August 16, 2012

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

Daniel Benjamin Schwarcz

Available at: https://works.bepress.com/daniel_schwarcz/5/
Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection

Daniel Schwarcz†

Abstract: Consumer protection in most domains of financial regulation centers on transparency. Broadly construed, transparency involves making relevant information available to consumers as well as others who might act on their behalf, such as academics, journalists, newspapers, consumer organizations or other market watchdogs. By contrast, command and control regulation that affirmatively limits financial firms' products or pricing is relatively uncommon in financial regulation. This Article describes a remarkable inversion of this pattern: while state insurance regulation frequently employs aggressive command and control consumer protection regulation, it typically does little or nothing to promote transparent markets. Rather, state lawmakers routinely either completely ignore transparency-oriented reforms or implement them in a self-evidently flawed manner. This pattern represents a deep and unappreciated flaw in state insurance regulation. Although substantive rules may be necessary in many insurance markets, such regulation must be coupled with strong transparency-oriented strategies in order to promote consumer choice, harness market discipline, and ensure regulatory accountability.

† Associate Professor of Law, University of Minnesota Law School. Daniel Schwarcz (schwarcz@umn.edu). This Article originates out of testimony that the author gave to United States Senate Subcommittee on Securities, Insurance, and Investment. See Emerging Issues in Insurance Regulation Before the Senate Subcommittee on Securities, Insurance and Investment (2011) (statement of Daniel Schwarcz, Assoc. Professor, Univ. of Minn. Law Sch.) http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=32a9fa33-328f-4289-aedd-f95aef7e5d3. Thanks to Prentiss Cox, Erik Gerdeng, Claire Hill, Pat McCoy, Steven Schwarcz and Daniel Sokol for helpful comments and to Will Stancil, Catherine London, Erin Conway and Mike Gendall for excellent research assistance.
As the Global Financial Crisis illustrated, consumers of financial products face numerous risks that they may fail to appreciate fully.¹ Mitigating these risks is a central goal of much financial regulation, spanning banking, securities, and insurance.² Historically, lawmakers’ central strategy for accomplishing this has centered on market transparency.³ One domain of financial regulation, however, has consistently and repeatedly refused to embrace market transparency as a regulatory tool: state insurance regulation.⁴ In both property/casualty and life insurance – the two insurance arenas that are predominantly regulated by the states⁵ – state lawmakers have routinely resisted transparency-oriented consumer protections, even though analogous safeguards are common in federal financial regulation.⁶

State lawmakers’ resistance to market transparency plays out on two levels. First, state law does virtually nothing to empower insurance consumers to make informed decisions among competing carriers or products. For instance, in contrast to the carefully crafted disclosure forms that federal law mandates for lenders, most states do not require property/casualty carriers to provide consumers with

---

⁴ Market transparency should be distinguished from the transparency of regulatory processes. The latter issue is put to one side in this Article. See generally Daniel Schwarcz, Transparency and Contrarian Experts in Financial Regulation: A Brief Response to Professor Bradley, 1 AM. U. BUS. L. REV. 33 (2012) (discussing transparency in the processes of financial regulation).
⁵ By virtue of the McCarran Ferguson Act, states are the primary regulators of insurance markets when federal law does not expressly preempt this authority. Federal law has substantially preempted this authority in the health insurance sphere. Even before the ACA, federal law explicitly and substantially preempted state authority over health insurance markets through statutes like ERISA and HIPAA as well as programs like Medicare and Medicaid.
⁶ One other commentator has noted this pattern, at least with respect to the life insurance industry. See Joseph Belth, THE INSURANCE FORUM 82-83 (Aug 1994) (“Insurance regulation is based on nondisclosure of material information to policyowners and prospective policyowners; the theory is that they will be protected by the regulators. In contrast, securities regulation is based on disclosure of material information to investors and prospective investors; the theory is that they will protect themselves if they are given the important information.”). Additionally, Howell Jackson has also noted that state insurance regulation tends to make use of much more aggressive regulatory tools than other forms of financial regulation, a result that he attributes to the relative complexity of insurance. See Jackson, supra note 1. Jackson, however, does not argue that this represents a problem or that transparency is a necessary supplement to more aggressive forms of regulation.
summaries of key coverage terms, even though carriers’ policies vary substantially.7 Similarly, consumers have no regulator-supported tools to compare insurance prices on an apples-to-apples basis, such as the “APR” measure that provides standardized cost information in lending.8 Second, state insurance law sharply limits the public-availability of information that would allow sophisticated consumers, academics, journalists, consumer interest groups, and federal regulators to serve as market watchdogs. For example, in contrast to federal laws requiring the public posting of credit card contracts, insurance carriers’ policies are not generally publicly accessible.9 And unlike health insurers, who must publicly disclose claims information under federal health care reform, company-specific information on how often state-regulated insurers deny or delay claims is treated as confidential.10

Counter-intuitively, while state insurance regulation generally shuns transparency-oriented consumer protection, it often embraces aggressive substantive regulation. For instance, states frequently (though unevenly) restrict insurers’ pricing decisions,11 mandate specific policy provisions, require carriers to operate non-profitable policy lines,12 and insist on capital and reserve requirements that are based on uniquely conservative accounting standards.13 Indeed, this suite of regulatory approaches often leads observers to note that insurance is the most heavily regulated of all financial sectors.14

This inverted pattern of consumer protection regulation – aggressive command and control rules combined with limited market transparency – represents a deep failure in state insurance regulation. In at least some cases, such as state regulation designed to suppress “excessive” insurance rates, effective transparency-based

8 See infra Part III.D. APR stands for “annual percentage rate.” It is a measure of the aggregate costs of borrowing, which is standardized by regulations and allows those seeking credit to easily compare the cost of that credit across different companies and products.
9 See infra Part II.B. Schwarcz, supra note 7.
10 See Part II.A.
tools could more effectively achieve regulatory objectives at less cost than current substantive regulations. In most cases, though, market transparency is an essential complement to substantive regulation. It can allow sophisticated consumers, advocates, and journalists to police the marketplace in tandem with regulators, empower informed consumers to make better choices among competing products, promote better consumer usage of financial products, and prompt more effective enforcement of substantive regulatory tools. Against these benefits, transparency-based consumer protection schemes usually impose fewer costs on industry and consumers than substantive regulations.

Standing alone, this deep failure in state insurance regulation has broad implications. State insurance regulation is a massively important, if consistently under-appreciated, element of financial regulation. Property/casualty and life insurers annually collect about a trillion dollars in premiums and they are regulated by over 11,000 state bureaucrats who, in the aggregate, have an annual budget of over a billion dollars. Insurers themselves protect individuals and businesses against risk while playing an essential role in promoting savings and directing investment.

But the failings of state insurance regulation also have important implications for financial regulation more broadly. In recent years, the disclosure-based regime of federal financial regulation has come under attack given its failure in the Global Financial Crisis. In response, federal lawmakers have appropriately developed much stronger forms of consumer financial protection. The deficiencies of state insurance regulation offer an important lesson to federal regulators as they implement these new regulatory powers: while the effectiveness of transparency-oriented consumer protection is certainly limited in many cases, market transparency can and should be maintained alongside more aggressive regulatory

15 See National Association of Insurance Commissioners, Insurance Department Resources Report (2010).
17 See, e.g., McCoy & Engel, supra note 1.
18 These include specific rules governing the design or distribution of financial products, broad standards of conduct limiting “unfair” or “unreasonable” behavior; and bonding arrangements that insure consumers against certain financial risks. See generally Jackson, supra note 2.
tools in ways that are designed to supplement and support those tools.²⁰

This Article proceeds as follows. Part I provides an overview of transparency-oriented consumer protection, describing four tools that fall within this umbrella: mandatory summary disclosure, mandatory full disclosure, structuring markets and/or products, and financial literacy education. It argues that each of these tools can effectively combat certain regulatory problems when they are properly designed and deployed. It also argues that market transparency can be particularly important when it is used in tandem with more aggressive regulatory tools. Transparency-based tools can address market problems that are not amenable to other forms of regulation and promote more effective substantive regulation by holding regulators accountable for their implementation and enforcement efforts.

Parts II and III – the heart of the Article – then focus on transparency-oriented consumer protection in property/casualty and life/annuity insurance markets, respectively. In both cases, they show that state insurance regulation either completely foregoes transparency-oriented tools or relies on obviously inadequate such tools, at least when federal law has not demanded otherwise. At the same time, these Parts show that comparable forms of federal financial regulation in banking, securities, and health insurance domains employ much more effective and thoughtful strategies for promoting market transparency. And in all cases, these Parts argue that relatively simple transparency-oriented reforms could effectively complement and, in some cases completely replace, more aggressive forms of regulatory scrutiny.

²⁰To date, at least, federal regulators seem to have largely heeded this point: For instance, while the newly created Consumer Financial Protection Bureau enjoys broad regulatory authority, much of its initial efforts have focused on producing better consumer disclosures of mortgages and student loans while increasing the information available to market watchdogs. Thomas P. Brown, Disclosure – An Unappreciated Tool in the CFPB’s Arsenal, 8 BERKELEY BUS. L.J. 209 (2011). Similarly, in addition to its various rules governing permissible policy terms and pricing, the Affordable Care Act requires the development of better summary disclosures, the establishment of exchanges, and the mandatory publication of claim-payment information. See Karen Pollitz & Larry Levitt, Health Insurance Transparency Under the Affordable Care Act, Notes on Health Insurance, March 8, 2012, http://healthreform.kff.org/notes-on-health-insurance-and-reform/2012/march/health-insurance-transparency-under-the-affordable-care-act.aspx; KENNE TH S. ABRAHAM & DANIEL SCHWARCZ, HEALTHCARE SUPPLEMENT TO ABRAHAM’S INSURANCE LAW AND REGULATION 32 (5th ed. 2010).
Part IV concludes by attempting to understand why state insurance regulation has so consistently failed to develop transparency-oriented consumer protection. Although numerous factors seem to contribute to this result, it concludes that the problem is indeed amenable to a practical solution. In particular, it suggests that states are likely to respond if federal officials, and particularly the new Federal Insurance Office ("FIO"), demand that they promote transparent insurance markets and back up that demand with a credible threat of federal preemption.

I. The Tools and Value of Transparency-Oriented Consumer Financial Protection

Broadly construed, transparency-based consumer protection encompasses regulatory interventions meant to increase awareness of relevant market information among consumers and investors, or those who might police the market on their behalf, such as regulators, academics, stakeholders, public interest groups, or journalists. Transparency-oriented regulation can address at least four types of regulatory concerns in financial markets. First, it can improve consumers' understanding of the products they ultimately purchase, and thus their capacity to use those products effectively. Second, it can promote better matching of consumers with appropriate financial products. Third, transparency can promote market discipline by ensuring that firms will be penalized through decreased demand for their products or increased public scrutiny if they attempt to increase their bottom line in ways that harm consumers. Finally, market transparency can promote regulatory

---

21 See Dodd-Frank Wall Street Reform and Consumer Protection Act, Sec. 502(a), § 313(a), 124 Stat.1580 (codified at 31 U.S.C.A. § 313(a)).
23 Transparency arguably may serve non-instrumental goals as well. This issue is put to one side here.
24 See Schwarcz, supra note 7, at 1337-38. Improved product matching can be understood to result from transparency's ability to reduce search costs. See, e.g., Paula J. Dalley, The Use and Misuse of Disclosure as a Regulatory System, 34 Fla. S. U. L. Rev. 1089, 1108-09 (2007) ("Disclosure requirements can improve the efficiency of a market by increasing the information available to market participants and reducing search costs. . . . [D]isclosure provides market participants with the information they need to make rational decisions, as opposed to following the herd.").
discipline by facilitating the public’s ability to identify problems in regulated markets and hold regulators accountable for failing to prevent those problems.\textsuperscript{26}

Unfortunately, effectively promoting transparent consumer financial markets is not easy. Just as this Part lays out four benefits of market discipline, it also describes four regulatory tools for promoting market discipline: mandatory summary disclosure, mandatory full disclosure, structuring markets and products, and consumer financial literacy education. There is no easy one-to-one correspondence between the four transparency-based regulatory tools and the four values of transparency that are described herein. For instance, while full disclosure can be quite effective at promoting market and regulatory discipline, it does not tend to promote better matching of consumers with products or better consumer usage of financial products. Financial literacy, on the other hand, has the opposite set of potential benefits. Only one strategy – mandatory summary disclosure – can promote all four values of transparency. In any event, none of the regulatory tools can achieve the benefits of market transparency unless they are properly designed and implemented.

\textbf{A. Mandatory Summary Disclosure}

The central regulatory tool for promoting transparent consumer markets is mandatory summary disclosure. Such disclosure is “often required at the point of purchase” and

\begin{footnotesize}
\begin{enumerate}
\item 1387, 1389 (1983); see also Sage, supra note 22, at 1778-79 (“[G]overnments may rely on data collection and reporting requirements to incentivize performance on measures deemed to be socially important. . . . [G]reater information processing capacity . . . has increased governmental interest in using performance-based disclosure requirements to achieve . . . goals regarding access, cost, and quality.”).
\item 26 See Jon S. Hanson & Duncan R. Farney, Life Insurance Companies: Their Promotion and Regulation, 49 MARQ. L. REV. 175, 311-312 (1965) (“Thus, the information is filed with the insurance commissioner rather than furnished to the policyholder. But this does not mean that the policyholder should not be entitled to information comparable to that furnished to a securities holder. The proposition that an individual must rely solely on a government regulatory body without the opportunity to act on his own behalf has received little, if any, acceptance.”) Some scholars have made a parallel argument: that disclosure allows the wider public to monitor the results of governmental policy and regulatory choices. Once informed, the public can more effectively set priorities through democratic decisionmaking. See, e.g., Sage, supra note 22, at 1807 (“[M]ailing forty million senior citizens information explaining their options under the new Medicare+Choice program may be an unintentional test of the deliberative value of information. . . . Medicare beneficiaries are not merely consumers of . . . products, they are a powerful political constituency. The information they receive about the new program will affect their political views as well as their market preferences . . . .”).
\end{enumerate}
\end{footnotesize}
“highlight(s) the most relevant information in order to increase the likelihood that people will see it, understand it, and act in accordance with what they have learned.”27 Most frequently, this information concerns product attributes, such as fee schedules, penalty terms, or other contract provisions.28 But it can also concern various other relevant pieces of information, such as expected consumer use patterns,29 the obligations and incentives of the seller/intermediary, consumer risks, or the non-contractual rights and responsibilities of the purchaser. The variety of information that can be included in a mandatory summary disclosure makes it a remarkably versatile regulatory tool: it can promote consumer comparison-shopping, encourage effective consumer usage of a product, or warn consumers of dangers associated with particular purchasing strategies.

Although mandatory summary disclosure is indeed a versatile regulatory tool, it has historically been over-used and poorly-designed.30 Because of the breadth of information that can be included in a summary disclosure, lawmakers have often embraced such disclosure as a cure-all for virtually any regulatory problem, ranging from inefficient product design to intermediaries’ conflicts of interest to the sale of unsuitable products to particular consumers.31 And at least before the last several years, the specific design and implementation of such disclosure rules has been largely ignored.32 Take together, these two trends have resulted in a steady stream of ineffective summary disclosures that have failed to achieve desired regulatory objectives and, in many cases, postponed the implementation of more effective consumer protections.33

Despite these historical failings, mandatory summary disclosure can be effective when it is used in appropriate

28 Ben Shahar & Schneider, supra note 19.
30 See generally Ben Shahar & Schneider, supra note 19.
31 A number of explanations have been advanced for the proliferation of disclosure regimes, including their low cost to regulators, the seeming ease of implementation, and the perception that greater disclosure can only help consumers. See id. at 682-83.
33 See id.
circumstances and well-designed to achieve specific regulatory goals. Settings conducive to mandatory summary disclosure must meet several basic conditions. Perhaps most obviously, consumers must systematically make suboptimal choices because they lack relevant information or guidance. Of course, there are various situations where regulatory problems arise for other reasons, such as behavioral biases or negative externalities. Consumer must also be both (i) capable of understanding and appreciating the information to be provided in the disclosure and (ii) willing to read it. This may prove difficult when the relevant information is inherently complex or consumers lack basic knowledge necessary to meaningfully use the disclosed information. It also may prove difficult when the consumer does not believe the disclosure contains relevant information. Finally, consumers armed with the information provided in the disclosure must have the will and capacity to change their behavior. In some cases, the underlying product or market context may make this impossible because there is no plausible adjustment in behavior for the consumer to make or the disclosure cannot be provided at the appropriate time to impact behavior.

Even when mandatory summary disclosure is potentially appropriate, its effectiveness depends substantially on its design and implementation. Three basic principles are essential to designing effective mandatory summary disclosures. First, they must employ a layered disclosure approach that focuses consumers' attention on a

---

36 Lynn Quincy, Making Health Insurance Cost-Sharing Clear to Consumers: Challenges in Implementing Health Reform’s Insurance Disclosure Requirements (2011), available at http://www.commonwealthfund.org/~/media/Files/Publications/Issue%20Brief /2011/Feb/1480_Quincy_making_hlt_ins_costsharing_clear_consumers_ib.pdf. Although this problem may be overcome when consumers can be provided basic consumer education as a component of or a companion to disclosure, such consumer education may not always be practical.
37 See, e.g., Sage, *supra* note 22, at 1731-36 ("Limitations on consumer response to information should also temper optimism about the usefulness of disclosure . . . . [H]ealth care consumers are often constrained in the choices they can make, no matter how much information they possess.").
38 Sunstein, *supra* note 27 ("There is a difference between making a merely technical disclosure – that is, making information available somewhere and in some form, regardless of its usefulness – and actually informing choices. Well-designed disclosure policies are preceded by a careful analysis of their likely effects.").
small number of key pieces of information while facilitating access to more complete information.\(^{39}\) The reason is simple: most consumers can or will only process a small amount of information on a disclosure.\(^{40}\) Disclosures can overcome this limitation by combining various pieces of relevant information into a simple rating or ranking. For instance, letter grades (i.e., A, B, or C) on the cleanliness of restaurants have proven quite effective in impacting consumer behavior and improving restaurant health sanitation.\(^{41}\) Similarly, APRs combine all of the costs associated with borrowing in a single number that lenders must disclose to consumers. Another potentially effective approach is to embed product use disclosures within product attribute disclosure. Mandatory disclosures regarding automobile fuel efficiency, cigarette nicotine and tar levels, and nutritional information for food all fit this description, as each discloses product information to consumers based on specific assumptions about the ways in which the underlying products will be used.\(^{42}\) Importantly, the effectiveness of these approaches to simplifying information depends on consumers understanding what the underlying metrics mean or, at the very least, how to compare them to determine which is “better.”\(^{43}\) There is evidence, for instance, that many consumers not only do not understand what the


\(^{42}\) Bar-Gill & Ferrari, supra note 29. These assumptions are typically based on the behavior of “average consumers.” But an alternative strategy is to construct product disclosures that embed use-pattern information assuming a “worst-case” scenario. See id. This, for instance, is the strategy that federal regulation takes for credit card companies, which are now required to disclose to consumers the total amount of interest that will be paid if consumers only pay the monthly minimum amount on their balance.

\(^{43}\) Quincy, supra note 36; Sunstein, supra note 30 (“If the scales are unclear or poorly designed, people may have a difficult time knowing what to make of the information; they might fail to incorporate it into their choices or draw the wrong conclusions.”).
APR represents, but do not even understand whether a higher or a lower APR is better.\textsuperscript{44}

Second, in order to be effective, mandatory summary disclosures should be centrally designed by regulators, but incorporate fields to be populated by individual firms based on relevant product and/or consumer characteristics. By contrast, mandatory summary disclosures are unlikely to be effective if regulators merely specify or limit the content to be communicated, leaving the precise language and design up to individual companies. When firms are required to use a centrally drafted disclosure template, consumers have an incentive to invest in learning how to use these disclosures effectively because such learning can be applied across companies and time. Thus, most consumers can quickly and easily use the information disclosed in nutrition labels because their content and design are consistent across all food products. Importantly, consistency across companies in disclosure design also facilitates comparison-shopping: it allows consumers to compare metrics that are calculated in the same way and located in identical places in the relevant form. Moreover, it focuses consumer attention on important pieces of information that may not be sufficiently emphasized by those who are selling the underlying financial products.

Centralized design of summary disclosure templates also promotes effective consumer testing of mandatory summary disclosure. Empirical testing of disclosure templates, both in the initial design stages and in the assessment of prototype disclosures, is vital to ensuring that consumers actually understand and can act on summary disclosures.\textsuperscript{45} Untested disclosures often prove ineffective because the experts who draft them are uniquely unsuited to determine what is comprehensible to ordinary consumers.\textsuperscript{46} For

\textsuperscript{44} See, e.g., Jeff Sovern, Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers, 71 OHIO ST. LJ. 761 (2010).
\textsuperscript{45} See Kennedy et al., supra note 32. Such testing should include qualitative testing regarding disclosure design in the early stages of disclosure development as well as the use of quantitative studies to test the effectiveness of prototype disclosures.
\textsuperscript{46} See, e.g., Carl E. Schneider & Mark A. Haw, The Patient Life: Can Consumers Direct Health Care?, 35 AM. J. L. & MED. 7, 42 (2009) ("[T]wo-thirds of the privacy disclosure forms academic medical centers used "were written beyond the 12th grade reading level, and almost the entire sample (90%) fell in the difficult range of reading ease." A similar study of hospitals found the forms "beyond the reading capacity of the majority of American adults."); White and Mansfield, Literacy and Contract, 13 STAN. L. & POL’Y REV. 233, 240-41 (2002) ("Judge Posner opined that a ‘careful reader’ could perform these tasks, but that not all persons are capable of being careful readers. . . . In fact, the [NALS literacy level] that Judge Posner
these reasons, consumer testing has become a central feature in federal agencies’ efforts to draft effective disclosures. Yet such testing is practically impossible when firms are left free to draft their own disclosures. Consumer testing in such settings would require individual firms to conduct their own testing of their own disclosure documents. This would not only result in massive inefficiencies as a result of duplicative testing, but would also make it extremely difficult to ensure an adequate amount of quality testing or disclosure redesign based on that testing.

Third, the effectiveness of summary disclosures is crucially dependent on them being provided to consumers at the appropriate time. Disclosures intended to promote comparison-shopping must be provided before the consumer has emotionally committed to a purchase or spent a substantial amount of time and energy learning about or applying for a product. Consumers who have made a psychological commitment to a purchase may well ignore information that creates cognitive dissonance – the uncomfortable feeling created by holding conflicting ideas. Additionally, regulators should avoid entrusting the provision of disclosures solely to individuals who have financial incentives to undermine the essential message of that disclosure. Finally, they should avoid requiring mandatory summary disclosures to be provided at a time when it will be overwhelmed by other disclosures. To accomplish this, regulators should not only specify the time frames within which disclosures should be provided, but also limit or prohibit additional disclosures to be provided to consumers at that time.

B. Mandatory Full Disclosure

appears to attribute to a broad, undefined group, is within the reach of less than 10% of the American adult population.”).

47 See Sunstein, supra note 27 (“To the extent feasible and when existing knowledge is inadequate, agencies should consider several alternative methods of disclosure and test them before imposing a disclosure requirement.”); FEDERAL TRADE COMMISSION, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007).

48 Sunstein, supra note 27 (“Agencies should attempt to offer the information that users need when they need it. . . . [T]hey should take steps to provide people with relevant information when they are actually making the decision or taking the action in question.”). C.f., Lauren E. Willis, Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price, 65 MD. L. REV. 707, 749-50 (2002) (describing the HOEPA mortgage disclosures, which are designed to facilitate comparison shopping, and are only provided after the opportunity to comparison shop has passed).


50 Ben Shahar & Schneider, supra note 19.
Full disclosure seeks to provide complete public access to a broad set of potentially relevant market and product information. Such disclosure is generally provided through online tools. Unlike mandatory summary disclosure, the primary audience for full disclosure is not ordinary consumers, who will infrequently access these resources and generally be unable to make use of them even when they do. Instead, the intended audience for full disclosure includes consumer-oriented magazines and journalists, consumer advocates, academics, sophisticated consumers, and government actors without direct access to the underlying information.51 Examples of full disclosure strategies include the securities offering statements and periodic securities disclosures under the 1933 and 1934 Act, the Home Mortgage Disclosure Act, which requires most lenders to collect and make publicly available information regarding loan applications, and the Credit Card Act, which requires credit card companies to make copies of their contracts available in a centralized online repository.

Mandatory full disclosure can increase market discipline by facilitating the ability of market intermediaries to scrutinize relevant data and independently assess product quality and appropriateness for specific segments of the population.52 Market intermediaries, in turn, can inform the public of their findings, leading consumers to adjust their shopping behavior accordingly.53 This can decrease consumer demand for the firm’s products and have broader, and harder to quantify, reputational effects on the firm. These effects

51 See Cass Sunstein, *Empirically Informed Regulation*, 78 U. Chi. L. Rev. 1349, 1384-85 (2012) (“Other disclosure requirements are not specifically directed to consumers or end users at all. They promote public understanding of existing problems by informing people about current practices . . . . [P]ublic attention can help promote behavior that fits with statutory purposes.”); see also Goshen & Parchomovsky, *supra* note 22 (arguing that the primary beneficiaries of detailed mandatory disclosures in the securities context are “information brokers” such as financial analysts).


may be significantly enhanced in recent years by social media, which decreases the costs to market intermediaries of communicating with consumers, and enhances the capacity of consumers to communicate with one another. Indeed, the mere threat of these effects may have a substantial disciplining effect on firms, deterring them from imposing new fees or hidden unfair terms. At the same time, when the underlying data or information is sufficiently complex, it may be that even broad disclosure of this information will not have any disciplining effects.54

Although the capacity of market intermediaries armed with full information to police private firms is obviously both varied and limited, there are numerous important recent examples of this process operating effectively. Legal scholars have often focused on this in the context of unfair or deceptive contract terms. Thus, in the software context, journalists have warned consumers about over-reaching contract terms in the online contracts of specific companies that would invade consumers’ privacy interests.55 Consumer Reports has written articles surveying contract terms in extended warranties for cars.56 Facebook were forced to change the terms of their online contracts in response to consumer protests over privacy-related issues.57 And bloggers have alleged that terms and conditions in specific cell phone companies’ contracts are unfair.58


55 See Larry Magid, It Pays to Read License Agreements, PC PitStop, http://www.pcpitstop.com.spycheck/eula.asp (last visited Aug. 14, 2009), (discussing the licensing agreement that accompanies Gain Publishing’s eWallet software, which authorizes the collection of data about a consumer’s reading behavior, TV interests, and communication partners, effectively allowing the company to “follow [the transferee] around”).


But the power of full disclosure extends to various other regulatory issues as well. For instance, when the CFPB recently created an online database of consumer complaints for credit card companies, various media outlets reported on these complaints, noting that Capital One has the highest number of consumer complaints. And when Bank of America’s customers learned that the bank planned to charge a fee for debit cards, online protest was so swift that the bank quickly reversed course.

A related, but distinct, value of mandatory full disclosure is that it promotes regulatory accountability. Market intermediaries with access to relevant data not only have the ability to convey information about product/service quality and appropriateness to consumers, but they also have the capacity to identify consumer protection problems in need of a regulatory solution. Once they have done so, they are often well-equipped to promote such scrutiny. For instance, numerous studies using HMDA data have helped to identify discriminatory lending practices and prompted various initiatives to make credit more available in traditionally under-served areas. Similarly, a recent report by the PEW Health Group reviewed online credit card contracts in an effort to demonstrate that unfair terms were still common and to influence the implementation of the Card Act. And in California, the public availability of health

59 Alwyn Scott & Rick Rothacker, Consumer Bureau Discloses Credit-Card Complaints, CHI. TRIB., June 19, 2012. (“Making credit card complaints public will put added pressure on banks to avoid unfair practices and help consumers make more informed financial decisions,” said Pamela Banks, senior policy counsel for Consumers Union, in a statement.)
64 PEW HEALTH GROUP, STILL WAITING: “UNFAIR OR DECEPTIVE” CREDIT CARD PRACTICES CONTINUE AS AMERICANS WAIT FOR NEW REFORMS TO TAKE EFFECT, available at
insurers’ claims denial data allowed the California Nurses’ Association to call attention to the fact that the states’ six largest insurers rejected nearly one out of every five claims they received during the first half of 2009.65 This effort, in turn, prompted the state attorney general to open an investigation into the claims payment practices of the state’s largest insurers.66

C. Structuring Markets and/or Products

A third regulatory tool for promoting transparent consumer markets is for regulators to structure either the market itself or the products sold in the market to create clearer choices for consumers. This approach is principally aimed at improving consumer comparison-shopping and thus encouraging market disciplining and improved matching of consumers and financial products. The central example of this approach is an exchange.67 Exchanges operate as a centralized marketplace, wherein private firms sell their products to consumers according to pre-specified rules that are designed to facilitate consumer choice. Such exchanges can be operated by government agencies, non-profit entities, or even private companies. The most prominent examples are the health insurance exchanges that health care reform requires to be operational in every state by 2014.68

Aside from simply reducing consumer search costs by aggregating relevant information in a single place, exchanges can use various tools to promote transparency. For instance, they can group competing products according to a single objective metric, such as actuarial value. They can allow consumers to sort plans according to features such as deductibles, copays, or whether a particular doctor is in network. They can provide a “seal of approval” function by ensuring that products within the exchange meet certain standards. And they can require standardization of certain product features. Exchanges can also function as automated “recommender systems” that match consumers with a small number of products based on


67 Exchanges can perform various functions in addition to transparency, depending on how they are set up. See generally Jon Kingsdale, Health Insurance Exchanges — Key Link in a Better-Value Chain, 362 NEW ENG. J. MED. 2147 (2010).

their specific needs and preferences. Available empirical evidence suggests that exchanges can be quite effective at promoting transparent markets, particularly when they create a standardized array of product features.

Product standardization outside of an exchange is an alternative approach to promoting transparent consumer markets. Standardization need not result in a one-size-fits-all model: for instance, Medigap insurance policies must fit one of eleven benefit designs that are specified in regulations. However, such standardization tends to be much more effective at promoting competition when it limits the dimensions along which products can vary. Product standardization can promote transparency by reducing reading costs for consumers: rather than familiarizing themselves with numerous different product types, consumers need only learn the basic details of a few different options. Moreover, product standardization facilitates learning from friends and family by creating a common set of choices.

Although product standardization can be quite effective at promoting transparency, in doing so it inevitably limits consumer choice and creates the risk of stifling efficient innovation. Alternative forms of product-structuring can limit this risk. For instance, lawmakers can set mandatory minimum floors for products, which allows for innovation above the minimum floor. This strategy helps promote transparency by assuring consumers of certain protections and allowing them to focus their shopping on the extent to which an offered product exceeds the minimum standard. An alternative, and even less intrusive, strategy, is for lawmakers to require firms to

---

72 SUSAN WOODWARD, URBAN INSTITUTE, A STUDY OF CLOSING COSTS FOR FHA MORTGAGES (2008), available at http://www.urban.org/publications/411682.html, shows that encouraging comparison heightens competition and improves consumer outcomes only in markets where the alternatives differ on a single dimension.
74 See Schwarcz, supra note 7.
offer a standardized set of default products, but then to allow firms to opt-out of that default if they receive affirmative consumer approval.75 This approach operates as an information-forcing penalty default rule76 by putting the onus on firms to effectively explain how any non-standardized products they offer depart from the standardized option. It can be strengthened by affording sales of default options with greater legal protections than sales of non-default options.77 Finally, it may be possible to design recommender systems outside of the context of an exchange. For instance, Vanguard operates a program that recommends mutual funds based on the user's answers to a few simple questions, and a similar tool is in development to recommend mortgages to consumers.78

D. Financial Literacy Education

Another form of transparency-oriented consumer protection is financial literacy education. This can be defined as “education about financial concepts undertaken with the explicit purpose of increasing knowledge and the skills, confidence, and motivation to use it.”79 Such education is designed to empower individual consumers to make responsible financial decisions by equipping them with a core amount of financial information as well as with the skills necessary to analyze individual financial products. It is generally provided prior to the point of purchase through classroom teaching, informational websites, and brochures or guides. Such education can be coordinated and developed by financial regulators, financial firms, individual schools, or financial advisors.

The evidence regarding the effectiveness of financial literacy education is mixed.80 Many studies report that such education has

75 See Lauren Willis, Slippery Defaults (describing such a default program in the context of overdraft protection, but arguing that it has only been partially successful because banks have made it so easy to opt out of the default).
77 See Michael Barr, Sendhil Mullainathan, & Eldar Shafir, Behaviorally Informed Financial Services Regulation (2008) (suggesting that lenders be required to offer plain vanilla products, but also permitted to offer more complex products, though with less protection against judicial intrusion); Daniel Schwarcz, Regulating Consumer Demand in Insurance Markets, 3 ERASMUS L. REV. 23 (2010); see also Jill E. Fisch, Rethinking the Regulation of Securities Intermediaries, 158 U. PA. L. REV. 1961 (2010) (suggesting a “conform or explain” approach to retail investment products).
little or no effect on consumers’ capacity to make informed financial decisions.\textsuperscript{81} But many studies report the opposite finding, showing that financial literacy education can indeed improve outcomes. While these studies are subject to methodological flaws, such as self-selection bias and data collection techniques that tend to be biased towards favorable outcomes,\textsuperscript{82} they also cannot be entirely dismissed.

The best interpretation of the extant evidence on financial literacy education is that is can indeed have a small, but positive, effects when it is provided “just in time.”\textsuperscript{83} Indeed, in some sense a mandatory summary disclosure is a form of “just in time” and highly context specific consumer financial literacy education. Just in time financial education is able to positively impact consumer decision-making because individuals do not face very substantial memory-related barriers to using the education, and the financial literacy education is targeted at a specific, and important, transaction.\textsuperscript{84}

II. Inadequacy of Transparency Regulation in Property/Casualty Insurance

This Part describes five major regulatory issues in property/casualty insurance market: (i) prompt and accurate payment of claims; (ii) provision of coverage consistent with consumers’ reasonable expectations; (iii) availability of insurance products for low-income and minority populations; (iv) objectivity of independent insurance agents; and (v) affordability of coverage. In each case, it demonstrates that state insurance regulation either completely foregoes transparency-oriented regulatory tools or relies on obviously inadequate such tools. And, in each case, it shows that relatively simple reforms could substantially improve regulation designed to address the underlying concern.\textsuperscript{85} Finally, it shows that


\textsuperscript{82} Willis, supra note 80.


\textsuperscript{85} To be clear, none of this means that transparency-oriented reforms could or should replace alternative regulatory strategies. Rather, the claim is that transparency reforms would, at relatively little cost, substantially enhance existing regulatory approaches to combating core insurance regulatory problems. Yet these
financial regulation in other spheres has often adopted much more effective and targeted disclosure-oriented strategies when faced with analogous problems. In advancing this final claim, this Part frequently looks to consumer banking issues – particularly mortgages, credit cards, and student loans – which raise some similar regulatory issues to property/casualty insurance. It also uses federal regulation of health insurance markets as a foil, demonstrating the remarkable disconnect between this federally-dominated form of insurance regulation and state-based regulation of property/casualty insurance.

A. Prompt and Accurate Claims Payment

One of the fundamental risks of property/casualty insurance is the prospect of insurer opportunism in the payment of claims. This risk arises because insurance policies are sequential and contingent: whereas the policyholder performs routinely by paying premiums, the insurer performs by paying a claim if, and only if, a covered loss occurs. Moreover, the complexity and abstractness of typical property/casualty insurance policies means that it is often unclear whether a loss is indeed covered. Insurers who are inclined to take advantage of these facts can deny or delay payment knowing that policyholders may fail to challenge coverage denials or be eager to settle because they have an immediate need for funds.

For these reasons, protecting insurance consumers from unfair or delayed claims resolutions is a central goal of insurance law and regulation. Every state has enacted broad laws protecting consumers from opportunistic claims handling, typically using the National Association of Insurance Commissioner’s (NAIC) Unfair Claims Settlement Practices Act as a template. The NAIC is a

approaches are consistently ignored in favor of more intrusive, and often less effective, regulatory strategies.

89 2 N.A.I.C. MODEL UNFAIR CLAIMS SETTLEMENT PRACTICES ACT (1980). These laws are enforced through generalized market conduct examinations as well as targeted investigations prompted by market conduct data or consumer complaints. See generally Kathleen Heald Ettlenger et al., State Insurance Regulation 103 (1st ed. 1995).
voluntary association of state insurance regulators that wields tremendous influence in insurance regulation through various mechanisms, including the drafting of model laws and regulations. In addition to insurance regulation, a central concern of insurance law doctrines, particularly rules governing bad faith, is preventing insurers from unreasonably refusing to pay claims or delaying claims payments.

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

The public unavailability of this or similar data is largely attributable to industry resistance. In 2008, the Market Conduct and Consumer Affairs Committee of the NAIC proposed publicly disclosing some of this data. Organizing through numerous trade

---

94 To be sure, there are multiple problems with MCAS data despite these safeguards. However, no data is perfect, and the data are evidently reliable enough that regulators use them to guide their market conduct priorities. In any event, insurance regulators would indeed be well served by collecting better and more fine-grained data. In particular, state insurance regulators should move towards collecting transaction-level data of insurance transactions, rather than summary data such as the MCAS. See NAIC, Recommendations to the NAIC Market Analysis Procedures Working Group For Market Conduct Annual Statement Long Term Care Insurance Data Collection (April 2, 2012), available at http://naic.org/documents/committees_d_mapwg_comments_mcas_ltc_consumer_representatives.pdf.
groups, the industry successfully undermined the proposal through a massive lobbying campaign. Their primary argument was that the underlying data should be considered confidential because it could reveal proprietary information. Formal NAIC minutes regarding the issue indicate that the NAIC agreed to spend a year to “determine whether, and to what extent, the data collected would be confidential or be available to the public.” However, since that time is has been assumed by virtually the entire regulatory community that MCAS data is confidential, and the issue has never, in fact, been revisited.

Although the NAIC does not make available any insurer-specific market conduct data, it recently began publicly releasing aggregate industry MCAS data for individual states. The data reveals that there are very substantial variations among individual carriers with respect to various data elements. For instance, in Ohio, the average homeowner carrier in 2009 closed approximately 21% of claims without payment. But approximately 20% of the 150 reporting carriers closed more than 30% of claims without payment, including 4 carriers that closed more than half of their policyholders’ claims without payment. Similarly, in Kansas, approximately 19% of claims associated with private automobile insurance were not paid within 60 days of being reported. But for approximately 20% of the 120 reporting carriers, more than 30% of claims took more than 60 days to pay, with one carrier reporting 80% of its claims took more than 60 days to pay, and another carrier reporting 60% of its claims fell within this category. Unfortunately, consumers in these states have no ability to tell which insurers fall in which categories and to adjust their purchasing behavior accordingly.


97 NAIC Proceedings, Joint Executive Committee, Plenary, 3rd quarter, 2008 (September 24, 2008).


99 KANSAS MCAS RESULTS (on file with author).
Consumer complaint information – the only information that state insurance regulators make available to consumers that has any bearing on claims-paying reliability – does very little to ameliorate these concerns. Most states, as well as the NAIC, make consumer complaint information available on their websites, though insurers need not disclose this information directly to consumers.100 And the majority of such complaints do indeed concern claims handling.101

However, this data is generally limited and inconsistent. Most aggrieved consumers never complain to their insurance department. And the rate at which consumers do complain is based on numerous different factors, including the willingness of companies to direct unsatisfied consumers to their insurance departments or the average affluence of policyholders, which tends to correlate with willingness to complain. MCAS claims data are not subject to any of these limitations.

Even apart from these limitations in the underlying data, state regulators currently report consumer complaint data in a manner that substantially limits its meaning. First, consumer complaints in many states and at the NAIC are only reported if they are “confirmed.”102 They are not deemed confirmed when they involve “questions of fact, law, or contract provisions,” insufficient information is available, or the consumer does not request a specific action. 103 Among all complaints reported to the NAIC, approximately 73% are unconfirmed and thus never publicly reported.104 Second, consumer complaints are reported by individual insurance company rather than by the insurance “groups” with which consumers are familiar, such as “Allstate” and “State Farm.”105 As a result, a consumer interested in the complaint ratio

100 According to 2010 resources report, only six states do not make this data publicly available. This data is collected by individual states, and then reported and aggregated by the NAIC, which maintains an online tool allowing users to generate various complaint ratios for individual consumers. CIS.
101 Schwarcz, supra note 88, at 751.
102 See Consumer Information Source, NAIC, https://eapps.naic.org/cis/. (defining a confirmed complaint as one in which the company violated state law, federal law that the department has the authority to enforce, or a term in its policy).
103 Id.
104 Notably, in using complaint information to identify market problems, regulators themselves look at both total complaints and confirmed complaints. Email from tim mullen. See Consumer Information Source, NAIC, https://eapps.naic.org/cis/.
105 Insurance “groups” include all insurers within the same corporate family. Typically the publicly known name of a company is the group name. For instance, Allstate and State Farm are both insurance groups. Each insurance group typically has numerous insurance companies, each licensed to do business in a different state. Even within a state, an insurance group may have multiple insurance companies (for example, Allstate Indemnity Company, Allstate Insurance Company, and Allstate Property and Casualty Company).
for a specific insurance group, such as “Allstate,” would be directed to potentially dozens of different insurance companies, all of which have different complaint numbers. Unless the searcher (i) was already a policyholder and had been assigned a specific insurance company, and (ii) understood the distinction between insurance groups and companies, this information would prove largely worthless.

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

Similarly, the Consumer Financial Protection Bureau’s (CFPB) database on consumer complaints for credit cards reveals the inadequacies of state consumer complaint reporting. In that database, consumer complaint information is reported by the brand names of credit card companies, rather than by company subsidiaries or product types. Moreover, complaints are included in the database regardless of whether any law or contract term may have been

---

106 California has collected data on health insurer claims denials since 2002. See CAL. HEALTH & SAFETY § 1367.03(f)(2) (2012). In 2010, the Connecticut legislature approved a bill mandating the reporting of certain health insurance claims denial data. See Substitute House Bill No. 5303, Public Act No. 10-19, § 38a-478c(6) (effective July 1, 2010).
108 Insurers participating in state insurance exchanges will be required to publicly disclose “[c]laims payment policies and practices . . . [d]ata on the number of claims that are denied . . . [and] [o]ther information as determined appropriate by the Secretary.” Patient Protection and Affordable Care Act, § 10104(f)(2).
109 Id.
violated, leaving it to the "marketplace of ideas" to determine what the data show.\textsuperscript{111} As the CFPB notes, "[s]o long as consumers are aware of the limitations of the data, there is little or no reason to believe that complaint data should make the market less informed and transparent."\textsuperscript{112}

If insurance regulators invested time and resources in publicly releasing quality, carrier-specific, data regarding different carriers' claims payment, their regulatory efforts would be much more efficient and effective. The public release of this information would provide much needed market discipline to insurers' claims paying practices. Currently, such discipline is limited, as carriers' public information about carriers' claims-paying practices is based entirely on anecdote and highly imperfect consumer surveys.\textsuperscript{113} More transparency could also substantially improve current regulation of insurers' claims handling practices.\textsuperscript{114} Empowering the public to better assess different carriers' claims paying practices – either through more useable publicly available information or even perhaps through mandatory summary disclosure of such information – would also improve the matching of consumers with carriers, by allowing independent insurance agents and consumer magazines to more accurately direct consumers to carriers with a desired mix of claims service and price.\textsuperscript{115} Finally, such information might help generate pressure on regulators to police outliers more directly through targeted market conduct exams.\textsuperscript{116}

B. Coverage Consistent with Consumers' Reasonable Expectations

A core concern of insurance law and regulation is that consumers' actual coverage matches their reasonable expectations of that coverage. On the regulatory side, states require that carriers’ policies comply with various specific coverage mandates. They also typically require that carriers’ policies not be "unfair, ambiguous,

\textsuperscript{111} However, the CFPB does maintain significant controls to authenticate complaints. \textit{See} Disclosure of Certain Credit Card Complaint Data, 77 Fed. Reg. 37,561.

\textsuperscript{112} \textit{See} Disclosure of Certain Credit Card Complaint Data, 77 Fed. Reg. 37,562.


\textsuperscript{114} \textit{See} Schwarcz, \textit{supra} note 88.

\textsuperscript{115} Schwarcz, \textit{supra} note 96.

\textsuperscript{116} Some, but not all, states do make market conduct exams of particular companies publicly available. However, accessing these reports is quite difficult, as there is no centralized place where they are located. More importantly, a substantial number of market conduct reports are not released because they are sealed pursuant to settlement between regulators and companies. This means that the exams that are released represent a biased and incomplete sample.
unreasonable, or contrary to public policy.” In most states, enforcement of these rules occurs through “prior approval” form review, meaning that the relevant insurance regulator must specifically approve that carriers’ policy documents comply with state law before they are used in the market place. Judicial doctrines also serve to promote consumers’ reasonable expectations of coverage. Indeed, one of the most controversial doctrines of insurance law is specifically designed to validate consumers’ objectively reasonable expectations of coverage notwithstanding policy language tending to negate those expectations.

Despite the centrality of ensuring that coverage matches consumers’ reasonable expectations, state insurance law and regulation does remarkably little to promote consumers’ understanding of coverage. Perhaps most strikingly, no state requires any type of summary disclosure regarding the terms of coverage to be delivered to consumers prior to, or at the time of, purchase. And the vast majority of states do not require any form of summary disclosure of policy terms at any time, including at the time of policy delivery, which is usually 2 to 3 weeks after purchase. NAIC model

120 In Colorado, insurers issuing policies of dwelling fire insurance, homeowners insurance or auto insurance must have on file for public inspection a summary disclosure form that contains a simple explanation of the major coverages and exclusions of its policies, as well as a recitation of general factors considered in cancellation, nonrenewal and increase in premium situations. C.R.S.A. § 10-4-111(1).
121 Several states require insurers to disclose at the time of policy delivery that the policy contains certain exclusions, such as for damages caused by flood or earthquake. See Code Del. Regs. 702 5 (flood); Miss. Admin. Code 19-1-2006-2:5 (flood or earthquake); N.J. Admin. Code 11:1-5.5 (flood); N.Y. Ins. Law § 3444 (mudslide or flood). The Delaware regulation also requires insurers the following disclosures: that a homeowners policy may not cover the full cost of replacement without depreciation of the property, disclosure of any limitations in the policy regarding reimbursement of items stolen, disclosure of any formal practice followed by the insurer regarding non-renewal of the policy on occurrence of certain factors on the basis of claims asserted by the policyholder, and disclosure of information regarding any required deductibles, including a description of what a deductible is, a full description of the circumstances that will trigger applicability of each deductible and a description and example(s) of how each deductible will be calculated. Mississippi also has a Homeowner Insurance Policy Bill of Rights, which requires insurers to provide an outline of coverage and comprehensive policy checklist to the policyholder prior to, with, or “shortly thereafter” issuance of the
rules or laws also do not require any form of summary coverage disclosure.\textsuperscript{122}

Instead, in the vast majority of states, the only description of coverage that insurers are required to provide to consumers is the insurance contract itself, which is typically a 20-40 page document that includes various amendatory endorsements. To be sure, most states do require policies to meet a specific quantitative readability score, usually a 50 or 40 on the Flesch-Kincaid Reading Ease Score.\textsuperscript{123}

The outline of coverage must provide a brief description of the type of coverage provided in the policy, amount of coverage, and whether the coverage is replacement cost or actual cash value, as well as a summary statement of the principal exclusions and limitations or reductions contained in the policy, and any other limitations or reductions. The outline must include a "comprehensive policy checklist," addressing whether the principal premises and other structures as well as personal property/contents are protected against fire, lightning, explosion, wind and hail, flood, earthquake, collapse, mold and theft. The checklist must also disclose whether the policy provides coverage for debris removal, loss assessment, additional living expenses, personal liability coverage, medical payments coverage, named windstorm deductible or building ordinance or law coverage. See Miss. Admin. Code 19-1-2007-1:5. Alaska requires at the time of policy delivery that if an auto insurance policy does not include mandated liability coverage, the insurer must disclose that fact in bold face type. Alaska Stat. § 21.36.465. Several states mandate some summary disclosures pertaining to rental car insurance. In Kentucky, rental vehicle insurance may not be sold unless certain disclosures are made in writing and included with the rental vehicle agreement. The disclosures must include a clear and concise description of the material terms and conditions of the coverage, including a description of exclusions and a statement that the coverage offered may be duplicative of coverage already provided by the renter's personal automobile insurance policy. See Ky. Rev. Stat. Ann. § 304.9-509. In Maine, comprehensive personal auto insurance must cover rental vehicles, and that fact must be disclosed to consumers in a notice accompanying the policy at the time of issuance. See Me. Rev. Stat. tit. 24-A, § 2927. Many states do require event disclosures whereby policy terms must be disclosed upon the occurrence of a certain event, such as a policy claim. See, e.g., R.I. Code R. 11 5 73 ("An Insurer shall fully disclose to its Insured all pertinent benefits, coverages, or other provisions of a Policy under which a claim has been presented.").

\textsuperscript{122} One exception applies when insurance is sold through an employer or affinity group, something which is very uncommon in the property/casualty context. NAIC Model Laws, Regulations and Guidelines 710-2, § 10 ("Every insurer, agent or broker selling insurance pursuant to a mass marketing plan shall, prior to sale, make full and fair disclosure to prospective insureds of all features of such plan, whether favorable or unfavorable, including but not limited to premium rates, benefits, duration of coverage, policyholder services, conversion privileges available, and the financial interests in the plan, if any, of the sponsoring employer, association, organization or the group.").

\textsuperscript{123} See Testimony of Professor Brenda Cude before the NAIC Readability Committee (Mar 2010); Edward B. Fry, The Varied Uses of Readability Measures Today, 30 J. READING 338, 340 (1987) ("The insurance industry is also a prominent user of readability formulas. As of March 1984, 28 U.S. states required that personal auto and home-owners' policies must have a Flesch Reading Ease Score between 40 and 50, or about a 10th grade level.").
Additionally, they often require that the policies contain a table of contents, “self-contained and independent” sections, be written in no less than 10 point font, and “use everyday, conversational language.” Generally consumers have the right to cancel coverage at any time and to receive a refund of their unused premiums.

However, these rules are inadequate at promoting real consumer understanding of policy coverage. First, the delivery of policy documents several weeks after purchase substantially undermines the realistic ability and incentive of consumers to read their policies. Most consumers will have trouble recalling and making use of the basic insurance knowledge and terminology they learned in making the initial purchase several weeks earlier. And they will have little affirmative reason to overcome this obstacle: they already made their purchase decision and switching carriers after purchase is difficult and costly. For all these reasons, it is hardly surprising that insurance consumers virtually never take advantage of “free look” periods. Second, even motivated consumers are ill-equipped to comprehend the meaning of typical property/casualty policies, which are, in many ways, uniquely impenetrable. Flesch-Kincaid and other readability requirements do little to remedy this problem. Not only are required score well above the reading level of most Americans, but these scores do not reflect the length of the underlying document, its organization or formatting, or the extent to which words are put together in logical and clear sentences.

These inadequacies are only partially mitigated by the various buyers’ guides and consumer advisories that regulators produce. The NAIC maintains and makes publicly available an extensive array of consumer financial education on insurance, including buyers’

126 See Schwarcz, supra note 88; Korobkin, supra note at 1226.
127 See Avery Katz, Your Terms or Mine? The Duty to Read the Fine Prints in Contracts, 21 RAND J. ECON. 518 (1990).
128 See Schwarcz, supra note 7. See generally Michelle E. Boardman, Allure of Ambiguous Boilerplate, 104 MICH. L. REV. 1105, 1107 (2006) (quoting a recent South Carolina Supreme Court decision as stating that “[a]mbiguity and incomprehensibility seem to be the favorite tools of the insurance trade in drafting policies”).
129 See Public Hearing on Insurance Contract Readability Standards before the NAIC Consumer Connections Working Group (Mar 2010) (testimony of Daniel Schwarcz) (on file with author); Testimony of Professor Brenda Cude before the NAIC Readability Committee (Mar 2010); Testimony of Amy Bach, Executive Director of United Policyholders before the NAIC Readability Committee (Mar 2010) (on file with author).
guides that describe coverage in generic terms and provide some useful background and helpful questions to ask insurance agents. Unfortunately, these informational resources suffer from two serious flaws. First, not only are these materials not provided “just in time,” but most consumers never actually see them at all: insurers and agents are not usually required to make these documents available to consumers in property/casualty markets, and they are instead buried away on frequently hard-to-find links on state insurance department websites. Second, with remarkably few exceptions, these materials are completely generic: they provide consumers with absolutely no carrier- or consumer-specific guidance. In many cases, consumers would be better off simply Google-searching the relevant coverage line than reading the relevant buyers’ guide.

The collective inadequacy of these regulatory efforts is put into sharp relief when they are compared to federal efforts to inform consumers about the key terms of complex financial contracts. For instance, consider the Consumer Financial Protection Bureau’s (CFPB) summary disclosure form for mortgages. This document is a three-page disclosure that is standardized across the industry in format, design, and information, but that is personalized to the borrower’s particular loan. It provides the most important information on the first page, it is written using simple and accessible words, and it is provided to consumers before they agree to the terms of a mortgage – within three days of loan application. The document itself has been tested extensively with consumers, through focus groups, consumer surveys, and the broad solicitation of consumer feedback online.

Perhaps an even more compelling comparison that reveals the inadequacies of property/casualty disclosure rules is provided by the Affordable Care Act’s disclosure regime for health insurance policies.

---

130 It also runs a website, “InsureU,” that aims to educate consumers about various insurance issues. In addition to these efforts, various states also maintain generic descriptions of different insurance lines of coverage on their websites and in informational brochures.

131 See Part I.D, supra.

132 The one exception is that one state, Texas, maintains a very good online tool that provides consumers with summary information regarding the content of individual carriers’ homeowners policies.

133 See Consumer Financial Protection Bureau, Integrated Mortgage Disclosures under Real Estate Settlement Procedures Act (Reg X) and Truth In Lending Act (Reg Z), available at Know Before You Owe, Consumer Financial Protection Bureau, http://www.consumerfinance.gov/knowbeforeyouowe.

134 See id.

135 Kennedy et al., supra note 32.
ACA required HHS, in consultation with the NAIC, to develop a uniform “summary of benefits and coverage” that would not exceed four pages, utilize uniform definitions, and provide consumers with a broad description of key coverage terms, cost-sharing requirements, and exclusions.136 State regulators, operating through the NAIC pursuant to a federal legislative command and under the need to prove itself to federal regulators, did an admirable job of developing such a document.137 The document was subjected to extensive consumer testing, and repeatedly refined in response to the results of that testing.138 As a result, it clearly communicates the central terms of a health insurance policy in a standardized format with which consumers will become increasingly familiar and that will tend to facilitate comparison-shopping and market discipline. Starting in September 2012, all health insurers will be required to use this form in disclosing the terms of their coverage to consumers.139

An analogous document for property/casualty insurance policies could easily be devised. It would likely focus consumers' attention on key exclusions for which supplemental coverage could be purchased as well as on the coverage limit, which generally must be sufficient to rebuild in the event of a total loss.140 It would highlight whether claims are paid out on the basis of ACV or replacement. And it might also focus consumers’ attention on exclusions that are intended to reduce moral hazard -- the risk that policyholders will take insufficient care because they are insured.141 Additionally, an effective disclosure would convey, in summary form, a metric of the extent to which the underlying policy was more or less generous than the presumptive industry baseline, the relevant ISO policy.142 Except in the increasingly rare instances when consumers purchase coverage over the phone, this summary

139 KENNETH S. ABRAHAM & DANIEL SCHWARCZ, HEALTHCARE SUPPLEMENT TO ABRAHAM’S INSURANCE LAW AND REGULATION 32 (5th ed. 2010).
141 See Schwarcz, supra note 88;
142 See id.
Disclosure would be provided to consumers well before the purchase of the underlying coverage and made available online.\textsuperscript{143}

Such a summary disclosure form could promote a number of vital regulatory goals. First, it would encourage market discipline by penalizing firms that decrease coverage to consumers in ways that are not reflected in their prices. Second, it would produce better matching of consumers with insurance providers by allowing consumers to intelligently select among the price/coverage combinations that are offered in the marketplace. Third, it would promote effective usage of insurance by limiting the risk of moral hazard: while many insurance contract exclusions are aimed at losses that are particularly likely to be the product of insufficient care, these provisions are only effective if policyholders are aware of them.\textsuperscript{144} If these clauses fail to reduce moral hazard risk, but simply shift this risk on to policyholders, they produce two independent social costs: they fail to efficiently minimize costs and they allocate those costs to the comparatively risk-averse party.

Not only does state insurance regulation fail to promote effective summary disclosure to consumers, but it also fails to promote full disclosure as well.\textsuperscript{145} It is currently incredibly difficult for motivated consumers, interested academics, consumer advocates, and inquiring news outlets to acquire copies of different property/casualty insurers' policy documents.\textsuperscript{146} Almost no insurers make these documents publicly available online, nor are they required to do so.\textsuperscript{147} Nor do state insurance regulators systematically maintain copies of different carriers' policies. The copies states happen to have on file generally must be accessed either through a freedom-of-information request or by physically visiting the regulator, locating the relevant documents, and photocopying them.\textsuperscript{148} And even with respect to the small handful of states that facilitate online access to regulatory filings, actually using

\textsuperscript{143} The two dominant ways that consumers purchase coverage is over the Internet or in person, with an agent. In either case, there is simply no technical barrier whatsoever to requiring consumers to be provided with relevant disclosure material prior to purchase. Over-the-phone sales present a more complicated case, and so exceptions to pre-sale disclosure requirements may be appropriate in this context. [can we find info on how frequently sales occur on internet, over phone, and through live agent]

\textsuperscript{144} See Schwarcz, supra note 88;

\textsuperscript{145} See Part I.B, supra.

\textsuperscript{146} See generally Schwarcz, supra note 7.

\textsuperscript{147} Exceptions include Washington, Florida (P and C), Indiana (Health and life), California, and Pennsylvania.

\textsuperscript{148} See Comments of NAIC Representatives Regarding Leveraging SERFF In Support of Public Access to Product Filings, available at www.naic.org
these tools to retrieve available policy forms takes many hours of effort as well as substantial technical expertise.149

Once again, these inadequacies contrast sharply with analogous efforts at transparency in the federal sphere. For instance, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) requires credit card issuers to publish on the Internet their cardholder contracts.150 These contracts are easily searchable on a single website that is specifically designed for ease of use.151 Similarly, ACA requires that all health insurance policies be made publicly available on the Internet, along with information about a carrier’s list of network providers and drug formularies.152

C. Availability of Insurance Products for Low-Income and Minority Populations

A major regulatory goal in the homeowners insurance arena is to ensure the availability of such coverage. The reason is simple: homeowners insurance is a practical pre-requisite for homeownership, because lenders require as a condition of a mortgage that borrowers purchase and maintain such coverage. As one court succinctly put it: “No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable.”153 This concern gained substantial attention several decades ago, because various insurers “redlined” low-income and minority geographic areas and refused to sell coverage in these areas.154 Available evidence suggests that homeowners insurance continues to be systematically more expensive and less available in certain low-income, urban areas.155 Even in the absence of discriminatory intent, facially neutral insurance practices producing these results may violate the Fair Housing Act if they have a disparate impact on protected groups and a less discriminatory alternative is available.156

149 See Schwarcz, supra note 88;
150 Credit CARD Act § 204, 15 USC § 1632.
151 See Credit CARD Act § 204, 15 USC § 1632.
152 Patient Protection and Affordable Care Act § 1303.
153 Cartwright v. American Savings & Loan Ass’n, 880 F.2d 912 (7th Cir.1989).
According to a recent report, similar availability problems are common for automobile insurance. In particular, facially neutral rating criteria – including credit score, education, and occupation – systematically make comparable insurance more expensive for low-income individuals than their wealthier counterparts. Moreover, coverage is often much less available in low-income regions because of the absence of insurance agents. And in some cases, carriers simply refuse to sell coverage to low-income drivers in certain geographic regions. These findings raise distinct regulatory issues: the unavailability of automobile insurance often means that low-income individuals cannot commute to work, locate new job opportunities, or easily acquire needed goods at affordable prices. Moreover, they result in a more substantial population of uninsured drivers, which jeopardizes larger state goals of reasonable compensation for accident victims.

Despite these concerns, state insurance regulation has actively resisted making publicly available any information regarding the availability and affordability of insurance in low-income and minority regions. Only four states require insurers to disclose any information regarding the availability of homeowners insurance in specific geographic regions, and no state makes publicly available geographic-specific loss or pricing data for individual insurers. Similarly, the National Association of Insurance Commissioners has no model laws or regulations requiring the collection and dissemination of such data, and has repeatedly ignored or rebuffed advocates’ efforts to promote such data collection and dissemination. Systematic data is also lacking in the automobile insurance realm. With the exception of a few states, particularly California, state laws and regulations do not require the collection or dissemination of data regarding the availability of automobile insurance to low income and minority populations.

---

159 Squires, supra note 155.
160 See id.
161 See NAIC Auto Insurance Work Plan, available at http://naic.org/documents/committees_c_d_auto_insurance_study_group_120605_draft_work_plan.pdf. This might include data regarding average premium, normalized for coverage differences, by geographic areas sorted by income level.
Improved transparency about the extent of availability and affordability problems would serve to increase regulatory accountability for these issues. Currently, much of the evidence on these issues is anecdotal and non-systematic precisely because of the lack of relevant information. Academics, public interest groups, and journalists have been unable to systematically document these problems or propose specific solutions. This has allowed regulators and lawmakers to avoid public pressure to do anything about the underlying problems, to the extent they exist in the first place.

Once again, the inadequacy of these efforts is put into sharp relief when they are compared with federal efforts to promote transparency in analogous domains. The Home Mortgage Disclosure Act (HMDA) requires most lenders to report and make publicly available geo-coded information regarding home loans, loan applications, interest rates, and the race, gender, and income of loan applicants.\textsuperscript{162} As noted above, HMDA has promoted richer understanding of credit availability and discrimination, helped identify discriminatory lending practices, and prompted various initiatives to make credit more available in traditionally underserved areas.\textsuperscript{163} In addition, the Community Reinvestment Act (CRA) subjects banks and thrifts to a federal examination of their record of lending to low- and moderate-income communities. The public section of those exam reports makes the findings and the institutions’ CRA ratings public.\textsuperscript{164}

In this instance, the inadequacy of state insurance regulation in promoting transparency proved sufficiently clear that federal lawmakers recently intervened. The Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a new "Federal Insurance Office" and specifically charged it with "monitor[ing] the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance."\textsuperscript{165} To do so, FIO can "receive and collect data and information on and from the insurance industry and insurers" and "analyze and disseminate [this] data and information."\textsuperscript{166} In other words, only after state insurance law repeatedly refused to make HMDA-like data for homeowners or automobile insurance publicly available did federal

\textsuperscript{163} See, e.g., sources cited supra note 63.
\textsuperscript{165} Sec. 502(a), § 313(a), 124 Stat. at 1580 (codified at 31 U.S.C.A. § 313(a)).
\textsuperscript{166} See id.
lawmakers step in and insist on this level of transparency, which has long been a core framework of federal housing policy.

D. Objectivity of Independent Insurance Agents

The vast majority of property/casualty policyholders purchase their coverage through an insurance agent. Although the majority of these agents are captive, and can only write coverage with a single carrier, a substantial percentage are independent, meaning they can write coverage with multiple different carriers.\(^{167}\) These agents actively promote their independence to consumers, emphasizing that it better allows them to find a policy and company that matches consumers’ needs and preferences.\(^{168}\)

Despite these assurances, most independent insurance agents have financial incentives to steer policyholders to particular carriers. The reason is that independent agents typically receive different amounts of compensation for placing consumers with different carriers. Often this is a result of “contingent commissions,” which are essentially year-end bonuses to agents based on the volume and/or profitability of the business sent to the insurer. Alternatively, some carriers may simply pay higher upfront “premium” commissions. Either way, differential compensation of agents creates obvious incentives for agents to place customers with particular carriers who may not always be optimal for the individual consumer.\(^{169}\)

These issues have prompted substantial regulatory scrutiny in recent years. High-profile investigations by the New York Attorney General revealed that Marsh & McClellan, the leading commercial insurance broker, systematically steered its sophisticated clients to more expensive coverage, at times even orchestrating phony bids from carriers to maximize it contingent compensation.\(^{170}\) Not surprisingly, evidence suggests that similar steering (though not bid-rigging) occurred at smaller independent insurance agencies as well.\(^{171}\) The reason for these concerns is obvious: insurance agent steering undermines market discipline by focusing insurers’ competition on wooing insurance agents rather than on providing


\(^{168}\) Schwarcz, supra note 96.

\(^{169}\) See id.


value to consumers.\textsuperscript{172} It also undermines the matching of consumers with products that best suit their needs.\textsuperscript{173}

Despite these concerns, state insurance regulators have consistently refused to promote transparency with respect to the compensation and incentives of ostensibly independent insurance agents. Most states do not currently have any rules or regulations regarding the disclosure of agent compensation. Those that do typically do not require any such disclosure unless the agent received compensation from the customer, which is highly atypical in most consumer transactions.\textsuperscript{174} Only a single state, New York, requires that agents in ordinary consumer transactions disclose prior to sale that “the compensation paid to the insurance producer may vary depending on a number of factors, including (if applicable) the insurance contract and the insurer that the purchaser selects, the volume of business the producer provides to the insurer or the profitability of the insurance contracts that the producer provides to the insurer.”\textsuperscript{175} Notably, this seemingly limited rule prompted massive outcry and resistance from the industry, including a lawsuit claiming that the rule was not within the Insurance Commissioner’s authority.\textsuperscript{176} No state curtails the ability of agents to promote their “independence” to consumers when they have financial incentives to steer consumers to particular carriers.

To be sure, disclosure of agents’ potential conflicts of interests is a limited solution that likely would not substantially solve the underlying problem of biased advice from independent insurance agents.\textsuperscript{177} But it is also substantially better than doing nothing at all, the current result in every single state other than New York.\textsuperscript{178}

\textsuperscript{174} Fitzpatrick, supra note 170.
\textsuperscript{175} N.Y. Comp. Codes R. & Regs. tit. 11, § 30.3
\textsuperscript{177} I have argued before and continue to believe that the regulatory problems created by contingent commissions are particularly resistant to disclosure-based responses. See Schwarcz, supra note 96; Schwarcz, supra note 173. At the same time, though, effective disclosure-based responses in this domain are clearly better than the status quo, wherein ostensibly independent insurance agents market themselves to consumers as trusted, independent advisors while operating under strong incentives to steer customers to particular carriers.
\textsuperscript{178} But cf. JANIS PAPALARDO, FEDERAL TRADE COMMISSION, THE EFFECT OF MORTGAGE BROKER COMPENSATION DISCLOSURES ON CONSUMERS AND COMPETITION: A CONTROLLED
Disclosure of this conflict of interest might create market pressures for independent agents to abandon differential compensation. Alternatively, it might force independent agents to better explain why they are encouraging consumers to secure coverage from a particular carrier, especially when agents' coverage recommendations align with their financial advice.

For these reasons, analogous conflicts of interest in other financial settings must be disclosed to consumers under federal law, at least where they are allowed to persist at all. For instance, until the Dodd Frank Act banned the payment of Yield Spread Premiums to Mortgage Originators, the Truth in Lending Act required U.S. mortgage brokers to disclose Yield Spread Premiums, as well as all other forms of compensation, to borrowers within three days of the borrower's initial application as well as the time of closing. Like differential compensation to insurance agents, yield-spread premiums created incentives for brokers to steer mortgage applicants to costly loans. Similarly, the Securities Exchange Act of 1934 requires investment managers to disclose any side-payments that they receive from brokerage firms. As above, these side-payments create risks that investment managers will select brokerage firms that are not in their clients' best interests because of their receipt of side-payments.

E. Affordable Insurance Rates

A major goal of state regulation of property/casualty insurance is to promote the affordability and fairness of insurance rates. Indeed, most states regulate homeowner and automobile insurance rates. 

---

180 Fitzpatrick, supra note 170.
181 Dodd Frank prohibits "any yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal)." 15 U.S.C. § 1639b (c)(4)(a).
185 See Jackson, supra note 183
insurers to ensure that their premiums are not “excessive,” although the intensity of this regulation varies significantly by states.186 Some states require that all carriers acquire pre-approval from the Department before they change their rates, others review carriers’ rate changes after they are implemented, and some states do not affirmatively review premium rates at all.187

As with much else in insurance law and regulation, though, state insurance law has largely ignored transparency-oriented tools to deal with the problem of excessive rates. Commentators and observers disagree substantially about the extent to which this risk exists in most consumer property/casualty markets.188 In fact, there is substantial evidence that unregulated competition among carriers is the best mechanism to keep rates, in the aggregate, low.189 In large part, this is because most state insurance regulation designed to keep rates from being excessive ends up back-firing, resulting either in insurer exit from the state or in sharp cycles of excessive and inadequate rates.190

However, to the extent that a principled defense of regulation to prevent excessive rates can be made, it is this: insurers’ actual rates are substantially opaque, for two reasons. First, carriers’ actual coverage varies substantially in ways that are impossible for consumers to observe,191 and so the rate per “unit of coverage” that any carrier charges is also difficult for consumers to observe. Second, even the nominal rate of coverage is quite costly for consumers to obtain: unlike many products, the price that a carrier charges depends substantially on the particularities of the policyholder.192 This means that insurers cannot advertise a single price and that, in order to obtain an accurate price quotation, consumers must engage

186 See generally David Cummins, supra note 14.
187 See id. States also intensely regulate unfair discrimination in insurance markets: to varying degrees, they limit the capacity of carriers to discriminate among policyholders on the basis of race, ethnicity, national origin, gender, age, credit score, sexual orientation, zip code, and others. See Avraham et al., supra note 11. However, the question of unfair discrimination is probably not susceptible to an effective transparency-oriented regulatory approach.
190 See id.
191 Schwarcz, supra note 96.
192 Such risk-based pricing is also a feature of many credit products.
in a time-consuming process of applying for coverage. Such risk-based pricing also may allow carriers to discriminate in the prices they charge to different customers, charging more to consumers who tend not to comparison shop, such as long-time policyholders.\(^\text{193}\)

State insurance regulators could meaningfully address these concerns using various transparency-oriented tools, many of which are used in other contexts and would be likely to be more effective than existing regulatory efforts to suppress excessive prices. First, and most aggressively, they could require carriers to sell standardized products to facilitate consumer comparison-shopping, allowing consumers to compare coverage on an “apples to apples” basis.\(^\text{194}\) Indeed, this is the approach that the federal government insisted on with respect to the sale of Medigap policies.\(^\text{195}\) Admittedly, this strategy is relatively intrusive. But states could also adopt less aggressive versions of this approach, such as requiring that all initial pricing of coverage take place on a standardized form, but thereafter allowing carriers to offer their own personalized adjustments.\(^\text{196}\)

A second pricing-transparency approach would be for state insurance law to mimic the approach of the ACA, which facilitates consumer comparison shopping on price by sorting insurance plans according to a single, universal metric: actuarial value.\(^\text{197}\) Consumers who purchase coverage on an exchange in 2014 will be able to comparison shop among plans within pre-specified actuarial values (such as gold, silver, and bronze).\(^\text{198}\) State insurance regulators could relatively easily establish similar metrics for property/casualty policies by developing pricing measures that embed within them

---

\(^\text{193}\) For instance, a recent study raises the possibility that carriers may systematically over-charge long-time policyholders, a possibility that is consistent with discriminating against those who fail to comparison shop. See office of Public Insurance Council, Not Shopping for Insurance Can Lead to Overcharges, available at http://www.opic.state.tx.us/news-and-publications/news-and-articles/255-not-shopping-for-insurance-can-lead-to-overcharges. See OPIC Study finding that insurers charge more to loyal customers.
\(^\text{194}\) See Part I.C., supra.
\(^\text{195}\) See Thomas Rice & Kathleen Thomas, Evaluating the New Medigap Standardization Regulations, 11 Health Aff. 194 (1992).
\(^\text{196}\) See Part I.C., supra.
\(^\text{198}\) See id.
presumed product use patterns, and thus control for variations in coverage.\textsuperscript{199}

Third, state insurance regulators could improve pricing transparency by better regulating commercial websites that purport to provide consumers with multiple premium quotations. Currently, various commercial websites claim to provide consumers with the capacity to enter personal information and receive insurance quotes\textsuperscript{200}. However, the vast majority of these websites function as “lead generators” -- rather than providing premium information, they generate unwanted solicitations from insurance producers\textsuperscript{201}. A relatively easy and effective step for promoting price competition would be for state insurance regulators to prohibit insurance companies from advertising or soliciting business on premium comparison websites unless those websites operate in the way they are advertised -- generating immediate premium quotes from multiple carriers. An alternative approach would be for states to provide this type of premium comparison information directly to consumers, in the form of a regulator-provided premium comparison guide. However, given the difficulties with keeping such a tool up to date and having it incorporate most rating factors, this approach is unlikely to be effective\textsuperscript{202}.

Fourth, insurance regulators could require carriers to better disclose to consumers the rating factors they use in their underwriting practice and the relative weight they place on those factors\textsuperscript{203}. Doing this would allow consumers to narrow down their search to companies that are more likely to offer a particular consumer affordable rates. For instance, a consumer who drives many miles but maintains an excellent credit score could target companies that place high reliance on credit score and limited reliance on miles driven. Currently, it is virtually impossible for consumers to get any sense of the rating factors that different companies use, much less the relative weight that different companies place on those\textsuperscript{204}.

\textsuperscript{199} See Part I.A., \textit{supra}.


\textsuperscript{201} See id.

\textsuperscript{202} According to a recent survey of state insurance offices, only three states maintain this type of premium comparison tool. See id.

\textsuperscript{203} See comments of Center for Economic Justice, Comments on Best Practices for Developing a Premium Comparison Guide (proposing such a disclosure and explaining in detail how it might work).

\textsuperscript{204} See id.
Finally, state insurance regulators could consider improving the transparency of insurance pricing by using a rate review process similar to that contained in the ACA. The ACA directs Health and Human Services (HHS), in conjunction with the states, to establish a process for the annual review of “unreasonable” premium increases. This process began in 2011. ACA does not give power to states to prohibit these rate increases, but it instead requires the public posting of rate increases that are deemed unreasonable. This transparency oriented approach provides better information to consumers about which insurers may be charging unreasonable rates, but at least avoids some of the pitfalls of more aggressive rate review.

III. Adequacy of Transparency Regulation in Life Insurance and Annuities

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

A. Solvency Regulation

The central goal of insurance regulation writ large is to ensure that carrier’s have sufficient financial resources to pay claims when they come due. However, this goal is particularly important in the life/annuity insurance arena because of the long-term nature of such

---

205 See PPACA Section 1003.
206 See id.
carriers’ obligations to policyholders and asset portfolios. The tools that regulators deploy to achieve this goal fall under the heading of solvency regulation, and include risk-based capital requirements, reserve requirements, and investment restrictions. Despite the central importance of solvency regulation to insurance regulation generally, and life and annuity insurance in particular, this form of regulation employs remarkably few transparency oriented tools.

In fact, state insurance regulation affirmatively limits the availability of public information about which insurers are in tenuous financial condition. Indeed, about half of the states label it an “unfair trade practice” for anyone in the insurance business to communicate any information that is “derogatory to the financial condition of an insurer,” even if that information is true. Similarly, many states prohibit anyone in the insurance business from communicating any information about the risk-based capital level of an insurer. Even the annual and quarterly financial accounting statements that insurers file with state regulators – which contain substantial amounts of data on the financial health of filing companies – are only made publicly available for a fee.

To be sure, bank regulators similarly limit the availability of information regarding troubled banks. For instance, the FDIC maintains a list of “problem banks” that it does not make publicly

---

211 See THE INSURANCE FORUM, June 2004; see, e.g., Indiana Statute Section 27-4-1-2; Code of Ala. § 27-12-9 (2012); A.R.S. § 20-445 (2012); Conn. Gen. Stat. § 38a-816.
212 See THE INSURANCE FORUM, June 2004; see, e.g., NAIC Model Laws, Regulations and Guidelines, 312-1 (including optional language that “the making, publishing, disseminating, circulating or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, an advertisement, announcement or statement containing an assertion, representation or statement with regard to the RBC Levels of any insurer, or of any component derived in the calculation, by any insurer, agent, broker or other person engaged in any manner in the insurance business would be misleading and is therefore prohibited.”)
available. However, in many ways banking rules are less extreme than insurance regulations. For instance, bank holding companies’ quarterly performance reports are publicly available, without cost, through the Fed’s National Information Center. Moreover, gag rules in banking are actually less extensive than they are in insurance: the only such rule involves disclosure by agencies and banks of safety and soundness examination reports and grades.

However, when evaluating transparency in insurance solvency regulation, the more appropriate comparison is to federal securities law rather than banking regulation. The primary reason for the secrecy that surrounds the financial conditions of particular banks is that banks are uniquely susceptible to policyholder runs, because a substantial amount of their liabilities are demand deposits that can be withdrawn in full at any time by policyholders for any reason. As such, negative financial information about a bank can actually substantially exacerbate that bank’s financial problems by triggering a bank run. Moreover, the vast majority of bank depositors can, and do, protect themselves from this risk by ensuring that their money is deposited in such a way that it is fully protected by FDIC insurance. Most bank depositors consequently do not need information about their bank’s financial health in order to enjoy absolute security in their deposits.

By contrast, most life insurers are not at substantial risk of a policyholder run. Many forms of life insurance and annuities do not permit policyholders to voluntarily withdraw funds. Those that do typically charge a fee that limits the desirability of this option. Finally, and perhaps most importantly, policyholders conceptualize life insurance products as long-term investments, whereas they conceptualize demand deposits in banks as a source of instant liquidity. History bears these distinctions out: there has never been a

---

216 See id.
218 See id.
run on the life insurance industry, despite occasional predictions of such runs in the popular press.\textsuperscript{222}

Additionally, it is much harder for insurance policyholders to protect themselves against solvency risk than it is for bank depositors to do so. This is because FDIC insurance applies a separate limit to every account that an individual owns at a different bank, allowing depositors with cash that exceeds the FDIC limit to simply open up accounts at multiple banks.\textsuperscript{223} By contrast, state guarantee funds – which provide policyholders with some measure of protection in the event that their insurer cannot meet its financial obligations\textsuperscript{224} – provide only a single limit that cannot be increased by spreading protection around to multiple different companies.\textsuperscript{225} Additionally, unlike FDIC insurance, state guarantee funds are neither pre-funded nor backed by the full faith and credit of the federal government.\textsuperscript{226}

Viewed against the backdrop of securities regulation, the lack of transparency surrounding insurance solvency regulation is particularly striking.\textsuperscript{227} Transparency and disclosure are, of course, the core tools of securities law.\textsuperscript{228} Thus, all publicly held firms must file annual and quarterly financial statements with the SEC, which are then made publicly available without charge through EDGAR.\textsuperscript{229} Individual who purchase securities products must be provided with a prospectus for the product that discloses all material risks.\textsuperscript{230} And regulated entities must promptly disclose any information suggesting the prospect of a deteriorating financial condition.\textsuperscript{231}

\textsuperscript{225}See National Conference of Insurance Guarantee Funds.
\textsuperscript{227}See Hanson & Farney, supra note 26 (exploring different levels of risk information that must be disclosed to an individual who purchases a life insurance policy for a single premium and an individual who invests an equivalent amount in the stock of the company and must be given detailed information about the risks).
\textsuperscript{229}See generally Stephen J. Choi & A.C. Pritchard, Securities Regulation: Cases and Analysis (3rd Ed. 2012).
\textsuperscript{230}See id.
\textsuperscript{231}See id.
A similar embrace of transparency could promote the effectiveness of insurance solvency regulation. Insurance consumers, particularly life insurance consumers, care substantially about the solvency of their carriers. This consumer preference means that there is already a great deal of market discipline with respect to insurers’ solvency. Increasing the availability of information about insurers’ solvency would improve this market discipline by removing the primacy of rating agencies in intermediating this information to policyholders. Indeed, for these very reasons, one of the three “pillars” of Solvency II, the European System for solvency regulation that is currently under construction, is transparency. Improving transparency might also increase regulatory accountability and limit the risk of regulatory forbearance in the face of a failing insurance company.

An additional, though admittedly more contestable, way in which state solvency regulation arguably wrongly eschews transparency-based regulation is that it does not require insurers to disclose in summary form to consumers any information about their financial strength. Such a requirement could easily piggy-back on the financial strength ratings that rating firms like AM Best and Moodys produce, which are generally easy to understand because they aggregate a tremendous range of information into a single metric. While carriers with strong ratings actively advertise that fact, many consumers who do purchase coverage from a poorly-rated carrier are completely ignorant of this fact. Requiring disclosure of this information could improve market discipline as well as the matching of consumers with insurers who meet their price/quality preferences.

To be sure, there are various legitimate objections to this proposal. Most importantly, the reliability of financial ratings is undermined by the fact that the insurers who are rated are also the ones who pay rating agencies. This point, of course, was well

---

234 See id.
237 See BELTH, supra note 235.
illustrated by the 2008 financial crisis. Additionally, entrenching the role of rating agencies in financial regulations may arguably exacerbate the problem by enhancing their power and thus insurers' incentives to game these ratings.

Despite these criticisms, it ultimately does make sense to mandate the disclosure of financial strength ratings. The relevance of these ratings to consumers is undeniable, even though these ratings are also imperfect. Moreover, these ratings may be harder to game than other types of financial ratings, as insurance regulators independently assess insurers' financial strength. As such, if an insurer earned a financial rating that were wildly undeserved, regulators would be able to spot this discrepancy rather easily. This, in turn, means that rating agencies in the insurance sphere are likely to be much less willing to game the system than they were in the context of specific mortgage products or firms like Enron, whose financial health was not the subject of independent scrutiny.

In contrast to insurance consumers, purchasers of securities of insurance companies are provided with financial strength ratings, which are deemed material to them. To be sure, these are provided not in summary form, but in the detailed prospectus. Although financial strength ratings are not currently provided in mandatory consumer disclosures in US law, other countries do indeed have such requirements in the insurance sphere.

B. Guarantee Fund Protection

In addition to regulating insurers to ensure that they have the financial capacity to pay the claims they insure, states also require the operation of guarantee funds. As noted above, these funds protect policyholders against the prospect that their insurer will not have sufficient funds to pay claims. As with solvency regulation, while these guarantee funds provide an important safety net to policyholders in all lines of insurance, their importance is arguably

---

239 See McCoy & Engel, supra note 1.
240 See Frank Portnoy, Historical Perspectives on the Financial Crisis: Ivar Krueger, the Credit-Rating Agencies, and Two Theories about the Function, and Dysfunction, of Markets, 26 Yale J. on Reg. 431 (2009).
241 See Hill, supra note 238.
242 Belth, supra note 235.
heightened in the life context because of the long-term nature of this policy line.

Despite the importance of guarantee funds to consumers, most states affirmatively restrict the capacity of insurers and their agents to inform consumers of the extent of the guarantee fund protection they enjoy. Indeed, the NAIC model law on the topic, which most states have adopted, prohibits advertising the existence of a state’s Insurance Guaranty Association for the purpose of sales, solicitation or inducement to purchase insurance. The law does require policyholders to be provided at the time of policy delivery – several weeks after purchase – with a summary disclosure describing the general purposes and limitations of the fund.

Although the purpose of these gag rules is to limit moral hazard, they have the impact of undermining the capacity of consumers to make informed decisions among competing life insurance carriers. Providing information about guarantee fund protection after a policy has been purchased does virtually nothing to help consumers make informed decisions about their products in light of guarantee fund protection. Yet accurate information about guarantee fund protection is vital to consumers looking to choose life insurance products that match their preferences. This is because the extent of the guarantee fund protection that life/annuities policyholders enjoy varies significantly by state and product, and is often woefully insufficient to fully protect even an average consumer’s policy rights. For instance, with respect to life insurance death benefits, most states provide only $300,000 of protection, but some states provide up to $500,000 of protection. In the case of life insurance cash surrender and cash withdrawal protection, most states cap protection at $100,000, but some have substantially larger caps. With respect to annuities, some states only provide up to $100,000 of guarantee fund protection, many provide up to $250,000 of protection, and some provide $300,000 or $500,000 in protection. Consumers who are informed about these levels of

---

245 NAIC Model Laws, Regulations and Guidelines 520-34, § 19.
246 Id.
247 The moral hazard that FDIC insurance creates for policyholders in the banking sphere is well understood. See Geoffrey P. Miller, Anatomy of a Disaster: Why Bank Regulation Failed, 86 NW. U. L. Rev. 742 (1992)
248 See Part I.A., supra.
250 See id.
251 See id.
protection at the time they are selecting a product may more carefully scrutinize their insurers’ financial status to the extent they are not fully covered. Alternatively, they may alter the amount of their purchase and/or the product they purchase in order to maximize the extent of their protection.

Once again, the lack of transparency with respect to state guarantee funds is put into sharp relief when state insurance law is compared to analogous federal law. In particular, bank depositors enjoy federal protection from the risk that their bank will become insolvent through FDIC insurance. Yet banks routinely and prominently advertise this protection to depositors—something which the FDIC requires them to do.\textsuperscript{252} Banks also advise policyholders on strategies to maximize protection, such as holding a joint account or holding an account with multiple beneficiaries. Moreover, products that banks sell which are not protected by FDIC insurance routinely warn consumers of this fact.\textsuperscript{253}

C. Annuity Disclosure

Because of their complexity and variability, annuities raise a host of consumer protection problems. At their core, annuities are contracts wherein a policyholder is promised a series of future payments from the insurer in exchange for an earlier lump sum payment, or series of payments, from the policyholder. But the details surrounding this basic framework can vary in an almost infinite set of ways. These include (i) whether insurer payouts are immediate or deferred, (ii) whether policyholder accumulation is made in a lump sum or over time, (iii) the ways in which money placed in the annuity earns a return, (iv) the guarantees associated with insurer payments, and (v) the existence of market-based adjustments to insurer payouts.\textsuperscript{254}

This complexity raises two basic types of risks for consumers. The first is that a consumer may purchase an annuity that is not well suited to her particular needs. While annuities can safeguard against a collection of risks—such as outliving one’s accumulated income or fluctuations in income levels—they can also serve as outright vehicles for profit.\textsuperscript{255} Which of these functions is most important depends on the purchaser’s anticipated lifespan, savings, future

\textsuperscript{252} See \textsc{Carnell, Miller \& Macey}, supra note.
\textsuperscript{253} See id.
\textsuperscript{254} See generally \textsc{Scott Harrington \& Gregory Niehaus}, Risk Management and Insurance 297-334 (2004).
\textsuperscript{255} See id.
financial needs, and retirement plans. Second, the complexity of annuities can undermine competition across companies, resulting in excessive fees and/or poor investment performance. Indeed, according to one source, annuity fees average about 2.51 percent of one’s investment, a dramatic difference from the low-cost mutual fund options that are available for fees of .2 percent.

To address these concerns, state insurance regulation relies on two strategies. First, it requires that insurers obtain personal information from prospective customers before a sale and evaluate whether the annuity being sold is “suitable” for that particular individual. Second, and of more direct relevance here, state law requires certain disclosures to be made to annuity consumers. This dual regulatory strategy is sensible. On one hand, consumer disclosures are not sufficient to protect consumers of annuities, which are extremely complex and multi-faceted products. On the other hand, though, mandatory disclosures can provide regulatory benefits that suitability rules cannot. For instance, effective disclosures could help some consumers ensure that an annuity is not merely suitable for their needs, but optimal. Perhaps even more

256 This complexity means that consumers are not infrequently sold annuities that do not meet, and even undermine, their financial needs. For example, in 2005, a class action lawsuit was filed against insurer Allianz, which was alleged to have sold actuarially unsuitable annuities to elderly consumers. Chris Serres, A Split Decision in Allianz Life Annuity Lawsuit, MINNEAPOLIS STAR TRIBUNE, Oct. 13, 2009. Allianz reportedly enticed these customers with significant interest bonuses; unfortunately, it imposed even heavier fees on early withdrawals from the annuity accounts. For instance, the named plaintiff, a 65-year old woman, received a 10% up-front bonus on her investment of $216,189—but paid surrender charges of 12.5% for the first fifteen years. While this arrangement might prove beneficial to a younger customer, it prevented many purchasers from withdrawing their money penalty-free for well beyond their life expectancy. In short, Allianz had used the investment aspect of the annuities in question to lure low-risk purchasers into overpaying for their insurance.

257 Margaret Collins, Variable Annuities: Lifelong Income, High Cost, http://www.businessweek.com/magazine/content/11_27/b4235047436378.htm. As one consumer financial expert explained, experts understand the “flip side to the annuity sales pitch—including the high costs; the long surrender periods with the resulting high surrender fees; and that many annuity sales are inappropriate because more suitable low-cost investment options are available.” Mel Lindauer, Annuities: Good, Bad Or Ugly?, available at http://www.forbes.com/2010/06/04/variable-annuities-high-cost-surrender-fees-personal-finance-bogleheads-view-lindauer.html.

258 See, e.g., NAIC Model Laws, Regulations and Guidelines 275-1 §6. Only two states have not adopted this law: Mississippi and New Mexico. NAIC Model Laws, Regulations and Guidelines 275-1 State Adoption. This paper takes no position on the adequacy of the current suitability rules. See MCCOY & ENGEL, supra note 1 (arguing for suitability rules in mortgage context).

259 See Part I.A (describing conditions where mandatory summary disclosure may be appropriate and effective).
importantly, effective disclosures could promote more effective competition among annuity providers, a consumer protection goal that suitability-based rules do not promote.

Unfortunately, the NAIC’s annuity disclosure regime is completely ineffective in promoting consumer understanding regarding annuities in a way that would help address the suitability and cost problems described above. The annuity disclosure strategy is based on an NAIC model law dating back to 1999.\textsuperscript{260} Under the law, purchasers must receive both (i) a Buyer’s Guide and (ii) a disclosure document. The Buyer’s Guide, created by the NAIC, describes the basic structure and general features of annuities. The disclosure document is a company-drafted form that must contain a description of specific contract terms and “emphasiz[e] its long-term nature.”\textsuperscript{261} The law also includes a lengthy section placing strict guidelines on the form and content of illustrations used to describe annuities.\textsuperscript{262}

Perhaps the most central deficiency of this disclosure regime is that it does not rely on a single disclosure template to be used by individual firms, but instead allows insurers to design their own disclosure documents. While disclosures must include specified information about the annuity, the facts need not be labeled in any particular way, presented in the same location on different carriers’ forms, or subjected to consumer testing. As explained in depth earlier, this inhibits consumer’s ability to comparison shop.\textsuperscript{263} The result is summed up by one prominent industry insider: “Say you wanted to compare five products side by side... Good luck.”\textsuperscript{264}

\textsuperscript{260} NAIC Model Laws, Regulations and Guidelines 245-1 § 1.
\textsuperscript{261} NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B).
\textsuperscript{262} NAIC Model Laws, Regulations and Guidelines 245-6.
\textsuperscript{263} See part I.A (describing the importance of uniform disclosure templates for mandatory summary disclosures).
\textsuperscript{264} Margaret Collins, \textit{Variable Annuities: Lifelong Income, High Cost}, \texttt{http://www.businessweek.com/magazine/content/11_27/b4235047436378.htm} (quoting Tom Idzorek, global chief investment officer for Morningstar Investment Management); see also Ohio Dep’t of Ins., Annuity Disclosure Initiative: Frequently Asked Questions, \texttt{http://www.insurance.ohio.gov/Company/Documents/AnnuityDisclosurereFAQs.pdf} (“Information contained in a contract can vary from one insurer’s annuity to another, making comparisons difficult. State disclosure laws also differ.”); Tom Lauricella, \textit{Annuity Shopping Made Easier}, \textit{WALL ST. J.}, Oct. 10, 2010, \texttt{http://online.wsj.com/article/SB100014240527487044442404575542590138626652.html} (“Retirees have generally had to depend on insurance agents to get information about annuities, where the choices they offer can be influenced by incentives for recommending a certain company’s products or one kind of annuity over others. As a result, doing true comparison shopping has been a headache at best.”); Darla Mercado, \textit{Lifetime-Income Options Pose Tough Benchmarking Puzzle}, \textit{Investment News}, Oct. 30,
The lack of any standardized disclosure document also undermines the enforcement of the disclosure rules that do exist. Despite the fact that individual companies design their own unique disclosure documents, these documents are not regularly submitted to or reviewed by regulators. In fact, the only enforcement mechanism that states employ to ensure compliance with applicable disclosure rules is market conduct exams. But such exams vary in frequency and are incredibly broad in scope, meaning that the amount of time that can be spent reviewing disclosure documents is minimal.

The annuity disclosure rule not only fails to provide a usable and uniform disclosure document, but the information that it requires insurers to place in their disclosures is simultaneously excessive and deficient. The disclosure document must include countless warnings and complex pieces of information about contract conditions and terms. These include information about accessing the current value of the contract; surrender fees; tax implications of withdrawals; guaranteed and non-guaranteed elements of the contract; the calculation of the initial interest rate and the guaranteed minimum rate; and the calculation of death benefits and the operation of any riders to the contract. Much of this information is only useful to a consumer with a relatively high degree of financial sophistication. This is particularly true of disclosures related to the calculation of rates or benefits. All of this information appears alongside much more fundamental disclosures, related to the basic functioning of the annuity’s fees and penalties.

265 This contrasts with the annuity contracts that life insurers sell, which generally must be submitted to and approved by insurance regulators prior to their sale. See JFRAC questionnaire.
266 Chapter 19, —Conducting the Life and Annuity Examination
268 See Part I.A, supra (emphasizing the limited amount of information that can be effectively disclosed to consumers).
269 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B).
270 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B) (3) (d)-(e)
271 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B) (3) (g).
272 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B) (1)-(3).
273 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B).
274 NAIC Model Laws, Regulations and Guidelines 245-1 § 3 (B) (3) (f), (h).
At the same time that it requires excessive disclosure, the NAIC disclosure rules also contain some notable omissions. In particular, they make no attempt to distill the various costs and interest rates of an annuity into a single figure to facilitate comparison.\textsuperscript{275}

Yet another failing of the NAIC’s disclosure strategy is that it does not ensure that the relevant documents find their way into consumers’ hands in time to be helpful.\textsuperscript{276} Delivery of the Buyer’s Guide and disclosure documents can take place at any time up until the point of sale, meaning that the documents may not be delivered until a consumer has already emotionally and mentally committed to the purchase.\textsuperscript{277} If the sale does not take place in a face-to-face meeting, the documents can be delivered after the purchase, as long as the buyer is given a fifteen day penalty-free period to return the contract.\textsuperscript{278} And in the case of online purchases, the NAIC rule only requires that the insurer take “reasonable steps” to make these documents viewable and printable from its own website.\textsuperscript{279}

Disclosure efforts in comparable regulatory domains suggest the inadequacy of these efforts. Consider the SEC’s work on consumer disclosures of mutual funds and variable annuities, which directly compete with state-regulated annuities.\textsuperscript{280} To be sure, these efforts have been far from ideal, and they have prompted quite compelling and persuasive calls for reform.\textsuperscript{281} But they nonetheless are far more sensible and sophisticated than state-based annuity disclosure regime described above. Most notably, the SEC requires all mutual funds to provide investors with a “summary prospectus” that is at the front of the overall prospectus.\textsuperscript{282} The document is limited to several pages, it contains the key pieces of information that mutual fund investors should consider, written in plain English.\textsuperscript{283} The information is displayed in a standardized order and format.\textsuperscript{284} This layered approach to disclosure makes detailed information that

\textsuperscript{275} See Part I.A, supra (emphasizing the importance of distilling complex information into tractable pieces of information).
\textsuperscript{276} See Part I.A, supra. (emphasizing the importance of the timing of the disclosure).
\textsuperscript{277} NAIC Model Laws, Regulations and Guidelines 245-4 § 5 (A).
\textsuperscript{278} Id.
\textsuperscript{279} NAIC Model Laws, Regulations and Guidelines 245-4 § 5 (A).
\textsuperscript{281} See, e.g., Fisch, supra note 77.
\textsuperscript{283} See id.
\textsuperscript{284} See id.
may be of interest to sophisticated investors available in the larger prospectus, without burdening ordinary investors with these details.\(^\text{285}\) For the last four years, the SEC has also been working on a comparable standardized summary prospectus document for variable annuities, though it has not yet released the proposal.\(^\text{286}\)

Additionally, unlike state insurance regulators, the SEC requires all disclosure documents associated with either mutual funds or variable annuities to be filed with the agency.\(^\text{287}\) It then reviews those documents carefully for accuracy and compliance with the SEC’s rules. As one SEC official explained: “Many of these products are very complex in their design and operation, making it very important that insurers provide clear and useful disclosure regarding how the products work and the risks of investing in them. For that reason, the Division carefully reviews these disclosures in its review of registration statements.”\(^\text{288}\)

To be sure, crafting a uniform, summary disclosure of annuities is likely to be a difficult task. But there is already at least one decent model for such a document: The American Council of Life Insurers (ACLI) has released a series of universal templates for annuity disclosures.\(^\text{289}\) Of course, because the ACLI templates are building off the NAIC’s previous work, they share some of the fundamental flaws of the NAIC approach—most notably, they still rely on dense text descriptions of the products in question. But they also represent a significant step towards solving the most significant problem with the NAIC law: its failure to create a standardized disclosure format universal to all annuities in a product class. Not only do the ACLI templates use an identical format for products of the same type, they use very similar formats for products of different types, helping consumers conduct comparisons across

\(^{285}\) See Part I.A, supra. (emphasizing the importance of layered disclosure).

\(^{286}\) In 2009, the SEC Director of Investment Management publicly endorsed the creation of a “variable annuity short form document” and the SEC’s Director acknowledged that the SEC was actively developing such a document. See INSURED RETIREMENT INSTITUTE, VARIABLE ANNUITY SUMMARY PROSPECTUS HIGH IN DEMAND BY CONSUMERS (2011).


\(^{288}\) Id.

DRAFT – DO NOT QUOTE OR CITE WITHOUT AUTHOR PERMISSION

product classes. Unfortunately, use of the ACLI’s templates is entirely discretionary.290

D. Cost Transparency for Cash-Value Life Policies

Although controversy regarding appropriate disclosure of cost in life insurance markets dates back to at least the 1960s, state rules have long failed to require any simplified disclosure of price terms analogous to the ubiquitous APR of credit products. To appreciate this issue, some background is needed. Life insurance policies can either be term or cash-value. Term life insurance is a relatively homogenous product: carriers promise to pay a specified death benefit for a set premium over a specified period of time. By contrast, cash-value life insurance products are extremely heterogeneous.292 At their core, though, these policies combine a term life insurance policy with a savings or investment component and are not confined to a pre-defined period of time. As the savings/investment component of the policy grows, it gradually displaces the insurance component. This gradual shift from an insurance-funded death benefit to a savings-funded death benefit is what allows premiums not to increase dramatically, and perhaps even to “vanish,” as the policyholder becomes older. During his or her lifetime, the policyholder can access the savings component of the policy in various ways, including by surrendering the policy and potentially paying some penalty or by taking out a loan secured by

---

290 Both Iowa and Ohio have adopted pilot programs to encourage use of the forms—most notably, by presuming that any insurer who uses the templates has already satisfied the states’ disclosure requirements—but there has been no state or regulatory agency that has simply mandated use of the template. See, e.g., Ohio Dep’t of Ins., Ohio Joins Initiative to Improve Annuity Disclosure, , available at http://www.insurance.ohio.gov/Company/Documents/AnnuityDisclosureFactShe et.pdf. Templates for Improving Annuity Disclosure: Ohio Pilot Program, ACLI, March 30, 2009, http://www.acli.com/Issues/Pages/GR09-120.aspx.


292 The most basic cash-value policies are “whole life.” These policies generally pay a fixed death benefit and have level premiums that are paid out either for the life of the policy or for a preset number of years. As the savings component of the policy increases, the insurance component decreases in order to keep the death benefit constant. In contrast to whole life policies, variable life policies link the death benefit to the performance of investment options selected by the policyholder. Universal life policies, by contrast, have variable premiums that can be shifted, within various parameters, by the policyholder during the policy term. The savings component accumulates based on stated interest rates that the insurer can vary and policy expenses are deducted from the account on a monthly basis. Variable universal policies combine these features, with return on the universal policy based on the performance of policyholder-selected investment options. See generally BLACK & SKIPPER, supra note 291.
the policy’s value. If the policy is “participating,” it will also pay out dividends to the policyholder.\textsuperscript{293}

The combined savings and insurance components of cash-value policies make it very difficult for consumers to compare different policies. This is because the premiums of cash-value policies do not, in fact, reflect the costs of these policies. Instead, in order to evaluate cost, one must assume a specified savings rate and then extrapolate this value. Alternatively, one can specify a particular cost for the insurance component of the policy, and then measure the rate of return. Either way, though, a policy can have relatively high premiums but be quite affordable/high-return or a policy can have relatively low premiums but be quite expensive/low-return.\textsuperscript{294}

Whereas markets in term life insurance are extremely competitive, the complexity of cash-value insurance policies has impeded welfare-producing competition. An important FTC study from the 1970s found that cash value life insurance policies routinely paid a substantially lower rate of return than comparable savings vehicles and that price dispersion of these policies was much larger than price dispersion for similar products.\textsuperscript{295} A more recent study of the life insurance industry by two prominent economists found that the price of term life insurance policies decreased dramatically – between 8 and 15% – in the mid-1990s as a result of the development of Internet tools that easily allowed consumers to compare different policies.\textsuperscript{296} The authors calculate that this change may have increased consumer surplus by anywhere between $115 million and $1 billion per a year.\textsuperscript{297} By contrast, the price of cash value policies did not fall at all during this period, and may have actually increased.\textsuperscript{298} The reason, they suggest, is that Internet tools did not allow consumers to compare the prices of different cash value policies, because of their complexity and heterogeneity.\textsuperscript{299}

\begin{thebibliography}{9}
\bibitem{293} Id.
\bibitem{294} See \textsc{Federal Trade Commission, Life Insurance Cost Disclosure} 70-71 (1979).
\bibitem{295} Id. at 25-62. See also Spencer Kimball & Rappaport, \textit{What Price Disclosure? The Trend to Consumer Protection Life Insurance}, 1972 \textsc{Wisc. L. Rev.} 1025.
\bibitem{297} One consequence of elevated insurance prices is decreased insurance protection. As Kyle Logue has described, under-insurance in the life arena is a pervasive problem. See Kyle Logue, \textit{Current Life Insurance Crisis: How the Law Should Respond}, 32 \textsc{Cumb. L. Rev.} 1 (2001).
\bibitem{298} Brown & Goolsbee, supra note 296.
\bibitem{299} See id.
\end{thebibliography}
The lack of price transparency in cash-value life insurance markets has also been the source of several acute consumer protection scandals in recent decades.\textsuperscript{300} In one particularly high-profile and wide-spread scandal, consumers were sold “vanishing premium” policies on the basis of representations that the savings components of these policies would grow at a sufficiently rapid rate to cover the cost of coverage.\textsuperscript{301} These growth rates were not achieved, causing policyholders to continue paying premiums well beyond the promised time horizon. Smaller-scale, but repeated, scandals have erupted at various times as it has come to light that insurance policyholders have frequently been encouraged by agents to replace a cash value policy with a different policy.\textsuperscript{302} Such replacements are often not in consumers’ interests because the cost of coverage is quite high in the first years of cash value policies, when much of the savings component of premiums is directed towards paying commissions and administrative expenses.\textsuperscript{303}

Despite these problems, current regulatory rules do not require any form of standardized disclosure of the cost of cash-value life insurance policies.\textsuperscript{304} This is all the more remarkable because the mechanism for making such a disclosure has been the source of study and refinement for nearly fifty years. In 1966, Joseph Belth, a professor at Indiana University, proposed a uniform scheme for the disclosure of cost information about cash-value life insurance policies.\textsuperscript{305} Shortly thereafter, US Senator Phillip Hart held hearings


\textsuperscript{302} For instance, in 1975, Senator Stone introduced a bill that focused on his concern about Veterans who were moving in large numbers into new life insurance policies through conversion policies. Disclosure of Insurance Policy Information to Veterans: Hearings on S. 718 Before the Subcomm. on Housing, Insurance and Cemeteries of the Senate Comm. on Veterans’ Affairs, 95th Cong., 1st Sess. (1977). In 1984 another hearing on policy replacements was held by Congress in response to evidence that conversion policy sales accounted for 1 out of every 2 cash value policy sales. James A. Hunt, Life Cost Disclosure: Prospects for True Reform, 13 J. Ins. Reg. 405, 407 (1995).

\textsuperscript{303} See Hunt, supra note 302.

\textsuperscript{304} See NAIC Model Laws, Regulations and Guidelines 580-1. These rules do require a policy summary to be delivered after the sale of coverage. These suffer from many of the flaws described above for annuity policy summaries: they are non-standardized, delivered after policy is purchased, and do not contain useful information.

on the topic and suggested a Truth in Life Insurance Bill that would mirror the recently enacted Truth in Lending Act.\textsuperscript{306} That law requires lenders to disclose to consumers the APR of their loans, which encompasses all of costs of borrowing, including the interest rate and fees.\textsuperscript{307}

These efforts led to extensive scrutiny of life insurance cost disclosure and eventually to the NAIC, in 1976, adopting a model regulation on life insurance cost disclosure. The model required disclosure at the time of policy delivery, rather than prior to or at the time of sale, of various cost indices for life insurance policies.\textsuperscript{308} These included a surrender index that was intended to convey the cost of a policy if it was surrendered at specified times, a payment index that provided the cost of the policy if death occurred at certain times, and an equivalent level annual dividend that was intended to show the relative importance of assumed dividends in the two indices just described.\textsuperscript{309} Over 30 states adopted this model law.\textsuperscript{310}

Although this disclosure approach was a small step in the right direction, it had numerous problems as well. Many of these problems were described in the aforementioned FTC report on life insurance cost disclosure. The FTC report noted that the NAIC approach presented consumers with “a bewildering array of numbers, most of which [were] of doubtful relevance to the average insurance consumer.”\textsuperscript{311} These numbers had no intuitive benchmark, such that a consumer could discern whether a particular index number was good or bad.\textsuperscript{312} Perhaps even more importantly, the indices were only appropriate for consumers comparing similar policy types: they did not allow consumers to compare different types of cash value policies to one another or to term insurance.\textsuperscript{313} Finally, the FTC report noted that the timing of the policy cost information was deficient, because it “should be provided as a time when a consumer is trying to decide which, if any policy to buy – not after that decision has already been made.”\textsuperscript{314} In the face of these problems, the Chairman of the Federal Trade Commission (FTC)

\textsuperscript{306} Hunt, supra note 302, at 412.
\textsuperscript{308} Foley & Johnson, supra note 301.
\textsuperscript{309} See FTC REPORT, supra note 294, at 130-31.
\textsuperscript{310} Id.
\textsuperscript{311} Id. at 132.
\textsuperscript{312} Id.
\textsuperscript{313} Id. at 126. The reason, from an actuarial perspective, is that it fails to control for differing amounts of risk in policies that are compared. Hunt, supra note 302, at 412-413.
\textsuperscript{314} See FTC REPORT, supra note 294, at 163.
testified to Congress in 1979 that “no other product in our economy that is purchased by so many people for so much money is bought with so little understanding of its actual or comparative value.”

In place of the NAIC model, the FTC suggested that consumers needed a single cost metric with which to compare different policies. It proposed the Linton Yield method as a mechanism to achieve this.315 This is a single metric that can be used to compare similar and different types of policies, comes with an intrinsic yardstick because it represents annual rates of return, and shows negative returns in initial years that warn consumers not to surrender a policy within that time period. To be sure, the metric is not without its problems, particularly because its calculation is highly dependent on both assumed future dividends and term insurance cost, which can be manipulated.316 Indeed, various alternatives to the Linton Yield index are possible and may, in fact, be superior, including a version of the metric that Professor Belth originally proposed fifty years ago,317 which would calculate the expected present value of premiums paid less the expected present value of all death benefits, policy dividends, and cash values.318

Although numerous plausible approaches are possible for clearly disclosing the cost of cash value policies to consumers, the NAIC ultimately chose to entirely jettison any requirement of life insurance cost disclosure. In the wake of the FTC report, industry successfully lobbied congress to statutorily bar the FTC from investigating life

315 The report did leave open the prospect of retaining a single surrender index for comparison of similar policies if this could be combined with a reasonable benchmark. However, this recommendation was largely premised on the notion that many had already gained familiarity with this tool, and so that learning should not be dismissed. That rationale no longer applies, of course.
316 This method essentially measured the value of different policies by setting a cost for the term insurance component of policies, subtracting this from cash value premiums, and then calculating the average annual rate of return that would produce the cash value plus dividends that the policy pays at any point in time. Id. at 120.
317 See note 306.
318 Jospeh Belth, The Relationship Between Benefits and Premiums in Life Insurance, 36 J. Risk & Ins. 19 (1969). Subsequent theoretical work has demonstrated that this index is far less manipulable than other indices and thus would tend to prevent insurer gaming of their policies to maximize index values. See Ralph Winter, On the Choice of an Index for Disclosure in the Life Insurance Market: An Axiomatic Approach, 49 J. Risk & Ins. 513 (1982). An alternative approach is to separately disclose the cost of coverage per $1000 of coverage and the rate of return on the savings component of the policy, in each case incorporating an assumed value for the other formula. See Belth, supra note 318; see also Breadwinners Insurance, available at www.breadwinnersinsurance.com (proposing a different approach to summary disclosure of cash-value life insurance cost).
insurance without a request from Congress. Meanwhile, the NAIC refused to revisit its model law on policy costs even after the “vanishing premium” scandals of the early 1990s, during which time its emphasis shifted to regulating deceptive illustrations. Eventually, in 2000, now convinced that the cost disclosures it provided were indeed as useless as the FTC report had indicated two decades earlier, the NAIC quietly decided to entirely eliminate any requirement that life insurers provide any cost disclosures at all.

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

IV. Understanding and Breaking the Pattern

The pattern of consumer protection regulation in insurance is both unique and troubling. Instead of embracing disclosure and transparency, state insurance regulation actively resists it while maintaining various forms of consumer protection regulation that are much more aggressive and costly. What can explain this pattern? Section A of this Part considers this question, looking both to the distinctive features of insurance as well as the uniquely state-based

---

319 See Hunt, supra note 302, at 412.
320 In 1993, when the NAIC was evaluating reforms to regulation of illustration, it decided not to attempt to improve these disclosures. See Hunt, supra note 302, at 420 (“[N]one of the extensive deliberations of the LDWG over the last two years have sought to provide consumers with an effective means of comparing cash value life insurance policies either to each other or to the alternative of buying term life insurance.”). Then, in 2000, the NAIC voted to eliminate any model law requiring these indices to be calculated and disclosed to consumers. See NAIC Model Laws, Regulations and Guidelines 585-1, Legislative History (“When the Optional Form of the Life Insurance Disclosure Model Regulation with Yield Index was adopted, the group recommended that each time the disclosure regulation was amended the alternative with the yield index should also be amended. When the disclosure regulation was amended, all references to indices were deleted. The working group clarified its intent with regard to the alternative with the yield index by voting to recommend its deletion from the list of official NAIC models laws. 2000 Proc. 3rd Quarter 88.”).
321 See, e.g., Jeff Sovern, Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers, 71 Ohio St. L.J. 761 (2010).
nature of its regulation. Part B then argues that, whatever explains the pattern in the past, there is one clear way to disrupt it in the future: the clear and credible threat of federal preemption.

A. Understanding the Pattern

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

First, there is no doubt that industry influence over insurance regulators and the NAIC has substantially limited transparency-oriented reforms in insurance. The industry has openly and vehemently resisted transparency with respect to the availability of MCAS data, the online availability of policy forms, the disclosure of price information in life insurance, and numerous other issues discussed above. It is hardly novel to note that unified industry resistance has a substantial amount of influence on state insurance regulators and lawmakers. The reasons are numerous. The revolving door is a large problem in insurance regulation given the number of different insurance commissioners. Where insurance commissioners are elected, campaign contributions can have similar impacts. In addition, there is no doubt that the superior technical resources of industry often allow it to provide and analyze

323 See Part II.A, supra (industry resistance to MCAS disclosure); Part II.B, supra (industry resistance to online access to policy forms); Part II.C, supra (industry resistance to HMDA-like data collection); Part II.D, supra (industry resistance to disclosure of agents’ conflicts of interest); Part III.B, supra (industry resistance to guarantee fund disclosure); Part III.D, supra (industry resistance to life insurance cost disclosure).
information in ways that far surpass the capacities of regulatory staff or the extremely limited number of consumer advocates who operate in the insurance domain (at least outside of health insurance).\textsuperscript{327}

The more difficult question is why, and how, the industry manages to maintain a uniform position against real transparency across so many different domains, given the reasonable supposition that at least some subset of firms would be benefitted by transparency, as would the industry as a whole. Part of the answer may be cultural: insurance is an industry that is almost uniquely built upon proprietary information.\textsuperscript{328} Indeed, insurers devote much of their internal resources to classifying policyholders' and scrutinizing the veracity of their claims. This arguably produces an almost knee-jerk effort by those within the industry to resist regulatory efforts that may result in information revelation.

Another part of the answer is that transparency does indeed pose a theoretical threat to insurers of adverse selection, which is the disproportionate tendency of high-risk individuals to purchase insurance.\textsuperscript{329} To the extent that consumers are better informed about the quality of different insurance products, this theoretically could result in more risky policyholders opting for higher quality coverage. Thus, insurers may tend to prefer consumer ignorance regarding coverage based on the assumption that such ignorance prevents adverse selection. Although this concern is theoretically plausible, it is practically quite limited: most insurance markets do not suffer from adverse selection and, in many cases, the consumers who are likely to be drawn to the most generous forms of insurance are actually relatively non-risky, but quite risk-averse.\textsuperscript{330}

A second explanation for states’ resistance to transparency is that state regulators want to limit their own public accountability. As described above, the complexity of insurance inevitably demands various forms of substantive consumer protection regulation.\textsuperscript{331} Transparency in insurance markets provides an important disciplining force on the exercise of this regulation by allowing

\textsuperscript{327} See Daniel Schwarcz, Preventing Capture Through Consumer Empowerment Programs: Some Evidence from Insurance Regulation, in Preventing Capture, supra note 324 (discussing the limited number of advocacy organizations that operate in the life and property/casualty insurance domains); Wendy Wagner, Administrative Law, Filter Failure, and Information Capture, 59 Duke L. J. 1321 (2010) (discussing general phenomena of information capture).


\textsuperscript{329} See Tom Baker, Insurance Law and Policy 7 (2d ed. 2008).


\textsuperscript{331} See Jackson, supra note 1.
consumers and market intermediaries to identify its potential failings. But while this is a social benefit that should simultaneously promote more effective regulation while reigning in unnecessary regulation, it exposes state regulators to greater public scrutiny, which they may prefer to avoid.

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

**B. Breaking the Pattern**

Although the political economy of state insurance regulation is indeed complicated and multi-faceted, one consistent force has tended to promote effective reform. Over the last century, glaring inadequacies in state regulation have tended to persist unless and until states are threatened with the risk of losing their regulatory authority. Once the threat of federal preemptions emerges, however, state insurance regulators often prove quite capable and effective. In lieu of a complete federal take-over of state insurance regulation, which remains unlikely, the best approach to promoting effective consumer protection regulation is to focus a bright federal spotlight on the transparency issue and back that up with a specific threat of federal preemption if demonstrable progress on transparency is not achieved within a designated time period.

(1) State Reform of Insurance Regulation in Response to Federal Scrutiny

In a variety of regulatory domains, including banking and corporate law, state law has been consistently and dramatically influenced by the prospect that the federal government will exercise

---

332 See Part II.B, supra.
334 See Schwarcz, supra note 7.
335 This explanation is consistent with the pattern in securities law, as state blue sky laws tended to be much less focused on disclosure than substantive regulation relative to federal securities regulation.
previously untapped authority. This threat of action typically causes states to bridge the gap between its laws and those that the federal government might enact. Doing so decreases the benefits to the federal government of acting while simultaneously signaling to it that exerting its power will be politically difficult.

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

Since this time, virtually all substantial state insurance regulatory reforms can be clearly and directly traced back to acute threats of federal preemption. Consider solvency regulation, which is widely regarded to be the most important and effective element of state regulation. The insurance solvency regime is centered on two core pillars: a risk-based capital requirement and a scheme of state accreditation, which is coordinated and enforced by the NAIC and several of its committees. Both reforms were only developed

337 See Roe, supra note 336.
338 See, e.g., Scott E. Harrington, *The History of Federal Involvement in Insurance Regulation*, in *Optional Federal Chartering and Regulation of Insurance Companies* 21, 21 (Peter J. Wallison ed., 2000) (“The history of insurance regulation is characterized by a series of perceived market or regulatory failures, followed by threats of federal regulation and subsequent changes by the states that have helped forestall federal action.”).
339 See Meier, supra note 322.
340 Id.
341 Id.
342 See Vaughan, supra note 233.
343 See *National Association of Insurance Commissioners, The United States Insurance Financial Solvency Framework* (2010). States have very strong reasons to maintain accreditation because of the system’s ingenious design: accredited states can rely only rely on the regulatory efforts of other accredited states. Failing to maintain accreditation thus risks subjecting domestic insurers to duplicative regulation.
and put into place in the early 1990s, after several insurer insolvencies prompted a highly critical congressional report and series of hearings.\textsuperscript{344} Similarly, state guarantee funds were put in place in response to a proposed Federal Insurance Act, which itself was prompted by several large insurer insolvencies \textsuperscript{345}

Although state reforms in the solvency domain are the most important modern example of this process of federally-triggered state reform, numerous other examples exist. For instance, state regulators’ numerous efforts to limit the duplicative and overlapping nature of state insurance product requirements – including the Interstate Insurance Product Regulatory Commission (IIPRC) and State Electronic Rate and Form Filing (SERFF) – were directly responsive to very public campaigns by certain large property/casualty insurers and life insurers for the adoption of an Optional Federal Charter.\textsuperscript{346} Similarly, recent efforts to limit the inconsistencies in state producer licensing were triggered by a direct preemption threat contained within the Gramm-Leach Bliley Act, which required a national scheme for producer licensing if states did not act.\textsuperscript{347} Perhaps most notably for present purposes, state lawmakers developed an excellent consumer tool for disclosing the terms of health insurance policies after the ACA delegated this responsibility to them, but subjected it to the approval of HHS.\textsuperscript{348}

\textbf{(2) The Path to Reform}

All of this suggests that the path to reform of state insurance regulation ultimately lies with federal actors. If federal lawmakers do not push state lawmakers to take market transparency seriously, they will not do so.


\textsuperscript{346} See Schwarcz, Regulating Insurance Sales, supra note 13, at 1779.

\textsuperscript{347} Lissa L. Broome & Jerry W. Markham, Banking and Insurance: Before and After the Gramm-Leach-Bliley Act, 25 IOWA J. CORP. L. 723 (2000).

\textsuperscript{348} PPACA requires that Health and Human Services (HHS) consult with the National Association of Insurance Commissioners (NAIC) in developing a Uniform Explanation of Coverage. Working through a Consumer Information Working Group, with extensive involvement form consumer groups and consumer testing of templates, the NAIC produced a very good disclosure template, which HHS accepted without change. See Schwarcz, supra note 62. The template is available online. NAIC, Uniform Explanation of Coverage Template, http://www.naic.org/documents/committees_b_consumer_information_soc_ppo_plan1_insurance_company1.pdf.
Fortunately, the federal government is ideally suited to make the case for state insurance regulators to dramatically reform their regulation of market transparency. In 2010, Congress passed The Dodd-Frank Wall Street Reform Act, which established a new Federal Insurance Office ("FIO"). Among the responsibilities of FIO is to “monitor all aspects of the insurance industry” and to issue a report on the regulation of insurance. Although these provisions of Dodd-Frank do focus FIO’s efforts on systemic risk and international regulatory issues, they also leave FIO with plenty of discretion to identify broad failures in state insurance regulation. FIO is thus well situated to expose the transparency-based failings of state insurance regulation in its report to Congress or in its other efforts to monitor the insurance industry.

Not only does the federal government now enjoy a mechanism for continuously monitoring state insurance regulation, but it is well-suited to use this authority to promote transparency. As this Article has made clear, federal financial regulation consistently employs much more sophisticated and expansive transparency-oriented tools to protect consumers in domains ranging from banking to securities to health insurance. This pattern provides the federal government with the moral authority to demand similar forms of consumer protection in state insurance regulation. It also provides the federal government with the ability to lend its expertise to state insurance regulators and lawmakers to the extent that they prove willing to rethink their approach to ensuring effective and transparent insurance markets.

If states are unable or unwilling to implement more effective transparency-based tools, then the federal government could credibly threaten to partially or entirely preempt state insurance regulation. For several decades, policymakers have considered creating an Optional Federal Charter that would allow insurers to be regulated at the federal, rather than the state, level. Indeed, many believe that FIO is a pre-cursor to an optional federal charter. Although this approach would have the substantial downside of creating destructive regulatory competition by allowing insurers to “choose” their regulator, it could also be employed as an effective

---

349 See Dodd-Frank Wall Street Reform and Consumer Protection Act, Sec. 502(a), § 313(a), 124 Stat. 1580 (codified at 31 U.S.C.A. § 313(a)).
350 Id. at 502(c).
352 See generally OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES (Peter J. Wallison ed., 2000)
threat against state regulators.\textsuperscript{353} Alternatively, the federal government could simply threaten to entirely preempt state insurance law, or to require as a condition of continued regulation the implementation of effective transparency oriented reforms.\textsuperscript{354} Whatever the threat, the continued debate about federalizing state insurance regulation coupled with the establishment of FIO place the federal government in an ideal position to demand that states reform and improve transparency in insurance markets.

\textbf{Conclusion}

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

\textsuperscript{353} See Schwarcz, \textit{Regulating Insurance Sales}, supra note 13, at 1779.
\textsuperscript{354} See Robert W. Cooper, \textit{OFC: Is it Really Overkill?}, 26 J. INS. REG. 5, 9 (2008) (proposing that the federal government “the federal government would be the rulemaker, and the state insurance commissioners would enforce those rules within their states.”).