

NATIONAL COUNCIL OF INSURANCE LEGISLATORS
FINANCIAL SERVICES & MULTI-LINES ISSUES COMMITTEE
BOSTON, MASSACHUSETTS
JULY 16, 2021
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) Financial Services & Multi-Lines Issues Committee met at the Westin Boston Waterfront Hotel on Friday, July 16, 2021 at 9:00 A.M. (EST)

Representative Edmond Jordan (LA), Chair of the Committee, presided*.

Other members of the Committee present were (* indicates virtual attendance via Zoom):

Sen. Mathew Pitsch (AR)	Rep. Brenda Carter (MI)
Sen. Jason Rapert (AR)*	Rep. Tracy Boe (ND)
Asm. Ken Cooley (CA)*	Sen. Jerry Klein (ND)
Sen. Travis Holdman (IN)	Sen. Shawn Vedaa (ND)
Rep. Matt Lehman (IN)	Asm. Ken Blankenbush (NY)
Rep. Joe Fischer (KY)	Sen. Bob Hackett (OH)
Rep. Jim Gooch (KY)*	Rep. Forrest Bennett (OK)
Rep. Derek Lewis (KY)	Del. Steve Westfall (WV)

Other legislators present were:

Rep. Deborah Ferguson (AR)	Rep. Bart Rowland (KY)
Sen. Keith Ingram (AR)	Rep. Kevin Coleman (MI)
Rep. Steve Meskers (CT)	Sen. Mike McLendon (MS)
Rep. Tammy Nuccio (CT)	Sen. Chuck Younger (MS)
Rep. Kerry Wood (CT)	Sen. Randy Burckhard (ND)
Sen. Spiros Mantzavinos (DE)	Sen. Neil Breslin (NY)
Rep. Roy Takumi (HI)	Sen. Sandy Senn (SC)

Also in attendance were:

Commissioner Tom Considine, NCOIL CEO
Will Melofchik, NCOIL General Counsel
Tess Badenhausen, Assistant Director of Administration, NCOIL Support Services, LLC

QUORUM

Upon a motion made by Asm. Cooley (CA), NCOIL Vice President, and seconded by Rep. Joe Fischer (KY), NCOIL Secretary, the Committee voted without objection by way of a voice vote to waive the quorum requirement.

MINUTES

Upon a motion made by Sen. Jason Rapert (AR), NCOIL Immediate Past President, and seconded by Asm. Cooley, the Committee voted without objection by way of a voice vote to adopt the minutes of the Committee's April 17, 2021 meeting.

CONTINUED DISCUSSION ON NCOIL UNIFORM CAPTIVE INSURER MODEL ACT (MODEL)

Sen. Rapert thanked Rep. Jordan and stated I'll be very brief and I'm really looking forward to being there in person for our next meeting in November in Scottsdale. I just want to express my support for this Model and for captive insurers in general. At its last meeting in April, this Committee had a very positive introductory discussion on this issue and the language that is before you in your binders on page 247. Since that time, I have officially signed on as sponsor of the model language which is really a compilation of several state's captive insurer statutes. As you may know, Vermont has been a leader in the captive insurance industry for over thirty years and is regarded as not just a national leader but a global leader in captive insurance as Vermont is first, worldwide, in gross written premium and assets under management, and ranks third in the number of active captive insurance companies.

Accordingly, having representatives from Vermont here today to discuss their experience in the captive insurance industry will be extremely beneficial to ensuring that the Model ends up being the strongest possible piece of work product that it can be. The Model can end up providing states guidance when they are looking to develop a captive insurer statute and can send a signal to those states that captive insurance is something that NCOIL supports provided there is an appropriate statutory framework in place. I think by our next meeting in November we can have a version of the model ready for consideration by the committee. Thank you, Mr. Chairman and I'll turn it back over to you.

Richard Smith, President of the Vermont Captive Insurance Association (VCIA), thanked the Committee for the opportunity to speak about the Model and about Vermont and some background on some of the important aspects we see in any kind of legislation that's going to either establish or update captive industry laws in individual states. I've been leading the VCIA for the last 10 years and will talk briefly about VCIA a little later on but first will turn it over to my fellow panelists for introductions.

Dave Provost, Deputy Commissioner of the Vermont Captive Insurance Division, stated that along with Sandy Bigglestone, Director of the Vermont Captive Insurance Division, they are responsible for regulating captive insurance companies that are domiciled in Vermont and working with our legislature to keep our captive law up to date. Ms. Bigglestone stated that I've been with the VT Dept for 24 years and work closely with legislative initiatives and licensing new captives and approving changes in business plans including National Association of Insurance Commissioners (NAIC) initiatives.

Ms. Bigglestone then noted some selected information of why Vermont is the leading U.S. domicile for captive insurance business. We've been in the business for over 40 years and it started in 1981 with a simple law called the special insurer act and our law has been adapted many times over the course of 40 years to meet the changing needs of the industry and I think that's an important piece. We do have as of the most recent year end \$30 billion in gross written premiums, \$197 billion in assets and VT is a small state so we have a great economic benefit to a small state like VT for our captive insurance industry existing there but what's important also is that VT's captive industry represents 10% of the overall captive industry in the world. We are a leading domicile for risk retention groups (RRGs) which are group captives formed under a federal act and VT chairs the RRG task force at the NAIC. Just a piece about our expertise over the years and the folks that are involved in the business and the infrastructure which includes all aspects of govt the industry ass'n the service providers in VT and the fact that we can be innovative has awarded us the gold standard of domiciles.

Mr. Smith stated that VCIA is the largest captive trade ass'n the world and we have nearly 400 member organizations and these organization rank from fortune 50 companies to small non profit hospitals. As you can see from this map our members come from almost every state in the union plus members from different countries so we have a breadth that represents a wide swath of the captive insurance industry. I know that you have already had a brief from Ann Marie Towle and Gary Osborne at your last meeting about what a captive is but we'll just do a quick overview.

Ms. Bigglsetone stated that the word captive inherently implies control so a captive is an entity licensed and controlled by its owners in covering the risk of its owners. It can write policies of insurance directly to its owners who also can interact with the commercial insurance carries on a reinsurance basis and reinsurance is just insurance for insurance companies. Captives are licensed and regulated in a single jurisdiction and usually under special insurance laws. For the next slide id like to point out some similarities between typical commercial insurance companies. If you think of an insurance company like liberty mutual or farmers insurance and how consumers buy insurance so I think making this comparison will help put it in perspective about how captives function and how they are similar. One, they are licensed insurance companies under state laws and set insurance premium rates for risk. It chooses to underwrite. They write insurance policies and collect premiums and pay claims against those premiums that they write.

On the next slide there are some comparisons and contrasts between traditional insurance companies and captives. Captives are typically only licensed in the state of their domicile. Commercial insurers are licensed in all states whether they are domiciled or writing. Captives write policies to its owners and affiliated businesses. Traditional insurers write policies to anyone. State regulators are focused on a business plan and solvency of a captive although certain types do fall under NAIC accreditation standards like RRGs who can register to do business in states under the federal act. Traditional insurers follow NAIC accreditation standards with all states applying those standards on a substantially similar basis the focus being financial solvency and consumer protection. Regulatory practices for captive compliance and solvency measures are primarily derived from the standards developed by the NAIC. These are standard that all insurance regulators do focus on. Because captive insurance is not focused on insurance for consumers we took he best of those NAIC standards and tailored them to the business of captive insurance. Traditional or commercial insurance companies employ people who run the operations of the insurance company whereas most of the time captives are managed by service providers with expertise in insurance operations and accounting.

Mr. Provost stated that I looked around the audience this morning and about half of you might remember a cover of Time magazine dealing with insurance and the other half is too young to know about it. In the early 1980s there was a hard market for insurance and we are back into a hard market now. There are lots of insurance companies like Geico and State Farm that are willing to sell consumers auto and home insurance any time and any day. In the commercial insurance space there are times when you cannot buy insurance – its not available at any price or reasonable price and that is one of the primary reasons why companies form captives. Captive insurance is all about control - companies taking control of their insurance buying and their insurance availability. If they cant buy insurance on the open market they form their own insurance company and then use that company to self insure risk or to buy reinsurance on the wholesale market. It is all about control and financing risk and managing risk. A captive provides a certain amount of self imposed discipline on a company's insurance and self insurance program. You can do anything you can do in a captive just by saying I'm not going to buy insurance and ill take care of those losses myself but with a captive you are forced to put

the money aside in advance and that money is watched over by regulators and examined by regulators and that's the big difference with captives – it provides a lot of discipline and provides a board governance and its another subsidiary in a corporate structure that then has to be looked at by the c suite and the president and CEO and general counsel so its really all about discipline in insurance buying.

As you go forward with the Model there are some things we think you really need to consider. For one, there are over 60 domiciles in the world right now and over 30 states with captive insurance laws already. These laws are dynamic and most states adopt these laws from existing captive domiciles and all of the states that wind up in the captive insurance business wind up adopting these models every year and changing so just keep in mind that this Model will need to keep up in the world around it and it needs to be a dynamic model and cant be stagnant otherwise its going to be left behind pretty quickly because we do change our captive laws every year to keep up with the insurance marketplace so that's something to really consider. Plus you're already going to have 30 sates with captive laws that might not match the model so you'll get a lot of input I think from those states that don't follow the Model that you are proposing so they are either going to have to make changes or make changes to the Model so there is going to be a lot of back and forth I think in that discussion.

Id also like to talk briefly about why states form captive laws as there really are only two reasons. One is to support your local industry so that you're industry can form a captive in your state and they don't have to fly to Bermuda or the Cayman islands or Vermont to have their board meetings. And the other reason is for economic development and that's why Vermont passed it and that's why Hawaii passed a captive law. We don't have industries that can support a captive insurance industry in Vermont. We're a very small state and put us all together and we're about the same size as the Boise, Idaho metropolitan area so a few jobs and a few tax dollars makes a big difference in Vermont. It took us 40 years to get to 400 jobs and most states can do that with one factory in a weekend so it's a difference. At any rate if you are going to support local industry with a captive law there are plenty of models out there. If you are going to try to form a new business in your state and use this for economic development purposes I'm not sure a model is the way to go you kind of want to build a better mousetrap so following the same model that everyone else does isn't going to provide you with much of a business edge in that regard.

Maryland did a study a few years ago about captive insurance and whether they should pass a law and the study came back with saying there is very little downside risk to any state so I think there is very little downside risk to a model. On the other hand there wasn't much of an upside. Unless you have a local business industry that can support a captive domicile there's already so many choices out there that you are going to have a hard time competing with other states and other domiciles around the world.

Mr. Smith stated that again we really appreciate the reasons the model is before you today as supportive of the captive insurance industry which is very important to us and we appreciate you looking at this. I think for us providing a roadmap for other states to look at in terms of establishing a captive law or updating their own captive laws is a terrific idea but one of our concerns is putting a model out there that doesn't have the flexibility or could potentially cause confusion among regulators looking at states like Vermont that have updated their captive law and evolved the law to meet the evolving needs of the industry it happens on a regular basis as a matter of fact VCIA works with VT every year to go into our legislature and tweak the law and sometimes make major changes but sometimes just tweaks but always looking to update our laws to make sure they meet the needs of the industry going forward.

Sen. Bob Hackett (OH) stated that I carried the legislation in Ohio and I appreciate you saying states are different and the reasons they pass captive laws are different. Ohio was a state that had so many domestic carriers as it's a big insurance state and we were losing so much business to exiting captives so when we set our own captive law we got a lot of business that came in but we did not want to have an aggressive captive situation because we have the other insurance companies. For example we do not allow association captives and I realize when you look at the model a lot of times NCOIL tries to create the framework and allow the states to put the policy in it and decide how they want to handle it but each state is very different in how they do it. Vermont is great but their thing is that they want the business as they are a captive state that really wants the business from other states but Ohio wasn't and really wanted to take care of our own corporations and own insurance companies. Maybe we'll change but when you make the statement that there is as much oversight – there isn't as much oversight between traditional carriers and captives. There is better oversight when they just self insure but captives and the path to oversight from the DOI is less than the regular oversight you see with insurance companies so you have to be careful that you don't be too aggressive with captives. Vermont is pretty aggressive with its captives. Sen. Hackett asked the speakers if they have ever had a captive go under in all their years.

Mr. Provost stated that Sen. Hackett is right in that the regulation is different but there is a reason and that is because traditional insurance companies provide insurance to the general public and captives provide it only to its owners so when we look at a captive for a fortune 500 company it is self insurance as they have the money and assets and resources to insure themselves in fact they often have more resources than the insurance company that wants to sell them insurance. There have been failures - Enron had a captive and Enron went under so when a captive parent fails the captive is going with it. In that case we have the same laws that traditional companies have for liquidating insurance companies so there is a very good reason for a difference in the laws and that really is the risk involved between insuring the general public and insuring yourself but you're absolutely right that not every state is going to want to form a captive market for captive insurance companies. States like Ohio has a lot of industry that you want to provide captive solution for those industries just as a home state solution and that's wonderful and common.

Enron was obviously very unusual as it went bankrupt overnight and it wasn't a long process like most failures are so when Enron went bankrupt the next day we went to court and seized the captive insurance company and looked at the assets and garnered all the assets that we could and like we would with any other liquidation we handed it over to a liquidator who then spent the next few years settling all the claims and paying them all out and at the end of the day there was a little bit of money left over that went back to the Enron estate so it is exactly the same process in this case it was a much quicker process because Enron again went down the tubes overnight but we were able to seize control and garner assets, pay its claims and close it down.

Sen. Travis Holdman (IN), NCOIL Immediate Past President, stated that he is somewhat involved with the captive industry and I know the IRS has taken quite an aggressive stand against captives or at least justifying the formation of a captive on behalf of a company. I'm speaking specifically in reference to 831b captives. Other than having actuarially determined premiums and actual policies in place and claims and risk distribution that's required where do you think the IRS and the service is going with their oversight of 831b captives? Mr. Provost stated that I will start with Vermont does not define captives by their tax elections. 831b is a tax election whereby small companies can be taxed only on their investment income and in order to

do so you have to qualify as an insurance company under the IRS rules. The IRS has been very aggressive in pursuing those that promote this as a tax haven. We look at insurance companies and captive insurance companies from the insurance perspective and your taxes are your business to the greatest extent possible. When we see someone who is focused on the 831b election we pretty much say no thank you we are not interested. The IRS has gone after promoters of the 831b captives with you are selling a tax deduction rather than an insurance product and that has been their focus which I think is totally justified. But if you have formed your captive properly with the proper structure and the right actuarial analysis and the right reasons for it as in what's the insurance problem you are trying to solve then you will have no issues with the IRS.

Mr. Smith stated that we have met a number of times with officials at the U.S. Treasury dept and have supported the fact that there are unscrupulous folks who are pushing these micro captives or 831bs as some sort of tax play as opposed to an insurance company and as Mr. Provost mentioned that doesn't fit the Vermont model and shouldn't fit any captive model. We are concerned that there is this kind of spill over effect where folks here about these 831bs and then think that's how the whole captive industry operates and that's the problem and concern we have and I'm concerned the IRS has that view to be honest with you. We've been supportive of what they have done in terms of moving on and focusing on some of these other actors but the concern we have is that it's the broad brush in terms of the laser on the bad actors and that's something we are dealing with and have broad concerns about for sure.

Ms. Bigglestone stated that state insurance regulators do have the leeway to be the gatekeepers of regulating captive insurance business and letting in business that makes sense that is lawful that is meant for insurance purposes, insurance risk financing purposes, so the state insurance regulators do have an obligation to implement sufficient regulatory practices to oversee the business that they are letting in.

Hearing no further questions or comments, Rep. Jordan noted that this topic will be further discussed and possibly voted on at our November meeting in Scottsdale.

CONTINUED DISCUSSION ON NCOIL REMOTE NOTARIZATION MODEL ACT (INCLUDING LIVE DEMO OF REMOTE NOTARIZATION)

Rep. Jordan stated that we first discussed this issue at our December meeting and at our last meeting in April draft model law language was introduced which I have now agreed to sponsor. The language is in your binders on page 243. One change that has been made to the language since April is in Section D on page 245 – the number of years in which the recording must be retained has been lowered from 10 to seven years. I think seven years is in line with the spirit of modernization efforts, will reduce costs of compliance with the act, and is also in line with several state attorneys record retention requirements, including my home state of Louisiana. Joining us today are Nicole Booth, Executive Vice President of Public Affairs at Notarize, and Jacqueline Phillips, Director of Notary Engagement and Education at Notarize. Ms. Booth and Ms. Phillips will be providing us with a demonstration of how a remote notarization takes place. I think this will be very beneficial for the Committee to see and then I believe the Model will be ready for a vote at our next meeting in November.

Ms. Booth thanked the Committee for the opportunity to speak and stated that Notarize is a digital trust provider and we are a platform that integrates technology with live human interaction to establish identities. We offer digital identity proofing and identification services including a market leading notary public platform to allow any person or organization to get their documents

notarized 24/7. Access to digital services is more important than ever and so we thank you for your leadership in holding discussions on issues like remote online notarization (RON) to make sure they work not only for consumers but all parties – attorneys, notaries and all citizens. Today we are going to give you a quick lay of the land on RON law and then we are going to dig into an example of how RON can work specifically using our platform of course.

So far in 2021, 10 additional states have passed permanent online notarization laws which allows for documents to be notarized online through multi factor authentication and live audio visual. Six of those state laws have been signed by their governors WY, WV, NM, KS, AR and OR and we are awaiting governor signature in four additional states IL, NY, NJ, and NH. So if you are looking at totals we have 35 states that have signed permanent RON laws and once those remaining states have signed their laws hopefully by the end of this year we'll be up to 39 states. With this review lets move onto how RON works in real time and practice. Today we're going to walk through the signer and notary experience. I'm going to be taking you through the experience as a signer and then Ms. Phillips is going to be my notary.

We're going to start here at the signer's dashboard, this is my dashboard, and I've already signed up for a notarize account so I can come back to this account at any point. I've already uploaded my document but I can upload my document here. We're going to continue to the document so once I've uploaded I'm going to be prompted to enter my name as it appears on my ID and this will help when we're going through credential analysis which we'll get to in a moment. This already starts the purposeful multi layered approach of fraud prevention and safety and security and we ensure the three factor authentication of something you know something you have and something you are. So then you'll be prompted to see if a second signer is needed for purposes of this demo we are going to skip this step so I don't need a witness or a second signer. Today we are going to go through a vehicle release form and at this point in the stage I'm still in control of the document and I can adjust and move my name anywhere on the screen. I can move around things on the form to make sure everything is uploaded. Once I have done any additional edits to the document I can move forward. This is important I will need to go through a quick tech check to make sure my internet is strong and my audio visual is setup correctly. Per law this is important because it's not only about a good experience for me to have as I'm getting my document signed but it's the live human element of the signer and the notary to be able to see each other and interact back and forth as part of that safety and security piece.

I'm going to continue and you can see me and I can see myself and I'm checking the output and you can see my voice is being heard and the last step is they are checking my internet connection to see how strong it is. It says my connection is weak but we can still use the platform with a weak connection so if you are in a rural area or you don't have the best Wi-Fi this is still an option to use no matter where you are located. We'll connect anyway. Once I'm done with that I can move on to the identity verification stage as it again is part of the multi layered safety and security process. We're going to check my name and my DOB and then use only the last four digits of my SS number and this is going to help our third party vendor perform dynamic knowledge based authentication. We do not share this info and in fact we only ask for the pieces needed to do the third party identification its only to help us complete this next step of the process. Everything looks good here and I'm going to continue and now what we're going to do is go through those dynamic knowledge based authentication questions. We use a series of third party databases to draw up these questions. Before I get into the program ill explain how it works and walk through it. To pass this step I must answer four out of five questions correct in two minutes. If I get it wrong once I have one other shot to do it. If I get it wrong then I'm done

with the system – its not that I cant get my document notarized I just cant get it notarized with a RON – that’s for safety and security as we want to make sure you are who you say you are.

So lets see if I can get these questions right. You’ll see that they cheated for me and gave me correct answers but clearly that is not on there when you are going through this as a signer but for demo purposes they gave me correct answers so I didn’t mess it up. In the bottom left corner you can see it tells me how much time I have remaining as I’m going through these questions. Once I feel like I have all the questions correct I check my time and I submit and I’ve successfully passed the knowledge based authentication. Now we are going to move onto credential analysis. How we do that is we use a gov’t issued ID and we’re going to take pictures of it. Today I’m going to use my business card acting as my driver’s license and you can do that one of two ways you can do it through your mobile device or you can do it through your web browser. Today I’m going to use the web browser and I’m going to take a picture of my fake driver’s license press a key and confirm and continue. We’ll take a picture of the back and then confirm and continue. Then I’m going to enter my driver’s license number as it would be on my drivers license or the ID I provided. All of the other info looks correct here and we are then prompted for a second form of ID. This document does not require a second form of ID so we will move on.

Here is the part where we are going to start bringing in Ms. Phillips into the process and it gives you an idea of the costs associated with RON. The national standard is \$25 per notarization and that is split between the technology platform and the notary so the notary can build their business. Now we can get started. On average the wait time to connect to a notary is less than a minute. Ms. Phillips stated now we are in the part where a notary and the signer are meeting each other so you can see me the notary on the top and the signer below and we’ll walk the signer on filling out their portion of the document. So I’m going to switch a little bit because I want you to see I can use a pointer as me as a notary and it will show up there as a signer so I can direct their attention to any part of the document. At that blue dot I’m going to ask Ms. Booth to choose a signature at the top left hand of the screen and she’s going to be able to choose that and drag it to where she is going to place the signature on the document. I’m going to have her create a new signature as the signer has the ability to have two signature choices – a text based signature and a handwritten signature for this demonstration we’re going to use text based. Ms. Booth will choose her signature and I’d like to point out here that the signer does have a disclaimer that they are agreeing that this electronic signature is just as binding as their pen and ink signature. This will now have her signature on the document and at this point the signer has completed their portion and you’ll see me switch my screen.

The notary portion is a lot more intensive because I’m doing a lot more adding to the document as necessary. I’d like to point out there on the top left hand of the screen there is a yellow exclamation point which is reminding the notary that they have to perform credential analysis so this is the part that you are. Here is the ID Ms. Booth uploaded for review and I’m going to check here to make sure that it was a drivers license and the name attached and DOB matched. If any of those don’t match its probably not the signer that needs to be here and I as a notary would terminate the call and then have the signer come back through with either the correct person that needs to sign the document or the correct ID. After I’ve done that I can look at the back and front of the ID to make sure that is valid and then I’ll complete the ID validation. The check mark then goes from a green exclamation point to a green checkmark. I am now able to complete my notarization on the document so I’m going to use some of the tools I have to add all of the info. The notary is then prompted when they are adding that annotation what kind of language they are using which allows the notary to do the journal that the notary must do for a RON. For this example I can drag all of the info I need onto the document including a disclaimer

that this had been done by audio visual communication. There is also a script that the signer and notary can go through and ill go through that now. Hello I am Ms. Phillips I am a commissioned notary in the state of TX and id like to let you know that todays audio visual session will be recorded. Do you agree. I agree. Another part of this is that we have the signer state their name for the record so please state your name for the record. Nicole booth. Are you participating in todays notarization under your own free will. I am. And you consent to engage in an electronic transaction today using your electronic signature as you binding signature in these documents. Yes. So this is all captured in the audio visual requirement that the states have in order to know who the signer is performing the notarization and also that they are legally binding themselves to this notarization. This document also requires an oath so this is also captured on the side so I'll go ahead and perform that. Please raise your right hand - do you solemnly swear or affirm under the penalty of perjury that anything made by you in these documents is true and correct to the best of your knowledge and belief. Do you swear or affirm. I affirm. So this part is now done. I'm going to go ahead and lock my document and the notary has now legally done their 509 digital certificate to the document.

The notary is now complete and ill lock the document and this allows for any kind of technology hiccups. Ill now complete this session and now I will move it back to Ms. Booth for the signer experience. So something worth noting is in the audio visual recording we are only recording the talking heads we are not recoding the sensitive info within the document only the talking heads to ensure that the person is who they say they are and that's for a couple of reasons – one is to watch for duress and assist the notary in that piece as well as for follow up in case anything happened as fraudsters don't like to be recorded on camera. We missed the survey portion of the discussion but I think that's ok. Now we're at the end where my document has been uploaded and I can e-mail it to anyone I need and I can come back and open it any time within the notarize portal. A few things id like to highlight is that you always have access to in the portal is you can see the doc and it tells you what the doc is and when it was completed and also the audio visual recording which takes a few minutes to process but that is available as well and you can see the type of notarial act that was competed, who completed it, their commission number, the platform that it was completed on. And also a summary of what was paid and my access pin to notarize and a summary of the status. That's it and it took a little longer than we expected but we wanted to make sure we went through each step.

UPDATE AND REVIEW ON STATE INSURANCE REGULATORY SANDBOXES

Before starting with the speakers, Rep. Jordan first noted that in your binders for your reference during this discussion, starting on page 261 is a copy of Vermont's insurance sandbox enabling statute, following by a copy of Utah's. I would now like to recognize my colleague from Kentucky, Representative Bart Rowland, for brief comments.

Rep. Rowland stated that thank you, Mr. Chairman. I'll be very brief. Before we hear from our speakers I would just like to note that my home state of Kentucky also has an insurance regulatory sandbox that has been in effect since 2019. I support the concept of insurance regulatory sandboxes and as you'll hear from the speakers today, the main goal of such sandboxes is to reduce regulatory hurdles for companies that want to introduce new concepts and products at the same speed as insurance technology develops. Before moving forward with any sort of NCOIL model law language relating to insurance regulatory sandboxes, I'm interested to hear how they have operated in other states and whether model language is indeed necessary. Thank you, Mr. Chairman.

Rees Empey, Director of State Gov't Affairs at the Libertas Institute, thanked everyone for coming out to Boston and for inviting him to speak. I'm grateful to be here. My name is Rees Empey and I'm the Director of State Government Affairs at Libertas Institute, a non-profit think tank based in Utah. While Libertas works on a range of issues in Utah, my role is to bring policies we've helped usher through the Utah State Legislature to other states. One of these, and my biggest priority, is the concept of a regulatory sandbox while also supporting the existing ones such as Kentucky and Vermont's insurance sandbox. Now imagine you've just graduated from college and you're ready to make some money, but your degree isn't helping you out as much as you were hoping I'm sure that most of you know someone struggling with this or maybe some of you even went through this. But imagine how different life would be for a post-graduate student if their earnings were secured for the first five years after graduation.

In other words, Degree Insurance, which is a company based not even five minutes from Libertas' office, is an innovative company that will cut a check for the student if that student's income fails to reach the average earnings for that particular degree, whatever that degree may be. Degree Insurance is licensed to operate in Utah, South Dakota, North Dakota, Illinois, and Arizona but frequently runs into issues with other states' insurance departments due to things like seasoning requirements or not fitting neatly within the typical insurance mold. That's because, prior to Degree Insurance, nobody has pursued an insurance product such as this. Degree Insurance is but one example of an innovative insurance product and serves as proof as to why regulatory sandboxes can be so helpful in the insurance space, as well as many others. Now, I should note that Degree Insurance is not a sandbox participant in any of those states, but the regulatory sandbox in South Dakota did attract them there, for example. In short, sandboxes enable innovators -- businesses both big and small -- to work with regulators in trialing new products, services, and business models while regulations inapplicable to their idea are temporarily waived. Now, states can pursue an industry-targeted sandbox, which highlights specific industries to allow for temporary regulatory relief. Utah and West Virginia's insurance sandboxes are good examples. On the other hand, states can also pursue an all-inclusive sandbox, which opens the door for any and all companies, regardless of industry, to apply for temporary regulatory relief, which Utah unanimously adopted this year. This "sandbox" concept originated in 2014 when the United Kingdom launched the world's first sandbox and targeted fintech companies.

Shortly after, countries such as Australia, Singapore, Hong Kong, and several others implemented sandboxes of their own while expanding the concept's application to other industries. Stateside, in 2018, Arizona passed America's first sandbox, which targeted fintech companies. Following Arizona's lead, states such as Utah, Vermont, Kentucky, Florida, West Virginia, California, Hawaii, Wyoming, and South Dakota began implementing their own while states like New York and North Carolina are actively considering them. At Libertas, we love sandboxes because it invites the business community to the table so they can highlight troublesome regulations while working with regulators and legislators to update the state's regulatory code to better welcome the innovations of tomorrow. In addition, with multiple states running sandboxes, businesses are able to scale up and offer their product across several sandbox states rather than just one or two. Now, a lot of folks are worried about "bad actors" and I don't blame them, but consumer protection is offered from the very beginning with the application process and throughout the trial period, which is typically two years max.

Businesses trialing their product in the sandbox are supervised by regulators while ideas that will obviously cause harm to consumers are barred from entry. As the sandboxes operate, it'll help the state legislature identify and update outdated regulations by providing real examples of those regulations not working. Now, these revisions and funding for the sandbox program itself

can't happen without the state legislature. These regulatory waivers are temporary. The regulators overseeing these businesses in the sandbox recommend reforms to the legislature based on what they're seeing when those regulations are waived. And, in the end, the sandbox concept strives to allow for its participants to enter the full marketplace once their trial period ends and offer their products to any and all consumers rather than the typical cap of 10,000 consumers within the sandbox. In Utah, our sandboxes are still mostly getting off the ground. While Utah hosts a fintech, legal services, insurance, and all-inclusive sandbox, I want to narrow in on our insurance sandbox. In 2020, Utah State Representative Adam Robertson sponsored House Bill 402, which established Utah's insurance sandbox. H.B. 402 passed the Utah State House of Representatives with 58 yea votes and 11 nay votes. Over in the Senate, H.B. 402 passed with 27 yea votes and 1 nay vote.

And after receiving both Republican and Democrat support in the legislature, H.B. 402 received the governor's signature and the program launched right as COVID hit, which, as many of you know, changed day-to-day life for almost everyone. However, we're hopeful it'll take off as more states in the Mountain West and, frankly, the entire country, begin to consider and adopt a similar sandbox, which will appeal to the insurance industry's trend of offering their products regionally. West Virginia, Louisiana, South Dakota, and North Carolina are good examples just from this year. Overall, sandboxes provide opportunities for creative minds to trial their new and innovative products while providing regulators and legislators with real examples of regulations not neatly working in today's innovative world. Also, rather than a startup spending thousands of dollars on lawsuits and lobbyists to change the law to accommodate them, which not all of them can afford, this offers them a more affordable avenue to trial their service. And we cannot begin to imagine the life-changing products and services that may come as a result of this new regulatory framework. Thank you all for having me and I appreciate your time.

Kevin Gaffney, Deputy Commissioner of Insurance at the Vermont Department of Financial Regulation, stated that Vermont was the second state behind Kentucky to implement an insurance regulatory sandbox. That sandbox was put in place through Act 57 in 2019 and just to give a brief overview of the concept I think you've heard it from Rees but basically it's the commissioner granting a waiver of either a law or regulation or bulletin that would prohibit either more efficiencies or more innovations in the marketplace it would also still maintain whatever the public policy goals of the law regulation or bulletin attempted to achieve by another means and the waiver would not substantially increase the risk to consumers and obviously the waiver would be in the public interest so that's all in the application process. A waiver may be granted for up to 12 months and within the 12 month waiver period an extension of an additional 12 month period can be requested.

With the consumer protection piece in Vermont we have a limit of 10,000 customers for any product or service being delivered to Vermonters and there are also mandatory disclosure requirements which is something that the legislature was very supportive of as was the commissioner in making sure that the purchaser or a product or service through a waiver was aware who the participant was in the market that the product and service and innovator was temporary and there was an end to the waiver period and obviously contact info to the dep't should the consumer have any questions concerns or complaints. The commissioner must give a public notice period so when the applicant applies for the waiver the waiver is then posted on the dep't website and there is a timeframe to offer public comment.

There are financial requirements as part of the sandbox and there are statutory deposit requirements by regulation the amount is no less than \$19,000 but its commensurate with the risk or product or service being provided. The participant must provide 60 days prior notice of

the effective date of the waiver with an estimate of the total amount of premiums and claims anticipated during the waiver period and that amount may be increased or decreased within the timeframe should the commissioner determine that the risk profile has changed during the waiver period. There is a distinction between issuing a license to a company and having them do business and the level of monitoring that the sandbox requires so there is additional monitoring within the sandbox regime that requires quarterly monitoring of the policies written, the premium dollars and claim dollars and any material changes in business plans underwriting and claims practices so this provides a little more detail and insight to your state regulators on what is actually happening with the sandbox participant and to evaluate the compliance with the conditions of the waiver; the commissioner has broader authority to examine further any transactions, accounts or records as the commissioner does generally under examination authority.

There are a number of provisions that are not subject to the waiver so obviously capital and surplus requirements, taxes and fee and any regulations that s an NAIC accreditation requirement, health insurance, guaranty associations, work comp, insurance trade practices, licensing requirements, and long term care (LTC) insurance. As you as regulators consider legislation in your states these are items you may or may not look at differently. We didn't have the foresight when we did this legislation of what came about 70 days after the regulation was promulgated which was the pandemic so I can see work comp there being opportunities for innovation in that space and I think the gig economy was emerging pre pandemic and I think it will emerge more post pandemic so I think there are a number of innovative ways to perhaps deliver insurance products that we didn't consider at the time because there was a level of conservativeness to offer that in the sandbox. What happens at the expiration of the wavier period - the participant will stop all waiver activity that we permitted through the wavier and comply with all generally applicable laws and there is annual reporting to the legislature by the commissioner of the total number of waivers we have to provide details on the petitions for waivers how many we received how many were granted and how many were denied waivers that were laxed or revoked or any disciplinary action imposed and a list of regs or bulletins that have been adopted or amended as a result or in connection with the waiver. Lastly with respect to statutes to which waivers apply the commissioner may make recommendations as to whether such statute should be continued, eliminated or amended in order to promote innovation and establish a uniform regulatory system for all regulated entities.

Regarding the legislative process I touched on it briefly we passed act 57 in 2019 and there generally were some concerns about giving the commissioner discretion to waive the laws but I think if you look at the structure of the sandbox there is a lot of monitoring and control to protect consumers and those robust consumer protections were important to both the commissioner and the legislature. Originally no waivers could be granted after July 1 2021 which would make this discussion moot so in the past legislative session due to the pandemic the legislature enacted a 2 year extension of the new application deadline and the sunset of the law so the law now sunsets on July 1 2025 and new applications can be received no later than July 1 2023. We have not yet received any applications I think in part both regulators and industry had to react in the last 17 months to the pandemic certainly and regulators we enacted many emergency rules that the industry had to respond to to protect consumers and to deliver the service that best served the public so their attention could have been taken away from the innovative initiatives. I also think its an opportunity always to just interact with the tech community. They are not necessarily insurance folks they may have the concept and may be contracting with an incumbent insurer to deliver an innovative product but what we would like to express is that the dept. is always open to hearing about innovative ideas and we do anticipate the greater need of products and services and a lot of times you'll hear the perspective from the

innovators but I also think the consumer demand not just the millennial generation and younger I think there is consumer demand across the board for products to be delivered in a more efficient way and also to get to markets and areas we found through the pandemic have been underserved so I think the sandbox can offer a lot of different opportunities for your constituents in your states.

Lastly I have some links to both the regulation if you want to look at the details and we also created a portal on our website so if an applicant wishes to pursue a waiver they can fill out some general info on the website to initiate the process as a way to give what's coming to us and arrange for further details before an application is submitted. I hope that gives you a flavor of what we engaged in legislatively and by regulation in Vermont and I'm happy to answer any questions.

Sen. Spiros Mantzavinos (DE) asked if you have seen either in Vermont or Utah any costs associated with doing this like additional regulators that may have expertise for a particular sandbox or anything like that. Mr. Gaffney stated it's a good question and it's something we have wondered. We're fortunate in Vermont to have been able to attract a lot of strong experienced regulators and we actually expanded our staff in areas of focus where we see innovative products already in the already regulated market outside of sandboxes so I think we have capacity to take that on but the reality is if those numbers grew we would have to account for the resources to conduct that work.

Rep. Steve Meskers (CT) stated that there is a part of me that finds this very exciting and a part of me that's completely horrified by the structure. The question regarding regulatory framework is that if I am insuring the product with legislative structure of a 2 year sunset provision what is the timeframe of the insurance I am looking to cover or the nature of the coverage. I can't sell performance on a college degree that requires 4 years to get the degree with a product that has a sunset before I graduate because obviously we won't know what my salary is going to look like before the insurance license expires so there is a question about the timeframes about the policies looking to be underwritten in the sandbox and the expiration of the law. Also, when I think about insurance a lot of it deals with credibility, trust, public confidence so the participants that are moving into this business are we looking into licensed insurance regulated entities that are looking to expand into the sandbox with new innovative products where we are granting them waivers to test products or are we bringing in new innovators who may or may not be known to the insurance community or to the regulators in my state. Am I trying to broaden the aspects of my existing insurance companies or am I allowing new which I would say untested players into the market so I'm trying to measure risk and when I open up the gate to new performance I want to make sure it's not like we all got involved in energy deregulation and we ended up with Enron so I want to make sure which road we're going down on this.

Mr. Gaffney stated both and for the initial observation on the timing in terms of the sunset that is one of the reasons why I wanted to present what we went through because I think that's a good observation as I think the sunset creates some limitations so you look at doing that in your state you may want to consider that and create and decide what limitations you are creating. Perhaps you could just ask for some kind of report back after a certain period of time to gain comfort to continue with the sandbox rather than a sunset. Pragmatically we are hopeful that we get some sandbox applications and we show a record of success and there will be a decision before the expiration of the legislation to perhaps extend the sunset but I'm not suggesting that I have the ability to do that but I think the information will provide the documentation whether it's warranted or not and ultimately the legislature will have to decide. In terms of incumbents versus innovators it's both and I think the applications and the detail that

we have in there the incumbents are very family with and very comfortable in that space and the innovators may not be but that doesn't mean that as you've heard from our captive team earlier and certainly there are plenty of consultants and experts that can sit with innovators to make sure they comply with all of the actuarial analysis and reg requirements so we will through the regulatory oversight make sure that we don't approve any applicants we don't feel comfortable with so there is an application process to protect against that but I think the observation is good and I think there is an opportunity to help both incumbents and innovators.

Rep. Meskers stated my only concern would be in the institutional framework you'd want to be very careful of the unwind provisions so if we go to a sunset and there is unwind and there have been no claims and no claim history and essentially you have your consumer buying into a product that has presented no insurable value is the unwind going back to the shareholders or is there going to be any restitution to the participants in the market who bought insurance and have had no loss record. Mr. Gaffney stated that absent loss doesn't mean absent value I mean insurance is a transfer of risk so when you are under the contract you have the protections if you have a claim you have that protection but if you go a year with your auto insurance and don't have a claim you don't get the money back because it's a risk pooling arrangement.

Rep. Meskers stated that's a risk pooling arrangement where you are spreading risk among a loss history and with this we have no loss history so I want to make sure we are not underwriting a product that has no value and charging consumers so there is kind of a back and forth there when we have no history and innovation, you want to provide legitimate levels of insurance and coverage and risk perception and make sure it's not just a fee harvesting arrangement for innovators. Mr. Gaffney stated absolutely and that's our role as regulators and I think we are adept enough to understand the difference. There has to be at true risk that exists and a true exposure that exists or remembering the earlier slide I mentioned there had to be a business plan that outlines the policies to be written and anticipated claims and premiums and we won't just accept those for face value we will ask questions how they got to that and if there are actuarial assertions they are going to have to have actuaries weigh in on that and justify that representation. I also want to clarify that I kept saying incumbents and innovators but there are plenty of incumbents that are innovators so when I say inventors I think there are innovators in the incumbent space and in the non-licensed insurance space.

Rep. Rowland stated that after passage in 2019 in KY of its sandbox the KY DOI had a lot of conversations with folks who thought they needed a sandbox to implement their ideas only to find out after discussing with our dept that they were able to find a way under current insurance statues and regs to operate so to date we have not successfully completed an application in KY but we have had a lot of conversations the dept. tells me and also there is discussion that KY itself is a market maybe too small for some of these innovators to come in and implement their idea there is just not enough market so potentially if we do implement a model and some other states implement it then maybe at that time the market becomes large enough for some of these innovations to operate but my question is we've had several states now that do have regulatory sandboxes so do you know of any state that has successfully granted a waiver under their sandbox.

Mr. Empey stated Utah's insurance sandbox if memory serves correctly has run into a similar problem where innovators mistakenly thought that they couldn't operate before the sandbox and to add on to that I think a lot of the new insurance sandbox programs such as WV, SD I think it's just too new and its going to take some more time and some more states to adopt especially in the region of KY and UT and VT for us to really see action so its more regional. Mr. Gaffney

stated I haven't seen any waivers granted but that doesn't mean there haven't been I'd have to check in with my fellow regulators. I do think there are some regulators who feel they already have the ability to do this without a sandbox and I think you could argue that if you look at the current insurance laws and the discretion of the commissioner but I think when we established the sandbox and I don't know if this was the case in KY we felt that it was a much more transparent process to lay out the landscape and consumers could be fully aware of what's coming and all the disclosures coming so we felt the sandbox was the right approach. I think now time will tell with whether we have the right balance in terms of the right structure of the sandbox. If there are barriers within the sandbox regime we'd like to hear from the innovators and we certainly will react to those and reengage with the legislature on this.

Rep. Rowland stated that he believes it was positive in KY and it at least did create some conversations between the innovators and its DOI and the entire time we were debating it in KY I felt like the biggest opportunity was not new insurance companies and new product but all the back office support that goes into selling pricing or handling claims for current insurance companies. I think that's the real opportunity that some of these folks will think of some product to help us support our existing insurance industry. Mr. Gaffney stated that ill add that we talk about risk transfer and the like but I also see the opportunity for risk mitigation as a to of insurance is looking at not just assuming risk but also looking at ways to mitigate loss and offer either wellness or other types of loss mitigators and I think there is a lot of innovation in that space and certainly those provide some strong benefits to consumers.

Rep. Deborah Ferguson (AR) stated that if the goal of the sandbox is to encourage IT and innovation obviously if not many states are getting takers for the waiver are there any states offering incentives for innovation like tax credits and things for the companies to get started? Mr. Empey stated that personally I think that temporary regulator relief is a good way to attract and I think a problem is that a lot of folks just aren't aware of these sandboxes and that's part of my role at Libertas is to try and increase that awareness so that folks know about and can take advantage of sandboxes across the country. Rep. Ferguson stated that UT was just insurance are you finding more interest in FinTech and other areas; where are you finding the most interest. Mr. Empey stated our fintech sandbox and insurance sandbox have not had any successful applicants they thought that they couldn't operate before the sandbox and then they found out they actually could however our legal service sandbox which is run by our state Supreme Court currently hosts over 30 entrepreneurs working on new products such as different ways to run a law firm and then our all inclusive sandbox just passed last session is set to go on next month and has received a lot of interest from all sorts of folks from different backgrounds and interests. Mr. Gaffney stated that I don't think Vermont would want to move away from the discipline we have established in the sandbox with incentives. You kind of heard that discussion earlier with captives in the tax code and first an foremost its an insurance product and if someone wants to come to market with an insurance product they have to follow the regulatory regime and meet that discipline. We welcome innovation but within the regime of insurance innovation.

Rep. Tammy Nuccio (CT) stated my expertise is in the healthcare arena and I'm thinking of this as if you are an incumbent and you are not innovating you are dying so I see this as an opportunity not only for incumbents but for new innovators. If I selectively pick a reg that I think is impairing my ability to come to market with a new product how is the risk determined for the consumer in relation to that singular reg. Who is determining that risk. Mr. Gaffney stated that part of the process is in the business plan so its the anticipated claims that will come with that so without knowing what reg you are talking about it would be hard to assess but I think that's why if you look at the provisions not part of the wavier a lot of the insurance trade practices laws

are not because we just felt like none of those can be compromised and those would present some difficult situations for consumers. It would depend on what specifically is being waived to assess that but a lot of times its not necessarily something that enhances risk but just changes process. A simple example is that policies are typically in the P&C side a 12 month policy but that regime has changed quite a bit now they can be monthly or hourly but then how do you do cancellation provisions that are 45 days so you have to waive those cancellation provisions to be able to deliver those products we don't necessarily see those as increasing the risk its just how do you deliver that and in what way and electronically most likely on a cell phone and its an opt in for a consumer so its more about process than enhanced risk.

Rep. Nuccio stated that leads me to my next question of for the states that have implemented this what are the types of regs that are being asked to be waived. Mr. Gaffney stated that I wish I could give you a whole list but we don't have any applicants right now but maybe the next time we talk ill have examples. Rep. Nuccio stated I'm thinking of the sunset date and the two years and depending on the type of insurance and the specific reg you are looking to waive that is found to be cumbersome especially with an emerging market and developing a new product, 2 years depending on the type of insurance may not be enough to establish in depth knowledge or trends to be able to say if we remove this reg across the board we are going to see a, b, c, or d. So I think there is some concern around the sunset in relation to the type of service, provider, and insurance and also the type of product that they are looking to innovate as you might need more flexibility around I need 5 years to see if this will create a positive trend or if it will have a 3 year positive spike and then tank so the sunset date being hard and fast is a little concerning for me. Lastly, from a health insurance perspective I'm thinking of how many times in industry we see new products and markets and ways to be able to specialize in new areas and I got to thinking about a 10,000 member limit you could really focus in on a national account who has several thousand and create a market driven specific thing if there is reg that is impairing a specific thing in that network but that would then have the possibility of crossing state lines so the sandbox if I'm hearing correctly would be state specific so you would either need to find a conglomeration of accounts that equaled up to 10000 or a national account that happened to have a large radius or base with a 10,000 number max. Is that what you think this is going to help with or are you seeing this as more smaller members pooled together or more of a national model with a combined membership.

Mr. Gaffney stated that the basis for the sandbox is to kind of test out a new idea not necessarily go to a full broad market. I was hearing some discussion the last few days about work comp about data and we like to see it so we can decide as legislators how to go about making decisions as we don't want to change a law without seeing the data to support the change. The sandbox is that – it gives you the opportunity to test something out and see some results and then decide at the end of that period whether some minor revision to the reg or law is required so its kind of a catch 22 as would 5 or 10 years be more robust yes but I don't think you'd want to waive or extend a reg or law for any extended period of time before you kind of make an evaluation of do you then have to convert from the sandbox regime into the traditional regime. In Vermont the waiver does not apply to healthcare and I think for some of the things you are touching on we just didn't feel healthcare was the right fit – we may be missing the mark there but our initial view was that it wouldn't work based on what we think the needs of the healthcare consumer are. Rep. Nuccio stated that is interesting because I think healthcare is probably one of the biggest areas of insurance that we need to understand and probably one of the biggest concerns of Americans across the country is healthcare costs so being able to find innovative ways to do that and to understand the regulatory impact kind of loops me back to again regardless of the insurance type looking at which reg how do we determine that risk and

not just taking info based solely on insurance companies but being able to actually gauge the risk to the 100,00 people.

Mr. Empey stated that regarding the point about crossing state lines I think that is why having reciprocity agreement language within the sandbox is so important which is something we started to see in fintech sandboxes. For example, WV just made an amendment to their fintech sandbox to add reciprocity agreements so that WV sandbox can talk to WY and UT and AZ and I think something along those lines can happen in the insurance sandbox space as well and would be a good thing.

J.P. Wieske stated that he is the former deputy commissioner in the WI insurance department and is now representing the American Insurtech Council and would note that in my position in WI we did have a similar regulatory sandbox and the law actually dates back to the 1970s and it allows the commissioner to waive an insurance law with a hearing and a ruling. Just for note we did go through a number of these processes with companies in WI that came in and in a very similar approach a lot of the waivers we did fine similar to other states that in a lot of cases there is nothing that needs to be waived but in a lot of cases there are filing issues inside depts. from a timing perspective and needing to be able to adjust the filings very fast and so as Vermont has indicated you need some staffing issues and some other pieces that go along with that. We had a number of successful products that went through we had private agreements with the insurers to in fact return premium in certain cases if a policy was never going to pay out the exception is the consumer can't know that money is going back because that messes up the whole experiment but they had a an agreement behind the scenes with us to be able to return the premium net of claims following the piece so there are a number of issues we went through but the biggest thing we saw was the ability to make changes in new product filings and to make them very quickly and to make adjustments based on specifics. You may have heard ads for a product sold across the country by an insurance company sold to landlords pre-COVID I don't know if they do post-COVID that would cover their rents in case they lost their job. That is something that went through our process and was ultimately launched. There are several others that went through the process as well and there is a lot of successful innovation that could happen as a result of this so I think its something that states should take look at.

Rep. Jordan staid thank you to everyone and noted we may discuss this again at our November meeting.

ADJOURNMENT

Hearing no further business, upon a motion made by Asm. Cooley and seconded by Rep. Fischer, the Committee adjourned at 10:30 a.m.