



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

March 18, 2005

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Honorable Michael G. Oxley
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Honorable Richard H. Baker
Chairman
Subcommittee on Capital Markets,
Insurance, and Government Sponsored
Enterprises
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairmen Oxley and Baker:

I received your March 9, 2005 letter expressing concern about a lack of communication between the National Association of Insurance Commissioners (NAIC) and Congress in recent months. Starting in January, we made every effort to arrange personal meetings with each of you, but were delayed in confirming final appointments due to scheduling issues. I am pleased to note that in February we were able to schedule a meeting for April 28th. If, however, you would prefer to meet sooner, we remain available. We recognize the importance of your work and the NAIC has been very actively engaged this year working with the Senate and House of Representatives on such issues as extending the Terrorism Risk Insurance Act, medical malpractice insurance, military life insurance sales, and asbestos settlement legislation.

With respect to the House Financial Services Committee and SMART Act discussion draft, we provided you with our three main concerns last year: (1) federal preemption of state consumer protections laws, (2) federal supervision of state regulation, and (3) mandatory federal rate de-regulation. The NAIC has been working since March 2004 to meet your requests for information and policy input regarding state regulatory modernization efforts. In addition to providing extensive formal and informal input to the Committee, the NAIC and state regulators have spent substantial time and resources cooperating with the General Accountability Office (GAO) on three major reviews requested by the Financial Services Committee regarding the Risk Retention Act, terrorism preparedness in the insurance sector, and legal interpretations of the insurance anti-trust exemption in the McCarran-Ferguson Act.

Chairman Oxley first presented his conceptual proposal for statutory federal insurance regulatory standards to NAIC members at our Spring National Meeting in New York last year. He indicated that his proposal would not preempt state laws and regulations, and challenged the NAIC to respond to his proposal by Memorial Day. The NAIC met Chairman Oxley's challenge on time by diligently working to put together a state-based plan entitled: *Modernizing the Insurance Regulatory Structure: The NAIC Framework for a National System of State-Based Regulation*. That plan is currently being implemented successfully across the United States. In submitting its plan to the Financial Services Committee, the NAIC noted that local control and understanding of

market conditions is a strength of state regulation for supervising rates, policy forms, and market conduct. While we intend to accomplish effective national uniformity wherever possible, our primary responsibility under state law is to protect consumers rather than pursuing uniformity for its own sake.

During August 2004, the SMART Act discussion draft was released amid indications that it would soon be formally introduced as a bill and acted upon before Congress adjourned. When no bill was forthcoming by December, the NAIC's Government Affairs Task Force and new officers decided we should conduct a thorough review of the SMART Act discussion draft and its impact on state insurance regulation. Seven review teams comprised of 117 commissioners, state regulatory experts, and NAIC senior staff were assigned to evaluate each Title of the SMART Act draft. Their report was presented to the Government Affairs Task Force at our Spring National Meeting in Salt Lake City on Monday, March 14, 2005.

The NAIC's review teams used the "*Framework for a National System of State-Based Regulation*" as the focal point for evaluating specific provisions of the draft SMART Act. They evaluated how the SMART Act's provisions would affect state implementation of the NAIC's modernization plan and state supervision authority if the Act became law. Each review team was asked to analyze its assigned sections of the SMART Act with the goal of answering three basic questions:

- (1) Are the NAIC's regulatory modernization goals adequate?
- (2) Is federal legislation necessary to reach NAIC's goals?
- (3) How does the SMART Act impact state regulation?

Although the NAIC's SMART Act review teams were not tasked with reaching policy decisions, their factual findings reveal fundamental problems for preserving essential state regulatory authority if the basic elements of the draft SMART Act bill become federal law. In summary, the NAIC review teams found:

1. The SMART Act would substantially and negatively impact state regulatory authority to supervise property/casualty, life, and health insurance, as well as reinsurance, by establishing federally-mandated standards and preempting state laws that disagree with them.
2. The SMART Act would create unhealthy regulatory confusion in insurance markets by subjecting state regulations and orders to second-guessing and possible interference by a new federal entity called the State-National Insurance Coordination Partnership. In addition to raising a host of serious legal and practical concerns regarding its composition, powers, and administration, this Partnership would encourage time-consuming and expensive litigation by those who disagree with state regulatory actions, during which the legitimacy of state actions would hang under a cloud of doubt until a final resolution is reached in federal courts.

3. The SMART Act would remove the ability for independent judgment and action by state regulators to protect consumers under state laws and regulations in such important areas as supervising rates and conducting market conduct exams. Even though Illinois has often been cited by SMART Act proponents as the model rate system for all states, the Act would undercut or negate important provisions of Illinois law that make its rate system work.
4. In general, the time limits for states to implement the SMART Act's requirements are too short, and many of the Act's provisions seem impractical, unworkable, or detrimental to state consumer protection efforts.
5. Federal legislation is generally not needed to implement the various provisions of the NAIC regulatory modernization Roadmap. However, federal legislation would be welcome to enable access by all state insurance regulators to the FBI criminal database, to enable sharing of confidential regulatory information among federal and state regulatory agencies, granting liability protection to NAIC as the central data exchange for states, and to grant states equal receivership powers with the federal government.

After discussions among the Government Affairs Task Force and NAIC officers in Salt Lake City, we remain concerned with the SMART Act draft in its present form. Our concerns are deeply rooted in the basic structure of the SMART Act that mandates federal preemption of state laws and regulations, federal supervision of state regulation, and complete rate de-regulation for all states. We do not believe that tweaking the language of the SMART Act discussion draft can resolve these basic conflicts.

The SMART Act is not a concept that NAIC would suggest to Congress. For example, the NAIC's review of the SMART Act draft found that federal preemption of state laws is involved in 13 substantive titles of the Act: Title II (Market Conduct and Uniform Standards), Title III (Insurer Licensing), Title IV (Producer Licensing), Title V (Life Insurance), Title VI (Commercial Property and Casualty Insurance), Title VII (Personal Lines Property and Casualty Insurance), Title VIII (Surplus Lines and Independently Procured Insurance), Title IX (Reinsurance), Title XI (Viaticals), Title XIII (Receivership), Title XIV (Financial Surveillance), Title XV (Partnership), and Title XVI (Creating Competitive Insurance Markets).

We are finalizing the SMART Act analysis undertaken over the past several months, which was discussed by the Government Affairs Task Force earlier this week. The NAIC plans to submit this summary of each SMART Act Title to you shortly in order to provide you with the background information you requested. We are also prepared to send NAIC staff to the sessions you identified for the purpose of reiterating these points. When a formal bill is introduced, the NAIC will be available to analyze and evaluate the impact of the bill's language with much more certainty and confidence than is now possible.

We will continue to be actively engaged in providing you and other Members of Congress with regulatory expertise and policy guidance to help complete the job of implementing state-based improvements to the insurance regulatory system. Congress plays an important role in overseeing the state insurance regulatory system. I look forward to meeting with you soon to discuss how we might work together to accomplish the regulatory modernization goals we all share.

Sincerely,

A handwritten signature in black ink that reads "Diane Koken". The signature is written in a cursive style with a large, stylized initial "D".

Diane Koken
Commissioner of Insurance, Pennsylvania
President, NAIC