain responsibility for implementation under the standards set by the federal legislation. While it has been clear since 1944 that the federal government has the authority to regulate insurance,³⁹⁰ this authority rarely has been exercised. Unlike the dearth of discussion about the nature of the insurance enterprise, the practices that should be regulated, and the ends that regulation should seek to address, the question of who should regulate insurance has received considerable attention.³⁹¹ Without reviewing that debate, this Article proposes an increased federal role for the following reasons.

390. See *supra* note 206 and accompanying text.

391. See, e.g., Kimball, *State versus Federal Regulation in Insurance, Government and Social Policy: Studies in Insurance Regulation* 411 (S. Kimball & H. Denenberg eds. 1969); Belkin, *State Regulation: Anachronism or Advantage*, 29 *FED'N INS. COUNS. Q.* 209 (1979); Hanson, *The Interplay of the Regimes of Antitrust, Competition and State Insurance Regulation in the Business of Insurance*, 28 *DRAKE L. REV.* 767 (1978-1979); *Potential Federal Intervention in the Insurance Industry: The Pending United States Senate Subcommittee Draft to Amend the McCarran-Ferguson Act*, 28 *DRAKE L. REV.* 926 (1978-1979); Johnson, *Insurance Regulation at the Crossroads*, 1977 *INS. L.J.* 7; McCallion, *Introductory Remarks: Panels on Issues of Federal and State Regulation of Insurance*, 13 *FORUM* 603 (1978); Note, *The McCarran-Ferguson Act: A Time for Procompetitive Reform*, 29 *VAND. L. REV.* 1271 (1976).

First, reform efforts in individual states frequently have been frustrated by insurers' threats of withdrawal, or even actual withdrawal, from doing business in the state.³⁹² Second, it has proven difficult for state regulators to withstand the political pressure that can be exerted by insurers.³⁹³ Third, because so much insurance business is done across state lines, state regulators are often no match for large national and international insurers.³⁹⁴ Fourth, to divert competitive efforts in selection competition to more desirable forms of competition, all insurers must be required to play according to the same rules. Finally, the proposed study of availability would require considerable resources and should look at availability concerns nationwide.

The proposal takes the Metzenbaum bill's structural approach of banning some classifications and giving state regulators authority to make judgments about other classifications. A small federal office would be charged with collecting data on state regulation, acting as a clearinghouse to make the states' procedures and decisions available to each other, and evaluating state actions after two years. The results of that study may suggest that more federal preemption is warranted. On the other hand, this federal and state sharing of authority may produce desirable experimentation, adaptation to state differences in circumstances, or other desirable results. The study should recommend modifications in the statutory framework if they are deemed appropriate.

A. *Standards for Classification*

Race, color, religion, sex, and national origin classification should be banned in all the personal lines of insurance.³⁹⁵ Both

392. For historical examples, see H. GRANT, *supra* note 181, at 60 (Wisconsin), 64 (Texas), 119 (Missouri); Works, *supra* note 20, at 479 n.75 (citing S. KIMBALL, *supra* note 119, at 171, 243, 273, 276, 284).

393. Grant provides a historical example with regard to the New York legislature. From 1900 to 1905, New York Life alone paid Andrew Hamilton more than \$475,000 "to act for the company in matters relating to taxation and legislation." H. GRANT, *supra* note 181, at 41. Sharp reports a million dollar advertising and direct mail campaign launched against the Hatfield-Packwood-Dingell bill. Sharp, *supra* note 166, at 234 & n.38.

394. This is particularly acute now that insurance companies are large multistate entities that are often part of even larger corporate conglomerates. Former Pennsylvania Insurance Commissioner Herbert Denenberg has commented that state regulators are "ill-equipped to keep up with the likes of Litton, Gulf & Western, and Teledyne." Denenberg, *supra* note 260, at 219.

395. See *supra* notes 93-102 and accompanying text.

the Hatfield-Packwood-Dingell³⁹⁶ and Metzenbaum bills³⁹⁷ would ban these classifications, although the Metzenbaum bill would do so only for automobile and property insurance. State insurance regulators should be required to approve all rating classifications used and the maximum that standard rates could be varied based on such classifications. In doing so, they should give substantial weight to, and make findings on, the following criteria:³⁹⁸

- A) the statistical power of the characteristic's prediction of loss;

396. See *supra* notes 59-62 and accompanying text.

397. See *supra* notes 104-08 and accompanying text.

398. The Metzenbaum bill proposed as criteria:

- (A) the compatibility of the use of the characteristic by which the grouping is defined with widely held social values;
- (B) the degree of incentive created by the use of such characteristic for the reduction and retention of losses by individual insureds;
- (C) the degree to which such characteristic is causally linked to likelihood of loss and controllable by individual insureds;
- (D) the accuracy of pricing which results for each individual insured so grouped;
- (E) the homogeneity with respect to potential for loss which results from the use of the grouping; and
- (F) the degree of statistical separation of the grouping of insureds from the remainder of the insured population which results from the use of the category.

S. 2474, *supra* note 104, at § 6(c)(2), 126 Cong. Rec. 6531 (1980).

My criterion A seeks to achieve some of the same ends as Metzenbaum's D criterion (accuracy of pricing for each insured), but Metzenbaum's wording suggests homogeneity as a criterion. Metzenbaum's criterion E specifically requires consideration for homogeneity. Because I wish to open the possibility of broader rather than narrower classifications, homogeneity has been rejected as a criterion. See Abraham, *supra* note 33, at 410-11, 417-19, arguing that separability is the proper statistical concern rather than homogeneity, which he terms a fairness consideration.

The wording of my B criterion, statistical separation, is identical to Metzenbaum's criterion F. See Abraham, *supra* note 33, at 410-11, regarding separability as a criterion for classification.

My criterion C refers to causality, as does Metzenbaum's criterion C. My wording is preferable because it recognizes that causation cannot be "known" while acknowledging the value of causation to perceived legitimacy.

My criterion D is similar to Metzenbaum's criterion B in emphasizing incentives to reduce the loss. "Reduction in number or cost of losses" has been substituted for "reduction and retention of losses."

My criterion E introduces controllability addressed by Metzenbaum in his criterion C. Criterion F is identical to Metzenbaum's criterion A. My G, alternatives available, introduces a value considered by Metzenbaum and suggested by this Article's analysis of the place of insurance in the society.

Other criteria with some similarities to this Article's criteria were developed in a Florida state study. See *Senate Oversight Hearings on Discrimination in Property and Casualty Ins.*, *supra* note 21, at 791; see also statement of criteria by the New Jersey Insurance Commission, *N.J. Overview*, *supra* note 127, at 1104, and the list of criteria developed by Commercial United Ins. Co., *Senate Hearings on S. 2204*, *supra* note 26, at 121.

- B) the degree of statistical separation of the grouping of insureds from the remainder of the insured population which results from the use of the category;³⁹⁹
- C) whether the characteristic's relation to loss can be supported by a persuasive causal explanation;
- D) the degree of incentive created by the use of such characteristic in rating for reduction in number or cost of losses;
- E) the degree to which the classification is controllable by individual insureds;
- F) the compatibility with widely held social values of the use of the characteristic by which the grouping is defined; and
- G) the alternatives to private insurance coverage that are available to potential insureds who cannot get this insurance.

State insurance regulators would be required to give weight to, and make written findings on, each of these criteria, but would be permitted to approve classifications for which there was little evidence, or even some negative evidence, on one or more criteria. The legislative history should make clear the recognition that regulators are to weigh values reflected by the criteria, and that these values often will be in conflict. The weighing process may result in approval of a classification that scores poorly in some regards with the weakness on one or more criteria reflected in a moderation of the rate differential for the classification rather than a ban on its use.

Criteria A and B retain statistical accuracy as a value but with a more precise statement of what is to be considered than "unfair discrimination" looking only to group average. Criterion C goes to causation as an important factor in the perceived legitimacy of classifications. Criteria D through G explicitly introduce values other than statistical accuracy into the process of approving classifications: incentives for loss control, controllability by the insured, compatibility with widely held social values, and coverage alternatives.

A number of terms in these criteria are open to varying interpretations. Determinations about persuasive causal explanation, widely held social values, and available alternatives all are likely to be hotly debated and to vary from state to state. Empirical evidence on how controllable are such characteristics as obesity

399. See Abraham, *supra* note 33, at 410-11.

and smoking may generate controversy. Whether not driving at all is an acceptable alternative to high insurance rates may depend on the age and locality of the potential drivers involved. The point of adoption of classification standards is to make criteria explicit and expose debate on them to the public.⁴⁰⁰

The Metzenbaum bill's restrictions on the use of classifications in underwriting and coverage decisions⁴⁰¹ also should be adopted and extended to all the personal lines of insurance. Under the bill, insurers could only cancel, fail to renew, or refuse to make a coverage available for: nonpayment, policyholder fraud, a suspended or revoked license in auto insurance, "uninsurability" of the insured, or if the state Commissioner determined that the insurer's capacity had been exhausted.⁴⁰² Insurers would be required to notify an insured or applicant of the reason for negative action.⁴⁰³ Insureds would be entitled to re-

400. Austin, *supra* note 11, at 558 and authority cited in n.257, questions whether values can be balanced when they are viewed as being subjective. There likely will be disagreement about a commissioner's assessment and weighing of the criteria. The recommended written statement of his reasoning should expose it for public debate.

401. S. 2474, *supra* note 104, § 6(b), 126 CONG. REC. at 6531. See *infra* notes 402-04 for provisions.

402. S. 2474, *supra* note 104, § 6(b)(1), 126 CONG. REC. at 6531 (emphasis added):

- (1) No insurer may *cancel, fail to renew* (at the policyholder's option), or refuse to make available to any applicant, in conformance with the same rates, rules, and terms applied to its other policyholders insured with comparable coverage, any included coverage which it generally provides, *except* for any of the following reasons or conditions:
 - (A) Nonpayment of premiums after reasonable notice.
 - (B) Fraud or material misrepresentation in the application for insurance or renewal thereof or in the filing of a claim.
 - (C) In the case of private passenger motor vehicle insurance, if the operator's license or motor vehicle registration of the applicant, named insured, or any other person covered under the application or policy is under suspension or revocation at the time of cancellation, nonrenewal, or application.
 - (D) If the applicant or insured is not an insurable risk.
 - (E) If the insurer which refuses coverage has been found by the commissioner of the State in which such refusal occurs to have exhausted its capital capacity to write any new policies providing included coverages and has been ordered not to write any such policies.

Although "uninsurability," § 6(b)(1)(D), is an imprecise and undefined term, the requirements for reasons and review should provide sufficient safeguards. See *infra* notes 403 & 404 and accompanying text.

403. S. 2474, *supra* note 104, § 6(b)(2)-(3), 126 CONG. REC. at 6531:

- (2) Any cancellation or non-renewal notice issued by an insurer shall state specifically and fully the reason or reasons for such cancellation or nonrenewal.
- (3) Any insurer which refuses to issue a policy providing any included coverage shall provide any applicant therefor with timely notice of the refusal to insure, including a specific and full statement of the reason or reasons for such refusal.

An additional phrase, "including the grounds for a determination of uninsurability,"

view of such decisions by a state official.⁴⁰⁴

One additional requirement should be added to the Metzbaum approach. Insurers should be required to develop written standards for uninsurability that must be on file with state insurance commissions and available to the public. Insurance commissioners should be given the authority to require changes in such standards. Otherwise, the uninsurability label could be used to subvert what otherwise might have been achieved by classification regulation.

B. Availability Study

Legislation should establish a national commission to design and take responsibility for an inventory of insurance availability at the time reform legislation is passed and two years after its implementation.⁴⁰⁵ This study should examine the availability of all important coverages in the personal lines of insurance. It should attempt to isolate the characteristics of people for whom rates are particularly high and for whom a specific coverage cannot be purchased at all.

The design of the commission, including such issues as membership, staffing, and funding, should reflect concern for at least three factors. First, adequate resources to design and institute a study of this scope must be provided. A number of studies of particular lines and classifications exist.⁴⁰⁶ These should be inventoried, a design for collecting information then must be devised, and steps must be taken to gather the data.

Second, cooperation between existing federal government agencies and the commission must be a concern. Much important data probably exists already within the government.

should be added to the end of § 6(b)(2)-(3) to make clear that the statement "applicant is uninsurable" is insufficient.

404. S. 2474, *supra* note 104, § 6(b)(4), 126 CONG. REC. at 6531:

(4) Any insured or applicant who receives notice of a refusal to insure, cancellation, or nonrenewal shall be entitled to review thereof by an appropriate State official.

This section should be amended to require the insurer to notify the insured of the right to such an appeal and the procedures to be followed along with the reasons for action required to be disclosed by § 6(b)(2)-(3). *See supra* note 403.

405. Some critics of Hatfield-Packwood-Dingell have predicted that availability problems will result from the elimination of sex classification. *See, e.g., House Hearings on H.R. 100, 98th Cong., supra* note 26, at 663-64 (statement of the Health Insurance Association of America). Such predictions should be tested.

406. For example, see authorities cited in *supra* note 21 and the study discussed in *Faulted on Health Care, supra* note 294.

Surveys that are routinely done by government agencies might be vehicles for gathering information.

Third, the commission should be designed to assure that its findings receive wide public exposure and attention at the highest levels of the executive and legislative branches of government. This is necessary to compel attention to availability gaps in insurance, whether these gaps should be closed, who should pay for broader coverage deemed desirable, and what mechanisms should be used to achieve this greater availability.

C. *Promoting Competition in the Insurance Market*

The Metzenbaum bill proposed shopping guides and readability standards for automobile and property insurance.⁴⁰⁷ Such guides and standards should be required for all the personal lines of insurance. Designing a format for disclosure in life insurance is more complex than for the other lines,⁴⁰⁸ but should be done. The adoption of a uniform system of disclosure akin to that required for credit by Truth-in-Lending⁴⁰⁹ should be considered. Such consumer information is designed to stimulate competition in price and services. Insurance regulators should also be required to compile statistics on consumer complaints about particular companies and their disposition of those complaints and make this information available to the public. Such information would allow consumers to take service better into account in making shopping decisions.

Consideration of reform legislation should include hearings on features of federal and state legislation that have been called anticompetitive. The Metzenbaum bill proposed repeal of McCarran-Ferguson antitrust immunity,⁴¹⁰ and hearings on such a repeal were held recently by a House Judiciary Subcommittee.⁴¹¹ Several features of state legislation should be considered for federal prohibition or modification. These include anti-rebate stat-

407. S. 2474, *supra* note 104, §§ 7, 9, 126 CONG. REC. at 6531. Former Pennsylvania Insurance Commissioner Herbert Denenberg has testified that "Shopper's Guides" published by that state "had more impact on the companies and the market than much of the more conventional regulatory action." *Senate Hearings on S. 2477, supra* note 26, at 133.

408. *See generally Cost Disclosure Hearings, supra* note 345.

409. 12 C.F.R. § 226 (1985).

410. S. 2474, *supra* note 104, § 3, 126 CONG. REC. at 6530.

411. *House Oversight Hearings, supra* note 10.

utes,⁴¹² fictitious group legislation,⁴¹³ and restrictions on sale of insurance through entities like banks.⁴¹⁴

CONCLUSION

Insurance classification has been the subject of much public debate. The traditional fair discriminators' perspective that additional government regulation of classification discretion would do violence to a venerable, fair system has little merit. The conclusion from the antidiscrimination perspective that race, color, religion, sex, and national origin classifications should be prohibited is a sound one but does not provide useful criteria for considering the use of other classifiers. The antidiscrimination perspective's domination of public debate and proposed reforms also obscures what should be a primary concern to the society: availability of the personal lines of insurance.

The classification debate should be viewed from two perspectives that have not received sufficient attention. These are the importance of insurance to Americans and the anticompetitive aspects of the insurance market. Given the importance of the needs that insurance meets and the public choice to meet those needs through private insurers, society should not cede to insurers' complete discretion in classifying people when the effect is to determine who can be covered and at what price. The federal government should establish appropriate criteria against which classifications are scrutinized. More important, society should examine the availability patterns that result from existing classification practices including changes that may occur in those patterns after prohibitions on the use of race, color, religion, sex, and national origin are put in place. This availability study and the publication of its results should be done in the manner most likely to require the public and their elected representatives to confront the issue of which gaps in availability will be tolerated and which should be closed by government action.

Procompetition rhetoric has been used to shield classification discretion from restriction. Uncritical acceptance of "competition not regulation" sloganeering ignores the special features of the insurance market and the way competition operates within it. Competition is valuable only insofar as it promotes lower prices, efficient service, innovation, and new or improved products and distribution methods. Restricting competition through

412. See *supra* notes 183-206 & 330-31 and accompanying text.

413. See *supra* note 335 and accompanying text.

414. See *supra* notes 333-34 and accompanying text.

classification should pressure insurers to compete in ways likely to achieve these ends. Regulators also should assure that consumers can get useful information about competing products. Legal barriers to competition should be scrutinized for possible repeal.

Insurance classification is a matter of great consequence to most Americans and to society generally. It is too important to be left to the actuaries.

