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ANTI-REBATING LAWS AND THE UTAH EXPERIENCE

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INTRODUCTION

Most free-market proponents recognize there can be a productive role for sensible regulation, but the bar is relatively high. First, one must identify some clear and compelling consumer harm that must be addressed. Then, one must identify potential corrective measures that do not inflict even more damage than the harm they are intended to fix. Finally, one must be mindful of potential unintended consequences, such as how the proposed regulatory apparatus could be twisted should the regulators become captured by the regulated.

Markets can and do function despite rules that fail to meet any of those tests. Bad and unnecessary regulations can persist for decades, calcifying into background structures that quietly add costs, diminish competition and stifle innovation in ways few tend to notice. Few notice, that is, until some enterprising firm comes to market with a new business model that fails to fit the old rules or an equally enterprising regulator finds a novel interpretation that threatens to make those old rules even worse.

In Utah's insurance market, we are currently seeing a confluence of both of those things simultaneously.

Anti-rebating laws – relics of the 19th century that long have saddled insurance markets with superfluous and anti-competitive regulations – are bumping up against the business models of some modern insurance producers who have found new ways to serve their customers. Moreover, Utah's anti-rebating law is now being applied in an unfair, anti-consumer and unjustified manner that threatens to undermine those same innovative products and services.

Repealing all of the nation's anti-rebating laws is likely too radical a change to expect to achieve in the short term. Even just simply repealing Utah's statute might be a step beyond political feasibility. But there are realistic and targeted amendments that can be made to rein in runaway regulations and, in this case, ensure that Utah's insurance marketplace remains among the most sensibly regulated in the nation.

ANTI-REBATING LAWS

The insurance industry is largely regulated by the states. Currently, 48 of the 50 states, as well as the District of Columbia, have statutes on the books prohibiting rebating by insurers or insurance producers.[1] California and Florida, with some caveats, are the exceptions.[2]

In the context of insurance, anti-rebating laws initially were passed to prohibit sharing the proceeds of an insurance commission with an insured. Today, such large cash payments are rarely seen, but the laws are still invoked to police rebates that come in the form of gifts, such as promotional "swag" emblazoned with insurer and insurance producer logos. At issue with rebates are the inducement they provide a consumer to purchase a product from a specific retailer (in this case, an insurer) or the retailer's representative (in this case, an agent or broker).[3]

There are many reasons offered to maintain anti-rebating laws. In fact, in a 1996 opinion about the constitutionality of anti-rebating laws, Alaska's attorney general offered a dozen justifications for their continued existence.[4] The rationales largely fall into two camps: those concerned with the deleterious impacts rebates could have on the market and

1. Health Now Administrative Services, "State by State Rebate and Licensing Regulations," http://hnas.com/LinkClick.aspx?fileticket=UWZdtOBp_uw=

2. Consumer Watchdog, "Background on Insurance Reform - A Detailed Analysis of California Proposition 103," May 2000. http://www.consumerwatchdog.org/feature/background-insurance-reform-detailed-analysis-california-proposition-103

3. Farlex Financial Dictionary, "Anti-Rebate Law," 2012. http://financial-dictionary.thefreedictionary.com/Anti-Rebate+Laws

4. Bruce Botelho, "Constitutionality of Insurance Anti-Rebates," Attorney General's Opinion: Letter to Sen. Dave Donley, April 1996. http://www.law.state.ak.us/pdf/opinions/opinions_1996/96-014_661960488.pdf

those concerned with preventing discrimination on the part of insurers or insurance producers.

Deleterious market impacts: The earliest anti-rebating law, introduced in Massachusetts in 1887, was concerned with insurer solvency.[5] Back then, regulators had few tools to monitor solvency, and what regulation there was tended to be inconsistent and/or naive. The major fear was that insurers could be forced into an arms race of excessive rebates, ultimately threatening the industry's ability to pay claims.[6] Contemporary developments have rendered this concern unnecessary. In particular, the introduction of risk-based capital standards has allowed regulators everywhere to remain appraised of the financial vulnerability of the parties they regulate.[7]

Beyond solvency concerns, advocates of anti-rebating laws maintain they are necessary to ensure that regulators are able to gain an unencumbered view of how insurers rate policies and how producers sell them. In practice, anti-rebating laws are not the tools that offer this perspective. In California, which repealed its anti-rebating law as part of the Proposition 103 initiative 27 years ago, state regulators are able to maintain a firm grasp on both insurer and broker practices via rate-filings and licensing procedures. The state has not suffered any of the predicted market-based horrors listed in the Alaska letter – at least, not any due to the absence of an anti-rebating law.

Discriminatory treatment: Some have suggested anti-rebating laws prevent unfair discrimination on the part of agents and brokers.[8] The concern is that an insurance producer might favor one client over another for an impermissible, discriminatory reason, such as race or religion. The insurance industry's history with "redlining" practices and even explicitly race-based underwriting suggests such concerns may once have been well-founded. However, it should be noted there is scant evidence of rebates applied in a discriminatory fashion today in those states that do permit it. Even if there were evidence of impermissible discriminatory conduct, that evidence both would have to be weighed against the conduct's severity and frequency and considered within the context of other legal proscriptions against discriminatory market conduct already on the books.

There are areas where some forms of discriminatory treatment – such as rebates extended to those of certain occupations, who have certain educational backgrounds or who have demonstrated certain levels of credit-worthiness – arguably could be more complicated. Generally speaking, financial firms are allowed to use factors such as credit to make distinctions among their customers.[9] The law also generally permits price differentials based on nothing more than bargaining prowess; car dealerships, for example, do not offer the same deal to every buyer. In many states, insurance producers are permitted to accept incentive-based bonuses based both upon the volume and profitability of the business that they sell. This sort of "discrimination" should not be conflated with invidious discrimination. Instead, it is better understood as a functioning price system.

The two broad rationales that provide a public policy foundation for the continued existence of anti-rebating laws are weak. Yet, because anti-rebating laws are so widespread, and because some segments of the market may have a reliance interest in their continued existence, the political inertia against their abolition may simply be too great to overcome.

Nonetheless, incremental reforms that limit the scope of, and promote consistency between, anti-rebating laws are reasonable short-term responses to the problems anti-rebating laws create. In particular, anti-rebating laws that are applied in an overly broad manner are prime candidates for action.

ANTI-REBATING IN UTAH

Utah's anti-rebating law is laid out in section 31A-23a-402.5 of the Utah Insurance Code.[10] As would be expected, the statute did not anticipate some of the innovations brought to the market by the Internet and how e-commerce would affect the business of insurance producers. In November 2014, the Utah Department of Insurance determined that an insurance broker could not make available to its commercial clients a free online benefits portal, deeming the service "an illegal inducement" under the statute.[11]

The department made this finding even though only a small portion of the firms that use the online platform actually used it to purchase insurance. In other words, the department determined that an inducement exists even when a product is offered for free to the general public independent of the purchase of insurance.

That finding removes the nexus between the sale of an insurance product and the inducement itself, a relationship that

5. Ibid.

6. Ibid.

7. National Association of Insurance Commissioners, "Risk-Based Capital," November 2014. http://www.naic.org/cipr_topics/topic_risk_based_capital.htm

8. Michael Griffin, et al. "You can't get – or give – something for nothing." Federation of Regulatory Counsel Journal. 2009. www.forc.org/public/articles/375.pdf

9. Arie Shapanya. "What is price discrimination and is it ethical?" Econsultancy. January, 2014. https://econsultancy.com/blog/64068-what-is-price-discrimination-and-is-it-ethical/

10. Utah Insurance Code, Section 31A-23a-402.5. Inducements. http://le.utah.gov/code/TITLE31A/htm/31A23a040205.htm

11. Jen Christian, "Letter to Zenefits: Investigation," Utah Department of Insurance, November 2014. https://s3.amazonaws.com/s3.documentcloud.org/documents/1374047/248816808-utah-insurance-letter-to-zenefits.pdf

defines anti-rebating statutes across the nation. If giving away a service that is completely incidental to an insurance transaction is deemed illegal, then in a market of increasingly intertwined services, firms essentially are barred from offering insurance and non-insurance products simultaneously. This interpretation of Utah's anti-rebating statute makes a problematic statute worse.

The current interpretation of Utah's anti-rebating statute is unrelated to sound public policy and is the result of a combination of statutory inertia and incumbent interest. It serves largely to protect a few entrenched producers from the challenges posed by new competitive business models. In this way, we see an anti-rebating law being used as punishment for innovation. Such regulatory abuse threatens Utah's insurance marketplace as a whole, because there is no clear harm that the current interpretation addresses.

NEAR-TERM SOLUTIONS

Utah should change its law to abrogate the current regulatory understanding of anti-rebating. It should move toward a more permissive understanding of the law, based upon the purposes that it believes its anti-rebating statute should and can achieve. To this end, lawmakers should define a more limited conception of what constitutes a rebate, so that genuine innovations to better serve consumers are not precluded. At the very least, Utah must move to prospectively accommodate novel market developments within the anti-rebating framework.

The most straightforward way to accomplish this goal is to address directly the problematic interpretation offered by the Department of Insurance. To ensure the anti-rebating statute isn't any broader than initially intended, there must be a connection between an inducement and the purchase of an insurance product. Since virtually all anti-rebating laws are based upon a model promulgated by the National Association of Insurance Commissioners, there is striking uniformity between the states on the interpretation of these laws.[12] By codifying an approach that links inducement with purchase, Utah will again become a "majority" jurisdiction.

CONCLUSION

In the long term, we hope Utah and other states begin to circumscribe the reach of anti-rebating laws. The experiences of California and Florida, states that have scrapped anti-rebating laws, suggest their impact on the market is relatively minor and hard to measure. But when wielded as a barrier to entry, as in Utah, the negative effect of such laws can be significant.

Utah's application of its anti-rebating law fails the first test of regulation: it does not identify any consumer who could feasibly be harmed by the market conduct in question, while many consumers potentially could benefit. As a first step toward reform, states like Utah must ensure that rules theoretically enacted to protect the public do not end up making it illegal to give that same public the products and services they value most.

ABOUT THE AUTHOR

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Ian is a 2009 graduate of Seattle University, with bachelor's degrees in history and philosophy and received his law degree from the University of Oregon in 2013. He is a member of the Illinois bar.

12. Peiyi Peggy Wen, et al, "Recent regulatory activity on rebates." Association of Corporate Counsel, March 2009. http://www.lexology.com/library/detail.aspx?g=1a4195c3-ba8f-4c0c-a4c8-ad38128a69b2