



NCOILETTER

June 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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FEDERAL PREEMPTIVE STRIKES

Movements in Washington to shift insurance regulatory authority from the states to some version of a federal oversight body have raised concerns among state legislators, who foresee fundamental problems for consumers, state budgets, current state laws and regulations, and the authority of state officials. State reform of the insurance regulatory system is the best way, legislators say, to help the marketplace respond to an increasingly complex, global environment

while safeguarding the interests of individual policyholders.

States already have taken the lead enacting major reforms regarding rate modernization, market conduct, producer and company licensing, and speed-to-market for life insurance products and, therefore, cannot support the current State Modernization and Regulatory Transparency (SMART) Act (see story below) or any new optional federal charter legislation (see story page 2).

SMART ACT INTELLIGENCE

The State Modernization and Regulatory Transparency (SMART) Act has been the subject of a flurry of correspondence the last several months between state legislators and regulators and Reps. Michael Oxley (R-OH) and Richard Baker (R-LA), chair of the House Financial Services Committee and the Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, respectively. In its current form, the SMART Act would supplant state insurance regulation and replace it with a quasi-federal entity, among other changes. The draft, which is being reworked in response to Committee hearings and comment periods, reacts to what some say is the slow pace of state insurance modernization.

The National Association of Insurance Commissioners (NAIC) had worked closely with Congressional staff to help develop the proposed language, but recently expressed strong concerns

with SMART, as overviewed in the 36-page findings of an NAIC SMART Act review team. NCOIL, from the initial release of the SMART discussion draft last August, has opposed the plan on the grounds that it would hurt consumers, imperil state budgets, and raise constitutional issues related to the authority of state officials.

On March 9, Reps. Oxley and Baker wrote the NAIC to (continued on page 4)

INSIDE:
Commentary From U.S. Senator Richard Durbin (D-IL) Regarding A Pending Alternative to AHPs

NCOIL welcomes **U.S. Representative Sue Kelly (R-NY)** as its keynote luncheon speaker during the NCOIL Summer Meeting in Newport, Rhode Island. Rep. Kelly, a member of the powerful House Committee on Financial Services, will address issues related to Terrorism Risk Insurance Act (TRIA) reauthorization, as well as other state-federal concerns. The lunch is scheduled from 12:30 to 1:45 p.m. on Friday, July 8.

OPTIONAL FEDERAL CHARTER: LETTER CLAIMS NEED FOR NEW SYSTEM

Renewed interest in pursuing OFC legislation appears due, at least in part, to current discussions surrounding a proposed State Modernization and Regulatory Transparency (SMART) Act.

On June 13, a coalition of more than 130 companies representing banking and insurance interests sent a letter to U.S. Senators Richard Shelby (R-AL) and Paul Sarbanes (P-MD), chair and ranking member, respectively, of the Senate Committee on Banking, Housing, and Urban Affairs. The letter urged the Committee to consider optional federal charter (OFC) legislation as an alternative to the state-based system of insurance regulation. Among other things, the coalition said that state oversight was inefficient and ineffective and that federal intervention was needed to respond to today's global insurance market.

NCOIL has historically opposed any attempt to cede insurance authority to the federal government, including creation of an optional federal charter, on the grounds that it would weaken consumer protections and jeopardize critical state premium tax income, among other concerns.

The June 13 letter claimed that "a market-based Optional Federal Charter proposal would embrace the best of state insurance regulation and would allow insurers, insurance agencies and insurance producers to take advantage of the regulatory flexibility that banks have long enjoyed." The letter said that "In addition, state premium taxes would be preserved and would continue to flow into state treasuries just like they do currently."

State legislators doubt that premium tax income would be safe under a bifurcated system of insurance regulation and predict that the OFC's federal regulatory authority ultimately would require funding that would be siphoned from state premium tax money. Loss of such income would devastate the general revenues of many states.

Legislators also have noted that state insurance regulation has a better history of ensuring company solvency than does the federal banking system, thereby doing a better job of protecting consumers.

Though states have worked hard to enact reforms that would help speed products to market, the letter to Senators Shelby and Sarbanes said that "success has always been limited" and that good intentions have not achieved a streamlined regulatory method that responds to today's more global environment.

Recently, states have made progress enacting legislation that would create an interstate compact for life, disability, annuity, and long-term care insurance products. Two-thirds of the requisite number of states (or more than half of the requisite market share) for the compact to go into effect are on board, including several large states with significant premium volume. The NAIC anticipates that by year-end 2006, the compact will be operational.

Renewed interest in pursuing OFC legislation appears due, at least in part, to current discussions surrounding a proposed State Modernization and Regulatory Transparency (SMART) Act (see *story page 1*). NCOIL opposes the SMART Act and is working with other state leaders to affect more meaningful reform of insurance regulation. SMART and OFC proponents each argue that states will retain more authority under their proposals.

OFC proposals were last considered in the Senate in 2003 and in the House in 2002 and would have substantially pre-empted state insurance authority. Enactment of Gramm-Leach-Bliley in 1999, which blurred the lines between banking and insurance, prompted many carriers, primarily life insurers, to seek a federal charter option.

Among those companies signing the letter to Senators Shelby and Sarbanes were: State Farm, AIG, Allianz, USAA, The Hartford, St. Paul Travelers, Zurich, Chubb, MassMutual, AXA, Munich Re, and Prudential. Trade groups included the American Bankers Association, the American Bankers Insurance Association, the American Council of Life Insurers, the American Insurance Association, the Council of Insurance Agents & Brokers, the Financial Services Forum, and the Financial Services Roundtable.

SEHBP: MAKING INSURANCE AFFORDABLE FOR SMALL BUSINESSES WHILE PRESERVING CRUCIAL STATE ROLE IN CONSUMER PROTECTION

By U.S. Senator Richard Durbin (D-IL)

Small businesses across America are struggling to afford health insurance in the small group insurance market. As insurance premiums continue to rise at double-digit rates, employers are now looking to federal elected officials for relief.

For the past several years, the debate in Washington has centered around the idea of allowing small businesses to pool their risk and purchasing power through trade association health plans that would be exempt from state insurance standards. Proponents of this approach, dubbed "Association Health Plans," contend that it is state benefit mandates and regulatory standards that are making insurance unaffordable for small businesses.

Senator Blanche Lincoln (D-AR) and I believe states play a crucial role in insurance regulation and consumer protection that should not be compromised. With the support of the American Medical Association and other health care provider groups as well as 10 of our Senate colleagues, we have introduced an alternative approach to small business pooling. Our plan, called the Small Employers Health Benefits Program (SEHBP), is based on the successful Federal Employees Health Benefits Program (FEHBP), which has provided wide benefit choices at affordable prices to federal employees for decades.

Like the federal employees program, SEHBP would offer small businesses with up to 100 employees a variety of local managed care and fee-for-service plans as well as several national plans. The state plans in SEHBP must be licensed in the state in which they operate and adhere to the benefit mandates of the state. Rating rules would be standardized to correspond with the "adjusted community rating" model set forth by the National Association of Insurance Commission-

ers. No other state standards would be pre-empted. Laws governing solvency, network adequacy, prompt pay, grievance processes and external review would all stay in place.

The national plans in SEHBP would be required to be licensed in all 50 states to qualify as national plans. As in the federal employees program, the national plans would not be subject to state benefit mandates, but instead would adhere to a benefit package set by the federal Office of Personnel Management (OPM). We are confident that the national package would provide comprehensive benefits for consumers as it currently does for federal employees. In addition to requiring inpatient and outpatient hospital care and physician services in FEHBP, OPM requires coverage for mental health, prescription drugs, childhood immunization, cancer screening and a range of organ transplants.

Besides the pooling benefits small businesses will gain from SEHBP, this program will lower administrative costs, which are a large factor affecting insurance premiums in the small group market. Insurers will no longer have to seek out and market to small groups, and administration will be streamlined through OPM, thereby making it less costly for insurers to offer and administer benefits to small businesses.

Finally, SEHBP will provide a tax credit to small business owners to help defray their cost of insuring lower income workers, more than half of whom are currently uninsured. For workers earning \$25,000 or less, participating businesses will receive a 25% subsidy for single workers, 30% for married workers and 35% for workers with families.

SEHBP is a common sense approach that will help small businesses provide insurance coverage to their employees. The program will maintain the crucial role states play in protecting consumers while providing small

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SEHBP will maintain the crucial role states play in protecting consumers while providing small businesses the opportunity to band together to command lower prices.

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NCOIL

SMART ACT

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express concern over regulators' "lack of communication" earlier in the year. The Congressmen said that "State-based insurance regulation is at a crossroads....The current system of overlapping regulation has not kept pace with the evolution of the marketplace. Restructuring and change is inevitable...."

NAIC President and Pennsylvania Insurance Commissioner Diane Koken responded on March 18, noting that when Rep. Oxley first presented his concept for federal regulatory standards, he said that it would not preempt state laws and regulations. Koken continued, "Our concerns are deeply rooted in the basic structure of the SMART Act....We do not believe that tweaking the language of the SMART Act discussion draft can resolve these basic conflicts."

Later, on April 22, the NAIC sent Reps. Oxley and Baker the findings of its 117-member SMART Act review team. The report analyzed the consequences of SMART and included case studies of states that would be negatively impacted by the draft's rate deregulation provisions—a centerpiece for the property-casualty insurance industry.

The study reached five overall findings: 1) consumers would be denied key consumer protections as a result of the preemption of state laws; 2) the new State-National Insurance Coordination Partnership would create regulatory confusion, lead to second-guessing of state regulatory authority, and create a host of major legal and practical issues tied to its makeup, powers, and administration; 3) SMART would usurp state oversight of rates and market conduct, thereby eliminating individual regulator authority and overriding key elements of even Illinois state law that make that state's open rate-filing system work;

4) the timeframes proposed to implement SMART reforms are too short, and the provisions are either unworkable or contrary to state consumer protection efforts; and 5) federal law is unnecessary to implement various SMART reforms, though federal input is welcomed with regard to accessing the FBI's criminal database, among other initiatives.

On May 16, Rep. Baker responded to the NAIC by canceling future meetings between regulators and Financial Services Committee staff. Among other things, Baker said that he didn't feel the need to "further familiarize" himself with regulators' concerns, and he challenged NAIC to craft its own reform plan.

In addition to regulator correspondence, Oxley and Baker heard from NCOIL Past President and NYS Senator William J. Larkin, Jr., who on April 7 sent them his analysis of SMART's "Top 10" consequences for insurance regulation. Among other things, Larkin pointed to the questionable constitutionality of requiring state attorneys general and governors to enforce federal law and noted that the SMART Act mandates may not adequately address local issues, such as assigned risk and FAIR plans, as well as natural disaster catastrophe funds.

Oxley and Baker responded on June 9. "We also share your desire to keep the regulation of the business of insurance primarily at the State level," they wrote. "We believe that SMART is the last opportunity to achieve our shared goals through the state regulatory system." They said further that they were concerned that attacks on SMART were energizing optional federal charter proponents.

A redraft of the SMART Act is expected to be released later this summer.

SEHBP'S

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businesses the opportunity to band together to command lower prices.

For more information about SEHBP (S.637) go to www.durbin.senate.gov or call Krista Donahue in my office at 202-224-2152 or Elizabeth MacDonald in

Senator Blanche Lincoln's office at 202-224-4843.

Senator Durbin is the senior Senator from the State of Illinois and the Assistant Democratic Leader in the U.S. Senate.