CLIENT ALERT

NAIC Report: 2018 Fall National Meeting

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The 2018 Fall National Meeting of the National Association of Insurance Commissioners was held in San Francisco, California on November 14-17, 2018. In light of the devastating wildfires taking place throughout California during the conference, and the recent damage caused by Hurricane Florence on the East Coast a month earlier, climate change and natural disasters were a focus at the Fall National Meeting. Other highlights included near-completion of the NAIC's revisions to the model credit for reinsurance laws and regulations in response to the Covered Agreement, the unveiling of the IAIS's draft activities-based systemic risk framework, and discussion of emerging issues including cannabis insurance and insurance business transfer laws.

This report summarizes some of the key activities at the Fall National Meeting and, as indicated, NAIC interim meetings and conference calls and other developments leading up to the meeting that may be of interest to our clients in the insurance industry.

GLOSSARY

Definitions used in this report include:

- "BRA" means bilateral reinsurance agreement, *e.g.*, the Covered Agreement.
- "BRA Reciprocal Jurisdiction" means a non-U.S. jurisdiction that has entered into a BRA with the U.S. that includes all the same reciprocity terms provided for in the Covered Agreement and has been recognized as a reciprocal jurisdiction by a state commissioner.
- "BRA Reciprocal Jurisdiction Reinsurer" means a reinsurer from a BRA Reciprocal Jurisdiction eligible to post no collateral.
- "Certified Reinsurer" means a reinsurer from a Qualified Jurisdiction eligible to provide less than one hundred percent (100%) or no reinsurance collateral.
- "ComFrame" means the Common Framework for the Supervision of Internationally Active Insurance Groups being developed by the IAIS.
- "Covered Agreement" means the Bilateral Agreement Between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on September 22, 2017.
- "Credit for Reinsurance Models" means the NAIC Credit for Reinsurance Model Law and NAIC Credit for Reinsurance Model Regulation.
- "Dodd-Frank" means the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- "Enhanced Reciprocal Jurisdiction" means a non-U.S. or a U.S. jurisdiction that is not a party to a BRA and is deemed a Qualified Jurisdiction pursuant to the NAIC Qualified Jurisdiction Process because it meets regulatory requirements set forth in the revisions to the Credit for Reinsurance Models released for public comment in November 2018 and has been recognized as a reciprocal jurisdiction by a state commissioner.
- "Enhanced Reciprocal Jurisdiction Reinsurer" means a reinsurer from an Enhanced Reciprocal Jurisdiction that is eligible to post no collateral.
- "FIO" means the Federal Insurance Office of the United States Department of the Treasury.

- "FSB" means the Financial Stability Board, a non-profit international body, currently composed of 54 representatives from 25 jurisdictions (including representatives from international financial institutions and international standard-setting, regulatory, supervisory and central bank bodies) that monitors and makes recommendations about the global financial system.
- "FSOC" means the Financial Stability Oversight Council of the United States Department of the Treasury.
- "Fully Collateralized Reinsurer" means a reinsurer that must post collateral equal to 100% of its U.S. obligations to its U.S. cedent.
- "G-SII" means Global Systemically Important Insurer, as designated by the FSB.
- "IAIS" means the International Association of Insurance Supervisors.
- "ICS" means the Insurance Capital Standard being developed by the IAIS to apply to internationally active insurance groups, including G-SIIs. The IAIS has been developing a risk-based global ICS since 2013 pursuant to a directive by the FSB. The IAIS released ICS Version 1.0 and Version 2.0 for public consultation on July 21, 2017 and July 31, 2018, respectively.
- "NAIC" means the National Association of Insurance Commissioners.
- "NFIP" means the National Flood Insurance Program.
- "NYDFS" means the New York State Department of Financial Services.
- "ORSA" means Own Risk and Solvency Assessment.
- "ORSA Summary Report" means a confidential annual report required by the NAIC Risk Management and Own Risk and Solvency Assessment Model Act (Model #505) from insurers above a specified premium threshold.
- "P&P Manual" means the Purposes and Procedures Manual of the NAIC Investment Analysis Office.
- "PBR" means principle-based reserving.
- "Qualified Jurisdiction" means a non-U.S. jurisdiction that the NAIC deems to be a "Qualified Jurisdiction" using the NAIC Qualified Jurisdiction Process.
- "Reciprocal Jurisdiction" means (1) a BRA Reciprocal Jurisdiction; or (2) an Enhanced Reciprocal Jurisdiction.
- "RBC" means risk-based capital.

- "SEC" means the United States Securities and Exchange Commission.
- "SIFI" means a systematically important financial institution designated by FSOC.
- "SVO" means the NAIC Securities Valuation Office.
- "SVO List" means the SVO List of Investment Securities.
- "Trade Representative" means the Office of the United States Trade Representative.
- "Treasury" means the United States Department of the Treasury.
- "U.S. DOJ" means the United States Department of Justice.
- "XXX/AXXX" means NAIC Valuation of Life Insurance Policies Model Regulation #830, referred to as Regulation XXX, and Actuarial Guideline 38, referred to as AXXX.

I. Topics of General Interest

a. Credit for Reinsurance

Throughout 2018, the NAIC has worked on proposed amendments to the Credit for Reinsurance Models in order to satisfy the substantive and timing requirements of the Covered Agreement. At the Fall National Meeting, the Reinsurance (E) Task Force and Financial Condition (E) Committee adopted the revised Credit for Reinsurance Models (the "2018 Draft Credit for Reinsurance Models"), but the Executive (EX) Committee and Plenary did not vote on the revised models during the Fall National Meeting, because the Financial Condition (E) Committee directed NAIC staff and ReFAWG to consider whether further technical changes and clarifications consistent with comments raised at the Fall National Meeting should be made to the revised Credit for Reinsurance Models. Executive (EX) Committee and Plenary will be reviewing and considering adoption of the 2018 Draft Credit for Reinsurance Models on a conference call scheduled for December 19, 2018.

The 2018 Draft Credit for Reinsurance Models in essence recognize four types of jurisdictions, and accordingly four types of reinsurers based on their domiciliary jurisdictions. Those categories of reinsurers are referred to herein as Fully Collateralized Reinsurers; Certified Reinsurers; and Reciprocal Jurisdiction Reinsurers, which include BRA Reciprocal Jurisdiction Reinsurers and Enhanced Reciprocal Jurisdiction Reinsurers. A reinsurer's domiciliary jurisdiction initially dictates whether the reinsurer must post 100% collateral, or is eligible to post reduced or zero collateral.

The Reinsurance (E) Task Force received 14 comment letters from interested parties pertaining to revised drafts of the Credit for Reinsurance Models released on September 25, 2018. The Task Force's revisions responded to these comments, which noted the following themes of concerns:

- ***Industry Concern: The latitude afforded to commissioners regarding the recognition of Reciprocal Jurisdictions and Reciprocal Jurisdiction Reinsurers***

The 2018 Draft Credit for Reinsurance Models authorize state insurance commissioners to determine whether a BRA party (or member state thereof) is complying with a BRA. A commissioner may also impose additional requirements on a Reciprocal Jurisdiction and on Reciprocal Jurisdiction Reinsurers. Certain industry commentators have criticized the latitude afforded to state insurance commissioners, however, at the Task Force meeting Superintendent Maria Vullo (NY), the Task Force chair, emphasized that the power granted to commissioners under the revised Credit for Reinsurance Models is consistent with and important to state insurance regulation and therefore will remain in the proposed drafts. The European Commission was also critical of state regulatory authority in this regard. In response, Superintendent Vullo stated that although commissioners will work in coordination with the FIO, initial determinations of BRA compliance must be made by the commissioner.

Superintendent Vullo added that the revised Credit for Reinsurance Models were fully consistent with the Covered Agreement, and that, in fact, certain provisions were directly lifted from the Covered Agreement and the Statement of the United States on the Covered Agreement. Superintendent Vullo also said that FIO, Treasury and Trade Representative raised comments similar to those of the European Commission, but did not identify such issues (or any other issues) as "red flags" that would halt the adoption of the revised Credit for Reinsurance Models.

- ***Industry Concern*: *Limited application of the Credit for Reinsurance Models to certain reinsurance agreements***

Industry participants also expressed concern that the zero collateral requirement would not apply "to losses incurred or liabilities ceded" prior to the Credit for Reinsurance Models' effective date. While certain industry commentators claimed this unintentionally excluded loss portfolio transfers and adverse development covers from zero collateral treatment, other commentators, notably California, maintained that the zero collateral requirement should apply only to losses incurred or reserves reported after an assuming reinsurer becomes eligible for zero collateral. In line with California's recommendation, the proposed revisions clarified that reserve credit may not be taken for the reinsurance of losses incurred or reserves reported prior to the date a state insurance commission has determined the reinsurer is eligible for zero collateral treatment.

- ***Industry Concern: The effective date of the zero collateral requirement in the Credit for Reinsurance Models***

Concerns had been raised that zero collateral treatment applied only to reinsurance agreements entered into after the 2018 Draft Credit for Reinsurance Models' application date—thereby excluding reinsurance agreements renewed or amended after that date from zero collateral treatment. The proposed revisions responded positively to the industry's recommendation that renewed and amended reinsurance agreements also be subject to zero collateral treatment. Specifically, the 2018 Draft Credit for Reinsurance Models provide that credit may be taken for reinsurance agreements entered into, renewed or amended on or after the date a commissioner has determined that the assuming insurer is eligible for zero collateral treatment.

- ***Industry Concern: U.S. states accredited by the NAIC should be eligible for zero collateral treatment***

For purposes of establishing the applicability of the Revised Credit for Reinsurance Models, the Industry noted that the current Credit for Reinsurance Models define "head office or domicile" to include "any jurisdiction of the United States," and therefore, industry commentators requested that the 2018 Draft Credit for Reinsurance Models include language specifically extending the zero collateral treatment to reinsurers domiciled and licensed in an NAIC-accredited state. Superintendent Vullo stated that the Credit for Reinsurance Models were not intended to provide any lack of parity or unequal treatment to the U.S. domestic insurance or reinsurance industry. She recommended the issue be referred to ReFAWG for analysis.

Before closing the opportunity for public comment, Vullo invited industry participants to voice any final issues. As currently drafted, the Credit for Reinsurance Models require that Reciprocal Jurisdictions recognize that insurers domiciled in U.S. states are not subject to group supervision at the level of the U.S. insurer's worldwide parent. According to certain industry commentators, a literal reading of this provision requires that a U.S.-domiciled insurer with a non-U.S. parent be governed solely by its U.S. state insurance regulator to the exclusion of the non-U.S. regulator governing the subsidiary's parent. After noting the tardiness of the concern, the Task Force instructed ReFAWG to consider an amendment to the provision clarifying that the Credit for Reinsurance Models are not meant to supplant the regulatory authority governing the non-U.S. parent or its U.S.-domiciled insurer. As noted above, ReFAWG will examine this and other outstanding issues prior to the vote set for the Executive (EX) Committee and Plenary meeting on December 19, 2018.

b. Group Capital and Group Supervision

i. NAIC Group Capital Calculation Tool

The Group Capital Calculation (E) Working Group continues to develop a group capital calculation tool using an RBC aggregation methodology and intends to field test the tool in early 2019 using year-end 2018 data. At the Summer National Meeting and on an interim conference call, the Working Group focused on the scope of the group capital calculation's application within an insurance group as well as non-insurance testing (*i.e.*, determining the appropriate method for testing the capital of a group's regulated and non-regulated entities). Regulators and interested parties agreed that the best approach to these issues is to field test a wide range of options to ensure field testing provides the Working Group a comprehensive range of data from a diverse sample of insurers and lead state regulators.

Just prior to the Fall National Meeting, the Working Group released a draft template to be used in field testing. NAIC staff provided an overview of the template at the Fall National Meeting, emphasizing that it is only an initial draft and that there will be conversations over the next several weeks to refine the document. In response to the feedback from interested parties, the scope of the template is intentionally broad and does not exclude any groups from participating. Field testing volunteers will input data into the template, which will then be able to provide a variety of outputs for analysis. For example, the template can run analyses with "immaterial" entities (as designated by the company) both included and excluded to compare the results. The template could also run analyses both including and excluding adjustments for captives, permitted practices, XXX/AXXX reserves, and scalars for foreign entities. The goal of the template is to test a variety of options and identify any "unintended consequences" resulting from how the scope of the group and adjustments are defined.

The Working Group exposed the template for comment for 75 days (until January 30, 2019) at the request of an interested party to allow stakeholders to experiment with the template and provide detailed substantive feedback prior to the commencement of field testing. Working Group Chair Commissioner David Altmaier (FL) stated that there is "a large amount of interest" among groups to volunteer for field testing. He encouraged others to volunteer so that there is a broad cross-section across group structures, group sizes and lines of business.

ii. International Developments

1. Update on ComFrame and ICS

At the Fall National Meeting, the NAIC's International Insurance Relations (G) Committee heard an update from IAIS Secretary General Jonathan Dixon on the work of the IAIS with respect to the ICS and ComFrame. On an interim conference call prior to the Fall National Meeting, the (G) Committee finalized comments on two major IAIS public consultation documents, one addressing the qualitative aspects of ComFrame and one addressing ICS Version 2.0, which is part of ComFrame. The IAIS has received over 350 pages of comments on the ComFrame consultation and over 1,500 pages on the ICS consultation. Secretary General Dixon stated that the comments are being closely considered and will inform the final round of field testing of ICS scheduled for 2019. Despite the volume of comments, there are relatively few issues outstanding, and Secretary General Dixon said that the IAIS remains on track for final field testing and to adopt ComFrame by November 2019. The IAIS will then enter a five-year monitoring period for ICS Version 2.0, which will provide an opportunity for further review by supervisors and the industry on the effectiveness of ICS as a common standard, prior to the implementation phase beginning in 2025.

Secretary General Dixon also noted that the IAIS is pleased with the "significant progress" that the NAIC has made on field testing of the group capital calculation tool using an aggregation methodology. The IAIS has undertaken data collection regarding the aggregation method and is seeking input from IAIS members to discuss comparability of outcomes across the ICS and other solvency frameworks such as the aggregation method.

2. IAIS Releases Draft Systemic Risk Framework

Since early 2017 the IAIS has been focused on systemic risk in the insurance sector by developing an "activities-based approach" ("ABA") to mitigate systemic risk through broadly applicable policy measures addressing potentially systemic activities. The ABA reflects a recognition by the IAIS that the existing entity-based approach focused on identifying G-SIIs (*i.e.* firms whose failure would pose a threat to the wider financial system) may not completely assess potential systemic impacts that stem from the collective actions or distress of insurers that are jointly exposed to certain risks. The IAIS released a preliminary consultation document on the ABA in late 2017.

As previously reported, the FSB (which is responsible for designating G-SIIs) decided not to publish a new list of G-SIIs in 2017 (maintaining, however, the nine G-SIIs identified in 2016). The FSB also encouraged the IAIS to continue work on the ABA, which may ultimately affect the global insurance groups identified as G-SIIs.

On November 14, 2018, the IAIS released for public consultation a draft Holistic Framework for Systemic Risk in the Insurance Sector (the "Framework"). In sessions at the Fall National Meeting, Secretary General Dixon gave an overview of the Framework, which he characterized as a key component of the IAIS's post-financial crisis reform measures along with ComFrame/ICS. The Framework continues the IAIS's move away from what Secretary General Dixon called the "binary" entities-based approach, in which certain additional policy measures are applied only to a small group of G-SIIs, and toward an ABA with a proportionate application of an enhanced set of policy measures to address activities and exposures that can lead to systemic risk in the insurance sector as a whole.

Secretary General Dixon described the following as key elements of the Framework:

1. An enhanced set of supervisory policy measures to prevent systemic risk from developing in the first place—*e.g.*, macroprudential surveillance by supervisors, enhanced requirements on enterprise risk management, liquidity management and measures related to crisis management and recovery planning;

2. A global annual monitoring exercise by the IAIS designed to detect the possible build-up of systemic risk in the global insurance sector;

3. Where systemic risk is detected, powers of intervention that supervisors should have at their disposal to enable a collective global response—*e.g.*, reports on the management of systemic risk, restrictions on business activities, reinforcement of financial positions and large exposure limits;

4. Mechanisms that help ensure the global consistent application of the Framework; and

5. Assessment by the IAIS of the ongoing implementation of the above elements.

Secretary General Dixon described the release of the Framework as a "significant development" in a multiyear process within the IAIS that included input from stakeholders including the NAIC, and stated that the Framework represents a "much improved approach" to the mitigation of systemic risk versus the current G-SII approach.

The IAIS is of the view that the implementation of the Framework should remove the need for an annual G-SII identification by the FSB. Instead, the enhanced policy measures in the Framework will be applied proportionately to a broader set of insurers. In light of the release of the Framework, the FSB has decided not to identify new G-SIIs in 2018. The FSB "welcomes" the publication of the Framework which "appropriately implemented, would provide an enhanced basis for mitigating systemic risk in the insurance sector." The FSB will assess the need to either discontinue or reestablish an annual identification of G-SIIs following the adoption and implementation of the Framework.

The IAIS will now receive input on the Framework from stakeholders until the consultation period closes on January 25, 2019. The IAIS plans to further refine the Framework taking into account public consultation feedback. The Framework is scheduled for adoption in November 2019, with implementation in 2020.

Commissioner Katharine L. Wade (CT) stated that the NAIC welcomes this move by the IAIS to focus on systemic risk versus the prior entity-level approach. The NAIC will review the approximately 65 questions posed by the Framework consultation document and provide comments to the IAIS.

3. IAIS Strategic Plan for 2020-2025

IAIS Secretary General Dixon said that 2019 will be a "watershed year" with the culmination of much of the IAIS's post-financial crisis work, including the adoption of the Framework and ComFrame. At its 2018 Annual Conference held in Luxembourg in early November, the IAIS worked on its strategic plan for the five-year period beginning in 2020. Secretary General Dixon gave a preview of the plan to the (G) Committee and in a Q&A session. With the work on post-crisis measures coming to a close, IAIS standard-setting activities will be less intensive and the IAIS will enter a period of greater "stability." Secretary General Dixon said that the IAIS will focus on supporting and assessing the implementation of the post-crisis measures and less on "setting new rules." New standard setting would be targeted to any new risks identified during the implementation process. In addition, the IAIS will focus on key emerging and accelerating areas requiring the attention of insurance supervisors including digital innovation, cyber risk and climate risk.

iii. <u>NAIC Macro-Prudential Initiative</u>

Work continues on the development of liquidity stress testing for certain life insurers, part of the NAIC's Macro-Prudential Initiative ("MPI"), which is aimed at identifying and calculating how risks from the broader financial markets and economies impact the insurance sector. At the Financial Stability (EX) Task Force meeting, Chair Katharine Wade (CT) described the MPI as a priority on the NAIC's agenda, and mentioned that this work parallels the IAIS's development of an ABA for systemic risk (see Section I.b.ii.2, above). Like the IAIS, the NAIC is focusing on financial, economic and other common risk exposures in the insurance sector. The NAIC views the MPI as a "logical continuation" of its post-crisis Solvency Modernization Initiative. The MPI initially involved a review of macroprudential monitoring practices in other jurisdictions, which led to a focus on stress testing.

Justin Schrader, Chief Financial Examiner at the Nebraska Department of Insurance and Chair of the Liquidity Assessment (EX) Subgroup, gave an update to the Financial Stability (EX) Task Force on liquidity stress testing. On an interim conference call of the Subgroup prior to the Fall National Meeting, comments were received on proposed scope criteria for stress testing. In response, the Subgroup exposed for comment a revised scope document on November 17.

The Subgroup proposes to include in the scope of stress testing any life insurer/group that exceeds certain dollar thresholds for fixed and indexed annuities, funding agreements and GICs, derivatives, securities lending, repurchase agreements and borrowed money. Mr. Schrader noted that the scope would currently include 23 insurers/groups based on the proposed criteria (up from 21 at the time of the Summer National Meeting). The entities within scope should have already been informed by their state regulators.

Mr. Schrader said that some interested parties still question the goal of the liquidity stress-testing framework, which he said is to provide insight into insurers and groups for macroprudential surveillance but also assist regulators with entity-level supervision. Stress testing will be a “regulatory tool” but will not result in “automated regulatory triggers” or “benchmarking” of insurers, although some comparisons drawn from stress testing may be useful to regulators to provide feedback to the insurers/groups.

With the scoping exercise “essentially completed,” the Subgroup will now focus on the design elements of the stress testing itself, which will be based on a cash flow approach. A field test exercise is expected to be performed in 2019 before a stress test is rolled out for all of the entities within scope. The Subgroup encourages all of these entities to participate in field testing.

iv. U.S. Federal Developments

1. FSOC Update

In September 2018, state insurance regulators appointed Superintendent Eric Cioppa (ME) to a two-year term as the state insurance commissioner representative on FSOC. Superintendent Cioppa replaced Peter Hartt (NJ), whose term expired. At the Fall National Meeting, Superintendent Cioppa provided an update on FSOC developments.

In October 2018, FSOC voted to rescind the designation of Prudential Financial, Inc. as a SIFI, deciding that there is not a significant risk that the company could pose a threat to financial stability. Superintendent Cioppa stated that this decision better reflects the insurance business model and its regulation and also recognizes the role of the New Jersey Department of Banking and Insurance as the state group-wide supervisor of Prudential. With the rescission of Prudential’s SIFI designation, there are no longer any nonbank financial firms designated as SIFIs.

2. New FIO Director Steps Down

Steven J. Dreyer has stepped down from his position as director of FIO effective November 16, 2018. Prior to his appointment to the position in June 2018, Dreyer worked as an analyst and executive at S&P Global for over 25 years. In an email to associates regarding his decision, Dreyer cited differences between working in the private sector and in government, and his belief that his experiences could be best applied in other pursuits.

During his brief tenure as director, Dreyer's role was to represent the United States at IAIS, serve as a non-voting member of FSOC, advise the Treasury Secretary on insurance matters, and assist in administering the Terrorism Risk Insurance Program. Until a permanent replacement is named, FIO Deputy Director Steven Seitz will serve as acting director, a role that he filled for 18 months following former Director Michael McRaith's retirement in January 2017 through Dreyer's appointment.

c. Innovation and Technology

i. Data Accuracy and Predictive Modeling

Data accuracy and predictive modeling continue to be significant focus points of the NAIC's innovation and technology-related subgroups. The Big Data (EX) Working Group continued discussions about data accuracy and company validation methods in accelerated/non-traditional life insurance underwriting and whether state insurance regulators (specifically market conduct examiners) have the tools to assess the validation, legality and appropriateness of data being used to predict mortality risk. The Working Group discussed the review of data being provided by new vendors, including whether non-insurance entities that collect, house and analyze data should be regulated or examined in the same way as insurance companies, and whether market conduct regulators have the tools necessary to assess these new activities. Working Group members also reiterated their concern about the use of certain data leading to intentional or unintentional discrimination.

The Working Group received a report from NAIC staff about a recently completed survey of states to research the appropriate skills and potential resources to assist the states in reviewing predictive models. NAIC staff is working to issue a draft report of the survey results to the Executive (EX) Committee by the end of the year for further direction by the Executive (EX) Committee at the 2019 Spring National Meeting. The NAIC Legal Division provided an update on a separate project focused on the methods and procedures to be followed by states in sharing predictive modeling information to maintain applicable statutory confidentiality. In October, the NAIC Legal Division circulated a survey to states on this topic and will be reviewing the survey results to better understand what information might be shared and the desired mechanism to share this information prior to issuing its final analysis.

The Working Group also received a report from the Casualty Actuarial and Statistical (C) Task Force ("CASTF") on a white paper providing guidance on best practices for the review of predictive models and addressing sources of data, company selection of data, predictive models and final rate filings with states. The CASTF's first draft identifies 16 best practices and 92 pieces of information that would assist the regulator in review of predictive models and analytics filed by insurers to justify rates, and proposes guidance on how to handle rate filings that are based on complex predictive models. The term "predictive model" refers to a set of models that use statistics to predict outcomes. Examples of predictive models include models that can predict the frequency of loss, the severity of loss, or the pure premium. Sources of "big data" that such predictive models can analyze include, *e.g.*, data gathered from wearable exercise monitors or information indicating whether an insured is divorced. CASTF suggests that the best practices will assist the states in identifying the elements that a regulator should review in a filing that includes predictive models. Best practices, however, are not intended to create standards for such filings. Ultimately, the purpose of the white paper is to provide greater consistency of reviews across jurisdictions. The CASTF has exposed the white paper for a public comment period ending January 15, 2019, and expects to expose revised drafts for public comment two to three times more before there is a final product.

ii. International Developments on Big Data

The Big Data (EX) Working Group also heard a report on the EU-U.S. Insurance Dialogue Project (the "EU-US Project") and a recently published issues paper on big data by the EU-US Project's members. The purpose of the EU-US Project is to enhance mutual understanding between the EU and the United States in order to promote business opportunity, consumer protection and effective supervision, whereby the parties aim to share information and not policy. The paper discusses what data is collected, how it is collected, data portability, data quality, and how it is made available and used by both insurers and third parties in the context of marketing, rating, underwriting and claims handling. Future work may include discussion of insurers' use of third-party vendors, disclosures to applicants and insurers' use of artificial intelligence models.

iii. Cybersecurity

The Innovation and Technology (EX) Task Force heard a report from Director Raymond G. Farmer (SC) on cybersecurity initiatives, including enactment of the Insurance Data Security Model Law (#668) in South Carolina. The Insurance Data Security Model Law was adopted by the NAIC membership in October 2017 and updates state insurance regulatory requirements relating to data security, the investigation of a cyber event and the notification to state insurance commissioners of cybersecurity events at regulated entities. The Insurance Data Security Model Law is not an NAIC state accreditation standard, and currently there is no indication of whether or when it may become an accreditation standard. South Carolina remains the first and only state to adopt the Insurance Data Security Model Law. South Carolina's bill goes into effect January 1, 2019. Treasury has urged prompt action by the states to enact the Insurance Data Security Model Law within the next five years, or face federal legislation in this area. Director Farmer reiterated that the Insurance Data Security Model Law is the best way states can lead in this effort and recommended that every state now consider adoption.

The Task Force also heard a report from NAIC staff on federal cybersecurity legislation. In general, the NAIC opposes recent federal legislative proposals that seek to preempt state laws and regulations in a manner that would inhibit ongoing efforts in the states to adopt data security laws and regulations in the best interests of insurance consumers. The NAIC staff continues to attend senate hearings and briefings to defend against broad preemption of state regulation.

iv. Innovation

In addition to hearing presentations on innovation in the insurance space (*e.g.*, promoting new insurance products that incentivize insurance customers to live healthier lives, and a renters' insurance product targeted towards millennials), the Innovation and Technology (EX) Task Force heard an update on Task Force activities and deliverables. State insurance regulators continue to try to better understand perceived and real obstacles to implementing innovative products and services, discussing three areas: 1) anti-rebating laws; 2) notice of cancellation/renewal issues; and 3) issues around e-signatures. For example, whereas other international jurisdictions have launched their regulatory sandbox to actively encourage pilot testing of innovative insurance technologies, products and services, the Task Force has identified the lack of uniformity in the anti-rebating, cancellation/renewal and e-signatures laws among the states as one obstacle to implementing innovative products and services, ultimately stifling such innovative products that might provide rewards or discount offerings (via points) to insureds. NAIC Legal Division staff is compiling information on what laws are on the books in each state and, if applicable, how the state laws differ from the models, and will create a legal compendium in these areas.

d. Financial Condition (E) Committee Updates

i. Valuation of Securities (E) Task Force

The Valuation of Securities (E) Task Force adopted a number of proposed amendments to the P&P Manual in its efforts to update and improve the manual. The new format of the P&P Manual, which was presented at the Summer National Meeting, was adopted, along with other revisions for simplicity and ease of reference, such as the deletion of old filing instructions, the relocation of certain financial modeling text to the Structured Securities Group website, modification of notching guidance, administrative symbols and modernizing credit substitution methodology. An amendment to the SVO Compilation Instructions pertaining to relationships between the SVO List and Reinsurance Standards, which is often considered by insurers who are determining if securities are considered collateral, notes that questions on the topic should be referred to the Reinsurance (E) Task Force, rather than the Valuation of Securities (E) Task Force.

ii. New Working Group to Consider Insurance Business Transfer Issues

In recent years, several U.S. states, including Rhode Island and Oklahoma, have enacted legislation or regulations providing a mechanism for insurance business transfers ("IBTs"). These IBT mechanisms are meant to approximate the effect of Part VII of the UK Financial Services and Markets Act 2000, which allows an insurer to transfer its business, or a book of business, to another entity through a court approval process without the need for individual policyholder consents.

At the meeting of the Financial Condition (E) Committee at the Fall National Meeting, Superintendent Beth Dwyer (RI) noted that there are currently no standards among the states for how IBT plans should be reviewed, and requested that the (E) Committee form a new working group to review the various state IBT frameworks and recommend specific standards for review of IBT plans, along with proposed accreditation standards related to IBT laws and potential revisions to guaranty association laws and RBC to address run-off companies resulting from IBTs.

Commissioner Dave Jones (CA) requested that the new working group also consider issues of legality. Specifically, Commissioner Jones questioned whether IBT laws are constitutional in that they purport to allow a state to approve the novation of insurance contracts to a new company that may not be licensed in the state where the contract was issued.

The (E) Committee will now work on recruiting a chairperson for the new working group and discuss possible charges. (E) Committee members specifically mentioned Rhode Island and Oklahoma as states with IBT laws, but said there are other states with similar mechanisms which will also be part of the new working group's review.

e. Timing for Review of ORSA Reports

The Financial Regulation and Accreditation Standards (F) Committee adopted a referral from the ORSA Implementation (E) Subgroup adding timing guidelines for the analyses of ORSA Summary Reports to the NAIC's Part B Accreditation Standards (which identify base-line regulatory practices and procedures required to supplement and support enforcement of the states' financial solvency laws). Effective January 1, 2020, the Part B standards will include that if the company is part of a group that is subject to ORSA requirements, an analysis of the ORSA Summary Report should be completed by the lead state and shared with other states that have domestic insurers in the group **within 120 days of receipt**. If the company is subject to ORSA requirements at the legal entity level, and an ORSA Summary Report has been prepared at that level, an analysis of the ORSA Summary Report should be completed by the domestic state **within 180 days of receipt**. The standards attempt to balance the need for the lead state to timely review an ORSA Summary Report and provide guidance to other states with the complexity involved with ORSA review.

II. Topics of Interest to the Life Insurance Industry

a. Progress on Potential Revisions to the Suitability in Annuity Transactions Model Regulation (#275)

The Annuity Suitability (A) Working Group of the Life Insurance and Annuities (A) Committee completed its discussion of the comments received earlier this year on the Suitability in Annuity Transactions Model Regulation (#275), and the Life Insurance and Annuities (A) Committee agreed at the Fall National Meeting to expose a preliminary draft of the Suitability in Annuity Transactions Model Regulation for a public comment period ending in mid-February 2019. The purpose is to elevate the standard of care in existing suitability standards for the sale of annuities and to make the consumer aware of any material conflicts of interest. This preliminary draft does not include the term "best interest" that is used in the U.S. Securities and Exchange Commission's ("SEC") April 2018 "best interest" proposal. The NAIC acknowledges that the goal of the SEC's April 2018 proposals is to move toward a harmonized best interest standard of conduct for broker-dealers and agents that substantially raises the professional obligations for recommendations, while preserving and differentiating the fiduciary standard for investment advisers. The SEC has received many public comments on use of the phrase "best interest" and may provide further greater clarity in its final rule. As a result, until there is greater clarity, the NAIC has opted to refrain from using the phrase "best interest" in its proposed modifications to the Suitability in Annuity Transactions Model Regulation. The goal is to have the Suitability in Annuity Transactions Model Regulation completed in 2019.

b. Principle-Based Reserving

The 2009 revisions to the NAIC Standard Valuation Law, which provides for a principle-based approach to life insurers' reserving methods (*i.e.*, principle-based reserving, or "PBR"), will become an accreditation standard effective as of January 1, 2020. With this deadline looming, nearly all states have enacted legislation implementing PBR. According to the NAIC, as of October 23, 2018, only three U.S. jurisdictions (*i.e.*, the District of Columbia, Massachusetts and New York) had not yet enacted such legislation. In New York, legislation authorizing PBR passed both houses of the state legislature in June 2018, but has not yet been delivered to the New York State Governor for signature. The NYDFS, which has supported this legislation, and members of the industry remain hopeful that this legislation will be enacted into law in the near future.

III. Topics of Interest to the P/C Insurance Industry

a. Climate Risk

The environmental threats caused by climate change pose an increasing risk for insurers and the businesses they underwrite. Accordingly, the Climate Change and Global Warming (C) Working Group is mandated to review the impact of climate change and global warming on insurers through presentations by interested parties. With 2018 being described by NAIC President Julie Mix McPeak as a "year punctuated by disasters of all kinds," including the California wildfires ablaze outside of San Francisco, the meeting of the Working Group garnered increased attention from interested party attendees.

Significant losses attributable to catastrophic weather-related events have encouraged both public and private enterprises to seek ways to mitigate such losses, including the safeguarding of natural infrastructure. The Working Group heard a panel discussion from four presenters on innovative financing solutions to protect the resilience of natural ecosystems and reduce insurance risk.

The panel began with an explanation of new kinds of bond instruments that are aimed at financing environmental restoration projects. These types of bonds utilize a "pay-for-success" financing model, whereby private capital from investors is used to fund such projects, and beneficiaries of the project (such as public agencies or private institutions) repay the investment amounts based on the achievement of agreed-upon outcomes. Zack Knight of Blue Forest Conservation, a not-for-profit conservation finance firm, and Mark Lambert of Quantified Ventures, an impact investor advisory firm that identifies, designs and structures impact investment transactions, spoke to the structure of these bond instruments, the role of insurers as investors in such instruments and the success of the bonds in financing projects aimed at forest fire reduction, storm water management, coastal restoration and waste recovery.

Next, the panel discussed the use of parametric insurance policies as a means of funding repair and restoration of natural ecosystems. Mark Way of environmental charity The Nature Conservancy and Matthew Wulf of reinsurer Swiss Re spoke about a parametric policy underwritten in conjunction with members of the tourism industry of Quinta Roo, Mexico, which automatically pays out a pre-set amount to fund repairs and restoration of the surrounding coral reef after a severe weather event. They also spoke to how the finding of insurable interest in the resilience value of ecosystems such as reefs or coastal wetlands has implications for regulators to consider.

b. Cannabis Insurance (C) Working Group

The recently-formed Property and Casualty Insurance (C) Committee – Cannabis Insurance (C) Working Group is charged with considering insurance regulatory issues surrounding the legalized cannabis industry, including the availability and scope of coverage, Workers Compensation issues and consumer information and protection. The meeting of the Working Group at the Fall National Meeting was standing-room only, indicating significant interest in the topic by insurance industry participants.

Commissioner Dave Jones (CA), who heads the Working Group, noted that the Working Group is currently developing a white paper outlining the issues relating to cannabis in the insurance industry, and containing recommendations for the development of regulatory guidance as appropriate. The Working Group expects to have a draft available for approval at the Spring National Meeting.

The Working Group heard a presentation from Sabrina Noah of Cresco Labs about the regulatory architecture of the cannabis industry and the cannabis supply chain. Noting the rapid growth of Cresco labs and the cannabis industry generally, she explained that cannabis is predicted to be a $57 billion industry by 2027, with California positioning itself to hold a large portion of the market. Challenges facing companies like Cresco Labs include safety risks for personnel when dealing with significant amounts of cash, expensive and lengthy license application costs (the licensing application process for companies such as Cresco Labs can cost between $750,000 to $1 million) and additional fees imposed by banks and expensive insurance policies, which may be cost-prohibitive for entities operating in this sector.

Michael Correia of the National Cannabis Industry Association, a trade association, addressed concerns about the legality of conducting business with participants in the cannabis industry. He referred to the Cole Memo, a U.S. DOJ policy memorandum issued in 2013 by former Attorney General James M. Cole, which guided U.S. attorneys not to prosecute cannabis businesses that are in compliance with state regulatory schemes. Accordingly, compliant businesses operating in the sector avoided federal prosecution for the past few years. At the start of 2018, however, former Attorney General Jeff Sessions rescinded the memorandum, once again opening cannabis operations up to U.S. DOJ scrutiny. Correia noted, however, that not much has changed in terms of federal prosecution of cannabis companies by the U.S. DOJ, and that 46 states have enacted some type of medicinal or recreational cannabis law that conflicts with federal legislation. In comments, the National Bank Association asserted the position that it is illegal for banks to engage with companies in the cannabis industry, while Commissioner Vullo of New York and Commissioner Jones reacted contrarily, noting that banks refusing to engage with the industry will lose out on a large business opportunity.

c. Surplus Lines (C) Task Force

i. Adoption of Guideline on Nonadmitted Accident and Health Coverages

The Surplus Lines (C) Task Force held an interim call on November 7, 2018 and adopted the Guideline on Non-admitted Accident and Health Coverages (the "Guideline"). The Guideline states that "[w]hile non-admitted insurance coverages are traditionally found within the property and casualty market, there is an increasing need to supplement the admitted market for certain types of accident and health coverages." The Task Force found that this need exists because "the admitted market disability products reduce the percentage of coverage as the amount of income increases, [thereby] placing insureds with high incomes with inadequate levels of coverage." Similarly, the Guideline notes that "[n]on-admitted accident and health coverage can be utilized to fulfill the risk mitigation needs of certain potential insureds." For instance, individuals in high-risk occupations (*e.g.*, sports and aviation) often cannot procure adequate disability coverage in the admitted market.

The purpose of the Guideline is to assist states in their review of existing laws which may explicitly prohibit the export of accident and health risks or generally authorize the export only of property and casualty risks. Some states already permit the surplus lines placement of certain types of accident and health coverage such as short-term medical, international major medical, excess disability and high-risk disability. In other states (*e.g.*, Washington), accident and health coverage is excluded from the list of "exportable" coverages. It appears that certain of these states are currently unwilling to modify their existing laws.

The federal Non-admitted and Reinsurance Reform Act of 2010 ("NRRA"), which was passed as part of Dodd-Frank, only applies to property and casualty insurance. The NRRA establishes a federal definition of "home state," and it provides that the placement of non-admitted insurance is only subject to the statutory and regulatory requirements of the insured's home state. During the Guideline's drafting process, the Office of the Insurance Commissioner of Washington State noted that potential issues could arise "if the insured's home state has adopted this Guideline, [thereby] allowing [accident and health coverages] in the non-admitted market, and [it] has risks insured in another state which has not adopted or allowed [accident and health coverages] in the [non-admitted] market." Since the NRRA's home state framework has created a “consistent method of determining jurisdiction for the regulation of non-admitted insurance,” the Guideline encourages states to consider applying this framework to accident and health coverages in the non-admitted market.

ii. National Flood Insurance Update

President Trump signed legislation on December 1, 2018 that extends the NFIP through December 7, 2018. Congress has struggled to pass a long-term NFIP reauthorization because it has been unable to reach a consensus on several outstanding issues, including the role of the private flood insurance market. As noted during the November 7 interim call, Commissioner James Donelon (LA), Chair of the Surplus Lines (C), and other regulators agreed that the NAIC must continue to push for a permanent solution.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

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