

NAIC 2018 Fall National Meeting Highlights

December 21, 2018

The National Association of Insurance Commissioners (“NAIC”) held its 2018 Fall National Meeting from November 15 to 18, 2018 in San Francisco. In this update, we highlight meeting developments of particular interest to our insurance industry clients.



Table of Contents

Life Insurers	2
Suitability in Annuity Transactions	2
Reinsurance	3
Property/Casualty Insurers	4
Big Data	4
Cannabis Insurance	5
Insurance Business Transfers	6
Group-Wide Supervision	7
Group Capital	7
International Insurance	7
IAIS Activities	7
Financial Stability Task Force	9
Macro-Prudential Monitoring	9

Acronyms and abbreviations used in this report:

- ACLI: American Council of Life Insurers.
- ComFrame: Common Framework for the Supervision of International Active Insurance Groups.
- EU: European Union.
- G-SII: Global Systemically Important Insurer.

- IAIS: International Association of Insurance Supervisors.
- RBC: NAIC risk-based capital.
- SEC: U.S. Securities and Exchange Commission.

Life Insurers

Suitability in Annuity Transactions

At the Summer National Meeting, the **Annuity Suitability (A) Working Group** discussed comments that the group had received on revisions to the definition section of the Suitability in Annuity Transactions Model Regulation (“Model Regulation”) and took a series of straw votes to gauge the members’ views on the proposed definitions. The chair of the Working Group stated that although progress was being made, he expected to hold at least one in-person meeting for further work on the Model Regulation before the Fall National Meeting.

The Working Group met again in person for two days in Chicago on October 22 and 23 to consider the Model Regulation’s remaining provisions. Considerable discussion was devoted to possible formulations for the proposed standard for a producer’s recommendation of an annuity. Iowa stated that it could not adopt a “best interest” standard, because, under Iowa state law, such a standard would equate to a fiduciary obligation. The Working Group rejected New York’s “only the interests of the consumer” standard as well as Ohio’s alternative standard requiring that the consumer’s interest be first and foremost.

In the end, the Working Group agreed on a formulation requiring a producer or insurer to “act in the interests of the consumer at the time the recommendation is made, without placing the producer’s or the insurer’s financial interest ahead of the consumer’s interests.” The proposed regulation also provides that compliance with such standard requires the producer or insurer to (i) act with reasonable diligence, care, skill and prudence, (ii) make suitable recommendations, and (iii) make specified disclosures concerning cash and non-cash compensation and material conflicts of interest. The Working Group did not agree on whether in-force transactions would be included in the revised model regulation.

At the Fall National Meeting, the Working Group approved several “clean-up” amendments to the Model Regulation and a drafting note explaining why the NAIC’s current draft of the Model Regulation does not include the term “best interest,” which is used in the SEC’s April 2018 proposed Regulation Best Interest.

At the meeting of the **Life Insurance and Annuities (A) Committee**, Idaho, which chairs the Working Group, reported on the status of the Working Group's activities and explained that additional work remains to be done and recommended that the Committee expose the preliminary draft for a public comment period. California asked whether that draft of the Model Regulation had been voted on by the Working Group and whether under the NAIC's procedures it is appropriate to expose a draft for public comments without the draft having been approved by the Working Group or the Committee. The chair explained that it would be more useful to expose the current draft and then continue the Working Group's deliberations based on the comments received. The chair also reiterated the NAIC's desire to ensure that its revisions to the Model Regulation be consistent with related federal efforts, including the SEC's proposed regulation, which may not be finalized until Fall 2019. The draft was exposed for public comments, which are due no later than February 15, 2019.

Reinsurance

The **Reinsurance (E) Task Force** completed its work amending the Credit for Reinsurance Model Law and Model Regulation so that they conform to the requirements of the Bilateral Agreement between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance (the "Covered Agreement"). The Task Force held a public hearing in February and subsequently exposed drafts for public comment in June and September.

At the Fall National Meeting, the Task Force adopted proposed revisions to the Model Law and Regulation and referred them to the **Financial Condition (E) Committee**. Most interested parties expressed support for the Task Force's work and the proposal that was developed. Some of the comments, including those from the European Commission, questioned whether the amendments go beyond the Covered Agreement and give too much discretion to state insurance regulators to add requirements by regulation. Although the Task Force expressed its view that the amendments are consistent with the Covered Agreement, the proof will likely come when states implement these provisions.

New York, which chairs the Task Force, expressed the need to move the proposal forward in light of the five-year pre-emption deadline that applies under the Covered Agreement, and indicated that the Task Force has shared the proposal with Treasury, which has not raised any red flags.

The **Financial Condition (E) Committee** later adopted the proposed revisions to the Model Law and Regulation, but directed NAIC staff to revise certain sections in order to address technical objections that were raised by interested parties. Although the **Executive (EX) Committee and Plenary** were expected to adopt the Model Law and

Regulation with those technical revisions during their December 19 conference call, the Committee announced during the call that it was postponing approval of the amendments to respond to recently-received comments from Treasury and the U.S. Trade Representative.

The proposed amendments add a new section to the Credit for Reinsurance Model Law and Regulation that allows credit for reinsurance ceded to an insurer that has its head office in, or is domiciled in, a “reciprocal jurisdiction.” The concept of “reciprocal jurisdiction” is similar to existing Model provisions relating to “qualified jurisdiction” in the certified reinsurer context (current qualified jurisdictions are also reciprocal jurisdictions). The definition of “reciprocal jurisdiction” is meant to include not only EU jurisdictions under the Covered Agreement but existing “qualified jurisdictions” that have not entered into an “international reinsurance agreement.” This is meant to provide parity between EU reinsurers and non-EU reinsurers from existing qualified jurisdictions, including Switzerland, Japan, Bermuda and the United Kingdom after Brexit.

The proposal requires state insurance commissioners to publish a list of reciprocal jurisdictions and a list of assuming insurers that have satisfied the requirements of the law and regulation so that cessions to such insurers qualify for reinsurance credit.

Property/Casualty Insurers

Big Data

Iowa Commissioner Doug Ommen, who chairs the **Big Data (EX) Working Group**, led a discussion about data accuracy and company validation methods used in accelerated and non-traditional underwriting. The discussion focused on whether regulators have sufficient tools to assess the validity and the potential market conduct implications of using predictive models for mortality and other insurance risks. The Working Group heard about the difficulty faced by state regulators in evaluating whether the data provided by vendors is accurate and used properly and the need to develop the skills necessary to understand the details of various third-party models. Interested parties submitted comments and suggestions for assisting regulators in evaluating those models.

The **Casualty Actuarial and Statistical (C) Task Force** presented a draft of a white paper that it is preparing that will address the sources and selection of data, predictive models and state rate filings. The current draft provides 16 best practices and identifies 92 items of information that may be collected to fulfill those best practices. The Task

Force also expressed a desire that its work would allow regulators to add greater uniformity to their reviews of insurance company submissions.

The **Innovation and Technology (EX) Task Force** heard a report from NAIC staff on federal activities concerning privacy and noted that a number of recent developments, such as the adoption of the EU General Data Protection Regulation and data breaches at social media and other companies, would likely result in increased efforts for cybersecurity legislation at the federal level. NAIC staff expressed concern over any federal effort that would preempt state insurance regulation.

The Task Force heard presentations from John Hancock and Farmers Insurance on innovative insurance technologies. Representatives of John Hancock discussed the company's new Vitality program, which integrates wellness and technology products in connection with life insurance services. Farmers Insurance discussed the development and implementation of Toggle, a division of the company that designs products and services targeting millennials. Toggle's initial focus is on providing an innovative approach to renters insurance by offering customized coverage, full portability and digital as well as human interaction. Insurance coverage can be added or changed on demand, but is not tied to a physical address. The product is offered currently in Illinois and Wisconsin.

Cannabis Insurance

The first in-person **Cannabis Insurance (C) Working Group** meeting was well attended, and began with a discussion of the fragmentation in the cannabis insurance market and its reliance on surplus lines insurers. Golden Bear Insurance Company, one of the few admitted carriers to offer cannabis coverage, described its experience offering commercial insurance as part of its cannabis package policy. The company noted that many of the insurance claims it had received thus far are typical business claims, such as fire and theft. The Working Group also heard from Continental Heritage Insurance Company on its experience providing surety bonds to the cannabis industry.

Interested parties told the Working Group that the cannabis industry has the same need for insurance coverage as other businesses and, even when coverage is available, it is often too expensive. Additionally, they noted that certain lines, such as crop insurance, are often unavailable, and that there is difficulty in obtaining management liability and employee coverage. The presenters discussed the fact that many insurance policies have restrictive exclusions, and that insurance carriers often impose barriers and requirements on cannabis businesses that go beyond what is required under state law.

Presenters emphasized the importance of having cannabis insurance expertise within state insurance departments and expressed support for a robust regulatory regime

outside of insurance to reduce insurance risk. Members of the Working Group described their own experiences with a hands-off approach that some legislators have adopted because of the uncertainty surrounding the federal government's stance on cannabis.

Interested parties also described the supply chain and structure of the cannabis industry, and the strict licensing and regulatory requirements imposed by California throughout the process, resulting in having three different state licensing authorities regulate commercial cannabis activities in California from cultivation to sale.

The Working Group members and interested parties discussed the need for increasing the availability of banking services for those in the cannabis industry, and the risks that banks could face from federal banking regulators because of the potential money laundering risks of providing financial services to the cannabis industry. A number of states, however, expressed concern that without adequate banking services, the cannabis industry would remain cash-only, which could lead to an increase in theft or other criminal activity.

Insurance Business Transfers

Although the topic was not on the agenda of the **Financial Condition (E) Committee**, Rhode Island Superintendent Elizabeth Dwyer asked the Committee to consider creating a working group to study the issues relating to insurance business transfer statutes, which a number of states have enacted recently. These laws are similar to a U.K. Part VII Transfer and would allow a U.S. insurer to separate a portion of its business and, through a court-supervised process, novate such business to another insurer.

Superintendent Dwyer noted that no state standards currently exist and suggested that the NAIC could get ahead of the issue by studying the various structures, capital standards, actuarial guidance for reserving, the role of protected cells, the impact on RBC requirements and guaranty fund implications. California Commissioner Dave Jones expressed support for the creation of such a working group, but noted that another aspect that deserves careful consideration is the legality of insurance business transfer laws and the potential binding effect that a decision by an out-of-state court could have on a California resident's insurance policy, especially if the new company is not licensed in California. The Committee agreed to attempt to find a chair for such a working group and consider potential charges.

Group-Wide Supervision

Group Capital

The **Group Capital Calculation (E) Working Group** reached a milestone in its development of a group capital calculation with the preliminary release of a group capital calculation field testing template. The Working Group heard a presentation from NAIC staff summarizing the template, which includes instructions and an Excel file for data entry.

The template attempts to synthesize the decisions that the Working Group has made with respect to the calculation while also collecting data on alternatives in several areas where decisions are still needed. For example, the scope of the group that will be subject to the calculation is still under discussion. Therefore, the template requests that a participant field testing the template submit data for every entity in its group, but allows the participant to designate entities as ones that the participant believes should be excluded from the calculation. NAIC staff will then run the calculations with and without the proposed excluded entities to determine the effect on group capital. The template also presents alternative treatments with respect to captives and senior debt.

Field testing is tentatively expected to begin in March 2019 and will incorporate information from field testing volunteers' 2018 annual statutory financial filings. The Working Group has opened field testing to all groups, including international groups and those that may be subject to a federal capital requirement, and is still accepting field testing volunteers. The Working Group suggested that it expects that only a single field testing exercise will be completed before the group capital calculation is implemented, which will likely occur in 2020.

The Working Group instructed NAIC staff to expose the template for a 75-day comment period ending January 30, 2019.

International Insurance

IAIS Activities

The **International Insurance Relations (G) Committee** heard an update on the IAIS's now-completed public consultations on ComFrame and the Insurance Capital Standard ("ICS") version 2.0. The IAIS is now reviewing the hundreds of pages of comments on each consultation that it received. The IAIS plans to review and integrate the comments received on the ICS prior to the field testing scheduled to begin in Spring 2019. Representatives from the IAIS Secretariat noted that the comments generally address a

narrower set of issues than have been presented in previous consultation comments. In addition, the IAIS has begun internal discussions about the criteria that it will use to assess the comparability of outcomes across the ICS and other capital calculation methodology, such as the aggregation approach. As previously announced, the initial monitoring period for the ICS will begin in January 2020.

The IAIS has exposed for public comment the Holistic Framework for Systemic Risk in the Insurance Industry (the “Holistic Framework”), which incorporates the IAIS’s shift away from a risk framework centered on entities and toward a framework centered on collective activities and exposures across the insurance and other industries. Comments are due by January 25, 2019. A public conference call providing background information on the exposure draft was held on November 29.

Related to the release of the consultation, on November 14, the Financial Stability Board announced that it would not identify any G-SIIs in 2018 and plans to assess the IAIS’s recommendation to suspend G-SII identification beginning in 2020, after the Holistic Framework is finalized in November 2019.

Representatives of the IAIS Secretariat reported that as of the first quarter of 2019, the IAIS executive committee will increase from 24 to 32 voting members, of which two additional members have been allocated to North America, in order to better reflect the diversity of the IAIS membership. U.S. state regulators on the executive committee are NAIC Chief Executive Officer Michael Consedine, Director of the South Carolina Department of Insurance Ray Farmer, and Commissioner of the Tennessee Department of Commerce & Insurance Julie Mix McPeak.

The **ComFrame Development and Analysis (G) Working Group** met in a closed regulator-to-regulator session to discuss ICS developments and 2018 field testing results.

The **Casualty Actuarial and Statistical (C) Task Force** heard a presentation on the EU-U.S. Insurance Dialogue Project (the “Project”) Issues Paper on big data, including what and how data is collected, the portability, quality and availability of data and how insurers and third parties use such data for marketing, rating, underwriting and claims handling. Since the Project began in 2013, regulators from the EU and the U.S. have been discussing cybersecurity, cyber insurance and big data. In the future, the Project may consider insurers’ use of third-party vendors, disclosures to applicants and insurers’ use of artificial intelligence models.

Financial Stability Task Force

Macro-Prudential Monitoring

The **Receivership and Insolvency (E) Task Force** heard updates from the drafting groups formed to consider the three referrals that it had received from the **Financial Stability (EX) Task Force** on assessing recovery and resolution planning in light of the ongoing NAIC Macro-Prudential Monitoring Initiative, which is focused on enhancing liquidity, recovery and resolution, capital stress testing and identifying exposure concentrations. The first drafting group is considering whether U.S. recovery and resolution planning incorporates best practices with respect to financial stability. The drafting group compared the powers of the receiver under the NAIC Insurer Receivership Model Act (“IRMA”) with the powers under IAIS Insurance Core Principle 12 (“ICP 12”).

The first drafting group concluded that IRMA grants receivers most of the powers enumerated in ICP 12, although some elements of ICP 12 have been identified as requiring further discussion. Because most states have not adopted IRMA, the drafting group will next compare IRMA to prior versions of the NAIC receivership model law and regulation. In addition, the drafting group will consider whether there are provisions in ICP 12 unrelated to the powers of the receiver, but that should be incorporated into the model law and regulation because the provisions enhance financial stability.

The second drafting group is reviewing processes for resolution and recovery planning that are used in other jurisdictions and how to apply best practices to cross-jurisdictional groups. The drafting group reported that it is focused on implementing risk assessment processes in exams and plans to schedule two conference calls before the end of 2018. The drafting group also noted that its recommendations may require referrals to other working groups.

The third drafting group is focused on misalignment in federal and state laws with respect to temporary stays of termination of netting agreements for qualified financial contracts. The drafting group has held discussions with federal regulators and intends to schedule a public call before the end of 2018 to discuss next steps.

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Please do not hesitate to contact us with any questions.

[Click here](#) for a recording of the recent NAIC Fall National Meeting client briefing highlighting these topics.

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