



# NCOILETTER

April 2005

www.ncoil.org

## NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

### Preserving State Insurance Regulation...

- By interacting with Congress on issues of critical importance to insurance public policy
- By educating state lawmakers on the solutions to their insurance-market crises
- By fostering relationships between state legislators
- By asserting the primacy of state insurance regulation under the McCarran-Ferguson Act of 1945

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## NAIC TO CONGRESS: SMART ACT WOULD CAUSE FUNDAMENTAL PROBLEMS FOR STATE REGULATION

In a March 18 letter to Reps. Michael Oxley (R-OH) and Richard Baker (R-LA), National Association of Insurance Commissioners (NAIC) President Commissioner Diane Koken (PA) declared that the State Modernization and Regulatory Transparency (SMART) Act would cause “fundamental problems” for state insurance regulation—problems, she said, that minor adjustments could not fix. The position echoed similar concerns first expressed by NCOIL upon initial release of the SMART Act last summer.

Commissioner Koken’s letter, which reflected NAIC’s strongest opposition to the SMART Act thus far, cited the recent findings of an NAIC Government Affairs Task Force charged with evaluating, in part, whether federal legislation would be necessary to realize state regulatory modernization goals, as well as to what extent the SMART Act would impact state regulation of insurance. According

to Koken, the Task Force’s “factual findings reveal fundamental problems for preserving essential state regulatory authority if the basic elements of the draft SMART Act become federal law.”

NAIC said that the SMART Act’s federally mandated standards and preemption of incompatible state laws would significantly impede state ability to supervise insurance, and that the proposed draft would create legal and regulatory confusion by exposing state regulations to interference by a new State-National Insurance Coordination Partnership. Koken noted that the Partnership’s own composition, powers, and administration were highly controversial.

The NAIC continued that the SMART Act would eliminate state ability to protect consumers under state law, particularly regarding rate supervision and market conduct surveillance. Koken said that the time limits by *(continued on page 2)*

## FINITE REINSURANCE: NCOIL TO EXAMINE CONTROVERSY

As news of investigations into finite insurance and reinsurance deals continues to flood the media, legislators at the July 8 NCOIL International Insurance Issues Committee meeting will examine controversial finite arrangements and discuss whether legislators need to act.

The session, scheduled from 9:30 to 10:45 a.m. during the NCOIL Summer Meeting, will include an overview of finite risk, which insurers often use to cover the cost of future claims related to policies carriers have already sold. Such deals have been used for decades.

However, regulators including the Securities and Exchange Commission (SEC) and NYS Attorney General Eliot Spitzer are investigating whether some agreements passing for insurance actually transfer little or no risk, thus violating a

basic tenet of insurance. In some cases, finite deals are said to have contributed to insurer insolvencies. A concern is that finite deals often appear to be loans helping an insurer mask deficiencies in its financial reporting.

Some foreign regulators have commented that U.S. regulators were “asleep at the wheel.” At March’s NAIC Spring Meeting, a key insurance commissioner predicted that the subject may “make the broker disclosure issue pale in comparison.”

Among those swept into the investigations are AIG, CNA, ACE, MBIA, St. Paul Travelers, Swiss Re, Zurich Financial Services, and General Re. AIG’s iconic leader, Hank Greenberg, recently resigned under pressure as a result of a finite reinsurance deal he allegedly orchestrated several years ago.

**SMART ACT**

*(continued from page 1)*

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which states must implement the SMART requirements were too short and that the requirements themselves were generally unworkable.

The letter also stated that federal legislation was not necessary to implement reforms. Koken committed NAIC to working with Reps. Oxley and Baker, chairs of the House Committee on Financial Services and the House Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, respectively, toward achieving state insurance modernization.

NAIC drafted its letter in response to an earlier letter from Reps. Oxley and Baker. In that document, the lawmakers lamented what they called a recent "lack of communication between the NAIC and Congress" over SMART Act development. Koken challenged that view, citing scheduling difficulties and the failure of Congress to formally introduce the SMART Act as reasons for suspended regulator input.

According to reports, industry representatives were surprised and displeased with the regulators' new stance. An unnamed industry official commented, "I think the NAIC is making a huge mistake. They are under the misapprehension that reform in the state capitals is an option that federal legislators are looking at, and it isn't. There will be federal legislation on this topic, and Congress is just beyond conducting oversight. The NAIC misses that point" (*National Underwriter*, "NAIC Calls SMART Act Totally Flawed," March 25, 2005).

**NCOIL has strongly objected to the SMART proposal** and has mounted a broad state-by-state effort to educate legislators, governors, and attorneys general on the serious conse-

quences that such federal legislation would have state laws, premium taxes, and state authority, among other concerns. In letters sent to Reps. Oxley and Baker in September and again in November of last year, **NCOIL took the lead** on urging federal lawmakers to drop further development of the SMART Act, to recognize the significant modernization that states already have accomplished, and to leave insurance regulatory authority to the purview of state governments.

Proposed in response to what certain federal lawmakers perceive as the slow pace of state insurance modernization, the draft SMART Act follows numerous House hearings on the issue and was largely the result of early NAIC dialogue with lawmakers and federal staff.

*Reps. Oxley and Baker have set the following timeline for detailed consideration of the SMART Act:*

<b>Titles III and VIII</b> <i>insurer licensing and surplus lines</i>	April 6
<b>Titles X and XIV</b> <i>anti-fraud and financial surveillance</i>	April 13
<b>Titles IX and XIII</b> <i>reinsurance and receivership</i>	April 20
<b>Titles V and XI</b> <i>life insurance and viaticals</i>	April 27
<b>Titles II and XII</b> <i>market conduct and misc. insurance</i>	May 4
<b>Titles VI and VII</b> <i>commercial and personal lines</i>	May 11
<b>Titles XV and IV</b> <i>partnership and producer licensing</i>	May 18
<b>Title XVI</b> <i>competitive markets</i>	May 25

**SPECIAL NCOIL EXECUTIVE COMMITTEE MEETING ON  
REINSURANCE COLLATERAL REQUIREMENTS  
FOR NON-US REINSURERS**

Friday, July 8, 2005

3:15 to 5:15 p.m.

Newport, Rhode Island

## NCOIL REAFFIRMS UNWAVERING SUPPORT FOR TRIA EXTENSION

NCOIL reaffirmed its unwavering support for extending the Terrorism Risk Insurance Act (TRIA) of 2002 in a March 24 letter from NCOIL President Rep. Craig Eiland (TX) to U.S. Rep. Michael G. Oxley, chair of the House Committee on Financial Services, and Congressman Richard Shelby, chair of the Senate Committee on Banking, Housing and Urban Affairs. The letter retransmitted an NCOIL resolution, originally sent to Congress in July 2004, supporting extension of TRIA in order to forestall major marketplace disruptions. The resolution also supported inclusion of group life insurance in any extension legislation.

Rep. Eiland, acting on behalf of the full NCOIL Executive Committee, warned in the letter that the United States continues to be the ultimate target of many international terrorists and that possible future attacks could include the use of nuclear, biological, chemical, or radiological weapons. According to Rep. Eiland, "Since risks from catastrophic terrorist events can't be quantified or diversified by

insurers, the consequence of such events could be the insolvency of both individual insurers and the industry as a whole." He continued that if such an event occurred, the federal government alone may have to cover losses.

After the tragedies of 9/11, TRIA allowed for the creation of a viable terrorism risk insurance market for commercial losses, the letter stated. Rep. Eiland cautioned that failure to extend TRIA likely would result in insurers being unable to offer coverage for terrorist events. If that occurred, banks might not extend loans for commercial transactions, including mortgages, construction projects, and other capital-intensive initiatives. Rep. Eiland advised that such a situation would have severe adverse effects on our nation's economy.

In 2001, NCOIL was the first legislative organization to publicly support creation of a limited, temporary federal backstop for terrorism coverage.

Rep. Eiland's March 24 letter and the July 2004 NCOIL resolution are available at [www.ncoil.org](http://www.ncoil.org).

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## LEGISLATORS SCHEDULE HEARING ON AFTERMARKET CRASH PARTS

NCOIL's Property-Casualty Insurance Committee will hold a **hearing on a proposed Certified Aftermarket Crash Parts Model Act** on Thursday, July 7, during the NCOIL Summer Meeting.

The hearing—which is expected to draw numerous witnesses representing car-company, aftermarket crash part, autobody shop, and car-safety experts—will address issues related to the controversial certification of aftermarket crash parts by third-party organizations, such as the Certified Automotive Parts Association (CAPA). Among other things, the proposal would require disclosure as to the use of such certified parts.

The hearing is scheduled for 3:15 to 5:15 p.m. Legislators have asked that

those interested in submitting amendments to the proposed model act, which is available at [www.ncoil.org](http://www.ncoil.org), do so in accordance with the NCOIL 30-day deadline rule for the Summer Meeting.

In 2002, after deliberating on the draft model act for more than one year, NCOIL voted to defer further consideration of the proposal until the 2005 Spring Meeting. Lawmakers at the time cited a need to address other issues.

Submit your order for the  
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**NCOIL ALMANAC**  
today at [www.ncoil.org](http://www.ncoil.org)

**SAVE THE DATE**

**The NCOIL Summer Meeting**

**July 7-10, 2005**

**Newport, Rhode Island**

## PBMS, IDENTITY THEFT TAKE FOCUS AT SUMMER MEETING

As lawmakers across the country probe issues related to **pharmacy benefit managers** (PBMs), legislators at the NCOIL Summer Meeting will advance discussion of the issue at a July 9 NCOIL general session entitled *Pharmacy Benefit Managers: Finding the Formula for Drug Savings?* The session, scheduled from 8:45 to 10:30 a.m., will focus on understanding how PBMs operate; connecting the dots between PBMs and related industries, including pharmaceutical companies; considering options for regulating PBMs; and addressing the likely future of the PBM market.

Panelists representing pharmacy benefit manager, pharmacy, health insurer, employer, and regulatory perspectives will look at differences between non-profit and for-profit PBMs, in addition to the anticipated role of PBMs in the new Medicare Part D drug benefit. Concerning potential state legisla-

tion, speakers will discuss whether disclosure of PBM agreements with drug companies would violate trade secret protections, what the potential costs of imposing new PBM laws might be, and the alleged anticompetitive practices of pharmacy benefit managers.

Also on July 9, legislators will examine ways to secure the **privacy of consumer information** during a general session entitled *Identity Theft: How Can States Protect Personal Information?* The panel, scheduled from 10:45 a.m. to 12:30 p.m., follows on the heels of recent scandals in which ChoicePoint, LexisNexis, and Bank of America breached the privacy of thousands of consumers' personal data.

Among other things, the identity theft session will focus on the regulation of credit reporting agencies and on what states should require if consumer information is violated.

## STATES TAKE SPOTLIGHT: AUTO ANTI-FRAUD INITIATIVES

Aiming to curb rising auto insurance costs, three states recently acted to more aggressively fight fraudulent claims either through legislation or through regulation.

The Indiana Senate earlier this month approved House Bill 1403, which would extend the state's current anti-fraud laws to encompass theft of premiums and sale of bogus insurance coverage. Filing of fake claims is now the only crime addressed under state statute.

The bill also would toughen penalties for criminals, which observers say would encourage more frequent prosecution of fraud cases. HB 1403 would establish a maximum penalty of eight years and a maximum \$100,000 fine. Those convicted of fraud currently are subject to no more than 18 months in prison and \$10,000 or less in fines.

In Florida, a state particularly burdened by the costs of staged auto accidents, the House Insurance Committee recently approved a bill that would establish a two-year minimum jail sentence for anyone convicted of filing a

police report after a fake accident. The bill further would require health facilities to post the number of the Florida anti-fraud hotline and to disclose information regarding rewards for reporting fraud. Chief Financial Officer Tom Gallagher supports the proposal. The Senate Banking and Insurance Committee passed a companion bill earlier this month.

In addition, Delaware Insurance Commissioner Matt Denn has begun a crackdown on auto fraud that includes making insurance department hearings on the issue public, rather than closed. The initiative increases fines for those convicted of fraud to twice the amount of the fraudulent claim, as well as requires the perpetrator to reimburse the insurer for any funds that the person received inappropriately.

Under the measure, the Department will refer anyone convicted of auto fraud to the Delaware Department of Justice for criminal prosecution. Regulators also will conduct periodic reviews of outstanding auto fraud cases to insure that they are treated as high priorities.

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