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Legal Alert: NAIC Report: 2016 Summer National Meeting

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The National Association of Insurance Commissioners (NAIC) held its 2016 Summer National Meeting from August 26 through August 29 in San Diego, California.

The meeting began with strong words from the NAIC President and Missouri Insurance Director John Huff concerning regulatory actions some European Union (EU) member states have taken against U.S. insurance groups based on their U.S. status and the lack of transparency into negotiations being conducted by Federal and EU officials. Those negotiations could culminate in a “covered agreement” that includes recognition of the U.S. regulatory framework as equivalent in the EU, but also preempts state authority with respect to the matters covered by the agreement. “Perhaps most troubling about the covered agreement negotiations,” President Huff said during the meeting’s opening session, “is how little state insurance commissioners, state and federal legislators, consumers or anyone else in the room for that matter, know about them. There is much speculation about what might be included or resolved, but no actual knowledge or insight except for a select few… Neither the Treasury Department nor the U.S. Trade Representative has offered to provide any insight on even high level expectations, let alone negotiating objectives.” These opening session remarks were followed by discussions during the International Insurance Relations (G) Committee and Reinsurance (E) Task Force (discussed below) that could signal a change in attitude among the states that have been working to eliminate barriers to non-U.S. reinsurers.

Other hot topics at the meeting—some well-worn, others new—include the NAIC’s development of the Insurance Data Security Model Law, the use of big data in pricing of insurance, state implementation of Principle-Based Reserving (PBR) and adoption of a XXX/AXXX Model Credit for Reinsurance Regulation.

The following are some highlights from the Summer National Meeting. We do not cover every meeting in this report; rather, we comment on select noteworthy developments and matters of interest to our clients.

A. Cybersecurity

B. Big Data

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4. Regulators Considering Prohibition on Mandatory Arbitration Provisions

5. Peter Hart Appointed as Insurance Commissioner Representative to FSOC

A. Cybersecurity

The Cybersecurity (EX) Task Force held its first meeting since the release of a new draft of the Insurance Data Security Model Law. The Model Law sets standards for data security and breach response applicable to insurance licensees that collect, distribute, process or store customer personal information, including insurers and insurance agents and brokers. An initial draft of the Model Law was revised after receiving extensive written comments from trade associations, market participants and regulators, and a two-day interim meeting. A summary of the changes can be found in our prior Legal Alert: NAIC Task Force Releases Revised Draft Insurance Data Security Model Law.

Trade association representatives spoke briefly to offer initial feedback. The period for submitting comments remains open until September 16. The Task Force Chair,

Commissioner Adam Hamm (N. Dakota), indicated the Task Force will convene by conference call for further discussions with Task Force members and interested parties after the comment period closes.

The principal criticism from the trade association speakers was that the Model Law will not result in uniform breach response requirements. Representatives from different trade associations said there is no need for a model law if it does not provide for exclusive standards that are consistently applied and result in level consumer protection among states. The spokesperson for the "Big I" (Independent Insurance Agents and Brokers of America) indicated it would oppose legislation in the individual states unless the problems it has identified are resolved, citing as its top concerns the absence of a harm trigger for required consumer notices following a breach, requirements for third-party services providers, breach notification provisions and the expansive definition of personal information. The "Big I" representative observed the Model Law will face challenges in the various state legislatures even if it enjoys insurance industry support because, among other reasons, the NAIC would be asking them to supplant existing breach response notification rules for a just one industry and the broad grant of authority to state insurance commissioners to fashion remedies following a breach would be met with skepticism by state legislators.

The Task Force also received a report from NAIC staff of the cybersecurity supplement to the annual statement,[1] which was first required for 2015. NAIC staff reported over 500 insurers provided cybersecurity insurance, with the vast majority of coverage written as endorsements to commercial and personal policies. Staff further reported a market of roughly $1.5 billion in direct written premium (compared to total reported property and casualty premiums of $522 billion). Of this amount only approximately $500 million was written as standalone cybersecurity insurance. The remaining was written as written as part of a package policy, but since about half of the insurers who wrote package policies did not report premiums because they could not break out the premium change for cybersecurity, this number was calculated using an extrapolation methodology the NAIC developed for purposes of its analysis. Staff reported the loss ratios for standalone cybersecurity ranged from zero to more than 500 percent but did not consider this to be surprising given the nascent nature of the business. Staff also reported that approximately 1.6 million identity theft polices were reported as sold in 2015, often as an add-on to auto or homeowners, with an average annual premium of $42 per policy.

NAIC staff observed that its report does not provide a complete picture because a significant volume of cyber insurance is written by nonadmitted insurers that do not file annual statement supplements. As a result, NAIC staff requested the Surplus Lines Task Force to ask the NAIC's International Insurance Department to collect this information from the excess and surplus lines insurers included on its *Quarterly Listing of Alien Insurers*.

B. Big Data

The Big Data (D) Working Group met to receive presentations from a funded consumer liaison and credit reporting agency and to discuss objectives and workstreams for the Working Group.

The first presenter was Birny Birnbaum, Center for Economic Justice. The thrust of Mr. Birnbaum's presentation was that the use of big data in insurance pricing and claims requires regulatory oversight for two reasons: First, according to Mr. Birnbaum, data mining and models are premised on correlation, but correlation is not causation, and he offered examples of "spurious" correlation. Second, Mr. Birnbaum said models may perpetuate historic discrimination based on biased data, biased models and assumptions and faulty model specifications, resulting in inequities.

The second presenter was Jeff Reynolds, Vice President, Insurance Product Management, TransUnion. Mr. Reynolds discussed how data analytics can be used for better predictability of risk. He described how the use of "other sources of data" for a consumer may give the consumer access to more affordable products. He cited as an example trended credit information, which may give an indication of a better credit risk than a traditional credit score. He also discussed how information can be used to better identify fraud rings and help reduce claims costs. He commented that existing regulations under the Fair Credit Reporting Act and Gramm-Leach-Bliley are adequate to protect consumers.

The Task Force then discussed ideas for its formal charges and potential workstreams. Prior to the Summer meeting, the Working Group proposed and received comments on a definition of "Big Data," but the Working Group Chair, Laura Cali (Oregon), indicated she would prefer the Working Group focus its energy on the uses of data and data sets, rather than wordsmithing the definition. The Working Group Chair proposed three workstreams: a first based on public policy and the regulatory framework; a second based on understanding what data is being used and how; and a third based on better tools for regulators and how to work together better. Specific topics commissioners on the Working Group indicated they want covered include the segmented use of data and the use of data for claims optimization (in addition to pricing). A common complaint voiced by regulators on the Working Group is their inability to understand how data is being used in rate filings and to explain rates to consumers. Joel Laucher (California) indicated that segmentation presents a separate issue: regulators can validate data, fix disclosure and resolve all issues around the data, but if the data is segmented so broadly that there is a 5000 percent deviation between the highest and lowest payors, then there is another issue. This comment echoed a concern voiced by Mr. Birnbaum earlier in response to Mr. Reynolds' presentation, namely, that insurance is about risk pooling, and state insurance laws require pooling of consumers with similar risks but "greater segmentation turns insurance into a pay as you go device." The Chair indicated this issue could be taken up in the first workstream covering public policy.

C. Issues of Particular Interest to Property and Casualty Insurers

1. Terrorism Insurance Market Data Calls

The Terrorism Insurance Implementation (C) Working Group received an update on federal activities related to terrorism insurance, including a discussion of the first annual report of the Federal Insurance Office (FIO) to Congress pursuant to the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA) (which reauthorized the Terrorism Risk Insurance Act (TRIA) through 2020).

FIO's report, based on information collected by FIO earlier this year as part of a voluntary industry data call, was delivered to Congress on June 30, 2016, and concluded that the Terrorism Risk Insurance Program (TRIP) under TRIA "remains an important mechanism in ensuring that terrorism risk insurance remains available and generally affordable in the United States . . . [and that] the coverage being made available . . . would likely not be possible in the absence of [TRIP]." Although insurer participation in the 2016 FIO data call was voluntary, on April 1, 2016 Treasury issued a notice of proposed rulemaking to implement a number of changes pursuant to TRIPRA, and these changes include making the submission of data by insurers mandatory beginning in 2017.

The Working Group also heard a report on the current state-level data call to collect countrywide data on terrorism risk insurance, which was issued by the New York Department of Financial Services (DFS) by letter dated July 29, 2016. The DFS letter indicates that all 50 US states and the District of Columbia have asked DFS to serve as the single point of collection for the data call. The collected information will be shared with and analyzed by the NAIC. The state data call follows a data call earlier in the year targeting insurers writing workers' compensation insurance, and applies to insurers writing premium in the following lines of business: commercial fire and allied lines, commercial multiple peril, ocean marine, inland marine, other liability, products liability and boiler and machinery.

Speaking at the Working Group meeting, Stephen Doody, Deputy Superintendent for Property & Casualty Insurance at DFS, reported that a number of companies have been requesting additional time to respond to the data call, and that the response deadline has been extended from September 30, 2016 to November 1, 2016. Companies were encouraged to use DFS's designated data call e-mail address (TRIAHELP@naic.org) for questions and general assistance completing the data call (including if companies cannot provide certain requested data) rather than contacting their domestic regulators, to ensure quick and consistent responses.

2. Recommendations to Reform the National Flood Insurance Program

The current National Flood Insurance Program (NFIP) reauthorization expires on September 30, 2017. As part of the reauthorization process, Congress will be considering potential changes and improvements to the program. During the

meeting of the Property and Casualty Insurance (C) Committee, there was significant discussion concerning the Committee's recommendations for NFIP reform. These recommendations include (but are not limited to) (i) supporting a long-term reauthorization of the NFIP, (ii) encouraging greater growth in the private flood insurance market as a complement to the NFIP, (iii) encouraging support for mitigation planning, (iv) encouraging a coordinated effort between the public and private sector to increase overall take up rates of flood insurance, (v) encouraging careful consideration of affordability issues and the impact of NFIP policy changes on current NFIP policyholders and (vi) considering a study on alternative approaches to the flood insurance program structure. A number of industry representatives have submitted written comments in support of the Committee's recommendations.

Birny Birnbaum, providing comments on behalf of the Center for Economic Justice, was highly critical of the Committee's recommendations. Mr. Birnbaum highlighted the low take up rates for flood insurance as one of the significant issues with the NFIP, and he specifically referenced the alarming combination of the recent catastrophic flooding in Louisiana and the low take up rates in the state. Mr. Birnbaum expressed that a significant reason for this low take up rate for flood insurance is the failure to educate consumers about the fact that flood damage is generally excluded from standard homeowner's policies.

Commissioner James Donelon (Louisiana) responded to Mr. Birnbaum's comments by explaining that the take up rate in Louisiana, although only 21 percent, is actually the second highest take up rate for flood insurance nationwide. Commissioner Donelon further explained that low take up rates are not due to a lack of education about coverage, but rather the affordability of flood insurance. Many consumers simply are unable to afford coverage. Mr. Birnbaum agreed that affordability is also a significant issue, but noted that the Committee's recommendations for NFIP reform fail to adequately address affordability. Ultimately, Mr. Birnbaum argued for getting the NFIP out of the direct provision of flood insurance and, instead, moving it back to private insurers who, according to Mr. Birnbaum, can provide the coverage more efficiently and at a lower cost than the NFIP.

The Committee will schedule a conference call to discussion revisions to the recommendations based on the interested party comments.

3. Increased Attention to Travel Insurance

State regulation of the travel insurance industry is an area of increased focus for state insurance regulators. In 2015, the NAIC created the Travel Insurance (C) Working Group, which is tasked with developing a model law or guideline to establish appropriate regulatory standards for the travel and tourism insurance industry. In San Diego, the Working Group heard presentations from a number of industry representatives on the benefits of travel insurance and the burdens presented by inconsistent state regulation of travel insurance products. State

insurance laws can differ significantly on the most basic issue of what line of business travel insurance constitutes—in many states, travel insurance is considered inland marine insurance (which is largely unregulated), while in other states travel insurance is considered health insurance (which is heavily regulated and may be subject to minimum loss ratio requirements). This inconsistency can create uncertainty with respect to the licensing requirements for individuals who sell travel insurance (often travel agents) and the pricing of travel insurance products.

The Travel Insurance Working Group has identified the following issues to be addressed in 2016:

- Consider whether free look periods should be mandatory for travel insurance products and draft a model law or guideline that will promote a consistent interpretation and treatment of that requirement.
- Review the NAIC uniform producer licensing standard for limited lines travel insurance and the travel insurance limited line laws that have been enacted in the states and recommend a model that makes these laws consistent across states.
- Research and if necessary provide clarity regarding whether certain products are insurance and should be written through licensed insurers only or are other benefits, such as "cancel for any reason" coverage, which may not constitute insurance and therefore not require a license to sell. The Working Group will also consider packaging travel insurance with other benefits that do not require a license to sell, and payment of applicable premium taxes.

Birny Birnbaum, speaking on behalf of the Center for Economic Justice, asked whether the Working Group's consideration of these issues would be informed by the ongoing work being conduct by the NAIC Market Actions Working Group (MAWG). Director Anne Melissa Dowling (Illinois), Chair of the Travel Insurance Working Group, responded that the Working Group would be coordinating with MAWG, but that MAWG's focus has been on the current state of the market and past compliance issues, while the Working Group is focusing its efforts on potential future issues and what the rules for travel insurance products should be going forward.

D. Issues of Particular Interest to Life Insurers

1. State Implementation of PBR

Preparation for state implementation of PBR continues to move forward. In June, the NAIC adopted a recommendation from the PBR Implementation Task Force that will activate PBR beginning on January 1, 2017. Technical amendments to the Valuation Manual, which can be changed anytime, are proceeding in anticipation of the January 1, 2017 effective date.

By way of background, in 2009, the NAIC adopted a revised Model Standard Valuation Law authorizing PBR and a Valuation Manual that sets forth the minimum reserve and related requirements for certain products under PBR. The Valuation Manual was subsequently adopted by the NAIC in 2012. The effective date for PBR (i.e., the Valuation Manual Operative Date), however, could not occur until the amended Standard Valuation Law was adopted by 42 states and state adoption reflected 75 percent of total life insurance premiums written in the United States.

The milestone was reached earlier this year. The Standard Valuation Law has now been adopted by 46 states, representing more than 85 percent of premium, and two additional states are working to pass PBR legislation. Notably, New York, which has historically been a vocal opponent of PBR, has announced that it intends to adopt PBR for its regulated life insurers in January 2018. The New York Department of Financial Services (DFS) has also convened a working group representing industry and consumers to assist DFS in establishing necessary reserve safeguards. The working group consists of six domestic life insurers (AXA, Guardian, MetLife, New York Life, Security Mutual and TIAA) and two consumer representatives (Birny Birnbaum, Center for Economic Justice, and Kristen McManus, AARP). The working group will be expected to assist DFS "in developing the minimum reserve floor for all products sold to consumers, regardless of company experience."

The life insurance industry sought the implementation of PBR because, as innovative new product designs were being introduced, the current rules-based approach resulted in reserves that did not accurately reflect the risks being assumed for the policies that were being underwritten. The industry argued that life insurers were required to hold higher reserves than necessary for some products. The rules-based approach also contributed to the establishment of life insurer-owned captives to finance redundant reserves.

PBR is ultimately expected to become a state accreditation standard, meaning that states will be required to enact "significant elements" of these amendments to the Standard Valuation Law to maintain accreditation by the NAIC. While the NAIC Life Actuarial (A) Task Force is still working to finalize the list of "significant elements" that would be required for state accreditation, PBR is projected to be adopted as a state accreditation in 2020.

2. Life Insurance and Annuities (A) Committee

The Life Insurance and Annuities (A) Committee discussed key NAIC initiatives, including the launch of the NAIC Life Insurance Policy Locator Service and the Retirement Security Initiative.

The Life Insurance Policy Locator Service was recently launched on the NAIC website. This launch is the first phase in developing a uniform, national system for locating lost life insurance policies and annuity contracts. The service does not require the submission of proof of death, but it will ask if a death certificate exists.

The NAIC will next work with life insurance and annuity companies to determine whether the service should only apply to policies with a face amount of at least $50,000. The NAIC anticipates launching the service as an application for mobile devices and fully implementing the national system this Fall. In public statements, NAIC President John Huff has emphasized that this service "underscores the NAIC's mission to protect consumers."

The Retirement Security Initiative consists of a three-pronged strategy: education, consumer protection and innovation, which NAIC President Huff highlighted at the Summer meeting. Regarding education, President Huff cited the policy locator service that is described above, a partnership with celebrity spokesperson Rita Moreno, and the NAIC's Insure U website, which is a public education program created by the NAIC to assist consumers with information about insurance issues. Regarding consumer protection, President Huff underscored that NAIC committees are reviewing and updating model acts and regulations, specifically those focusing on annuities. In this vein, the Committee discussed what efforts should be made to obtain broader adoption of the 2015 revisions to the Annuity Suitability and Disclosure Model Regulation. Although 40 states have adopted the 2010 version of the Model, few states have adopted the 2015 revisions. Industry representatives noted at the Summer meeting that they have made efforts to stress to regulators the importance of the enhancements in the 2015 revisions. The representatives also commented that regulators did not seem to be resistant to the revisions, but rather have just not prioritized the issue. In connection with the Committee's desire for greater adoption of the Suitability Model Regulation, the Committee voted to create new working groups. These working groups will assess whether any changes need to be made to the Suitability Model Regulation to promote greater uniformity.

Regarding innovation, President Huff asserted that "there is no greater area of the insurance sector in need of innovation than with long-term care insurance." He then stated that, as part of a more comprehensive look at these products, including the challenges facing legacy policies, the Long-Term Care Innovations Subgroup is looking at ways to remove barriers to product offerings while ensuring consumers remain protected.

3. XXX/AXXX Model Regulation

The Reinsurance (E) Task Force discussed comments received on the draft XXX/AXXX Credit for Reinsurance Model Regulation that was exposed for comment on August 4. The draft Model Regulation was subject to a comment period ending on August 22, during which the Task Force received written comments from regulators and other interested parties.

The Model Regulation, which is based on the requirements of Actuarial Guideline XLVIII (AG48), is intended to establish uniform national standards governing reserve financing arrangements pertaining to XXX and AXXX policies. Subject to certain exemptions, AG48 prescribes a required actuarial analysis on each non-

exempt reinsurance agreement to determine whether: (i) funds consisting of "Primary Security" are held by or on behalf of the ceding insurer as security under the reinsurance contract in an amount at least equal to the "Required Level of Primary Security;" and (ii) funds consisting of "Other Security" are held by or on behalf of the ceding insurer in an amount at least equal to the portion of the statutory reserves in excess of the Required Level of Primary Security.

The Model Regulation was previously exposed on February 26. Revisions made in the August 4 draft include:

- Removing recapture as a remediation option;
- Adding a drafting note pertaining to commissioner discretion in relation to the Model Regulation's consequence option and remediation provisions;
- Revising the section addressing the actuarial method to better synchronize it with the Valuation Manual; and
- Removing the exemption for:
  - attained-age-based yearly renewable term (YRT) life insurance policies;
  - certain n-year renewable term life insurance policies; and
  - yearly-renewable-term (YRT) reinsurance, if the policy is issued on or after January 1, 2020.

The Task Force was expected to complete drafting and adoption of the Model Regulation by the Summer meeting, but some technical revisions still need to be made. The Task Force anticipates adopting the Model Regulation during an interim call this Fall, with the Model Regulation being ready for adoption by the Financial Condition (E) Committee at the Fall National Meeting.

4. Special Session on Infrastructure Investment

The Valuation of Securities (E) Task Force held a special session where a number of industry representatives made a joint presentation on the benefits of permitting insurers to invest in infrastructure. Led by ACLI, TIAA, Pacific Life, AIG, MetLife and Swiss Re asked regulators to consider implementing changes to their insurance regulatory requirements that would remove impediments and create incentives for insurers to invest in infrastructure. The insurers extolled the economic benefits of allowing life insurers, in particular, to match their long-term liabilities (life insurance contracts) with stable, long-term assets like infrastructure investment contracts. It was noted that infrastructure investment contracts typically have a long-term duration of 15 years, with a 35-year maturity. The insurers also noted the following factors which make infrastructure investment contracts particularly beneficial investments for insurers: relative illiquidity, stable and secure cash flows,

diversification of risks and attractive risk adjusted returns. Current impediments to these types of investments include relatively high capital charges under U.S. risk-based capital rules and SVO rating requirements that require historical financial statements (which typically are not available for these types of investments that, by their nature, occur only once over a twenty or thirty-year period).

A representative from Oliver Wyman described the significant funding gap that exists between current infrastructure funding levels and the funds that are needed to support infrastructure maintenance and development. The presentation highlighted that, due to ongoing fiscal tightening at state governments and the low interest rate environment, the traditional municipal bond market is not enough. It was noted that approximately 80-90 percent of infrastructure development projects are funded through debt investment contracts, while the remaining 10-20 percent of financing is obtained through equity investment. Representatives from Standard & Poor's and Moody's presented on the unique nature and overall strength of infrastructure investments. As compared to corporate debt investments, infrastructure investment contracts provide lower default rates and higher recovery rates in the event of default (including the relative consistency of recovery rates over time and through various economic cycles).

E. International Issues

1. Group Capital Calculation

Since 2013, the International Association of Insurance Supervisors (IAIS), at the direction of the Financial Stability Board (FSB), has been developing group capital standards applicable to global systemically important insurers (G-SIIs). Prompted by concerns that international standards being developed fail to account for the U.S. approach to financial solvency regulation, the NAIC has been working to develop a group capital assessment tool as well. The recently created Group Capital Calculation (E) Working Group has been charged with constructing a U.S. group capital calculation using an RBC aggregation methodology.

At the Summer National Meeting, the Working Group heard a presentation from the Blue Cross and Blue Shield Association (BCBSA) regarding the group capital calculation. The presentation focused on the BCBSA's model for RBC aggregation, which is based on existing RBC formulas. The BCBSA stressed that although they are focused on the health sector, the model could work for other industry segments as well.

The Working Group also discussed an August 22, 2016 NAIC staff memo regarding questions on various aspects of the inventory approach to group capital calculation. The memo identifies issues that have generated discussion during recent Working Group conference calls, and frames questions regarding the group capital calculation that the Working Group would like answered. At the meeting, industry groups suggested that a question be added to the memo regarding the scope of the group capital calculation (*i.e.*, the groups and entities to be included for purposes of

the calculation), noting that lack of clarity on scope has been a barrier to companies' ability to provide meaningful input on the group capital calculation. Members of the Working Group conceded that they had initially wanted the scope question to be delayed until later in the development of the group capital calculation, but agreed that it should be addressed at this point in the process.

The Working Group voted to add a question regarding scope to the August 22, 2016 memo and expose the updated memo, which now contains nine questions, for a 60-day public comment period. The Working Group is requesting responses by October 25, 2016.

At the same time, industry and the NAIC have been reviewing the Federal Reserve's recently published Advanced Notice of Proposed Rulemaking on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (ANPR). Comments on the ANPR were due last month. During the Financial Stability (EX) Task Force meeting, Prudential shared some of its comments, noting that further tailoring of the rules is needed and that companies should be allowed a reasonable time period to transition to the new rules. A summary of the ANPR can be found in our prior Legal Alert: the Federal Reserve Board's ANPR with Respect to Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities.

2. International Reinsurance

NAIC President John Huff's remarks during the opening session concerning regulatory actions that some European Union (EU) member states have taken against U.S. insurance groups were echoed during the meeting of the International Insurance Relations (G) Committee, which heard from a panel of representatives of U.S. insurers and reinsurers active in Europe. The panelists described difficulties they have encountered with EU implementation of Solvency II. Panelists offered a common grievance: as the U.S. has lowered barriers to non-U.S. reinsurers operating cross-border in the U.S., some EU countries are raising barriers on the basis that the U.S. does not have a regulatory framework that is equivalent to Solvency II. The panelists cited, in particular, their experiences in the United Kingdom, Germany and Poland. In the U.K., the panelists described having to seek and obtain a waiver from full compliance with Solvency II. They regard the waiver process as burdensome and leaving them with overhanging uncertainty because the waivers are of limited duration and are revocable. They also described having to post collateral in Germany and Poland, although in Germany collateral is not required for reinsurance placed directly without a broker. One panelist described the uncertainty of having multiple supervisors because of EU non-recognition of the U.S. supervisor. Another panelist described "nationality-focused" regulation in which EU member state regulators are requiring more local directors and localized senior management.

President Huff pointedly asked the panelists if they knew of a reason why covered agreement negotiations with the EU, which could result in recognition of the U.S. as

equivalent, have to be negotiated behind closed doors. They did not. Commissioner David Mattax (Texas) asked whether the issue is breaking down trade barriers or establishing a level playing field. He asked for input on specific requirements imposed by one jurisdiction but not the other, observing that EU companies will complain if U.S. companies are allowed to avoid requirements imposed on them. One panelist, in response, commented that Solvency II imposes a rigid, burdensome regulatory regime, with heavy capital and reporting requirements, and that the issue is not a level playing field, but adequate consumer protection and financial regulation.

President Huff asked if the vote on whether revisions to the NAIC Credit for Reinsurance Model Law and Regulation that allow reduced collateral for reinsurance ceded to non-U.S. reinsurers should be put on hold. Commissioner Mattax replied it should not be held hostage for EU collaboration, but should be enacted on its own merits. The vote, which was scheduled later during the Summer meeting, passed.

The international dialogue continued during the meeting of the Reinsurance (E) Task Force, where the same concerns were voiced by various trade association representatives. John Finston, California Department of Insurance General Counsel, acting as Task Force Chair, indicated the Qualified Jurisdiction Working Group would receive a referral to hold open public meetings and take comments on what actions EU countries have taken against U.S. insurers, and to consider whether there is any action the Working Group can take.

Under the Model Law, an unauthorized reinsurer may be certified to provide credit for reinsurance with reduced collateral if it is domiciled and licensed in a “qualified jurisdiction.” In determining whether the domiciliary jurisdiction is eligible to be recognized as a qualified jurisdiction, the commissioner must consider, among other things, whether there is reciprocal recognition of U.S. reinsurers. A list of qualified jurisdictions is published through the NAIC committee process. If a commissioner approves a country that does not appear on the NAIC’s list, the Model Law requires the commissioner to thoroughly document the justifications for the approval. With that as the backdrop, Mr. Finston commented that European regulators need to understand how their actions are being perceived, and that there may be consequences if European regulators do not take appropriate corrective action.

Separately, the Financial Condition (E) Committee received from NAIC staff an initial outline of options for regulating reinsurance as alternatives to the current approach of relying on collateral for unauthorized reinsurers. The report was the result of a charge from the Committee during the Spring National Meeting “to consider and develop contingency regulatory plans to continue to protect U.S. consumers and U.S. ceding insurance companies from potential adverse impact resulting from covered agreement negotiations.” The NAIC staff memorandum notes the NAIC is currently in the process of updating capital requirements for property/casualty insurers’ credit risk by replacing a flat factor with a factor that

varies based upon the ratings of each reinsurer, and that this approach takes into account the reduced risk if the reinsurer posts collateral. The memorandum offered the consideration of certified reinsurer status in the calculation of the RBC charges as an option.

F. Regulators Considering More Frequent Reporting on Investments

The Statutory Accounting Principles (E) Working Group has exposed for comment a proposal to require increased reporting from licensed insurers on investment holdings. Specifically, the Working Group has proposed that reporting entities provide quarterly or mid-year data as an NAIC supplemental filing that includes information detailing CUSIP, par value, book/adjusted carrying value and fair value of investment holdings. Regulators believe this additional reporting will assist them in earlier identification of industry-wide investment changes and trends, but industry representatives have expressed concerns about the increased costs associated with additional reporting.

Currently, licensed insurers are required to complete Schedule D, which is a detailed summary of investment holdings, as part of their statutory annual financial statement filings. A comparable summary is not currently required to be filed with an insurer's statutory quarterly financial statement filings, but regulators are considering ways to obtain this information more frequently. The Working Group has been considering a number of alternatives. The first alternative is that the NAIC hire a consultant to help NAIC staff to aggregate macro-level investment data that is already on file at the NAIC. The second alternative is that reporting entities provide an electronic-only supplemental filing on investment holdings as part of their quarterly financial statement reporting. The third alternative is that reporting entities be required to provide full Schedule D reporting on a quarterly basis, and that the current requirement for quarterly acquisition/disposition schedules be eliminated. The fourth and final alternative under consideration is that insurers provide a mid-year electronic-only supplemental filing on investment holdings, which would be due by August 15 of each year.

G. NAIC Adopts Minimum Standards for State Regulation of Market Conduct

The NAIC is in the process of adopting a Market Regulation Certification Program that establishes minimum standards for state market conduct examinations. The Program is being developed, at least in part, in response to a recommendation in FIO's 2013 Report on How to Modernize and Improve the System of Insurance Regulation in the United States. Among the Report's findings was a recommendation that:

States should reform market conduct examination and oversight practices and: (1) require state regulators to perform market conduct examinations consistent with the National Association of Insurance Commissioners Market Regulation Handbook; (2) seek information from other regulators before issuing a request to an insurer; (3) develop standards and protocols for contract market conduct examiners; and (4)

develop a list of approved contract examiners based on objective qualification standards.

In San Diego, following a close 7-6 vote, the Market Regulation and Consumer Affairs (D) Committee adopted the Market Regulation Certification Program Self-Assessment Guidelines and Checklist Tool, which includes 12 minimum requirements for state market conduct examinations and a self-assessment checklist for states to use in self-assessing their compliance with the requirements. The Guidelines include the following requirements:

- The department must have the statutory authority to conduct market regulation activities, including: market analysis; comprehensive and targeted market conduct examinations; the continuum of market regulation actions, including enforcement; and collaboration and coordination with other regulatory agencies. Additionally, the jurisdiction has adopted key insurance consumer protection laws and regulations.
- When a department initiates a market conduct examination, it must be guided by the version of the NAIC Market Regulation Handbook in effect at the time the exam was initiated.
- The department must have sufficient staff, or statutory authority to engage and supervise contractors, to conduct a market conduct examination.
- The department must ensure that market conduct staff and contractors are appropriately qualified.
- The department must have the authority to maintain exam work papers and information shared by other jurisdictions as confidential.
- The department must participate in collaborative actions with other jurisdictions (including through the Market Actions (D) Working Group (MAWG)).
- The department must participate in the centralized collection of Market Conduct Annual Statements.
- The department enters data no less frequently than on a quarterly basis to all relevant NAIC systems.
- The department participates in or monitors NAIC market conduct and market analysis related working groups.
- The department appoints a Collaborative Action Designee (CAD) that attends (in person or telephonically) at least 50 percent of MAWG discussions.
- The department participates in the review of national analysis data annually,

and participates on one national analysis team at least every other year.

- The department has established and follows a systematic procedure for interdivisional communication (as referenced in the NAIC Market Regulation Handbook).

It is still unclear how exactly the NAIC will enforce these requirements—indeed, a point of contention among D Committee members was whether these requirements should be considered an accreditation standard, a "certification program" (as it is currently called) or simply a guideline. The Market Regulation Accreditation (D) Working Group has proposed an Implementation Plan for the Market Regulation Certification Program. As currently proposed, the Plan contemplates that, beginning in 2019, a new NAIC Market Regulation Standards and Certification Committee will determine whether a jurisdiction meets the certification standards, and each jurisdiction would then be reviewed every three years to assess its ongoing compliance with the certification standards.

H. Briefly Noted

1. NAIC Home Sharing White Paper

The Sharing Economy (C) Working Group is developing a white paper on home sharing services, such as Airbnb and Home Away, and the insurance coverage issues that they present. The White Paper is expected to address the following topics:

- What homeowner hosts need to know.
- What apartment hosts need to know.
- What owners of rental units, whose renters may be hosts, need to know.
- What customers need to know.
- A review of current Airbnb and HomeAway coverage (and whether this coverage constitutes insurance under state insurance laws).
- An appendix of related NAIC presentations and notices that have been issued by some states.

The proposed timeline for completion of the White Paper is aggressive, with an initial draft expected this October, a public conference call to be scheduled before the 2016 Fall National Meeting (scheduled for December 10 through December 13), and a final draft to be adopted at the 2016 Fall National Meeting. The Home Sharing White Paper follows a white paper on Transportation Network Companies (TNCs), such as Uber and Lyft, which was published in March 2015.

2. Autonomous Vehicles

It was an afternoon for futurists when the NAIC's Center for Insurance Policy and Research hosted an event entitled, "Gearing Up for Autonomous Vehicles." The opening and closing remarks were offered by Commissioner Teresa Miller (Pennsylvania). The current landscape for auto insurance was laid out by Robert Gordon, Senior Vice President, Policy Development and Research, Property Casualty Insurers Association of America (PCI). This was followed by a panel discussion among Commissioner Dave Jones (California); Susan Bonilla, California Assemblymember; Matteo Carbone, Principal, Bain & Co.; Chan Lieu, Senior Legislative Advisor, Venable LLP; Eric Nordman, NAIC Director of Regulator Services and CIPR; and Howard Mills, Global Insurance Regulatory Leader, Deloitte LLP.

Mr. Gordon provided a statistic-rich presentation that detailed steep recent increases in auto deaths and injuries. He noted a mismatch of perception and reality: the perception is that technology is making cars safer, but in fact there are more accidents, resulting in more claims and claims costs are rising. He discussed various trend factors considered as sources of the increase in frequency and severity (*e.g.*, increased traffic congestion and miles driven due to improving economic conditions, demographics, weather, drug use, distracted driving, increased speed limits), but it appears that there are no single or multiple factors that are clearly identifiable as driving the trend.

Mr. Gordon's presentation offered a nice segue to the panel discussion, because improved safety is one of the justifications most frequently offered for fully autonomous vehicles. That notwithstanding, there appeared to be small doubt among the panelists that fully autonomous vehicles will be on the road – at least in some places – and soon. One panelist offered a quote often repeated in Silicon Valley, "the future is already here, it's just not evenly distributed yet."

Despite the insurance setting, the panelists had little insight into the future of insurance in a world with autonomous vehicles. That may be because even the futurists don't know who will own and operate them – individual owners, ride sharing services or others. Nor does anyone know how crash-proof autonomous vehicles will coexist with conventional driver-operated vehicles. One panelist floated the idea of converting to a pure first-party insurance system, with no liability component. Another noted the service, not the asset, could be insured. Though none of the panelists offered any specific predictions, there appeared to be keen awareness of the potential for significant disruption. Wrapping up the meeting on a satirical note, one quipped, "but how exciting would NASCAR be?"

3. Surplus Lines Task Force

The Surplus Lines (C) Task Force is considering whether to develop a standard definition of "home state" for purposes of nonadmitted insurance policies written for unaffiliated groups of insureds. The Nonadmitted and Reinsurance Act (NRRA)

grants exclusive regulatory and taxing authority to the “home state” of an insured under a nonadmitted insurance policy. Specifically, the NRRA provides that (i) the placement of nonadmitted insurance is subject to the statutory and regulatory requirements solely of the insured's “home state,” and (ii) only an insured’s “home state” may require any premium tax payment for nonadmitted insurance. The NRRA clearly defines the terms for determining the “home state” of an individual insured and for affiliated groups, but does not address “home state” determination for “unaffiliated groups” such as purchasing groups. In the absence of clear standards, states – including New York and Illinois – have begun adopting their own rules defining what constitutes the “home state” for such groups, and there is a concern in the industry that these rules may be inconsistent.

As noted above, the Task Force is also expected to ask the NAIC’s International Insurance Department to collect information about cybersecurity insurance coverage from the excess and surplus lines insurers included on its *Quarterly Listing of Alien Insurers*. The NAIC recently completed its review of the cybersecurity supplement to the annual statement that was first required for 2015, but NAIC staff noted that information about alien surplus lines insurers (which do not file annual statements and thus were not required to complete the supplement) was noticeably absent.

4. Regulators Considering Prohibition on Mandatory Arbitration Provisions

The Market Regulation (D) Committee is considering whether states should prohibit mandatory arbitration provisions in property/casualty and health insurance policies. During the D Committee meeting, a number of industry representatives spoke in favor of mandatory arbitration provisions, noting the efficiencies that arbitration provides in claims settlement and coverage disputes. While the Committee's consideration of this issue is still in preliminary stages, hot button issues will include whether mandatory arbitration provisions should be prohibited in personal lines policies (even if they are permitted in commercial lines policies) and, if permitted, whether mandatory provisions should provide that arbitration must be held in the policyholder's state of residence. Noting the importance of this issue, Commissioner Dave Jones (CA) emphasized that mandatory arbitration provisions requiring arbitration in another state (or another country) place an unreasonable burden on small business owners.

5. Peter Hart Appointed as Insurance Commissioner Representative to FSOC

The NAIC has appointed Peter Hart, Insurance Director at the New Jersey Department of Banking and Insurance, as the state insurance commissioner representative to the Financial Stability Oversight Council (FSOC). Director Hart will be one of five non-voting members of FSOC. He replaces Commissioner Adam Hamm (N. Dakota) who served a two-year term on FSOC.

[1] Cybersecurity Insurance and Identity Theft Coverage Supplement to the NAIC Property and Casualty Annual

Statement.

If you have any questions about this Legal Alert, please feel free to contact any of the professionals listed below or the Sutherland attorney with whom you regularly work.