The National Council of Insurance Legislators (NCOIL) Joint State-Federal Relations and International Insurance Issues Committee met at The Marriott Newport Beach Hotel on Thursday, July 11, 2019 at 4:30 p.m.

Senator Jerry Klein of North Dakota, Chair of the Committee, presided.

Other members of the Committees present were:

Asm. Ken Cooley (CA)  Asm. Andrew Garbarino (NY)
Rep. George Keiser (ND)

Other legislators present were:

Sen. Vickie Sawyer (NC)  Rep. Wendi Thomas (PA)

Also in attendance were:

Commissioner Tom Considine, NCOL CEO
Paul Penna, Executive Director, NCOIL Support Services, LLC
Will Melofchik, NCOIL General Counsel

MINUTES

After a motion was made by Rep. George Keiser (ND) and seconded by Rep. Lewis Moore (OK) to waive the quorum requirement, the Committee unanimously approved the minutes of its March 15, 2019 meeting in Nashville, TN upon a Motion made by Rep. Joe Fischer (KY) and seconded by Asm. Andrew Garbarino (NY).

CONTINUED DISCUSSION ON DEVELOPMENT OF NCOIL INSURANCE BUSINESS TRANSFER (IBT) MODEL LAW

Rick Newton, CEO of International Solutions Services, LLC, and Luann Petrellis, Insurance Industry Consultant, delivered a joint presentation. Ms. Petrellis stated that she and Mr. Newton began to work together in 2014 and they worked very closely with the Rhode Island Department of Insurance and helped draft the RI IBT legislation. A couple of years after that, Ms. Petrellis worked very closely with the Oklahoma Insurance Department in drafting the OK IBT law. Ms. Petrellis stated that both the RI and OK IBT laws are based off of the Part VII Transfer which is legislation enacted in the U.K. in 2000 and since then there have been hundreds of successful transactions that have been completed. The Part VII Transfer is a proven business model. The existing NCOIL
IBT model law is based on the OK IBT law which Ms. Petrellis believes is a solid foundation for states to use when considering IBT legislation.

Ms. Petrellis stated that the relevant market for these types of transactions is very large. Based on a PWC survey of the global insurance market, U.S. property & casualty (P&C) runoff or legacy liabilities are estimated to be $335 billion dollars which is almost equal to the rest of the entire world. Almost all companies have some form of runoff or discontinued business on their balance sheets. The life market is even larger and in the May 2018 Moody’s Investors Service analysis, it stated that insurers have over $420 billion dollars of annuity, life insurance, long term care and other liabilities publicly designated as legacy or run-off that are targeted for an exit transaction. Those numbers represent third-party transactions and it is important to note that of the hundreds of Part VII Transfers completed, at least half were completed for internal restructuring, not to a third party, for reasons such as corporate simplification or basic corporate restructuring.

Mr. Newton stated that it is important to understand that the market is massive. The $420 billion referenced by Ms. Petrellis was for third-party transactions and there is probably an even bigger number as to what companies can do to restructure. There have been massive restructurings such as MetLife and AIG and these situations will continue to come up more and more in the future. The legislation being considered by the committee would facilitate those restructurings. They are going to happen either way and at the end of the day they are recognitions from the companies that something needs to be done to stay competitive. It is very important for the insurance industry to continue to thrive and be competitive on a global basis.

Ms. Petrellis stated that she believes one of the reasons why the U.S. legacy liability market is so large is because there has not been an effective restructuring tool like an IBT as there is in most advanced countries. Companies hold these liabilities for discontinued business and they are looking for effective options to achieve finality, and operating and capital efficiencies. The options that exist currently and are most frequently utilized by companies to restructure or gain finality have been sale, reinsurance, loss portfolio transfers (LPTs), or assumption reinsurance. However, each of those options is limited in scope and effect and most importantly, they don’t provide the level of finality that the company is looking for. A reinsurance transaction will give a company economic relief but no legal finality – it is still on their books and they still have the credit risk of the company that is reinsuring them. It is also a long term relationship that can be very costly for companies. Mr. Newton stated that over the course of time everything adds up as every quarter you send out statements and you reinsured your block of business 20 years ago but you are getting no benefit today. But because reinsurance does not bring financial or legal finality to the relationship, it is time consuming and resource consuming. Because the IBT can bring finality, it is a much more efficient vehicle to help restructurings.

Ms. Petrellis stated that the key in the marketplace is capital optimization as holding onto legacy liabilities is costly and inefficient. There are companies like Berkshire Hathaway and investment groups like Apollo that have capital to take on legacy liabilities perhaps more efficiently and give a better claims experience to the claimant. Ms. Petrellis stated that in many jurisdictions worldwide there are IBTs and as a tool to restructure business operations it is very effective. There are multiple layers of review so you have regulatory review as well as court supervision and you have an independent expert that is going to focus on security to policyholders. The independent expert’s duty is to the court and to
the regulator and it is important to understand that the independent expert will look at all policyholders, not just the transferring policyholders so you are not going to have a good-bank/bank-bank situation since the non-transferring policyholders cannot be materially adversely impacted as well. Accordingly, the review process is very thorough especially with respect to protecting policyholders.

Mr. Newton stated that the IBT has more safeguards than the Form A and other transactions. It is a well-vetted transaction and it is because of the heightened level of review standards that it has been so successful around the world and will be here as well. The Form A is a great process but the IBT raises the bar even more. Ms. Petrellis stated that major industry groups have recognized the need for restructuring mechanisms. Ms. Petrellis stated that she was pleased to see that at the NCOIL Spring Meeting this past March, New York Life was very favorably commenting on the Part VII Transfer and that can be inferred to an IBT because that is what the IBT is based on. In addition to NCOIL considering an IBT model law, the American Council of Life Insurers (ACLI) has published guidelines for restructuring transactions which is a good first step to provide guidance to the industry for these transactions. Ms. Petrellis stated that the she believes the draft NCOIL IBT model law is a good framework and states need a consistent framework to work from and they need the flexibility to then perhaps pass guidelines and regulations that help them to address the needs of their state.

Ms. Petrellis stated that of the 285 Part VII Transfers completed in the U.K., at least 30% are for life and about half were for internal restructurings that did not involve a third party but rather just for corporate simplification. The same type of mechanism exists throughout Europe. Importantly, this law has stood the test of time as the guidelines and regulations have evolved over time and U.K. regulators have put out guidelines for the industry that are appropriate for their needs. What’s important is that the regulators have the flexibility to regulate the transactions. Ms. Petrellis stated that this past Monday there was a conference call of the Restructuring Mechanisms Working Group that the National Association of Insurance Commissioners (NAIC) held and her takeaway from it was that regulators feel that they have the tools and experience to handle these types of transactions but they do want the flexibility to address the needs of their domestics.

Ms. Petrellis stated that it is important to understand why IBTs are important to states. IBTs can be a driver for economic expansion but it is also important to understand that it is not just a matter of expanding a state’s market but also a matter of defending said market because if other states have IBT legislation they could be moving business outside of your state through re-domiciling and re-domestication. A good analogy is that IBT legislation is similar to what happened with captives. Vermont was first to market and they dominate it. Accordingly, being first to market is important.

Ms. Petrellis then discussed how an IBT works. You evaluate your options as to what is best for your company – is it reinsurance, an IBT, or something else? Then you move forward with submitting your IBT plan, getting regulatory approval, getting an independent expert report, and then getting court approval. Because this is a non-consensual situation for policyholders, there are checks and balances that are designed to protect them which include: notice to all stakeholders, including policyholders; extensive financial disclosure; regulatory review; court review; and importantly, an independent expert report that does focus on security to policyholders.
Ms. Petrellis stated that many companies have runoff that is embedded in live business and there is no tool to extract it to separate it out for separate management or position it for sale. The IBT allows a company to segregate out, perhaps live, runoff, or different lines of business so they can be positioned or managed separately. The IBT can also allow a company to consolidate separately regulated entities to achieve operational or capital efficiencies. The IBT can also be used to transfer between third parties, either to obtain or sell business and it is more flexible than a sale because it does not involve an entire company but rather just focuses on a book of business. Ms. Petrellis stated that the key benefits of the IBT are finality for companies and having the opportunity to restructure their business so it is more efficient and able to provide a better claims experience for claimants because as legacy and runoff business gets older and older it is not the focus of management since they focus on core business. A runoff company that focuses on that can give the claimant a better experience.

Karen Melchert, Regional VP of State Relations at ACLI, stated that ACLI has recently finalized its principles and guidelines (principles) on IBT and corporate division legislation. Ms. Melchert noted that ACLI also recently submitted a marked-up version of the NCOIL draft IBT model law which reflects how ACLI believes its principles fit into said model. Ensuring that the regulatory review process is robust is the most important thing to ACLI. Accordingly, ACLI spent most of its energy on the proposed amendments to the model’s regulatory review process section - Section 6. Ms. Melchert stated that ACLI went back and forth on whether or not their principles regarding the regulatory review process should be in the statute and it was decided that they should be included so that it is clear what must be considered by the regulator when reviewing these transactions.

Reviewing the financial condition of the companies both prior to and following the transfer is most important to ensure it does not result in a good-bank/bad-bank situation. Ms. Melchert noted that the ACLI did not have unanimity in setting forth its principles and therefore, going forward with any introduced IBT legislation, ACLI will oppose any legislation that does not contain its principles and remain neutral on any legislation that does contain its principles. Accordingly, ACLI would appreciate its principles being included in the NCOIL IBT model and would stay neutral if so. Ms. Melchert stated that ACLI looks forward to continuing work on these issues as it does believe these are important tools for companies to have and they need to be examined very carefully before being approved in order to determine what impact they could have.

Kevin Griffith, Partner at Faegre Baker Daniels, LLP and Counsel to the National Organization of Life & Health Insurance Guaranty Associations (NOLGHA), stated that when talking about doing a transaction under the laws of one state that impact the insurance consumers, NOLGHA wants to make sure there is an appropriate dialogue and assurance that consumers in the other states that are impacted by the transaction are not inadvertently burdened or inadvertently lose a critical piece of consumer protection that the guaranty system provides. Accordingly, the best way to do that is to explain how the system works, what it takes to be covered, and what it takes for consumers to remain covered. The reality is that if one of these transactions is completed, we won’t know for 20 to 30 years whether or not it was successful and will not know whether the assuming carrier will actually be alive or ultimately have financial trouble and have to be liquidated. NOLGHA neither endorses nor opposes any IBT or corporate division proposal and just wants to make sure that consumers maintain the critical protections that they currently have.
Mr. Griffith stated that on the life and health side there are certain criteria that must be met for a consumer to be protected when their insurer becomes insolvent and is placed into liquidation. First, each person must be a resident in their state at the date of an order of liquidation finding insolvency. That is a threshold requirement so one person is going to be covered by one state’s guaranty association and that will be driven by where that person resides when the insurer that issued the policy becomes insolvent and is placed into liquidation. Second, the product itself must be a covered policy under the laws of the state where that individual resides because it is that state’s guaranty association that is providing protection. There are some products that are not covered and medical stop-loss is one that in many states is not covered. Most forms of individual life, annuity, health, long term care (LTC) are going to be covered in all of the states on the life and annuity side.

Third, the insolvent company must be a member-insurer of the guaranty association or must have been a member-insurer of the guaranty association. That is a fancy way of saying that the company has to be licensed in the guaranty association’s state where the consumer resides. Mr. Griffith stated that starts to give NOLGHA some pause to make sure that those things are considered because if there is an IBT where the transferor was licensed in all states but the assuming company is not similarly licensed when they take over the business then you have destroyed one of the fundamental elements that is necessary to ensure the consumers in those states remain protected by the guaranty system. If that third criteria is not met, all states today – with New York being the last state to adopt it following the Executive Life Insurance Company of New York liquidation – have “orphan” coverage which means coverage falls back to the state of domicile of the insurance company.

Mr. Griffith stated that the orphan coverage is designed to be a stop gap to make sure there is not some type of disconnect which would allow a consumer to fall through the policyholder safety net. It rolls back to if the insurance company that becomes insolvent is not licensed in a policyholder’s state, then the guaranty association in the jurisdiction where the receivership is going on where the insurance company was formed will pick up coverage for those individuals. This is never intended to be a nationwide coverage mechanism. In fact, when the guaranty association coverage statutes were first adopted by the NAIC in the early 1970s, the first guaranty association statutes did exactly that – the guaranty association of the state of domicile of the insurance company provided nationwide coverage for all of that insurance company’s policyholders if that insurance company became insolvent. It took a couple of large insurance company failures to demonstrate that that is not a good way to spread the cost and it places a significant burden on a disproportionate number of insurance companies in one state if you are providing 50 state coverage. The NAIC quickly moved away from that model and today it is the state-based residency of the policyholder and NOLGHA wants to make sure that if OK has an IBT, the other state laws are not going to result in a loss of coverage or visiting an inappropriate amount of liability and risk back on a state should that company subsequently fail and cause a difficult failure to be shouldered by the industry.

Mr. Griffith then discussed an IBT/corporate division hypothetical that represents what NOLGHA is seeking to avoid. If the successor company - the transferee - was licensed only in OK and the business that was transferred to it was nationwide the problem is that it would not be a member-insurer of any guaranty association other than OK’s. So if that company were ever to fail, then OK would be picking up the nationwide liability whereas
the day before the transfer it would have been spread across the states and there would have been a wider base of assessment capacity. It is also a problem in that if the company that takes on the business, particularly in the life and LTC space, is not a member insurer in each of the states then those states will lose assessment capacity because they will not be able to assess an insurer that is not a member insurer for other failures. Accordingly, both sides of the balance sheet are in play here: the consumer protection of the assuming company, should it ultimately fail; and in the interim if there are other companies that fail it is important to ensure that the premium and assessment base - and when taking about life insurance and annuities and LTC we are talking about ongoing premiums that will continue for decades after the IBT – remains intact and part of that state’s assessment base to be able to protect consumers for other insolvencies.

Mr. Griffith stated that the guaranty associations perform an incredibly important and critical consumer protection role in society. NOLGHA is neither supporting or endorsing IBT and/or corporate division legislation but would ask that people be very thoughtful with regard to what amendments might need to be made not just in the state that adopts an IBT statute that permits the transfer to occur, but in all the other states to ensure the consumer protections remain intact.

Roger Schmelzer, President & CEO of the National Conference of Insurance Guaranty Funds (NCIGF), stated that NCIGF represents the P&C guaranty funds and that said funds are the last stop in the risk-sharing chain on which the entire business of insurance is built. Mr. Schmelzer stated that the public policy goal that everyone probably holds is that guaranty fund coverage cannot be disrupted by any IBT/corporate division transaction. We won’t know for many years after such a transaction is consummated whether it worked or not and we don’t know what works or not right now. That is not a reason not to try but we do not have the answers to those questions right now. Mr. Schmelzer stated that all language in an IBT/corporate division statute should reflect that coverage should not be disrupted and it should not be inconsistent with that. The whole point is that we have a lot of people right now who by matter of public policy are already covered by the guaranty funds if indeed their insurance company were to fail and you do not want to take that coverage away. Nor do you want to cover new people who have not been covered previously. IBT/corporate division transactions should not have the effect of undoing or providing new coverage.

The emphasis is on the priority of the guaranty fund coverage and NCIGF’s objective is to serve as a resource to public policymakers as they make decisions. Mr. Schmelzer stated that whatever the solutions are must respond to challenges that are fully identified and fully defined. P&C guaranty funds are funded through assessments but that is not the first place the money comes from however when an insurance company fails – it comes from the failed company itself as the assets are usually very substantial. In some states there are deposits that are statutory for a company to write a line of business in that state. The last place is assessments to go to the live market to bring in money there in order to pay policyholders. P&C guaranty funds probably recover 60%-70% from the failed company and the rest is made up from those other sources. A P&C guaranty fund more or less adjusts and pays claims just like an insurance company would. Mr. Schmelzer noted that it is important to know that P&C guaranty funds protect people, not companies. Also, a key difference between P&C and life and health guaranty funds is that life and health has orphan statutes while P&C does not which means in extremely rare and fact sensitive occasions you could have a situation where there is no guaranty
fund coverage available. That is something that the P&C guaranty funds have been working on for years in trying to fix as even one orphan claim is not good.

Mr. Schmelzer stated that NCIGF has flagged two critical issues relating to guaranty fund coverage and IBT/corporate division transactions. The policy has to be issued by the same insurance company that becomes insolvent – that is the way the statute reads today. Since we won’t know for some time whether the restructuring will work or not it is hard to know exactly what you would have if indeed there was a failure, which is not to say there will be. The insurer also must be licensed, but they may not be licensed when the policy is issued and may not have been licensed when the injury occurred. Those are timing issues but need to be taken into account when looking at restructuring legislation.

Mr. Schmelzer stated that NCIGF does not have the answer to all of these questions and issues but they are working very hard and the process is ongoing. Above all, NCIGF wants to make sure that the guaranty fund coverage that is in place remains in place and that new guaranty coverage not be generated by a potential failure by a restructured company. These are matters of public policy that NCIGF looks forward to updating NCOIL on as its work in examining the issues progresses.

In response to Mr. Schmelzer’s comment that the guaranty association is funded by assessments, Ms. Melchert noted that he did not follow up with who specifically is assessed and that is the remaining solvent insurers have to pay for that 30% that is not recovered from the entity that has gone insolvent. That is why that is a huge issue for insurers because they are left holding the bag if a restructured company goes insolvent and it is important to note that there should be no need for a “bag holder” if there are enough protections built into the review process so that it is highly unlikely, as you can never guarantee, that an insolvency will not occur. All measures need to be taken to prevent that from happening.

Frank O’Brien, VP of State Gov’t Relations at the American Property Casualty Insurance Association (APCIA), stated that he has had the experience of surrounding these issues as when they first came out in RI and Vermont, APCIA’s predecessor organizations were opposed to them but they have now come full circle and are not opposed to these types of transactions. APCIA believes that these types of transactions do serve a place in the market as there is a tremendous amount of value locked away in some of these underperforming or nonperforming books of business that can be freed in these types of innovative transactions. The transactions are innovative only in the sense that the U.S. did not invent them as they are based on the U.K.’s Part VII Transfer and they have been used in the European Union for a long period of time. Having said that, the transactions are very complicated and sophisticated that have their own unique set of regulatory and statutory terms such as a novation.

Mr. O’Brien stated that when looking at these issues public policymakers need to move very carefully and methodically so that there can be put in place the type of financial and consumer protections which will provide a certain measure of certainty as well as a certain measure of reputational risk protection for the insurance industry. One of the worst things that you can do when you are running an insurance company is to have it go insolvent. Nobody wants a restructuring transaction to go bad and in order to do that you must have very robust, transparent, and rigorous reviews in consumer protection. The debate is beginning to center on what constitutes that level of review.
Mr. O’Brien stated that RI has had a lot of experience with these particular types of transactions and OK is moving in that direction. As we move forward with these types of transactions - and we are going to see more - they are going to have to be reviewed almost with a jaundiced eye. That means that as NCOIL moves forward with its draft IBT model that is based off of OK’s IBT law, NCOIL needs to ask whether the OK IBT law provides the right level of consumer protection. There are some who think that it does while others would like to see additional consumer protections added which merits debate. APCIA will be part of that debate as it has a number of members who would like to take advantage of these types of transactions as well as members who participate in them.

Mr. O’Brien stated that these issues will be present for a number of years and if conducted properly, the restructuring mechanism will free up a lot of entities with a lot of capital that can be put to more efficient uses and provide a solution to a number of other vexing problems in other areas of the insurance industry but it needs to done carefully and methodically.

Dennis Burke, VP of State Relations at the Reinsurance Association of America (RAA), stated that with exception of maybe the two guaranty association representative on the panel, no one has mentioned the best interests or the expectations of consumers when they enter into an insurance transaction. That is the role of legislators and regulators – to defend consumer’s expectations. Mr. Burke stated that reinsurers have interest in these types of transactions that are largely trampled in the NCOIL draft IBT model law. Because these types of transactions traditionally prejudice the rights of reinsurers RAA has opposed them. The RAA, like everyone else, is evolving in its evaluation of these transactions and would like to work with NCOIL to see if there is a way to move forward on the model. There is an independent evaluation and fairness opinion that is involved in the OK IBT law and RAA would like to see that expanded to include an evaluation of whether or not the transaction is fair or prejudicial to reinsurers’ interests amongst all of the other interested parties involved in the transaction.

Mr. Burke stated that part of what these transactions do is circumvent the will of state legislatures who have said that there should be consumer consent for these transactions. That clearly interferes with the ease of changing or entering the transaction from an insurer perspective and that is recognized, but that is something that needs to be considered – should a body like NCOIL be actively supporting a provision that arguably circumvents if not tramples on the will of another state.

Mr. Burke stated that with regard to the orphan issue with guaranty funds, one of the questions about that is how are claims actually handled? So if you wind up with, for example, the transferee company being licensed in one state but it has 50 state obligations, handling claims is the business of insurance and if they are not licensed in the other 49 states how do the handle that? Surplus lines is an analogy but those people are eligible to write surplus lines in advance. So you could have a company thrown into a 50 state claims handling obligation yet it is unlicensed and arguably not permitted to handle claims. Mr. Burke stated that is an issue that, to him, no one has explained well – the best explanation being that there is thought to be a provision out there that will permit it and they can use independent adjusters, but that is not fully settled. Mr. Burke urged NCOIL to explore that issue.
The Honorably Glen Mulready, Commissioner of the Oklahoma Department of Insurance, noted that he was the House author of the OK IBT law during his time as a legislator, and stated that the overriding factor throughout this process is to ensure that policyholders are not materially adversely impacted. While this is in effect plowing new ground in the U.S., over 200 of these transactions have taken place over the past 20 years with no failures in the U.K. Cmsr. Mulready stated that when talking about the independent expert, both of those words are very important as the person must be truly independent and be an expert, and it is vital to the review process. With regard to the licensing scenarios discussed, Cmsr. Mulready stated that they are accurate but noted that he believes they would not occur as you would be materially adversely impacting those policyholders and would therefore be kicked out during the review process.

Cmsr. Mulready stated that the whole idea of these transactions is to provide a tool that is needed. When talking to national and multi-national companies, they stress that these transactions are a tool to reactivate capital into the marketplace into areas that they want to grow and that they want to focus on. Cmsr. Mulready stated that he believes ACLI’s principles are excellent but they do not belong in statute and should serve as a guiding principles document which was what was done in the U.K. so that regulators are not backed into a corner. Cmsr. Mulready also noted that the NAIC has a Restructuring Working Group that is currently researching these issues.

Asm. Andrew Garbarino (NY) stated that it sounds like there is general agreement that IBTs can be valuable as long as they are done properly with the right level of consumer protections. Asm. Garbarino stated that consumer protection is something that the Committee needs to consider and that a lot of great points were made by the panel today. Asm. Garbarino stated that perhaps the Committee should have an interim conference call meeting before the NCOIL Annual Meeting in December to determine if the ACLI’s and any other proposed amendments should be included in the NCOIL IBT Model Law. Rep. Lewis Moore (OK) agreed with Asm. Garbarino and thanked everyone for the valuable information.

Rep. George Keiser (ND) stated that the guaranty funds are really not paid for by assessments – they are paid by premium increases and that should be recognized. In the case of LTC, that was paid by the states because they were given a credit on the premium tax so that is coming right back to the consumer. Rep. Keiser asked why courts should be involved in these transactions and what does the court bring that the regulator would not provide? Rep. Keiser stated that court involvement implies that the consumer is being harmed. Ms. Melchert stated that in ACLI’s principles for the corporate division process they do not require court approval but do require it for the IBT process because you are doing a novation of a contract without the consideration or approval by the policyholder. Rep. Keiser asked why the regulator cannot do that instead of the court. Ms. Melchert replied because it is a legal novation and regulators do not have the authority to do that. Ms. Melchert also noted that it is a form of protecting the transaction so that it cannot be challenged down the road. If a policyholder believes that this was done without their consent and there was no approval of it by a court of law they could challenge it and undo the whole transaction. The process is different in a corporate division transaction.

Asm. Ken Cooley (CA), NCOIL Treasurer, stated that it is interesting that the entire concept of novation is based on consent. When done at scale, which is what we are talking about when discussing these transactions, it is very complicated. Guaranty funds
are there to protect people and it is therefore important to keep an eye on that when discussing these issues. The rating statutes are the first line of defense for a policyholder’s expectancy and the last line of defense is access to a guaranty fund. Asm. Cooley noted again that it is interesting that this process calls for a novation but it is not actually predicated on consent but rather something that the court is going to do and therefore outside the typical use of novation.

DISCUSSION ON PROPOSED AMENDMENTS TO NCOIL MARKET CONDUCT SURVEILLANCE MODEL LAW

Paul Martin, Regional VP – Southwestern Region at the National Association of Mutual Insurance Companies (NAMIC), discussed the proposed amendments submitted by NAMIC on the NCOIL Market Conduct Surveillance Model Law (Model). The goal is to create a substantive and robust analysis and to assure all parties that the least intrusive and most cost-effective way is used to do that. There are a number of amendments that NAMIC is suggesting including incorporating a demonstrated material risk standard as opposed to a potential risk or a significant deviation. The idea is to judge decisions and actions of companies based upon true risk in the marketplace as opposed to just mere technical violations. NAMIC is also suggesting that a corrective action plan provision be placed into the model statute, the idea being that if there are opportunities for companies to work with the regulator to address problems in a proactive fashion, they should be able to do that.

NAMIC is also encouraging through amendments to the Model that companies be encouraged to self-report violations and that when they are doing so, the self-assessments be used in lieu of significant penalties and that they work further with the regulator to sort those out. There have been some ideas and suggestions about excluding multiple de-minimis violations from the definition of pattern or practice in order to get away from technical violations as opposed to substantive violations of statutes and regulations. Mr. Martin stated that NAMIC’s proposals also include provisions for regulators concerning time parameters and schedules for regulators as some companies have reported that some market conduct exams go on for multiple years and are very expensive and NAMIC believes there is a way for regulators to at least set some sort of scope so that the company that is going to be examined has an idea of how long it is going to take and how much it is going to cost. Lastly, Mr. Martin stated that to ensure meaningful analysis performed by the regulators, ascertaining any conflicts of interest with the vendor and the department and the industry should be required.

The Honorable Dean Cameron, Director of the Idaho Department of Insurance and NAIC Secretary-Treasurer, thanked NCOIL for being involved several years ago then the NAIC was seeking to improve market conduct surveillance processes. There is always room for improvement and there needs to be an appropriate balance of an efficient market regulation for both the regulator and the company while maintaining an effective consumer protection. Much of what the NAIC has concerns with regarding the proposed amendments to the Model would violate that premise.

Dir. Cameron stated that it would obviously be great if there were no market conduct processes as there would be carriers always paying their claims appropriately and handling everything else appropriately but that is not always the case. Dir. Cameron then discussed three of the NAIC’s concerns with the proposed amendments to the Model. One proposed amendment states that “…nothing in this act shall authorize a
market conduct examination of the insurer’s cybersecurity protection measures which is otherwise provided for in domiciliary state financial examinations consistent with the NAIC’s coordinated approach to examinations.” Dir. Cameron stated that everyone is in favor of efficiencies but it is important to think about what could happen under that provision - particularly after the Anthem cybersecurity attack - and what would happen with consumers if they felt like their state Insurance Commissioner was unable to ask the appropriate questions to determine whether or not Anthem was handling that situation appropriately. That is a step too far – state Insurance Commissioners should be able to ask and examine companies to see that their cybersecurity approaches are effective and efficient.

The second concern is that the proposal creates some uncertainty and would create some additional disagreements between regulators and carriers and the industry. The proposal uses references like “material violations of state laws” but “material” is not defined; and “reliable and credible sources” but that term is not defined. Lastly, the proposal ties the hands of the regulator to three months from issuing the warrant which seems to be extremely unfair especially since the carriers have sixty days to respond to many of the allegations so that would make it extremely difficult and the entity that ends up getting hurt in the process is the consumer.

Dir. Cameron then provided an example of when his department received word of a carrier in Idaho disallowing preauthorization of in-patient mental health treatment which is a serious allegation because it is violation of state and federal law. Accordingly, the department started to investigate and the carrier was less than willing to share information and, while not proud of it since the department likes to be “in and out” with market conduct exams, it took over two years and ultimately over 30 consumers were found who were harmed and denied coverage and several thousands of dollars that were denied. Therefore, a limit of 90 days would be extremely detrimental to consumers.

Dir. Cameron stated that the NAIC is certainly open to discussing how the market conduct surveillance process can be improved and would encourage NCOIL, NAMIC and other organizations to come forward with any concerns in order to determine what the underlying problems are.

Rep. Keiser stated that with regard to Dir. Cameron’s statement about how the 90 day timeframe would be unfair, the proposed amendment allows for extensions at the direction of the regulator. Dir. Cameron stated that the NAIC does not believe that the extension language cited by Rep. Keiser is adequate and consumer protection needs to be the overarching goal. If a carrier has committed a promise and is not fulfilling that promise and it is found to be a systemic problem which requires review of records dating back several years a 90 day timeframe is unreasonable.

The Honorable Tom Considine, NCOIL CEO, stated that he understood Dir. Cameron’s statement regarding how “material” can be vague if not defined, but noted that the current version of the Model requires no departure of any regulation or law in order for any action to be taken. Cmsr. Considine asked for Dir. Cameron’s thoughts on that. Dir. Cameron stated that most departments are undermanned and overworked and there is almost an inference in the wording referenced by Cmsr. Considine that somehow the department would be looking at something that is not a violation of law which is not the case. If the department has a complaint or some reason to believe that a company is
not appropriately paying claims and it is a systemic problem then that is where the surveillance process is important.

Dir. Cameron stated that he doubts that there have been instances where a market conduct examination is being done on something that is not a violation of federal or state law. Cmsr. Considine asked if the Model's current phrase “deviate significantly form the norm” should be enough to constitute the basis for an action taken. Dir. Cameron stated that they can certainly take that back and the NAIC is willing to work with NCOIL to ensure an appropriate standard is in place but noted that of the problems the NAIC deals with he is not sure it sees this as something there are a lot of complaints about. If ACLI, NAMIC or other organizations are having concerns with the process the NAIC is certainly willing to talk about it and determine how it can improve its approach.

CONSIDERATION OF AMENDMENTS TO NAIC CREDIT FOR REINSURANCE MODEL LAW AND REGULATION IN CONJUNCTION WITH NCOIL RESOLUTION OF JULY 17, 2016 ENDORSING MODELS

Cmsr. Considine referenced the famous incident of Robin Ventura charging the mound and fighting Nolan Ryan. With reinsurance, this is an example of how if the states do not take action it will be the equivalent of charging at the federal government and saying “go ahead and preempt state law in the area of reinsurance.” Accordingly, it is time for states not to be the Robin Ventura to Nolan Ryan. Cmsr. Considine stated that several years ago the NAIC passed its Credit for Reinsurance Model Law and Regulation (Models). There has been a lot of discussions between NCOIL and the NAIC regarding how duplicative model laws are not beneficial so in this area NCOIL made the decision to endorse the NAIC models and not pursue developing its own models even though there was interest in doing so.

NCOIL formally endorsed the NAIC models in a Resolution dated July 17, 2016, sponsored by Rep. Joe Fischer (KY). Because of the Covered Agreements, the states really have to pass amended versions of the NAIC’s Models that are consistent with the Covered Agreements or else the states will be preempted. The NAIC has formally amended its Models and therefore NCOIL supports states taking action to amend their respective laws.

Rep. Fischer stated that while he and NCOIL opposed the Covered Agreements as an intrusion by the federal government into the state based system of insurance regulation there is no way to avoid federal preemption in the area of reinsurance if state laws are not amended to conform to the Models which now conform to the Covered Agreements. Accordingly, Rep. Fischer made a Motion to adopt his “Resolution in Continued Support of the NAIC Credit for Reinsurance Model Law and Regulation.” Sen. Bob Hackett (OH) seconded the Motion. The Committee then voted without objection to adopt the Resolution by way of a voice vote.

ADJOURNMENT

There being no further business, the Committee adjourned at 6:00 p.m.