



NCOILETTER

January 2005

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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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BROKER DISCLOSURE: NAIC AMENDMENTS A GOOD START, MORE NEEDED

The NCOIL Steering Committee earlier this month reiterated its interest in developing a strong response to broker compensation issues when it determined that NAIC's newly adopted amendments to the *Producer Licensing Model Act* are a good first step, with more needed.

Legislators on the Committee, which is comprised of NCOIL officers and committee chairs, said including language on broker responsibilities/fiduciary duty would be important to effective legislation. The Committee saw the need for a bright line between "agents" and "brokers" and for study into items such as agent-owned reinsurance arrangements.

On December 29, NAIC adopted language that would prohibit a producer or affiliate from accepting insurer or third-party compensation for placement of insurance unless that producer/affiliate first obtained documented acknowledgment that a customer was aware of the compensation arrangement. They also must disclose the amount of income received from an insurer or other third-party and the method for calculating that,

including contingent fees. If the contingent income is unknown, the producer/affiliate must give reasonable estimates of the amounts and methods for calculating it.

Regulators deferred for 90 days other language that would mandate, among other things, notification that a producer may receive additional income from an insurer based on premium volume placed with that carrier, as well as on the loss experience of the policies in force. NAIC plans to investigate other issues during that time, including agent-owned reinsurance, disclosure of all quotes a broker receives, and a broker's fiduciary duty.

NCOIL will examine broker disclosure further during a March 5 session entitled *Broker Compensation: Impact on the Insurance Market*. The panel, held during the NCOIL Spring Meeting, will look at various ways brokers are compensated and at proposed options for reform. Agent, broker, p-c, and life-insurance industry representatives will comment on those reforms. A special Executive Committee meeting on the issue will convene immediately after the general session.

NCOILSETS LEGISLATIVE AGENDA: 2005 SPRING MEETING

The most debated issues affecting state legislatures will be on focus during the March 3 through 6 NCOIL Spring Meeting in Hilton Head, SC. Some of items up for discussion are:

- * The SMART Act (see article page 2)
- * Financial Modernization (see page 2)
- * Broker Compensation/Disclosure (see pages 1, 2)
- * Claims History Databases
- * Life Settlements
- * Drug Reimportation (see page 3)
- * Natural Disaster Insurance Legislation (see page 3)
- * Medicaid
- * Aftermarket Crash Parts (see article page 4)
- * Patient Safety
- * TRIA Reauthorization (see page 3)
- * Long-Term Care Partnerships

2004 ROUNDUP: INSURANCE IN REVIEW

No proposal would change insurance oversight more than Reps. Michael Oxley and Richard Baker's SMART Act. The draft would divest state legislators of their regulatory authority; preempt state laws; challenge the power of state officials and the future of premium taxes; and go a long way toward unraveling state consumer protections.

Nothing less than the future of state insurance regulation came under fire last year, as federal lawmakers began a plan for "streamlined" insurance oversight and a interested parties stepped up to have their opinions, and requests, heard.. Financial modernization gained greater emphasis in light of the proposed State Modernization and Regulatory Transparency (SMART) Act. The 2004 insurance agenda also included broker disclosure; medical malpractice; drug importation; and terrorism, flood insurance, and natural disaster issues.

SMART Act

No proposal would change insurance oversight more than Reps. Michael Oxley and Richard Baker's SMART Act. The draft would divest state legislators of their regulatory authority; preempt state laws; challenge the power of state officials and the future of premium taxes; and go a long way toward unraveling state consumer protections. The draft would effectively hand authority over to the NAIC, a quasi-governmental entity responsible to no one, in place of state regulators and lawmakers.

Last fall NCOIL opposed the SMART Act and expressed interest in working with Congress to preserve state oversight. Others opposed to the Act include Robert Hunter (Consumer Federation of America), who commented that "The proposal is obviously written by the insurance companies, and Congress has not thought it through."

The p-c industry supports the draft because it would end state rate regulation in favor of open competition. Life insurers (supporters of an optional federal charter) have offered mild support.

NAIC worked with Congressional staff to craft the SMART proposal, a move that concerned some regulators. NAIC as a whole opposes preemption of state laws (namely regarding p-c rating) and creation of a federal advisory body to oversee insurance regulation.

Financial Modernization

Gramm-Leach-Bliley compelled states to streamline insurance regulation and to speed products to mar-

ket—goals that still rank high on Congress' watch list. States worked to foster reciprocity/uniformity in producer licensing; enact company licensing reforms; and encourage competitive rating for p-c insurance. More states aimed to ease p-c rating restrictions, and NCOIL adopted a flex-band model law to help with the transition. Another NCOIL bill would create a personal lines use-and-file system.

Last year NCOIL adopted, and NAIC amended then supported, the first market conduct surveillance regulatory reform model. This groundbreaking piece of legislation would standardize procedures for market analysis and targeted exams and promote domestic deference for market conduct reports. The bill would eliminate periodic examinations, among other things.

Momentum gained last year for implementation of an interstate compact to hasten regulatory approval for life, disability, annuity, and long-term care insurance products. The efforts continue in 2005.

Broker Compensation

It would have been hard to have missed NYS Attorney General Eliot Spitzer's investigation into broker contingency fees. When Spitzer filed a civil complaint against Marsh & McLennan, agents, brokers, and insurers rushed to disavow bid-rigging and other abusive practices and to largely defend the compensation systems that have served for years. Some eventually abandoned contingency fee arrangements.

In the aftershocks of Spitzer's action, states including CA launched their own investigations and proposed regulations.

NAIC adopted amendments to its *Producer Licensing Model Act* that would mandate disclosure, in part, of the amount of compensation a broker receives. Other language was deferred for 90 days to allow time to consider certain issues. NCOIL proposed its own model that stressed strong enforcement and establishment of a broker's fiduciary duty. Legislators have responded to NAIC efforts on the issue.

Though some say the scandal helps the SMART Act, many think the investigation, which benefited from NYS Insurance Dept. help, proves the need for state oversight.

Medical Malpractice

2004 legislative consideration of med mal issues highlighted the divide between those who think large jury awards have devastated the system and those who think insurers are pointing fingers in the wrong direction. Last year, as in years previous, medical societies lobbied for caps on non-economic and punitive damages, and trial lawyers targeted insurers' declining investment income and the cyclical nature of the insurance market as reasons for rising premiums.

Congressional Republicans unsuccessfully pushed for federal legislation that would feature a \$250,000 cap on non-economic and punitive damages. With the new Congress, chances of enactment have improved.

NCOIL continued its examination of medical malpractice issues, adopting a resolution endorsing certain tort system reforms and considering ways to promote patient safety as one approach to reducing rates. Consideration of a proposed NCOIL patient safety model act resumes in 2005.

Drug Importation

Spurred by rising prescription drug costs and the growing uninsured, the push for legal reimportation of lower-cost drugs from Canada into the U.S. gained force in 2004. A handful of states operated Web-based programs, advocates (and some governors) urged Congress to legalize the effort, and consumers showed greater interest in cheap drugs from across the border.

Pharmaceutical companies and the Bush administration claimed foreign drugs could not be guaranteed safe. The Food and Drug Administration (FDA) said reimportation activities violate the *Federal Food, Drug, and Cosmetic Act*.

Further, it appeared that movement may be building in Canada to restrict reimportation. Some parties say reimportation, among other things, threatens Canadian drug supplies and hurts small Canadian pharmacists.

NCOIL is considering a resolution that would endorse drug reimportation and will discuss the issue further

during the NCOIL Spring Meeting.

Catastrophe Risks

With the **Terrorism Risk Insurance Act (TRIA)** set to expire in December 2005, the Treasury Department extended the "make available" provisions requiring insurers to include terrorism coverage in their commercial p-c policies. Despite bipartisan support, Congress failed to reauthorize TRIA.

NCOIL was the first national legislative organization to support a limited, temporary federal backstop for terrorism risk, and last July adopted a resolution urging Congress to reauthorize TRIA.

Federal lawmakers reformed and extended the **National Flood Insurance Program (NFIP)** until 2008. The new NFIP requires owners of repetitive-loss properties to mitigate future loss and authorizes the Federal Emergency Management Agency (FEMA), among other things, to charge property owners up to 150 percent of their current premiums should they fail to do so.

Issues related to flood insurance education came to a head in MD when Hurricane Isabel claimants grew frustrated with their claims. MD was unused to the level of flood devastation wrought by the storm, so affected parties were unfamiliar with details of the NFIP.

Among other disasters, the four Southeastern hurricanes led to more than \$20 billion in insured losses and proved the need for **federal natural disaster insurance legislation**. The FL catastrophe fund has so far forestalled insurer insolvencies in that state.

New FL law creates a reimbursement program for homeowners who paid more than one windstorm deductible. Ongoing, the law allows policyholders to pay just one deductible per season.

Congressman Bradley Sherman offered an amendment to a TRIA-reauthorization bill that would have promoted federal natural disaster awareness. The measure did not advance, but NCOIL was on record as strongly supporting such federal investigation. NCOIL also began examining various natural disaster options and continues its deliberations in 2005.

2004 legislative consideration of medical malpractice issues highlighted the divide between those who think large jury awards have devastated the system and those who think insurers are pointing fingers in the wrong direction.

SAVE THE DATE

The NCOIL Spring Meeting

March 3-6, 2005

Hilton Head, South Carolina

NCOIL RESUMES AFTERMARKET CRASH PARTS DISCUSSION

The NCOIL Property-Casualty Insurance Committee will consider issues surrounding **certified aftermarket crash parts** when legislators meet at 10:45 a.m. on Friday, March 4, during the NCOIL Spring Meeting. The Committee had considered a proposed *Certified Aftermarket Crash Parts Model Act* in 2002 but, after more than a year of deliberations, deferred the matter until the upcoming 2005 NCOIL

meeting. Among other things, the proposed model would support certification of aftermarket crash parts by independent third-party organizations, such as the Certified Automotive Parts Association, and would require disclosure that such parts were used. A focus of the March discussion will be options for future NCOIL efforts on the issue, including whether NCOIL should pursue model legislation.

FACT FINDINGS: CBO SAYS “NO” TO TRIA REAUTHORIZATION

This month, the Congressional Budget Office (CBO) released a report on reauthorization of the Terrorism Risk Insurance Act (TRIA), set to expire at year-end 2005. Among other things, CBO says the economy would benefit from a fully private-sector mechanism for terrorism risk. The report has drawn strong opposition from a wide range of interested parties. Below are excerpts from the study.*

“Although capital markets are currently absorbing some terrorism risk, the development of financial instruments for spreading that risk would probably be more rapid in the absence of TRIA. The reason is that private alternatives have difficulty competing with a free federal program.”—page 5

“Competition should force insurers to pass the subsidies provided by the Terrorism Risk Insurance Act through to policyholders, so current premiums for terrorism coverage should be below market rates. Insurance companies and brokers might be keeping a small portion of the subsidies—an outcome that is more likely if recent allegations of bid-rigging by insurers and brokers are substantiated.”—page 12

“If the federal government continued to subsidize terrorism insurance, it would probably contribute to deferring the private-sector’s long-term

adjustment to the increase in risk. Less adjustment means that losses from future attacks would be greater than would otherwise be the case. Experience with other federally subsidized insurance programs suggests that their economic effects can be substantial.”—page 14

“...There is a growing perception that the risk of terrorism is likely to remain high. That development suggests that property owners and businesses need to take measures to reduce their exposure to that risk. They would have a stronger incentive to take such measures if the insurance subsidies conveyed through TRIA were reduced or eliminated.”—page 17

“...Letting TRIA expire would not increase the expected cost of terrorism to the economy but rather would change who bore it. Only if the government can bear terrorism risk at a lower cost than private firms and insurers will costs rise with the expiration of TRIA. However, there is no evidence to suggest that the government can bear terrorism risk more efficiently than others can.”—page 17

**NCOIL was the first legislative organization to support a temporary, limited federal backstop for terrorism risk. In July 2004, NCOIL passed a resolution urging Congress to reauthorize TRIA.*

NCOILetter

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