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**January 14, 2004**

**MEMORANDUM**

**TO: Ann vom Eigen  
American Land Title Association**

**FROM: Scott Sinder  
John Fielding**

**RE: The SMART Act – An Overview and Questions to Help Formulate Policy  
with respect to the Federal Insurance Regulatory Reform Draft Legislation**

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Last fall, Rep. Mike Oxley (R-OH), Chairman of the House Financial Services Committee, and Rep. Richard Baker (R-LA), Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, released a discussion draft of their long-anticipated insurance regulatory reform bill.

Entitled “*State Modernization and Regulatory Transparency Act*” or “*SMART Act*,” the bill – if enacted – would leave the current state-based insurance regulatory system in place but would facilitate a major overhaul of that system, and eliminate conflicting state laws and regulations. The Act is a behemoth of a bill, consisting of 17 separate titles and over 500 pages of legislative text, and addresses a full range of insurance regulatory issues including licensing, market conduct, and product and rate approval.

This memorandum provides an analysis of the key provisions of the proposal and decision points for ALTA. The initial decision ALTA will need to make as the legislative process moves forward is whether title insurance should be included or excluded as you deem appropriate with respect to some or all of the Act’s provisions. Depending upon the answer to that question, there will be more specific questions for consideration.

The ensuing analysis is divided into five parts: The Introduction is essentially an expanded table of contents. It includes a short statement in bold type summarizing each section of the memorandum and sets forth questions designed to assist ALTA members as you formulate policy with respect to the SMART Act and federal insurance regulatory reform. The statement and questions are repeated at the beginning of each section of the memorandum. The remainder of the memorandum addresses the separate titles of the proposal: Part A provides a general overview of the bill; Part B outlines the insurer-specific provisions that could affect title insurers;

Part C outlines the insurance producer-related provisions; Part D explains the state-federal partnership office that would be created to oversee the new regulatory regime; and Part E lists other provisions in the bill that are not title insurance-related. Each Part includes a citation of the applicable section of the SMART Act and is followed by the actual text of the draft bill.

When reviewing Parts B and C of this memorandum, it is important to bear in mind that some, but not all, of the current provisions exclude title insurance. Under the language of the current bill, title insurance is (at least arguably) included in the Market Conduct provisions (Title II), the insurer licensing provisions (Title III), the producer licensing provisions (Title IV), and the personal lines property and casualty speed to market provisions (Title VII). Title insurance is specifically excluded from the commercial property and casualty speed to market provisions (Title VI) and the property and casualty rate reform provisions (Title XVI). As a general matter, the titles that can be construed as applying to title insurance either have no specific definition of insurer or include a generic definition with no exceptions; the two property and casualty titles that exclude title insurance contain express exclusion language.

## INTRODUCTION

### A. General Overview

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The SMART Act, if enacted, would be a comprehensive overhaul of state insurance regulation. It encourages the states to reform insurance regulation by establishing legislative and regulatory goals that the states are required to meet and preempting state laws and regulations that differ from or do not meet the federal standards. The proposal contemplates a significant role for the National Association of Insurance Commissioners and the state insurance regulators and preserves the McCarran Ferguson Act.

- Is comprehensive regulatory reform necessary or desirable for ALTA members?
- Is overhaul of state insurance regulation the best approach to achieve insurance regulatory reform?
- Will federal involvement in insurance regulatory reform make it easier or more difficult for ALTA members to do business?
- Should ALTA support the inclusion of title insurance in the SMART Act regulatory reform provisions as a general matter?
- How does the SMART Act interact with the NAIC Title Insurers Model Act as that Act has been enacted in the states?
- Are there provisions of the NAIC Title Insurers Model Act that should be incorporated into the SMART Act to force the states to achieve uniformity on issue(s) related to title insurance?

### B. Insurer Provisions

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#### 1. Market Conduct

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##### *SMART Act Title II*

The SMART Act requires states to coordinate market conduct examinations, standardize the scheduling of market conduct examinations, and establish uniform standards and implementation for such examinations. The “home state” of an insurer is required to conduct regular market conduct compliance examinations once every five years. “For cause” examinations are permitted in limited circumstances. The SMART Act requires states to adopt and uniformly implement NAIC market conduct model acts and regulations or face preemption. The Act also directs the NAIC to develop a market conduct accreditation process along the lines of the NAIC’s financial solvency accreditation process.

- Is market conduct reform desirable for title insurers?
- Should title insurers be excluded from the market conduct reform provisions of the SMART Act?

- Would uniformity in market conduct regulation across the states outweigh the additional burdens imposed by the SMART Act in the form of regularly-scheduled examinations?
- Is it necessary to have regularly-scheduled market conduct examinations in addition to “for cause” examinations?
- Is the additional burden to ALTA members warranted?
- Are the standards set forth in the SMART Act for “for cause” examinations fair? Are they measurable?
- Are the timeframes for notifying companies regarding upcoming examinations reasonable?

## 2. Insurer Licensing

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### *SMART Act Title III*

The SMART Act requires implementation of a streamlined company licensure process and uniform licensing standards, comparable to the changes in the producer licensing system subsequent to the passage of the Gramm-Leach-Bliley Act’s NARAB provisions. State authority to review application materials is limited and state laws and regulations that are not uniform will ultimately be preempted.

- Should title insurers be included in provisions reforming the company licensing process?
- Should ALTA support the development of a company licensing system that limits the ability of non-domiciliary states to review/approve/disapprove applications?
- Is the NAIC’s ALERT standard an acceptable licensure standard for ALTA members or should ALTA support the addition of provisions to the SMART Act that would require the states to adopt revisions to ALERT?

## 3. Speed To Market

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### *SMART Act Title VI Commercial Property and Casualty Insurance*

### *SMART Act Title VII Personal Lines of Property and Casualty Insurance*

The SMART Act attempts to force states to reform and streamline their rate and form laws. The Act requires states to coordinate filing processes and prohibits “desk drawer” rules for *all* property & casualty lines. Although the SMART Act requires the states to implement extensive rate and form deregulation for many commercial lines, *title insurance was specifically excluded from these provisions based on ALTA communications with Representative Richard Baker (R-LA), the Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises.* In addition, for those lines that are included, the Act takes an inconsistent approach to commercial rate deregulation. With respect to personal lines, the SMART Act requires states to establish expedited review for personal lines property & casualty forms.

- Should ALTA continue to lobby for title insurance to be excluded from the (i) rate and/or (ii) form approval provisions of the SMART Act?
- Should title insurance be included in the rate and form deregulation provisions of the SMART Act?
- Should rate and form regulation in connection with title insurance be completely deregulated?
- Is there a certain level of regulation that is acceptable or desirable?

#### 4. Insurance

(Page 14)

##### *SMART Act Title XI*

The SMART Act would centralize financial regulation of reinsurers on the reinsurer's home state; reinsurance contracts would be governed by the primary carrier's home state. To the extent the states do not adopt uniform solvency requirements, forms and financial filing requirements, they face preemption. The reinsurance sections of the draft proposal relate to uniform financial statement filings for reinsurers and uniform solvency review of reinsurers and do not generally raise any issues for ceding companies.

- Would centralization of reinsurance regulation in the home state of the reinsurer and uniform reinsurance laws in all states have any impact on ALTA members?
- If so, should ALTA attempt to have title insurance specifically included or excluded from the SMART Act reinsurance provisions?
- Does the retention by domiciliary states of filing authority impose any burdens on ALTA members that ALTA should attempt to have revised?
- To the extent the SMART Act provision covers ceding insurers as well as reinsurers, should ALTA attempt to have title insurance specifically excluded or included?

#### 5. Financial Surveillance

(Page 16)

##### *SMART Act Title XIV*

The SMART Act establishes standards that states must meet to make financial surveillance activities uniform, including standards addressing issues such as best practices, self-audits, administrative supervision and accounting.

- Are uniform financial surveillance requirements desirable for ALTA members?
- Should title insurance be specifically included or excluded from the SMART Act financial surveillance provisions?
- Should ALTA attempt to insert specific standards with respect to establishing corporate management best practices?
- Would self-audits (and uniform self-audit procedures in the states), uniform accounting standards and uniform administrative supervision standards benefit ALTA members? Should they be encouraged?
- Would coordination with affiliates be beneficial/economical?

- Should ALTA push for a clearer preemption standard with respect to state compliance with the SMART Act financial surveillance requirements?

## 6. Receivership

(Page 18)

### *SMART Act Title XIII*

To create uniformity and efficiency in state receivership laws, and equitably apportion losses, the SMART Act incorporates much of the Uniform Receivership Law (URL). The receivership court generally would not determine guaranty association liabilities; the receiver would be required to provide the guaranty association with relevant information. Reinsurers would be obligated to receivers and third parties in the event of a receivership, regardless of contractual agreements. If a state does not enact a law substantially similar to the SMART Act's receivership provisions, the state may not regulate receiverships.

- Are the current state receivership laws problematic for ALTA members?
- Would a more uniform approach to receivership regulation be desirable for ALTA members?
- Is the Uniform Receivership Law acceptable to ALTA members or are there provisions that should be revised before being incorporated into federal law under the SMART Act?
- Should the receivership court have the authority to determine the liability of a state guarantee authority?
- Should a state guarantee authority continue to have the right to intervene in receivership proceedings?

## C. Producer Licensing Provisions

(Page 19)

### *SMART Act Title IV*

**Full Licensing Reciprocity and Uniformity.** The SMART Act requires all states to have reciprocal producer licensing requirements in place in two years and to have uniform licensing standards in three years. ALTA succeeded in getting title insurance excluded from the uniformity/reciprocity producer licensing provisions of the predecessor legislation to the proposal, the Gramm-Leach-Bliley Act's NARAB provision. Unlike the NARAB provision, the SMART Act does not include an exception from the reciprocity/uniformity requirements for countersignatures.

- Should ALTA continue to lobby to maintain the exclusion related to uniformity/reciprocity of producer licensing requirements?
- Is 50-state uniformity in producer licensing standards (the standards by which the states judge whether or not an applicant is qualified for licensure) desirable or necessary for ALTA members?
- Should ALTA push for the specific inclusion or exclusion of title insurance from the producer licensing provisions of the SMART Act?

- Should there be more specificity with respect to describing uniform producer licensing standards?
- Should the SMART Act specifically refer to or incorporate the NAIC's Uniform Resident Licensing Standards document? Should those standards be made applicable to all insurance producers?

***Criminal Background Checks.*** The SMART Act would enable the states to establish a streamlined criminal background check process with uniform standards that requires only one set of fingerprints from producers.

- Should there be more comprehensive background check requirements of insurance producers in all states than the requirements that exist in some states currently?
- Are more stringent background checks acceptable to ALTA members in exchange for full reciprocity in producer licensing requirements and full uniformity in producer licensing standards?
- Should state insurance regulators have the authority to access the FBI criminal history database for producer background information or is there an alternative means to determine whether an applicant's background disqualifies him or her from receiving a producer's license that might be less burdensome and less intrusive on, for example, the producer's privacy?

**D. The State-National Insurance Coordination Partnership (Page 22)**  
*SMART Act Title XV*

The "Partnership" would not be a regulator, but would be responsible for arbitrating disputes regarding uniformity and bringing suits challenging state implementation of the SMART Act. The Partnership would have seven members, including representatives of the state insurance commissioners and the federal financial services agencies; it would have no permanent office.

- Is the Partnership an effective vehicle for determining compliance with the SMART Act?
- Should ALTA support a stronger or weaker federal role in determining compliance with the Act?
- Is there an alternative method for resolving disputes and ensuring compliance that would be preferable to ALTA members?
- Should ALTA support an alternative approach that would ensure greater state authority over the decision-making process and greater influence over the final decisions?

**E. Other Provisions (Page 23)**

- *SMART Act Title V* – Streamline the life insurance product approval process

- ***SMART Act Title VIII*** – Streamline/improve the regulation of commercial p&c surplus lines products
- ***SMART Act Title X*** – Create an antifraud network among all of the state and federal financial regulators
- ***SMART Act Title XI*** – Improve consumer protection laws governing the sale of viaticals and clarify the division of viatical regulation among the various state and federal regulators
- ***SMART Act*** – Require the states to report to Congress regarding their efforts to develop and implement uniform health insurance standards in various areas

## DESCRIPTION AND ANALYSIS

### A. General Overview

The SMART Act, if enacted, would be a comprehensive overhaul of state insurance regulation. It encourages the states to reform insurance regulation by establishing legislative and regulatory goals that the states are required to meet and preempting state laws and regulations that differ from or do not meet the federal standards. The proposal contemplates a significant role for the National Association of Insurance Commissioners and the state insurance regulators and preserves the McCarran Ferguson Act.

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- How does the SMART Act interact with the NAIC Title Insurers Model Act as that Act has been enacted in the states?
- Are there provisions of the NAIC Title Insurers Model Act that should be incorporated into the SMART Act to force the states to achieve uniformity on issue(s) related to title insurance?

The SMART Act addresses nearly every facet of insurance regulation: producer and company licensure; background checks; life product approval; property & casualty form and rate approval; surplus lines; viaticals; market conduct; financial solvency; receivership; reinsurance; and more. It also establishes a state-federal partnership to resolve disputes arising out of the Act. Although every provision is clearly important, most critical for ALTA members are the provisions addressing company licensing, market conduct, financial surveillance, and other issues related to property & casualty insurance. These issues are discussed individually below.

Although the draft proposal is broad in scope, it is not detailed in depth. The proposed legislation incorporates two general approaches to regulatory reform. First, with respect to each issue area addressed, the bill sets forth congressional intent relating to future state regulatory behavior. Although the weight of such “intent” is unclear, the statutory language gives states a clear signal that failure to meet congressional expectations will likely have consequences in the form of future federal intervention. Second, the draft includes specific requirements or prohibitions with respect to certain state actions. In general, this is accomplished by setting a goal or standard for the states to meet (for example, full reciprocity in producer licensing), incorporating by reference the applicable NAIC model law or regulation (to the extent one exists), and preempting, or in some other way penalizing, any state that does not follow the congressional directive. Thus, the bill essentially establishes a framework for uniformity and then places responsibility on the states to enact laws and regulations to address the details.

As contemplated in the draft proposal, the National Association of Insurance Commissioners (NAIC) and state insurance regulators will have a significant role in the new scheme of insurance regulation. NAIC model laws and regulations form the basis for many of the reforms. The proposal pushes the states to adopt many NAIC models in “materially identical” form or face penalties, thus essentially making insurance regulation uniform with respect to the issues addressed in the Act. In addition, as described more fully below, the commissioners will have a powerful role in the state-federal partnership created under the Act. The regulators will control four of the seven partnership seats, including the chairmanship.

The SMART Act also preserves the McCarran Ferguson Act, which generally reserves to the states the right to regulate the business of insurance. The reasons for specific mention of McCarran are two-fold: (i) the drafters of the SMART Act want McCarran to stand so it remains clear that the states still regulate insurance and, if Congress wants to adopt a law that affects insurance, the law must specifically state that it deals with insurance (in other words, federal laws that apply generally, such as antitrust laws, do not apply to insurance); and (ii) the drafters want to preserve the insurance industry’s exemption from federal antitrust law.

## **B. Insurer Provisions**

### **1. Market Conduct – *SMART Act Title II***

**The SMART Act requires states to coordinate market conduct examinations, standardize the scheduling of market conduct examinations, and establish uniform standards and implementation for such examinations. The “home state” of an insurer is required to conduct regular market conduct compliance examinations once every five years. “For cause” examinations are permitted in limited circumstances. The SMART Act requires states to adopt and uniformly implement NAIC market conduct model acts and regulations or face preemption. The Act also directs the NAIC to develop a market conduct accreditation process along the lines of the NAIC’s financial solvency accreditation process.**

- **Is market conduct reform desirable for title insurers?**
- **Should title insurers be excluded from the market conduct reform provisions of the SMART Act?**
- **Would uniformity in market conduct regulation across the states outweigh the additional burdens imposed by the SMART Act in the form of regularly-scheduled examinations?**
- **Is it necessary to have regularly-scheduled market conduct examinations in addition to “for cause” examinations?**
- **Is the additional burden to ALTA members warranted?**
- **Are the standards set forth in the SMART Act for “for cause” examinations fair? Are they measurable?**
- **Are the timeframes for notifying companies regarding upcoming examinations reasonable?**

Market conduct examination rules and procedures differ widely across the states. They are regarded in many cases as not only overly burdensome, but as arbitrarily enforced. In keeping with the general goals of the SMART Act, the proposal seeks to streamline market conduct examination processes, requiring the states to coordinate examinations and make them more uniform from state to state.

The proposal expresses the intent of Congress that the home state of an insurer examine the company for market conduct compliance on a “regular basis.” The other states in which the insurer does business may participate in the examinations, but must defer to the domestic regulator in terms of calling and leading examinations.

The proposal allows the states to determine the frequency of regular examinations, although insurers conducting business in a majority of states must be examined at least once every five years. If an insurer has not been examined by its home state within the agreed upon time period (or five years, as applicable), other states may examine the company. An insurance company’s home state is the insurer’s domiciliary state or a state designated by the domiciliary state as one of the four other states in which the insurer conducts the greatest percentage of its business measured by gross premiums for all lines. Thus, regular examinations could be conducted by one of five states.

Although no time period is specified, insurers must be given prior notice of regular examinations by the state calling the examination (usually the home state), and the NAIC must provide other states a minimum of 60 days notice to allow for their participation in the examination.

A “for cause” examination is permitted if (i) there is an immediate danger to consumers, or (ii) the scope of the examination is limited to specific patterns and practices that have not been addressed by a regular examination within the previous five years or have been raised in another state and not addressed by the insurer. “Immediate dangers” include fraud and other “egregious conduct” by insurers that is likely to cause substantial financial loss to consumers.

States that call a “for cause” examination are required to give the targeted insurer at least 10 days’ prior notice, and the NAIC must give other states at least 30 days’ prior notice along with an explanation of the reasons for calling the examination. If there is an immediate danger to consumers, the examination may be conducted with no prior notice to the insurer, provided notice to the NAIC and other states is provided as quickly as possible.

***Sanctions:*** Sanctions against insurers for market conduct violations must be based on clearly written requirements based on specific standards contained in statute or published rules, or on “majority interpretations.”

***State implementation and preemption:*** As with the other provisions of the proposal, implementation of the market conduct provisions is left to the states. Although the proposal does not explicitly direct the states to coordinate items such as schedules, reports and requests for information, the draft expresses the intent of Congress that the states reach uniformity in market

conduct regulation by adopting and uniformly implementing current and yet-to-be-drafted NAIC model laws and regulations.

The proposal incorporates by reference the NAIC Market Surveillance Model Act, the NAIC Market Analysis Handbook, and the NAIC Uniform Examination Procedures, as well as “future model acts on market conduct that increase uniformity, coordination, transparency, and efficiency.” States are directed to adopt the existing model acts within three years or face preemption. Also within three years, the NAIC is required to make any necessary amendments to existing models, and adopt any new models, as necessary. Any standards in the new NAIC models that differ from those set out in the SMART Act would become effective upon adoption by a majority of the states, provided the new standards comply with the goals of the SMART Act. Noncompliant states face preemption of laws that prohibit regulators from recognizing standards set in NAIC models.

In addition to the development and revision of NAIC model laws and rules, the proposal also expresses congressional intent that the NAIC develop a market conduct accreditation process within three years. The market conduct accreditation process, which would likely be modeled after the NAIC’s financial solvency accreditation process, essentially would ensure that every state is in compliance with the uniformity and coordination requirements of the SMART Act.

The potentially most effective enforcement mechanism to force state compliance with the Act’s market conduct provisions is likely to be a general provision stating that insurers are not liable for payment of any fees or charges related to a “for cause” market conduct examination that was not conducted in material compliance with the SMART Act. “Material compliance,” like other terms in the SMART Act, is not defined.

## **2. Insurer Licensing – *SMART Act Title III***

**The SMART Act requires implementation of a streamlined company licensure process and uniform licensing standards, comparable to the changes in the producer licensing system subsequent to the passage of the Gramm-Leach-Bliley Act’s NARAB provisions. State authority to review application materials is limited and state laws and regulations that are not uniform will ultimately be preempted.**

- **Should title insurers be included in provisions reforming the company licensing process?**
- **Should ALTA support the development of a company licensing system that limits the ability of non-domiciliary states to review/approve/disapprove applications?**
- **Is the NAIC’s ALERT standard an acceptable licensure standard for ALTA members or should ALTA support the addition of provisions to the SMART Act that would require the states to adopt revisions to ALERT?**

The SMART Act proposal seeks to streamline the insurer licensing process to allow an insurer that is “licensed in good standing” in a “model state” to obtain licensure in all other states

simply by submitting a uniform application and Uniform Certificate of Authority. A “model state” is a state that implements “updated” licensing laws and regulations in compliance with the Act. The insurer licensing provision also includes a statement of “congressional intent” that states should streamline their consideration of (i) multiple state approvals pertaining to reappointment of producers and policy and rate re-filings, and (ii) multi-jurisdictional mergers and acquisitions.

***State implementation and preemption:*** The proposal requires the states to base their licensing requirements on a “model licensing act,” which is defined to mean either the NAIC’s ALERT standard or “any model law setting forth standards for licensing requirements, best practices and minimum review procedures” for insurers that is adopted “in a materially identical form” by at least 10 states or states representing at least 25% of nationwide premium.

A non-domiciliary state reviewing a license application from an insurer licensed and in good standing in a model state may only request information from the insurer based on the standards listed in the model licensing act, and the application itself would be limited to a uniform application and a uniform certificate of authority. The non-domiciliary state could obtain additional information from sources other than the insurer, including the state of domicile and the NAIC, and may disapprove a license based on standards “published in statute, rule, or regulation.” Although this requirement is not specific, it appears that those state statutes, rules and regulations would have to mirror the model licensing act because the SMART Act provides that if a state does not have laws and regulations in place identical to the model licensing act within two years of the enactment of the SMART Act, that state’s law would be expressly preempted to the extent it relates to insurer licensing.

### **3. Speed To Market –**

***SMART Act Title VI Commercial Property and Casualty Insurance***

***SMART Act Title VII Personal Lines of Property and Casualty Insurance***

**The SMART Act attempts to force states to reform and streamline their rate and form laws. The Act requires states to coordinate filing processes and prohibits “desk drawer” rules for *all* property & casualty lines. Although the SMART Act requires the states to implement extensive rate and form deregulation for many commercial lines, title insurance was specifically excluded from these provisions based on ALTA communications with Representative Richard Baker (R-LA), the Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises. In addition, for those lines that are included, the Act takes an inconsistent approach to commercial rate deregulation. With respect to personal lines, the SMART Act requires states to establish expedited review for personal lines property & casualty forms.**

- **Should ALTA continue to lobby for title insurance to be excluded from the (i) rate and/or (ii) form approval provisions of the SMART Act?**
- **Should title insurance be included in the rate and form deregulation provisions of the SMART Act?**

- **Should rate and form regulation in connection with title insurance be completely deregulated?**
- **Is there a certain level of regulation that is acceptable or desirable?**

One of the biggest regulatory complaints property and casualty insurance companies have voiced in recent years is with the anti-competitive rate approval process and the cumbersome form approval process for new products. Companies have urged Congress to remove rate controls to enable insurance markets to operate competitively, and to streamline the form approval process, effectively de-regulating the process for sophisticated commercial insureds.

For both commercial and personal lines, the proposal would require the states to achieve:

- full implementation of SERFF (the NAIC-sponsored System for Electronic Rate and Form Filing), with coordinated filing review checklists for each state, in order to establish a single, nationwide, coordinated electronic system for filing property and casualty policy forms;
- development of uniform transmittal documents and a common filing nomenclature to reduce unnecessary form filing deviations and coordinate filing reviews;
- greater transparency in rate and form regulation through the elimination of desk drawer rules and by requiring that all disapprovals be (i) in writing; (ii) based on a specific statute or regulation; or (iii) based on identical or substantially similar interpretations in 10 or more states.

In contrast to the treatment of personal lines, the SMART Act attempts to more extensive de-regulation of certain “applicable” lines of commercial property and casualty insurance. “Applicable lines” are defined as all commercial lines **except title insurance**, accident and health insurance, reinsurance and personal lines. **Thus, ALTA members would not benefit from these commercial lines deregulation provisions with respect to the placement of title insurance.**

With respect to those lines of insurance that are not specifically excluded from the definition of “applicable lines,” de-regulation is to be accomplished through updated state regulatory standards:

- ***Commercial form laws.*** For state form review laws, “updated” laws mean state laws that (i) are materially identical to the NAIC Property and Casualty Commercial Rate and Policy Form Model Law (NAIC Model P&C Law), or (ii) provide for (a) approval within 30 days of a self-certified filing on a file-and-use basis; (b) approval within 30 days of a self-certified filing on a use-and-and-file basis, or (c) an exemption from filing/approval requirements.
- ***Multi-state policies.*** For state form review laws addressing multistate commercial insurance policies, “updated” laws mean state laws that (i) are materially identical to the NAIC Model P&C Law, or (ii) provide that the state where the insured is domiciled is the sole state with forms review authority, and all other requirements relating to the policy or its terms apply only if the state is the “home state” of such

risk. There is an exception for laws and regulations relating to UM/UIM, auto no-fault coverage, and workers' compensation.

- ***Exempt commercial policyholders.*** For “exempt commercial policyholders,” “updated” laws mean state laws that (i) are materially identical to the Model P&C Law, or (ii) provide for the exemption of certain commercial policyholders from rate and form review laws for a policyholder that meets at least two of the enumerated criteria for net worth, revenues, number of employees, use of a risk manager, premium size, annual budget or assets, or if the policyholder is a municipality or subdivision of the state with a population of at least 50,000 people.

The SMART Act appears to have inconsistent provisions regarding commercial rate deregulation. Under Title XVI, “Creating Competitive Insurance Markets,” the Act would fully deregulate insurance rates for many commercial lines, thereby creating a nationwide competitive insurance pricing regime. After the expiration of a two year period, no state would be permitted to require the approval or prior review of any rate charged for an insurance policy by an insurer. In order to avoid significant market disruptions, a “flex-band” phase would be incorporated for covered lines to phase in competitive pricing. The flex band would be based upon the increase or decrease in the aggregate rate for all such coverages. It would not apply on an individual insured basis, and only one rate filing may be made by an insurer during any 12 month time period. The flex band would be 7% during the first 12 month period, and 12% during the second 12 month period.

Title VI provides that a state would be considered compliant with the SMART Act by enacting the NAIC Model P&C Law. The model requires every insurer to file with the regulator “every policy form, endorsement, and other contract language and related attachment rules, manual, minimum premium, class rate, rating schedule or rating plan and every other rating rule, and every modification of any of the foregoing that it proposes to use.” A state that does not enact the model could still be in compliance with the Act if the state provides for “competitive rating” with approval on a “use and file” or a “file and use” basis. Thus, the SMART Act requirement would not result in true deregulation, but would, essentially, codify the status quo.

The Act also opens the door to allowing regulators to require the filing of underwriting rules to the extent necessary to determine the applicable rate. The states could circumvent the federal standards for rate and form regulation of commercial lines if a majority of states adopt a provision in a new model that governs the requirements for submission and review of rates or forms.

**Under both Title VI and Title XVI of the SMART Act, title insurance is specifically excluded from the covered lines of insurance and thus, will not benefit from any rate approval deregulation.** Other excluded lines include credit, mortgage, gap, and medical malpractice insurance. Note that states will retain the authority to require the informational filing of rates for all lines of insurance. State statutes, rules, regulations or orders that prohibit the use of race, color, religion, creed, ethnicity, or national origin as an underwriting or rating factor or classification remain in effect.

Congress “intends” that the states enact measures to provide for “expedited review” of personal lines property and casualty policy forms. The proposal makes clear that this is simply a goal with respect to most personal lines forms, requiring that the states implement standards “materially identical” to an unnamed NAIC model law. The proposal is more specific for filings submitted under a “self-certification” system, requiring reviews of such filings to be completed within 30 days. If states do not comply, they face penalties in the form of restrictions on their right to collect filing fees. Some industry representatives are questioning whether such federal action would be constitutional.

#### **4. Reinsurance – *SMART Act Title IX***

**The SMART Act would centralize financial regulation of reinsurers on the reinsurer’s home state; reinsurance contracts would be governed by the primary carrier’s home state. To the extent the states do not adopt uniform solvency requirements, forms and financial filing requirements, they face preemption. The reinsurance sections of the draft proposal relate to uniform financial statement filings for reinsurers and uniform solvency review of reinsurers and do not generally raise any issues for ceding companies.**

- **Would centralization of reinsurance regulation in the home state of the reinsurer and uniform reinsurance laws in all states have any impact on ALTA members?**
- **If so, should ALTA attempt to have title insurance specifically included or excluded from the SMART Act reinsurance provisions?**
- **Does the retention by domiciliary states of filing authority impose any burdens on ALTA members that ALTA should attempt to have revised?**
- **To the extent the SMART Act provision covers ceding insurers as well as reinsurers, should ALTA attempt to have title insurance specifically excluded or included?**

The SMART Act seeks to develop and implement updated laws and regulations to create a more uniform and efficient system for the filing of financial statements for reinsurers. The goal of the reinsurance provision is to prohibit states from imposing conflicting or duplicative financial statement filing requirements and financial solvency requirements on reinsurers. To reach its goal, the Act seeks to ensure uniform solvency regulation of reinsurers with deference to the regulator of the reinsurer’s home state.

The Act imposes no restrictions on an insurer’s domiciliary state from applying its laws and regulations on the insurer, and regulating the filing of financial statements by the insurer. Multi-state insurers would be required to file with the state insurance regulator of the domiciliary state of the primary insurer only those financial statements required by law that are in accordance with standards established by NAIC.

Non-domiciliary states may require the filing of financial statements by non-resident insurers only to the extent such requirements are in accordance with “forms, instructions, practices, and procedures approved and published by the NAIC.” Although, presumably, these “forms, instructions, practices, and procedures” would be uniform, uniformity is not required

explicitly. Thus, this provision could result in the use of multiple standards in a single state depending upon where the insurers operating in the state are domiciled.

As to financial solvency, the draft proposal provides that the domiciliary state of a reinsurer is responsible for regulating the company's financial solvency, provided the domiciliary is accredited by the NAIC with respect to financial solvency requirements. If the domiciliary state is so accredited, a non-domiciliary state may only regulate the financial solvency of the reinsurer pursuant to a model act governing financial solvency that has been adopted in at least ten states or states representing 25% of all insurance premiums written in all states and provided the non-domiciliary state is accredited by the NAIC as to solvency requirements or the state's solvency requirements are "substantially similar" to the NAIC's accreditation standards.

Under the proposal, the terms and conditions for any reinsurance contract will be governed by the laws of the home state of the contract's primary insurer. A state that is not the home state of an insurer may not regulate, change or affect the terms or conditions of any reinsurance contract entered into by the insurer.

Note that the SMART Act uses the term "insurer" rather than "reinsurer" in the sections addressing the filing of financial statements. Accordingly, the financial statement provisions appear to apply to ceding insurers as well as reinsurers. It is not clear that this is the intent of the drafters. Substantively, however, applying the financial statement provisions to property and casualty insurers does not appear to cause problems because the provisions are consistent with current law.

***State implementation and preemption:*** The SMART Act's reinsurance provision expresses congressional intent that the states develop and implement updated laws and regulations governing reinsurance within two years of the enactment of the federal law. A state is considered to have updated reinsurance laws if the state has in effect: (i) a uniform filing system for financial statements; (ii) uniform forms for financial statements for reinsurers; and (iii) uniform solvency regulation with home state deference. The states' laws and regulations are "uniform" if they have been adopted in "materially identical form" by not less than ten states or states representing not less than 25% of volume of all insurance premiums written in all states.

At the end of the two year period, if a state does not have "updated" laws and regulations, the federal law provisions will apply, and state laws and regulations different from the federal provisions will be preempted to the extent they conflict with the federal provisions. The proposed Act also provides that a state may regulate reinsurance only in accordance with the provisions of the federal law.

The determination as to whether a state has updated laws and regulations is to be made by the NAIC after consultation with the state insurance commissioner. Federal district courts are given jurisdiction to review challenges to the NAIC determination.

Although the SMART Act provisions do not generally raise issues for ceding companies, the proposal would change substantive law relating to choice of law issues. Under the proposal,

the terms and conditions of the reinsurance contract will be governed only by the laws of the home state of the primary insurer. As a practical matter, reinsurance contracts often provide that they will apply the law of the ceding company's home state. Frequently, however, the contracting parties will want the law of a particular state, such as New York, to apply. This would be prohibited by the proposed language. Note also that the term "primary insurer" is not defined in the law. The party obtaining reinsurance is more commonly called the ceding insurer because often the ceding insurer will not be the primary insurer but an excess insurer.

## **5. Financial Surveillance – *SMART Act Title XIV***

**The SMART Act establishes standards that states must meet to make financial surveillance activities uniform, including standards addressing issues such as best practices, self-audits, administrative supervision and accounting.**

- **Are uniform financial surveillance requirements desirable for ALTA members?**
- **Should title insurance be specifically included or excluded from the SMART Act financial surveillance provisions?**
- **Should ALTA attempt to insert specific standards with respect to establishing corporate management best practices?**
- **Would self-audits (and uniform self-audit procedures in the states), uniform accounting standards and uniform administrative supervision standards benefit ALTA members? Should they be encouraged?**
- **Would coordination with affiliates be beneficial/economical?**
- **Should ALTA push for a clearer preemption standard with respect to state compliance with the SMART Act financial surveillance requirements?**

The SMART Act seeks uniformity in financial surveillance activities by allowing states to enact uniform laws and regulations based upon standards identified in the draft legislation. Specifically, the draft provisions would require:

(i) Uniform procedures for holding periodic meetings between regulators and company management to review business strategies and financial information: At these meetings, the regulators and insurance company management will review business strategies, financial results, capital adequacy and other critical solvency issues.

(ii) Uniform standards for developing corporate management best practices: The proposal requires the states to have uniform standards for the development of corporate management best practices. It does not identify a standard for adoption of such best practices, leaving it unclear as to what practices the standards would apply. The proposal's broad language could include not only financial oversight, but also corporate governance and administration, or more specific standards aimed at, for example, financial statements.

(iii) Uniform procedures for encouraging insurer self-audits: The proposal requires states to adopt uniform standards for self-audits. This is a new concept that is not clearly

defined in the SMART Act and has no counterparts in the state statutory/regulatory system.

(iv) Uniform adoption of administrative supervision standards: The proposal requires states to implement the NAIC Model Act on Administrative Supervision (or any new standard later adopted by a majority of the states). If a state does not implement the model within two years, any state provisions regarding administrative supervision would be preempted by this model act to the extent they conflict with the model.

(v) Uniform accounting standards with limited deviations for extraordinary circumstances: The proposal requires uniform implementation of the NAIC's Accounting Practices and Procedures Manual (or any new standard later adopted by a majority of the states) within two years. If the NAIC manual (or new standard) is not adopted, the state law would be preempted and replaced by the manual (or new standard).

The proposal provides a limited exception to uniformity by allowing "permitted accounting practices" only for extraordinary circumstances. All states must be notified of the permitted practice. Within three years of enactment, the states are to develop a coordinated notification system.

(vi) Coordination of financial surveillance resources for affiliated insurers: The proposal seeks uniformity for on-site examinations, exchange of information, and implementation of the NAIC's lead-state surveillance framework. Within two years, the states must adopt uniform standards for each of these activities or face preemption. With the exception of the reference to the NAIC lead-state surveillance framework, there is no identified standard to form the basis for preemption. If after two years the states have not adopted uniform standards for on-site examinations and exchange of information, there is an open question as to what standards will apply until Congress can enact legislation to provide for such standards.

## **6. Receivership – SMART Act Title XIII**

**To create uniformity and efficiency in state receivership laws, and equitably apportion losses, the SMART Act incorporates much of the Uniform Receivership Law (URL). The receivership court generally would not determine guaranty association liabilities; the receiver would be required to provide the guaranty association with relevant information. Reinsurers would be obligated to receivers and third parties in the event of a receivership, regardless of contractual agreements. If a state does not enact a law substantially similar to the SMART Act's receivership provisions, the state may not regulate receiverships.**

- **Are the current state receivership laws problematic for ALTA members?**
- **Would a more uniform approach to receivership regulation be desirable for ALTA members?**

- **Is the Uniform Receivership Law acceptable to ALTA members or are there provisions that should be revised before being incorporated into federal law under the SMART Act?**
- **Should the receivership court have the authority to determine the liability of a state guarantee authority?**
- **Should a state guarantee authority continue to have the right to intervene in receivership proceedings?**

The SMART Act seeks to develop and coordinate uniform state laws regarding receivership of insurers. The stated goal of the Act's receivership provision is to better protect the interests of the public, insureds, claimants and creditors; create uniformity among state receivership laws; create efficiency in administering receiverships; and equitably apportion any unavoidable loss.

The Act refers to the substantive law created by its provisions as the Uniform Receivership Model Act (URMA). By and large, the URMA provisions are taken from the Uniform Receivership Law (URL). URMA will apply to all rehabilitation and liquidation proceedings commenced in any state after the date of enactment of the Act. The receivership court obtains exclusive jurisdiction of all property of the insurer, wherever located, even if it is outside the court's territorial limits. The rehabilitator or liquidator appointed pursuant to the receivership proceeding obtains all the powers of the directors, officers and managers of the insurer.

With respect to guaranty funds, the receivership court does not have jurisdiction under URMA to determine guaranty association coverage liabilities, except to the extent the guaranty fund has expressly consented to such jurisdiction pursuant to a plan of rehabilitation or liquidation. The receiver is required to provide guaranty associations "with all information necessary to carry out their statutory obligations." In addition, guaranty associations have standing to intervene as of right in any receivership proceeding in which a guaranty association may become liable as a result of the entry of a liquidation order and they may file late claims with the receiver and still receive a ratable distribution of prior distributions as if the guaranty fund's claim were not late.

With respect to reinsurance issues, the amount recoverable by the receiver from reinsurers may not be reduced as a result of the filing of the rehabilitation or liquidation proceeding, regardless of any provision in the reinsurance contract or any other agreement. The proposal also contains a cut through provision providing that if, in the event of insolvency of the ceding insurer, a reinsurance contract expressly provides that such reinsurance be paid to a third party, any payment made or due to such third party will reduce the amount due the receiver.

***State implementation and preemption:*** As with other provisions of the SMART Act, the receivership provision sets forth congressional "intent" that each state implement "updated" laws and regulations governing receiverships of insurers. The proposal provides that a state shall be considered to have "updated" laws and regulations if it has laws and regulations substantially similar to the URMA.

The “preemption” provision provides that, if a state does not have “updated laws and regulations” three years after enactment of the Act, URMA shall apply in that state and all laws and regulations that conflict with or are different from URMA are preempted. A state may regulate receivership only in accordance with URMA or laws “materially identical” to URMA.

C. **Producer Licensing Provisions**  
*SMART Act Title IV*

***Full Licensing Reciprocity and Uniformity.*** The SMART Act requires all states to have reciprocal producer licensing requirements in place in two years and to have uniform licensing standards in three years. ALTA succeeded in getting title insurance excluded from the uniformity/reciprocity producer licensing provisions of the predecessor legislation to the proposal, the Gramm-Leach-Bliley Act’s NARAB provision. Unlike the NARAB provision, the SMART Act does not include an exception from the reciprocity/uniformity requirements for countersignatures.

- **Should ALTA continue to lobby to maintain the exclusion related to uniformity/reciprocity of producer licensing requirements?**
- **Is 50-state uniformity in producer licensing standards (the standards by which the states judge whether or not an applicant is qualified for licensure) desirable or necessary for ALTA members?**
- **Should ALTA push for the specific inclusion or exclusion of title insurance from the producer licensing provisions of the SMART Act?**
- **Should there be more specificity with respect to describing uniform producer licensing standards?**
- **Should the SMART Act specifically refer to or incorporate the NAIC’s Uniform Resident Licensing Standards document? Should those standards be made applicable to all insurance producers?**

For producers, the most important components of the proposed bill relate to producer licensing. Title IV builds on the reciprocity regime mandated by the NARAB provisions of the Gramm-Leach-Bliley Act (GLBA), enacted in 1999. The NARAB provisions provided for the federalization of non-resident producer licensure unless a majority of the states enacted laws and regulations that permitted an insurance producer licensed in a state to be licensed as a non-resident on a fully reciprocal or uniform basis. Although a majority of the states responded to this challenge by implementing compliant reciprocal licensing regimes for non-residents, several of the larger states – including California and Florida – did not, and a host of regulatory licensure problems remain unresolved.

Title IV is intended to fix those unresolved problems by requiring that every state have a suitable reciprocity licensure regime in place within two years of the date of enactment of the SMART Act. Any state that does not satisfy this requirement will be prohibited from collecting fees from non-resident producers until it is in compliance. Discrimination against non-resident producers is also prohibited.

Another licensing-related issue in critical need of reform is the current lack of uniformity in licensing standards. Although many states have similar or identical licensing laws and rules, the standards used by states are not uniform. Several states that have failed to adopt compliant licensure reciprocity regimes claim that their refusal is based on this absence of uniformity, thus implying that other states have lesser standards even though their producer licensing laws and regulations are similar, if not identical. Chairmen Oxley and Baker also have expressed a dedication to helping forge not just a more streamlined regulatory system but also one with more regulatory integrity. This is the reason Title IV goes further than the NARAB provisions enacted in 1999 by requiring the states both to have full reciprocity licensing regimes in place and to have uniform licensure standards for their own resident producers within 3 years of the date of enactment of the Act.

Although the bill sets forth the areas in which uniformity would be required, it does not dictate what those standards should be. Determination of the actual standards is left to the states – provided the standards are uniform. The areas in which uniformity would be required include:

- licensure cycles and renewal dates;
- the use of a centralized computer licensure and background check database;
- the electronic submission of applications and fees to a central nationwide database;
- licensure criteria including integrity, personal qualifications, education, training, and experience;
- continuing education requirements;
- lines of insurance requiring licensure, including limited lines licenses;
- fiduciary maintenance of client funds;
- licensing testing requirements;
- consistent, simple agent appointment procedures that place obligations on insurers to maintain current lists of producers and file appointments with state regulatory authorities;
- producer disclosures to consumers; and
- criminal background checks.

Achieving uniformity in these areas would be left to the states and accomplished through the development and implementation of model laws and regulations. If a state does not have the appropriate model(s) in place three years after the bill is enacted into law, the state faces financial penalties and preemption of any of its producer licensing laws, regulations and other actions that are inconsistent with the model. The financial penalties vary depending on the regulatory issue, but they generally restrict the ability of non-compliant states to collect fees from non-resident producers. The state-federal partnership, which is described later in this memorandum, determines if a state is compliant.

***Criminal Background Checks.*** The SMART Act would enable the states to establish a streamlined criminal background check process with uniform standards that requires only one set of fingerprints from producers.

- **Should there be more comprehensive background check requirements of insurance producers in all states than the requirements that exist in some states currently?**
- **Are more stringent background checks acceptable to ALTA members in exchange for full reciprocity in producer licensing requirements and full uniformity in producer licensing standards?**
- **Should state insurance regulators have the authority to access the FBI criminal history database for producer background information or is there an alternative means to determine whether an applicant's background disqualifies him or her from receiving a producer's license that might be less burdensome and less intrusive on, for example, the producer's privacy?**

Two of the largest perceived shortcomings of the current producer licensing system are: (i) producers licensed in more than one state often must undergo multiple criminal background checks; and (ii) several states do not perform any criminal background check whatsoever. This is one of the principal complaints of states such as California and Florida, which, to date, have refused to adopt fully reciprocal licensure programs because they want to ensure that all producer license applicants undergo a background check that meets their standards.

To overcome these shortcomings and to better enable financial regulators to share pertinent criminal information, Title X of the bill, "Antifraud Network", includes a series of provisions that would foster the creation of a criminal background check process under which each licensed insurance producer in the country would be fingerprinted one time for an initial, and any subsequent, criminal background check (a producer's background may need to be re-checked for any of a number of reasons, including, for example, when a producer changes his or her state of domicile). The producer licensing provisions of the draft bill require the states to implement uniform criminal background check standards so the states would look at the same type of background information and analyze it against the same standards. This is reinforced in Title X, which prohibits the Attorney General from releasing criminal background information to an insurance regulator from a state that does not have uniform or reciprocal producer licensing laws and regulations. Thus, because each state will have the same criminal background check requirements and standards, only one check, probably by the producer's domestic state, will be necessary for licensure and other states should be comfortable relying on the domestic state's decision.

As outlined in the draft bill, the NAIC, acting as agent for the states, would create a central database to obtain and store fingerprints. Once a producer license applicant's fingerprints are on file, a state regulator would merely need to access that database to submit the applicants prints to the FBI for the producer's background information. Thus, only one set of fingerprints will need to be filed and, after that, the process will be invisible to the applicant. Even if additional background checks are needed after a producer's initial license is granted, no additional action is required of the producer.

The NAIC is currently drafting a model act that would give a state's insurance regulator authority to check the criminal backgrounds of producer license applicants by requiring applicants to submit fingerprints to the regulator and requiring regulators to access federal

criminal record information as part of the application review process. The NAIC is also undertaking the development of a pilot project to create a fingerprint/criminal history database. Although clearly this NAIC activity has not been drafted with any knowledge of the specific requirements of the SMART Act, it will likely serve as the basis for the state regulators' compliance with this portion of the Act.

**D. The State-National Insurance Coordination Partnership**  
*SMART Act Title XV*

**The “Partnership” would not be a regulator, but would be responsible for arbitrating disputes regarding uniformity and bringing suits challenging state implementation of the SMART Act. The Partnership would have seven members, including representatives of the state insurance commissioners and the federal financial services agencies; it would have no permanent office.**

- **Is the Partnership an effective vehicle for determining compliance with the SMART Act?**
- **Should ALTA support a stronger or weaker federal role in determining compliance with the Act?**
- **Is there an alternative method for resolving disputes and ensuring compliance that would be preferable to ALTA members?**
- **Should ALTA support an alternative approach that would ensure greater state authority over the decision-making process and greater influence over the final decisions?**

Perhaps the most controversial element of the proposed bill is the creation of a “State-National Insurance Coordination Partnership.” The Partnership is not designed to be a regulatory body. Rather, the draft bill would establish a coordinating entity responsible for: (i) identifying whether certain uniformity requirements set forth in the Act have been met; (ii) helping resolve conflicts between the Act and state government implementation; and (iii) facilitating coordination of financial and international trade issues that affect insurance.

Although the Partnership would have no formal rule-making powers, it would have the power to arbitrate disputes between state insurance departments and federal agencies, as well as the power to review petitions regarding actual conflicts over uniformity requirements. The Partnership also would be authorized to bring lawsuits in federal court in the District of Columbia challenging state actions as impermissible under the terms of the Act, and offer non-binding arbitration.

The Partnership would be composed of seven members – three insurance commissioners (one from a “small” state; one from a “medium” state; and one from a “large” state), designees from the Securities and Exchange Commission, the Department of the Treasury and the Board of Governors of the Federal Reserve, and a seventh member nominated by the state insurance commissioners and appointed by the President to act as the Chair of the Partnership and break tie votes. In order to ensure that the Partnership does not evolve into something more than the

coordinating entity it is intended to be, the Partnership will not have a permanent office, it will be allowed only one liaison per member, and it will have minimal clerical staff.

**E. Other Provisions**

The bill also includes provisions that would –

- *Title V* would streamline the life insurance product approval process;
- *Title VIII* would streamline/improve the regulation of commercial p&c surplus lines products;
- *Title X* would create an antifraud network among all of the state and federal financial regulators;
- *Title XI* would improve consumer protection laws governing the sale of viaticals and clarify the division of viatical regulation among the various state and federal regulators;
- *Title XII* would require the states to report to Congress regarding their efforts to develop and implement uniform health insurance standards in various areas

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