NAIC Report: 2019 Fall National Meeting

December 26, 2019

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The 2019 Fall National Meeting of the National Association of Insurance Commissioners was held in Austin, Texas on December 7 through 10, 2019.

With the meeting theme “Bigger in Texas,” NAIC President and Maine Insurance Superintendent Eric A. Cioppa said the NAIC “went big” in 2019. The NAIC’s notable accomplishments include making significant progress in incorporating the Covered Agreements (as herein defined) into NAIC model laws, completing field testing for the group capital calculation tool, moving toward finalizing a best interest standard of care in suitability standards for the sale of annuities by year-end, honing its focus on long-term care insurance by creating an executive task force, and continuing to develop new macroprudential measures aimed at enhancing policyholder protection and insurer solvency. Innovation and data security in the insurance sector will continue to be key NAIC priorities, with a new focus on data privacy and artificial intelligence. The meeting also addressed significant developments on the international stage, namely the IAIS’s recent adoption of ComFrame, the ICS and the holistic framework for the assessment and mitigation of systemic risk in the global insurance sector.

NAIC members also elected the following officers for 2020:

President: South Carolina Insurance Director Raymond G. Farmer
President-Elect: Florida Insurance Commissioner David Altmaier
Vice President: Idaho Insurance Director Dean L. Cameron
Secretary-Treasurer: Missouri Insurance Director Chlora Lindley-Myers
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.
TOPICS OF GENERAL INTEREST

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Amended Credit for Reinsurance Models on Track to Become State Accreditation Standards

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Long-Term Care Insurance

Term and Universal Life Insurance Reserve Financing Model Regulation – Adopted as Accreditation Standard

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Cannabis Insurance

BRIEFLY NOTED

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New Capital Standard Under Consideration for Mortgage Guaranty Insurers
GLOSSARY

Definitions used in this report include:

- “ACLI” means the American Council of Life Insurers.
- “APCIA” means the American Property Casualty Insurance Association.
- “ComFrame” means the Common Framework for the Supervision of Internationally Active Insurance Groups being developed by the IAIS.
- “Covered Agreements” means the U.S./E.U. Covered Agreement and the U.S./U.K. Covered Agreement, as defined below.
- “Credit for Reinsurance Models” means the NAIC Credit for Reinsurance Model Law and NAIC Credit for Reinsurance Model Regulation.
- “Executive and Plenary” means all of the U.S. state insurance commissioners in plenary session along with the NAIC’s Executive (EX) Committee.
- “FSB” means the Financial Stability Board, a non-profit international body, currently composed of 59 representatives from 25 jurisdictions, as well as 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.
- “G-SII” means Global Systemically Important Insurer, as designated by the FSB.
- “IAIG” means an internationally active insurance group.
- “IAIS” means the International Association of Insurance Supervisors.
- “ICS” means the Insurance Capital Standard being developed by the IAIS to apply to IAIGs.
- “NAIC” means the National Association of Insurance Commissioners.
- “OECD” means the Organisation for Economic Co-operation and Development.
“Qualified Jurisdiction” means a non-U.S. jurisdiction listed on the NAIC list of “Qualified Jurisdictions” established pursuant to the NAIC Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions. A Qualified Jurisdiction-domiciled reinsurer that satisfies financial, rating and other standards may qualify as a “certified reinsurer,” and depending on its rating, may be approved by state regulators to post reduced or zero collateral under state credit for reinsurance laws.

“RBC” means risk-based capital.

“Reciprocal Jurisdiction” means a jurisdiction in which an eligible reinsurer is required to be domiciled in order to qualify for zero reinsurance collateral pursuant to the 2019 revisions to the Credit for Reinsurance Models.

“SEC” means the United States Securities and Exchange Commission.

“SIFI” means a systematically important financial institution designated by FSOC.

“Team USA” refers to the partnership formed by the NAIC, the Board of Governors of the Federal Reserve System, and FIO in an effort to develop consensus positions related to the formation of group capital standards.

“U.S./E.U. 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.

“U.S./U.K. Covered Agreement” means the Bilateral Agreement Between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on December 11, 2018.
I. Topics of General Interest

A. Group Capital

i. NAIC Holds First Public Discussion of Initial Field Testing Results

In 2015, the Group Capital Calculation (E) Working Group (the “Group Capital Working Group”) began work on a group capital calculation tool (“GCC”) for insurance groups. Field testing for the proposed GCC began on May 10, 2019 and was completed this fall. GCC test participants included over 30 U.S. property/casualty, life and health insurance groups, involving 15 lead states. The test participants also represented groups with a reinsurance focus, potential IAIGs, and groups with U.S. depository entities. Initial results of the field testing, including participant feedback on the form and substance of the GCC were discussed at the Fall National Meeting, and are summarized herein. The Group Capital Working Group expects to expose a revised GCC template and instructions in the spring of 2020 and thereafter to make final determinations on outstanding issues, as discussed below. Final adoption of the GCC is anticipated in 2020.

Although state insurance regulators have legal authority to obtain information regarding the capital positions of insurance group members, there hasn’t been a consistent analytical framework for evaluating such information. Thus the NAIC has designed the GCC to deliver regulators a panoramic, transparent view of the interconnectedness, business activities and underlying capital support for an insurance group. The GCC uses a “bottom up” Aggregation Method (“AM”) that requires an accounting of available capital/financial resources and the required regulatory capital of corporate group members. Calculations of both available capital and required regulatory capital are based on the asset and liability valuations of various corporate group members, including insurers, financial entities and non-financial entities. The AM builds on the U.S. legal entity RBC assessment as does the Building Block Approach developed by the Federal Reserve for Savings and Loan Holding Companies predominantly engaged in insurance operations, as described below.

As part of the GCC testing, each group participant met with its lead state insurance regulator and the NAIC to discuss the results of the field test and provide feedback. Participants provided input on the GCC template and instructions and identified several questions and requests for clarification, including descriptions of capital instruments (i.e., financial instruments such as surplus notes, senior debt and hybrid instruments), definitions of “intercompany debt” and “insurance group” (e.g., determining the materiality threshold for excluding non-insurance, non-financial entities), instructions on reporting for intercompany receivables and payables, and whether information related to XXX/AXXX assets and liabilities should be provided for informational purposes only.

As noted herein, the IAIS will begin monitoring the use of its group capital tool, ICS Version 2.0, in 2020. Because of the NAIC’s concerns regarding the ICS construct, including its emphasis on Europe’s approach to insurance regulation, non-recognition of certain instruments used to finance U.S. insurance operations and reliance on market adjusted capital, the NAIC and Team USA have rejected the ICS. Instead, the NAIC and Team USA have developed a separate AM for
calculating group capital, as discussed above. During its November 2019 meeting, the IAIS issued an Explanatory Note on the ICS and Comparability Assessment agreeing on both a definition of comparable outcomes and high level principles for assessing comparability by which an alternative to ICS, such as an AM, may be used by regulators.

ii. NAIC Pursues Confidentiality Protection for GCC Filing

In order to address its goal of maintaining the confidentiality of a GCC report, the Group Capital Working Group is pursuing an amendment to the NAIC Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation (together, the “Model HCA”) to establish a confidential filing to be known as a “Form G.” During an interim conference call held by the Financial Condition (E) Committee, Commissioner Altmaier “emphasized that the request [for model law development] seeks authority only to require such filing and hold it confidential but does not include any level of regulatory intervention as a result of the [GCC] filing.” However, we note that the Group Capital Working Group’s model law development envisions that the GCC will provide an “additional early warning signal” to regulators, so that they could begin working with the relevant insurance company to resolve any concerns. In Austin, the Executive (EX) Committee approved the Financial Condition (E) Committee’s request to consider amendments to the Model HCA and discussions are expected to get underway in early 2020.

B. International Developments

i. IAIS Adopts Global Framework for Supervision of IAIGs

Following years of development, the IAIS adopted a comprehensive set of reforms related to the cross-border supervision of IAIGs at its Annual General Meeting in Abu Dhabi in mid-November. The adopted reforms include ComFrame, the ICS and the holistic framework for the assessment and mitigation of systemic risk in the global insurance sector (the “Holistic Framework”), which are discussed below. The IAIS’s milestone was well received by the NAIC and interested parties in Austin, and it provided a hot topic for discussion at the Fall National Meeting.

a. ComFrame

ComFrame establishes supervisory standards and guidance focused on the group-wide supervision of IAIGs. It is an outcome-focused framework tailored to the international activity and size of IAIGs. In sum, ComFrame is intended to support the coordination of supervisory activities between the IAIG’s group-wide supervisor and other involved supervisors, provide global regulators with a common language for the supervision of IAIGs, and help supervisors address group-wide risks.

The IAIS Insurance Core Principles (ICPs) are globally applied requirements for the supervision of the insurance sector. The ICPs apply to a wide range of insurance markets and supervisory approaches to insurance regulation. Because IAIGs’ businesses cross international jurisdictions, ComFrame was developed to augment the ICPs and assist regulators in collectively coordinating supervisory activities under the leadership of a group-wide supervisor.
The group-wide supervisor is responsible for identifying IAIGs based on the criteria set forth in ComFrame, and the IAIS will compile a public register of IAIGs in early 2020, which list will be updated regularly. The IAIS’s current focus is to support its members’ efforts in the implementation of ComFrame by providing training and workshops for supervisors. The IAIS will thereafter assess ComFrame’s implementation using the assessment methodology adopted in November as part of the overall framework. The IAIS expects to maintain a dialogue with stakeholders throughout the implementation process and will provide more information about the implementation assessment in 2020.

The Group Solvency Issues (E) Working Group discussed its 2020 charges in light of the IAIS’s adoption of ComFrame. Justin Schrader, Chief Financial Examiner at the Nebraska Department of Insurance and Chair of the Working Group, noted that state insurance regulators should review the ComFrame elements in order to determine whether they are already incorporated into the U.S. insurance holding company regulatory system or whether gaps exist between the two systems. Several interested parties commented that it will be important for state insurance regulators to consider whether any change to the U.S. state-based insurance regulatory system would be appropriate. Mr. Schrader provided assurances that the process of determining whether any regulatory gaps exist will be done in an open forum that seeks input from interested parties.

b. ICS

The IAIS is developing a risk-based global ICS that will apply to IAIGs and ultimately form a part of ComFrame. The IAIS’s Explanatory Note regarding the agreed ICS Version 2.0 states that “[t]he purpose of the ICS is to create a common language for supervisory discussions of group solvency to enhance global convergence among group capital standards. The ultimate goal is a single ICS that includes a common methodology by which one ICS achieves comparable, i.e., substantially the same outcomes across jurisdictions.”

Last month the IAIS adopted ICS Version 2.0 for a five-year monitoring period beginning in 2020. During this period IAIGs will confidentially report ICS to their group-wide supervisors. According to the IAIS, the purpose of the monitoring period is to assess the performance of the ICS, and not the capital adequacy of the IAIGs. Therefore, the ICS results during the monitoring period will not be used as a basis for supervisory action. Rather, the IAIS intends to use the feedback it receives during the monitoring period to improve the ICS. Feedback will be gathered from supervisors and stakeholders, there will be a public consultation of the ICS, and the IAIS will perform an economic impact assessment.

The second phase of the ICS implementation will begin following the completion of the monitoring period, at which time the ICS will be implemented as a group-wide prescribed capital requirement (“PCR”) for IAIGs. “It will constitute the minimum standard to be achieved and one which the supervisors represented in the IAIS will implement or propose to implement taking into account specific market circumstances in their respective jurisdictions.” The ICS will be then be integrated into the rest of ComFrame.
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U.S. operating subsidiaries of non-U.S. IAIGs could be subject to the ICS monitoring period where the group-wide supervisor, usually the supervisor of the head of the insurance group, is from a jurisdiction that participates in the ICS. U.S. group-wide supervisors will not be involved in the five-year ICS monitoring period. Conversely, the NAIC has stated in its “Interpretative Guidance on ICS Comparability Assessment Framework” that U.S. IAIGs will not be required to participate in the ICS, nor will they be “strongly encouraged” to do so. However, U.S. IAIGs may report on the reference ICS and/or the AM during the monitoring period, based on discussions with the relevant group wide supervisor.

c. Comparability of Group Capital Standards

The IAIS released an Explanatory Note on the ICS and a “comparability assessment” with respect to the NAIC’s aggregation methodology. Importantly, the framework adopted by the IAIS includes the following definition of comparable outcomes: “the Aggregation Method (AM) would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds.” The IAIS’s Explanatory Note states that the “IAIS aims to be in a position by the end of the monitoring period to assess whether the AM provides comparable (i.e., substantially the same (in the sense of the ultimate goal)), outcomes to the ICS. If so, it will be considered an outcome-equivalent approach for implementation of ICS as a PCR.”

With respect to comparability, the IAIS is developing criteria to determine whether the AM produces comparable outcomes to the ICS, and it will consider several factors to develop this criteria, including the following: (i) the responsiveness of the ICS and AM to changes in conditions over time (e.g., financial market conditions over the business cycle, as opposed to short-term market fluctuations); (ii) the scope of the group included under the ICS and AM; and (iii) the extent, quality and scope of information on the ICS and AM.

The IAIS intends to issue a public consultation on the draft criteria for assessing whether an AM produces comparable outcomes to the ICS in the fourth quarter of 2021, and it expects to begin the comparability assessment in the third quarter of 2023, with its decision expected in the third quarter of 2024. The IAIS will also provide opportunities for stakeholder engagement on this topic. Immediately following the IAIS’s adoption of its global framework for the supervision of IAIGs, the NAIC issued a press release offering positive feedback on the IAIS’s milestone.

d. Holistic Framework

The Holistic Framework developed by the IAIS consists of three key elements: (i) a set of supervisory policy measures for macroprudential purposes; (ii) a global monitoring exercise that is designed to track global market trends and detect the build-up of systemic risk in the global insurance sector; and (iii) an implementation assessment by the IAIS. The IAIS has explained that “[t]he Holistic Framework recognizes that systemic risk may arise not only from the distress or disorderly failure of an individual insurer, but also from the collective exposures and activities of insurers at a sector-wide level.” With respect to the global monitoring exercise, the IAIS intends to share the outcomes each year with participating insurers, IAIS
members, the FSB and the general public. The implementation assessment will build on the existing methodology to be used to assess the IAIS’s implementation of ComFrame, and it will occur in phases, with a baseline assessment taking place in 2020. The IAIS will also share these results with the FSB and the general public.

Since the Holistic Framework is expected to produce an improved system for assessing and mitigating systemic risk in the insurance sector, the FSB, in consultation with the IAIS, has decided to suspend G-SII identification from the beginning of 2020. In November 2022, the FSB will review whether it should discontinue or re-establish the G-SII designation system based on the implementation results of the Holistic Framework.

C. Systemic Risk

i. Update on NAIC’s Macroprudential Initiative

One of the NAIC’s top priorities is the Macroprudential Initiative (“MPI”), which is intended to enhance risk identification efforts by building on the state-based regulation system. Key components of the MPI include liquidity; resolution and recovery; capital stress-testing; and counterparty exposure.

a. Liquidity Stress Test Framework for Large Life Insurers Nears Completion

The NAIC has been developing a liquidity stress test framework as a regulatory tool since 2017 for certain large U.S. life insurers and insurance groups (based on the amounts of certain types of business written or material exposure to certain investment transactions). At the Financial Stability (EX) Task Force meeting, Mr. Schrader, Chair of the Liquidity Assessment (EX) Subgroup, presented a proposal for the 2019 NAIC Liquidity Stress Test Framework for Life Insurers Meeting the Scope Criteria (the “2019 Proposed Liquidity Stress Framework”).

The 2019 Proposed Liquidity Stress Framework gathers cash-flow projection information that reflects liquidity sources and uses over different time horizons under several different scenarios, including a baseline scenario and several stress scenarios. Large life insurers are expected to submit year-end 2019 data under the 2019 Proposed Liquidity Stress Framework to their lead state regulators in the third quarter of 2020. The 2019 Proposed Liquidity Stress Framework contains two liquidity stress scenarios: (i) a 2008 financial crisis scenario, and (ii) a scenario contemplating an interest rate spike, a decline in equities markets and credit spread stress, including a negative revision in the insurance industry outlook by a nationally recognized statistical rating organization. Each of the stress scenarios will include a state insurance regulator-provided narrative and state insurance regulator-prescribed assumptions that must be used in the insurer’s internal modeling. In addition, the 2019 Proposed Liquidity Stress Framework provides for an “insurer-specific information request,” which requires the particular insurer to which the 2019 Proposed Liquidity Stress Framework applies to report its severe worst-case stress scenario in a detailed narrative; this information could be used to create future stress scenarios. If an insurer reports a capital deficiency in any scenario, the insurer will be asked to disclose the expected asset sales needed to meet this shortfall. The NAIC will aggregate expected asset sales data across insurance groups so that these
results can be compared against different benchmarks, such as normal or stressed trading volumes for various assets classes. Lead state insurance regulators intend to use their examination authority to collect results from the 2019 Proposed Liquidity Stress Framework.

The Financial Stability (EX) Task Force jointly exposed the 2019 Proposed Liquidity Stress Framework with the Liquidity Assessment (EX) Subgroup for a 60-day period with comments due on February 10, 2020. Mr. Schrader noted that the 2019 Proposed Liquidity Stress Framework does not address all liquidity risk concerns since the focus has been on key liquidity risks. In the future, the Financial Stability (EX) Task Force plans to develop a broader liquidity stress test framework that will “address model laws to establish regulatory authority, confidentiality and other policy considerations.”

ii. U.S. Federal Developments

a. FSOC Approves Activities-Based Approach for Designating Non-Bank SIFIs

During the Financial Stability (EX) Task Force meeting, Superintendent Cioppa reported on FSOC’s December 4, 2019 final interpretive guidance for designating non-bank SIFIs (the “Final Guidance”). The Final Guidance states that “[FSOC] will prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that begins with an activities-based approach [("ABA").] This shift from an entity-based approach to an ABA mirrors the IAIS’s adoption of the Holistic Framework, as discussed above, recognizing that systemic risk may arise both from the distress of individual entities and from collective activities on an industry-wide level (i.e., an ABA).

Under the Final Guidance, FSOC will pursue entity-specific determinations only if a potential risk or threat cannot be addressed through an ABA. “This approach will enable [FSOC] to effectively identify and address the underlying sources of risks to financial stability on a system-wide basis, rather than addressing risks only at a particular nonbank financial company that may be designated.” If FSOC considers a non-bank financial company for a potential determination, it will perform a cost-benefit analysis and make a determination “only if the expected benefits to financial stability from the determination justify the expected costs that the determination would impose.” The Final Guidance also sets forth procedures that provide an “off-ramp” for companies post-designation. In a significant development, Superintendent Cioppa noted that FSOC is committed to more robust engagement with state insurance regulators. The Final Guidance will be effective on the date that is 30 days after it is published in the Federal Register.

In a statement of support, the NAIC said the Final Guidance “appropriately prioritizes activities-based approaches to identifying systemic risk and the importance of working with regulators to address concerns. The NAIC has long advocated for these changes and appreciates the revisions adopted by FSOC.”
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b. **Third Financial Sector Assessment Program Is Underway**

The International Insurance Relations (G) Committee received a brief update on the Financial Sector Assessment Program ("FSAP") of the United States, which is underway. The FSAP is an evaluation conducted every five years by the International Monetary Fund (the "IMF"), which analyzes the strength and scope of an insurance regulatory scheme under the standards of the ICPs promulgated by the IAIS. The meetings related to the "first mission" of the process, which considers compliance with the ICPs, concluded in November. The "second mission" involves techniques such as stress testing, and these meetings will begin in February 2020. The IMF is expected to publish a technical note on insurance by summer 2020.

c. **Federal Reserve Issues Notice of Proposed Rulemaking on the Building Block Approach**

On October 24, 2019, the Board of Governors of the Federal Reserve System (the “Federal Reserve”) published in the Federal Register a notice of proposed rulemaking, inviting comment on a proposal to establish risk-based capital requirements for depository institution holding companies (i.e., savings and loan holding companies) that are significantly engaged in insurance activities—i.e., the so-called “Building Block Approach,” or “BBA.” (The Federal Reserve will consider the applicability of BBA to bank holding companies at a later date.) Like the GCC, the BBA aggregates the capital positions of entities in the holding company in order to calculate the combined, enterprise-level available capital. Unlike the GCC, which is intended to be a “regulatory tool,” as opposed to a capital requirement, the BBA also calculates a capital requirement for the holding companies to which the BBA applies—which include depository institution holding companies where: (i) the top-tier depository institution holding company is an insurance underwriting company, (ii) the top-tier depository institution holding company, together with its subsidiaries, holds 25% or more of its total consolidated assets in insurance underwriting subsidiaries (with certain exceptions), or (iii) the firm has otherwise been made subject to the BBA by the Federal Reserve. According to the Federal Reserve Supervision and Regulation Report issued in November 2019, there are currently 11 savings and loan holding companies meeting these criteria. The Federal Reserve’s proposal imposes a minimum capital requirement for the depository institution holding company to which the BBA applies by setting forth a minimum “BBA ratio” (i.e., the ratio of the aggregated “building block” available capital to the aggregated “building block” capital requirement) of 250%. This proposal was exposed for a public comment period that ended on December 23, 2019.

D. **Innovation and Technology**

i. **NAIC to Proceed with Model Law Amendments to Reconcile Anti-Rebating with Innovation**

The Executive (EX) Committee voted in Austin to approve a Model Law Development Request from the Innovation and Technology (EX) Task Force to draft amendments to the NAIC Unfair Trade Practices Act (Model #880) to clarify what is considered a “rebate” or “inducement” in light of new technologies being deployed to add value to existing insurance products and services. The request came in response to concerns from regulators and interested parties that current anti-
rebating language—and inconsistent interpretations of that language across states—may impede innovation designed to prevent or mitigate the risk of loss for consumers.

The Innovation and Technology (EX) Task Force had previously discussed drafting an NAIC bulletin to address anti-rebating issues, but in light of the approved model law development request, and in the interest of greater uniformity across states, opted to shelve discussions of a bulletin and focus on amending the Unfair Trade Practices model. The Task Force will designate a smaller drafting group to work on the amendments on conference calls with the use of subject matter experts. The National Conference of Insurance Legislators (NCOIL) is also working on updated anti-rebate model language as part of its insurance modernization initiative, and indicated that it will work with the NAIC on these efforts. Time will tell whether any model adopted by the NAIC will become an accreditation standard — which would likely be the only path to ensuring that any applicable exemptions from anti-rebating laws are uniform across the states.

ii. Data Privacy and Consumer Rights

a. Privacy Protections (D) Working Group Begins Work

The Privacy Protections (D) Working Group was formed on October 1, 2019 to review state insurance privacy protections regarding the collection, use and disclosure of information gathered in connection with insurance transactions and make recommended changes, as needed, to existing NAIC model laws and regulations. At the Fall National Meeting, NAIC Senior Counsel Jennifer McAdam provided a summary to the Working Group of existing data privacy regimes and identified considerations for the Working Group going forward. Ms. McAdam differentiated between data privacy (i.e., how data is collected and used by business) and data security (i.e., how data is stored and protected). Although these topics are often conflated and certain existing model laws address both, the focus of this Working Group will primarily be data privacy, while data security is the focus of the NAIC Insurance Data Security Model Law adopted in 2017.

Ms. McAdam reviewed the history of existing NAIC models, including the Insurance Information and Privacy Protection Model Act (#670) (adopted in 1980) and the Privacy of Consumer Financial and Health Information Model Regulation (#672) (adopted in 2000), which generally require insurers to provide certain notice to consumers about privacy practices and give consumers certain rights to request information about and correct data collected about them. Ms. McAdam also mentioned the EU’s General Data Protection Regulation (effective in May 2018) and the California Consumer Privacy Act (to be effective January 1, 2020) as examples of recent omnibus (non-industry specific) privacy laws. At least 24 states are currently considering some type of data privacy laws, and other states have established task forces to study data privacy.

Considerations for the Working Group going forward include: what types of data collection, sharing, and usage are specific to insurers; what privacy risks affect insurance consumers; locating gaps in federal and state law; what obligations insurers should have to consumers; and what rights consumers should have to control their personal information.
During public comments at the meeting, trade associations expressed support for the data privacy framework currently applicable to the insurance industry and stressed the importance of avoiding dual or conflicting regulation between omnibus and insurance-specific laws as well as ensuring that insurers are not disadvantaged compared to the tech sector and other industries. Consumer representatives called for a better balance between the information that insurers/producers have access to and the rights of consumers to privacy protection, and expressed concern about the growth of new and unregulated databases of personal information.

Chair Cynthia Amann of the Missouri Department of Insurance stated that the Working Group will develop a framework with more details on what it can accomplish by its year-end 2020 deadline, and will begin to hold conference calls every six to eight weeks. Chair Amann noted that the Working Group’s charge is not to restrict business but to make sure that consumer privacy concerns are addressed. Since the NAIC models “have not kept up with the times,” the Working Group must at a minimum make sure that they are technologically accurate. Finally, Chair Amann noted that privacy is being discussed across the NAIC so the Working Group expects to coordinate with various other subgroups.

b. Big Data (EX) Working Group Considers Oversight of Third-Party Vendors

During 2019, the Big Data (EX) Working Group has gathered information on the use of big data in fraud detection and claim settlement, with the goal of assessing whether current regulatory frameworks used to oversee this area should be modified. At the Fall National Meeting, Working Group members and interested parties expressed mixed views on whether regulators currently have adequate tools to monitor big data vendors in the fraud detection and claim settlement arena. Consumer representatives and some Working Group members suggested that current tools are inadequate to ensure consumers are protected with regard to the types and accuracy of data collected by third-party vendors and used by insurers in fraud detection and claim settlement. For example, George Bradner of the Connecticut Insurance Department stated that big data vendors are “black boxes” into which regulators have little access.

Other Task Force members suggested that existing state tools, including unfair trade practices and claims settlement laws, states’ examination authority and third-party administrator licensing regimes give regulators broad oversight, and that regulators have authority to hold licensees responsible for services provided by their big data vendors. No Working Group member made a motion for further action, and Commissioner Doug Ommen (IA), Working Group Chair, closed the topic but encouraged members to continue to evaluate these issues at the state level.

The Big Data (EX) Working Group also heard a presentation by Birny Birnbaum of the Center for Economic Justice regarding whether big data vendors engaged in collective decision-making on behalf of insurers, e.g., providing algorithms for pricing, underwriting and claim settlement, should be subject to oversight similar to advisory organizations. Traditional advisory organizations (or rating bureaus) are subject to licensing and examination requirements due to states’ historic concern about potential anticompetitive activities by these organizations. Such requirements do not currently apply to big data vendors.
Commissioner Ommen thanked Mr. Birnbaum for bringing this topic to the Working Group’s attention and said the Working Group will give it further consideration.

iii. Artificial Intelligence in Insurance

   a. New Working Group to Draft Artificial Intelligence Principles

The Artificial Intelligence (“AI”) (EX) Working Group was formed after the 2019 Summer National Meeting to study AI in the insurance sector and develop regulatory guidance and recommendations, beginning with AI “guiding principles” for insurance. Prior to the Fall National Meeting, the AI Working Group identified the OECD’s AI Principles as a potential starting place for its work, and solicited comments from interested parties on whether the OECD AI Principles could be appropriately applied to the insurance industry. The OECD Principles, which have been adopted by 42 countries including the United States, are intended for general (non-industry specific) application and present high level concepts, such as transparency, fairness and accountability, that OECD members should promote for responsible stewardship of trustworthy AI.

There was a general consensus from interested parties that the OECD Principles are a useful starting point for the AI Working Group, but require tailoring to ensure applicability to the insurance sector. In response, the North Dakota Insurance Department created a draft principles document (the “ND Principles”) that identify high-level goals similar to the OECD Principles (e.g., fairness, transparency, accountability, and security), while also making reference to insurance-specific concepts. The scope of the ND Principles is “insurance companies and all persons or entities facilitating the business of insurance that play an active role in the AI system lifecycle” (defined as “AI actors”). AI actors would be expected to, among other things, have specific knowledge of all applicable federal and state insurance laws and regulations, and demonstrate respect for the rule of law relating to trade practices, discrimination, promotion of fair access to insurance, underwriting and eligibility practices, ratemaking standards, advertising decisions, claims practices and solvency. Commissioner Jon Godfread (ND), AI Working Group Chair, stated that the principles are not meant to prescribe specific requirements, like a model law or regulation, but to guide other NAIC committees that may consider issues related to AI.

The Working Group exposed the ND Principles for comment until January 17, 2020, and will hold an interim conference call prior to the 2020 Spring National Meeting, with an ultimate goal to provide guidance to the Innovation and Technology (EX) Task Force by the 2020 Summer National Meeting.

   b. NAIC Gathering Information on Accelerated Underwriting in Life Insurance

The Life Insurance and Annuities (A) Committee voted to form an Accelerated Underwriting (A) Working Group at the 2019 Summer National Meeting to consider the use of external data and data analytics in accelerated life underwriting, and, if appropriate, draft guidance for states. The new Working Group is in an information gathering phase and at the Fall National
Meeting heard a presentation by Dr. Patrick Brockett of the University of Texas describing the process of accelerated life underwriting as well as its potential benefits and limitations.

Based on a recent survey of life insurers, accelerated underwriting is currently used by at least 27 insurers across all types of life products. These programs allow some applicants to forgo medical examinations if they meet certain pre-determined thresholds. Accelerated underwriting generally makes use of new data together with algorithmic tools and modeling techniques to assess applicants’ risk. This can reduce the underwriting decision time from 2-12 weeks to 48 hours or less. Data sources used by life insurers include applicant prescription histories, motor vehicle records, files maintained by the Medical Information Bureau, applicant applications and interviews, consumer data, credit scores, and evidence of other insurance coverage and prior underwriting decisions.

The Working Group will continue in its information gathering phase until the 2020 Spring National Meeting, after which it plans to identify issues and potential work product (e.g., a white paper, model bulletin, model law or something else) and prepare a final work product by the 2020 Fall National Meeting.

iv. Data Security

South Carolina Department of Insurance Director Raymond G. Farmer provided an update on state adoption of the NAIC Insurance Data Security Model Law. As of early December 2019, eight states (AL, CT, DE, MI, MS, NH, OH and SC) had adopted the model. Director Farmer stated that the NAIC is dedicated to ensuring that states have the necessary tools to protect consumers from data breaches, and believes state adoption of the model is the best way to accomplish this. The NAIC expects and encourages other states to pursue adoption in 2020. Director Farmer noted that the U.S. Department of the Treasury has endorsed the model and has encouraged states to adopt it promptly in order to avoid congressional action on insurer data security.

E. Reinsurance

i. Amended Credit for Reinsurance Models on Track to Become State Accreditation Standards

The Credit for Reinsurance Models (Models #785 and #786) were amended in June 2019 to incorporate applicable requirements of the Covered Agreements (the “2019 Amended Credit for Reinsurance Models”).¹ At the Fall Meeting, the NAIC considered states’ adoption of the 2019 Amended Credit for Reinsurance Models in light of FIO’s authority (under the Dodd-Frank Act and the Covered Agreements), to preempt a state law that is inconsistent with the Covered Agreements and treats a qualified non-U.S. reinsurer less favorably than a U.S. insurer licensed in that state. FIO is required under the Covered Agreements to commence its preemption analysis by no later than April 1, 2021 and complete it by September 1, 2021.

¹ For more information on the key provisions of the 2019 Revisions and their impact, please see our previous client alert on this subject, which is available here.
2022. Upon conferring with FIO, the Reinsurance (E) Task Force determined that the 2019 Amended Credit for Reinsurance Models must be effective in the states by the time FIO completes its preemption analysis, i.e., by September 1, 2022.

The (F) Committee in Austin voted to move forward with adopting the 2019 Amended Credit for Reinsurance Models as an accreditation standard with an effective date of September 1, 2022 to coincide with the completion of FIO’s preemption analysis. The adoption included a waiver of procedure for expeditious handling to enable the Committee to proceed without first exposing the accreditation proposal for comment.

Executive and Plenary is expected to approve the new accreditation standards by the 2020 Spring National Meeting. In the interim, the NAIC will work to assist states with the process of amending their laws to conform to the new standards.

ii. Bermuda, Japan and Switzerland Approved as Reciprocal Jurisdictions Eligible for Collateral Elimination

Three countries currently designated as Qualified Jurisdictions that are not subject to Covered Agreements—Bermuda, Japan and Switzerland—had to apply for and obtain Reciprocal Jurisdiction status through the Process for Evaluating Qualified and Reciprocal Jurisdictions in order to be eligible for collateral elimination. In Austin, Executive and Plenary voted both to re-qualify Bermuda, Japan and Switzerland as Qualified Jurisdictions, and then to place them on the NAIC List of Reciprocal Jurisdictions effective January 1, 2020. This means that once a state adopts the 2019 Amended Credit for Reinsurance Models, qualifying reinsurers domiciled in Bermuda, Japan and Switzerland, similar to qualifying reinsurers in the EU and the UK, will automatically be eligible for reinsurance collateral elimination. In a statement, Superintendent Cioppa cited the NAIC’s successful history of working with the insurance regulatory authorities in these jurisdictions and confidence that these jurisdictions should receive similar treatment to reinsurers domiciled in Covered Agreement jurisdictions.

F. Insurance Business Transfer and Division Laws

Since its formation in February 2019, the Restructuring Mechanisms (E) Working Group has been gathering information about corporate division and business transfer laws adopted in various states in order to draft a white paper that summarizes these mechanisms and describes issues thereunder. In Austin, the Working Group announced that it will move forward with drafting the white paper based on the information it has gathered to date, while continuing to gather information. The starting point will be previous NAIC white papers on Liability-Based Restructuring (1997) and Alternative Mechanisms for Troubled Insurance Companies (2009). While the previous white papers discussed troubled companies, the focus now will be on non-troubled companies. NAIC staff is compiling a list of issues to be included in the white paper based on the Working Group’s discussions to date. The goal is to complete the white paper by the 2020 Summer National Meeting and thereafter consider changes to specific NAIC model laws or regulations as a result of findings from the development of the white paper.
One issue that the Working Group plans to include in its white paper is the impact that a restructuring might have on guaranty associations and policyholders’ guaranty fund protection. In Austin, the Working Group heard the position of the National Conference of Insurance Guaranty Funds (“NCGIF”), which is that if a policyholder had guaranty fund protection prior to a restructuring transaction, it should have the same protection after the transaction. Under existing property casualty guaranty fund laws, this would likely not be the result if policies are transferred to a different company that is not a member of the relevant guaranty association. NCGIF is accordingly calling for a nationwide effort to amend state property casualty guaranty fund laws to carve out division and transfer transactions to ensure that policies covered by guaranty funds before such a transaction will continue to be covered afterward, notwithstanding conflicting membership requirements in guaranty fund laws. NCGIF is working on template language for such a carve-out and targeting 2021 for getting state laws amended.

The Working Group also heard presentations from ACLI and APCIA regarding these groups’ recently adopted principles on insurance business transfer and corporate division legislation. In particular, both ACLI and APCIA’s principles call for legislation to mandate that independent experts be utilized in all regulatory reviews of division or transfer transactions. Some Working Group members representing states with division or transfer laws in effect (including Connecticut, Illinois and Rhode Island) objected to this principle, arguing that regulators should have the discretion to decide whether to retain an expert and that in-house expertise may make the regulator better equipped to review transactions and ensure that policyholders are protected. ACLI representatives were firm in their position that independent experts must be utilized, arguing that additional expertise in reviewing transactions protects policyholders and insulates regulators. ACLI will oppose legislation that does not substantially comply with its principles, and will support legislation to amend existing laws to comply with the principles. ACLI representatives noted that current transfer and division laws appear to lack many of the principles it would require as to the process for reviewing transactions.

II. Topics of Interest to the Life Insurance Industry

A. Revisions to Suitability in Annuity Transactions Model Regulation Set to be Finalized at Year-End

At the Life Insurance and Annuities (A) Committee meeting, Jillian Froment, Chair of the Annuity Suitability (A) Working Group and Director of the Ohio Department of Insurance, presented an update on the proposed revisions to the Suitability in Annuity Transactions Model Regulation (the “Model Regulation”). She noted that the goal is to develop a definition of “best interest” that is less than a fiduciary standard, but more than a suitability standard. The current draft of the proposed revisions defines the best interest standard as follows: “A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer’s or the insurer’s financial interest ahead of the consumer’s interest. A producer has acted in the best interest of the consumer if they have satisfied the [Model Regulation’s specified] obligations regarding care, disclosure, conflict of interest and documentation.” In Austin, the (A) Committee unanimously approved the revised draft of the Model Regulation with the quoted best interest standard, with several regulators noting that the draft was “moving in the right
direction” and “striking the right balance.” In order to finalize the proposed revisions by year-end, the (A) Committee will have a conference call on December 30 to consider adoption of the proposed revisions to the Model Regulation.

B. Long-Term Care Insurance

In the President’s opening remarks at the Fall National Meeting, Superintendent Cioppa identified solvency and stability in the long-term care insurance (“LTC”) market, along with innovation in the LTC space, as continued priorities for the NAIC. Accordingly, an executive-level task force was formed this year to focus on coordination and consistency in LTC products. The LTC Task Force is charged with developing a national approach to reviewing LTC rate increases and identifying options for consumers for modifications to LTC benefits where policies are no longer affordable due to rate increases. The Task Force has now been organized into six “workstreams” related to its charges, including evaluation of state rate review practices, LTC restructuring techniques, reduced benefit options offered to consumers, reserve valuation issues, states’ use of non-actuarial factors in rate review, and identifying additional data needs of the Task Force. The Task Force expects these workstreams to overlap as work progresses. The Task Force has been asked to deliver a proposal to the Executive (EX) Committee by the 2020 Fall National Meeting.

C. Term and Universal Life Insurance Reserve Financing Model Regulation – Adopted as Accreditation Standard

The (F) Committee adopted the Term and Universal Life Insurance Reserve Financing Model Regulation (Model #787) as a new accreditation standard with a September 1, 2022 effective date. Model #787 establishes uniform, national standards governing reserve financing arrangements pertaining to the term life and universal life insurance policies with secondary guarantees. Model #787 was adopted by the NAIC in December 2016, but had only been adopted by four states as of November 1, 2019. The NAIC intends for states to adopt the 2019 Amended Credit for Reinsurance Models, discussed above, as a package with Model #787 to the extent it has not already adopted these models.

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

A. Surplus Lines

The Surplus Lines (C) Task Force previously exposed a proposal to modify Schedule T in insurance company financial statements to include a new “Part 3,” which would require insurers to report detail on “Home State” premiums written. The proposal is meant to enable state insurance regulators to reconcile surplus lines premiums reported by surplus lines brokers with surplus lines premium tax information reported by insurance companies, with the goal of ensuring that states are receiving the proper amounts of surplus lines premium taxes. The proposal was intended to go into effect starting with 2020 annual financial statements, but was temporarily tabled following discussion in Austin and objections from trade associations questioning the efficacy and legal basis for the proposal. Discussions will be resumed at the 2020 Spring National Meeting.
B. **Cannabis Insurance**

Executive and Plenary in Austin voted to adopt *Understanding the Market for Cannabis Insurance*, a white paper meant to provide information to state insurance regulators, insurers and the broader public about the cannabis business supply chain, insurance needs of the cannabis industry, the availability of cannabis business insurance in state insurance markets and the extent of insurance gaps, and best practices that state insurance regulators can adopt to encourage insurers to write insurance for the cannabis industry. The Cannabis Insurance (C) Working Group will continue its work in 2020 tracking cannabis insurance-related legislation and coverage information and will release a report by the end of 2021.

IV. **Briefly Noted**

A. **U.S. Senate Passes Long-Term Reauthorization of TRIA**

The Terrorism Risk Insurance Act of 2002 ("TRIA") is a federal program that protects insurance companies from catastrophic losses incurred from a terrorist attack. On December 19, 2019, the U.S. Senate passed federal spending legislation that provides a long-term reauthorization of TRIA, which has long been advocated by the NAIC, until December 31, 2027. The legislation requires a study by the Government Accountability Office on cyber terrorism risks.

B. **New Capital Standard Under Consideration for Mortgage Guaranty Insurers**

The Mortgage Guaranty Insurance (E) Working Group voted to expose for a 45-day comment period the State Regulatory Mortgage Insurance Capital Standard ("SRMICS") and accompanying revisions to the Mortgage Guaranty Insurance Model Act (Model #630) and Mortgage Guaranty Insurance Standards Manual, along with work product underlying SRMICS. Milliman developed SRMICS in consultation with the Working Group to replace RBC standards for mortgage guaranty insurers. The Working Group also exposed for 45 days proposed annual statement exhibits for mortgage guaranty insurers calling for expanded reporting to give regulators greater visibility into the mortgage guaranty insurance business. Working Group Chair Kevin Conley of the North Carolina Department of Insurance stated that he expects to make changes to all of these materials following the exposure period to incorporate input from Working Group members and interested parties. The Working Group’s charge is to finalize Model #630 by the 2020 Spring National Meeting.
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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