Jim's Perspective…

The Beginning of State Regulation of Insurance

In 1866 the Virginia legislature enacted two related statutes that figured prominently in the history of insurance regulation. The first prohibited a foreign (non-Virginia) insurance company from doing business in the state unless it first acquired a license. To acquire the license, it needed to deposit bonds of specific character with the State's treasurer. The second statute forbade an agent to act for a foreign insurance company without being licensed in Virginia as an agent. In what appears to be a "set-up test case," an agent named Samuel Paul applied for a license, and offered to comply with all of the state's requirements on behalf of some insurance companies and for himself, except for the requirement to deposit certain types of securities with the state. The state refused to issue Paul a license. Paul nevertheless obtained a policy for a client as the agent of a non-admitted New York insurance company. He was appointed as an agent for this New York insurance company in May, 1866. He was indicted, and was convicted of violation of the statute involving deposit of bonds, and was fined fifty dollars.

This case was appealed and eventually it was heard before the United States Supreme Court and an opinion was issued regarding proper regulation of insurance under United States law.[1] On appeal, Paul argued that the Virginia laws regulating insurance were in violation of the Commerce Clause of the United States Constitution which gives Congress the power to "regulate commerce with foreign nations, and among the several states and with Indian Tribes." Referring to that clause the Court said;

Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire. . . . These contracts are not articles of commerce in any proper meaning of the word. . . . Such contracts are not inter-state transactions, though the parties may be domiciled in different states. . . . They are, then, local transactions, and are governed by the local law.

State and federal court opinions subsequent to Paul v. Virginia regularly held that a transaction of insurance was not only not interstate commerce, but was not commerce at all. This odd understanding that insurance did not involve interstate commerce continued for over 70 years! This rule of law was finally reversed in the United States Supreme Court case of United States v. South-Eastern Underwriters, 322 U.S. 533 (1944). This case was brought by the Missouri Attorney General with assistance from the Antitrust Division of the U.S. Department of Justice. The indictment alleged that all the insurers in South-Eastern Underwriters were in violation of the The Sherman Act, which was a federal anti-trust law. The South-Eastern Underwriters can be described as a group of "cartelized fire insurers" doing business together in the southeast United States including the state of Missouri. All of the fire insurers in South-Eastern Underwriters worked together to plan and charge a set amount of rates used by all the insurers to provide fire insurance. South-Eastern Underwriters consisted of about 200 stock fire insurance companies. The Supreme Court decision simply found that "insurance was certainly commerce." The Court found that insurance was, therefore, fully subject to the reach of Congress. The Sherman Act applied to the South-Eastern Underwriters, and the indictment against this operation was upheld.

The dangers of such a revolutionary change to the regulation of insurance as a result of the Supreme Court holding insurers subject to the anti-trust provisions of the Sherman Act, led to Congressional

[1] Paul v. Virginia, 75 US 168 (1868).

passage of the McCarran-Ferguson Act in 1945. This Act essentially provided that states were to have regulatory power over insurance, and that federal intervention into the regulation of insurance was significantly limited. This regulatory process is set forth in the Act as follows:

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, or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance.* (emphasis added)

State regulation of insurance has been the primary and generally the only regulatory process of the insurance industry since passage of the McCarran-Ferguson Act. However, I did place the end of the above quoted material in italics because this language does give the federal government some authority to regulate insurance and thus, today, we have the Federal Insurance Office within the U.S. Department of the Treasury which was part of the Dodd-Frank Act passed July 21, 2010. I appreciate that most of you already are familiar with many of the regulatory characteristics of the insurance industry. I write about this regulatory process for a different purpose. My purpose with this discussion of insurance regulation is to determine who we should recognize as the creator of state regulation of insurance? Who deserves a “thank you” for establishing this state regulatory process? Well, it is an insurance agent! It is Samuel Paul, the Plaintiff in Paul v. Virginia. This agent pursued binding coverage on an insurance risk exposure by obtaining insurance coverage for the risk exposure from a company not licensed in Virginia and Mr. Paul also did this without an insurance agent license. I wonder if Mr. Paul was a member of the PIA? And so, I just want to express my appreciation for Mr. Paul and his actions to provide an insurance policy for his client in the 1860’s which initiated the birth of state regulation of insurance! Mr. Paul needs to be recognized for what he did to develop state regulation of insurance!

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