

NATIONAL COUNCIL OF INSURANCE LEGISLATORS
NCOIL – NAIC DIALOGUE COMMITTEE
ALEXANDRIA, VIRGINIA
SEPTEMBER 25, 2020
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) NCOIL – NAIC Dialogue Committee met at the Hilton Alexandria Old Town Hotel on Friday, September 25, 2020 at 2:15 P.M. (EST)

Assemblyman Ken Cooley of California, Chair of the Committee and NCOIL Vice President, presided*.

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

Sen. Jason Rapert (AR)	Sen. Paul Utke (MN)
Sen. David Livingston (AZ)	Sen. Vickie Sawyer (NC)
Sen. Travis Holdman (IN)	Sen. Neil Breslin (NY)*
Rep. Matt Lehman (IN)	Sen. Bob Hackett (OH)
Rep. Michael Webber (MI)	Del. Steve Westfall (WV)

Other legislators present were:

Rep. Jim Gooch (KY)
Sen. Kirk Talbot (LA)

Also in attendance were:

Commissioner Tom Considine, NCOIL CEO
Will Melofchik, NCOIL General Counsel

QUORUM

Upon a motion made by Sen. Travis Holdman (IN), NCOIL Immediate Past President, and seconded by Sen. Neil Breslin (NY), the Committee waived the quorum requirement without objection by way of a voice vote.

MINUTES

Upon a motion made by Sen. Breslin and seconded by Rep. Matt Lehman (IN), NCOIL President, the Committee voted without objection by way of a voice vote to approve the minutes from the Committee's March 6, 2020 meeting.

FORMATION OF NCOIL SPECIAL COMMITTEE ON RACE IN INSURANCE UNDERWRITING

Rep. Lehman mentioned the formation of the NCOIL Special Committee on Race in Insurance Underwriting which was just announced earlier this morning and will be Chaired by Sen. Breslin. Rep. Lehman stated that it is important to reiterate that the decisions made by the Committee will be guided by actuarial data. By its nature, insurance can be discriminatory which is why it is important to follow the data.

Sen. Breslin agreed with Rep. Lehman and stated that it is a slippery slope and difficult, but it is important to exhaust every possibility as to whether racism exists or not in the insurance industry. Sometimes when you look at a pricing scenario in insurance, it might appear to be discriminatory against someone but in effect it is an insurance company doing its due diligence to come up with a fair and just pricing system. Sen. Breslin stated that he looks forward to inviting experts to testify on both sides of the aisle and at the very least sharing information with the NAIC. There could be a synergistic relationship between NCOIL and NAIC to come up with the proper conclusions. Asm. Cooley stated that the word synergistic is appropriate to use in this instance because the work of legislators and regulators is frequently intertwined.

UPDATE ON STATE ADOPTION OF AMENDED NAIC CREDIT FOR REINSURANCE MODELS

Asm. Cooley stated that after much hard work, the NAIC adopted amendments to its Credit for Reinsurance Model Law and Regulation in order to incorporate certain provisions of the Covered Agreement between the U.S. and European Union, and a similar Covered Agreement between the U.S. and United Kingdom. Since that time, both NCOIL and NAIC have been working hard to ensure that states adopt the Models so that there is no risk of federal preemption. NCOIL is committed to making sure there is no federal preemption in this area. NCOIL President, Rep. Matt Lehman, has made this a priority and he has had discussions with NAIC President, South Carolina Director Ray Farmer, to make sure both organizations dedicate their time and resources towards meeting the goal of state adoption of the Models.

Both NCOIL and NAIC have also been tracking each state's adoption of the Models, as well as listing all states' progress on each organization's website. Asm. Cooley noted that earlier this month, California adopted the amended Models which he sponsored in the Assembly. Asm. Cooley asked for an update as to how the NAIC's efforts have been progressing in terms of working with state legislatures to introduce and adopt this legislation.

The Hon. Scott White, Virginia Insurance Commissioner, stated that Asm. Cooley laid out the issue very well in terms of mentioning the Covered Agreement with the EU dating back to 2017. The NAIC looks at it as a reciprocal agreement and will agree to get rid of the reinsurance collateral requirements but in return the EU has agreed to recognize a state's approach to group supervision including group capital so that is a very important consideration to keep in mind. A component of that is a five-year timeline to have all states complete these changes through their laws to conform with the requirements of the Covered Agreement. That is a pretty tight timeline.

Cmsr. White stated that the NAIC first had to make changes to the Reinsurance Models and they were able to do that successfully in 2019. The Models then go to the states to have the Models passed in the legislature and to have the state insurance department amend certain regulations. In terms of numbers, there are about 14 states that have passed the Model Law – there may even be a few more as South Carolina adopted the Model law just yesterday. That is a number that the NAIC would like to see be higher. Only two states have adopted the amended Model regulation – California and Virginia. Cmsr. White stated that the NAIC is aware of a number of states that expect to adopt the Models soon so the NAIC is optimistic. The NAIC also made adoption of the Models an accreditation standard as well to really incentivize the states.

The Hon. Dean Cameron, Idaho Insurance Director and NAIC Vice President, thanked NCOIL for its help with this issue and noted that the NAIC is working very diligently to make sure there is no federal preemption. That is a goal of both NCOIL and NAIC.

Dir. Cameron then thanked Rep. Lehman and Sen. Breslin for their work regarding the Special Committee on Race in Insurance Underwriting. This is not the year anyone expected but it is what it is and the NAIC is very serious about these issues going forward. Dir. Cameron stated that one of the first calls he made after the NAIC Officers met and decided to move forward on these issues was to Rep. Lehman in order to get his input and collaborate. The NAIC looks forward to working with NCOIL on these issues going forward in a collaborative manner. The NAIC's Race in Insurance Committee is being broken into five working groups and they are focused on determining whether there is discrimination – unintentional or otherwise – and looking at ways to improve access and improve the industry to be able to reach out to those who have not been involved in the industry and have not used the industry's products.

DISCUSSION ON PANDEMIC BUSINESS INTERRUPTION ISSUES

Asm. Cooley stated that business interruption insurance coverage issues arising from the global pandemic have undoubtedly been among the most important issues throughout the past several months regardless of one's involvement in the insurance industry. Both NCOIL and NAIC have taken positions on the issue in general, as well as the specific of issue "retroactive" business interruption insurance legislation. Additionally, the NAIC initiated a data call to collect data related to business interruption insurance and COVID-19. Asm. Cooley asked if a review and update on the NAIC's position statement, along with any information that can be shared regarding the results of the data call could be provided.

Dir. Cameron stated that this issue can be controversial, so it is important to lay a groundwork on the issue before discussions. Each state is dealing with the issue slightly differently and the story is probably not finished yet. COVID-19 really highlighted that many existing business interruption policies had exclusions for viruses and other diseases. In most cases – probably 99.9% of cases – coverage only triggered if there was actual physical damage to the property. Therefore, many of the policies were generally not designed to provide coverage arising out of COVID-19 – nor were they priced for a pandemic. That is not surprising because that is not how insurance works well as the only way insurance remains affordable is if risk is shared over a broad group. Therefore, the industry is not typically well-suited for a global pandemic or when virtually everyone suffers significant losses at the same time.

Historically, business interruption coverage for viral pandemics has been available on a separate endorsement or a policy form by certain carriers but few businesses have chosen to purchase it. The NAIC understands from the industry that only about 30% of small businesses and 40% of businesses overall have any type of business interruption coverage at all. In March, when the stay-at-home orders were first issued and many businesses were forced to close their doors and terminate their operations, the issue came to the forefront and began to receive significant media attention. Many businesses believed the pandemic would be covered and were surprised to learn that it was excluded from policies. Insurers have been taking the position that such claims were not covered because of no physical damage to the business from the virus or there was an explicit exclusion within the policy for viruses or communicable diseases. Often times that exclusion was contained within an overall pollution exclusion.

Dir. Cameron stated that several lawsuits have been filed by the business community. To date, these lawsuits have focused on whether the virus causes direct property damage to an insured's place of business such that business interruption or civil authority coverage is triggered. Businesses have also sought relief from Congress and state legislators. In March, the NAIC issued a statement to Congress opposing the federal legislative proposal to

retroactively apply such coverage on the basis that it would pose a significant risk to the solvency of many insurance firms and would have a systematic impact on the industry as a whole and potentially the entire financial system. According to industry estimates, the exposure estimate ranged from \$255 billion to \$431 billion a month which would easily deplete any industry's cash or capital surplus in a short period of time as well as dramatically impact the reinsurance market. Importantly, the NAIC raised concerns with respect to retroactivity of coverage of claims that were excluded and has encouraged policyholders to review their policies and carefully determine whether there may be coverage.

Since that time, the President and Members of Congress have weighed in on the issue. In April, the President made comments suggesting that insurers should cover business interruption claims regarding the pandemic that were not clearly excluded suggesting many insurance policies did not exclude such claims. Dir. Cameron stated that his home state of Idaho and many other states have taken a similar position. If the policy didn't specifically exclude coverage, then the carriers have been asked to pay. In most cases, the policies do specifically exclude. At the same time, Senator Scott from South Carolina along with several other Members of the Senate Banking Committee, including the Chairman, sent a letter to the President citing the NAIC's statement raising concerns about retroactive application to business interruption coverage and expressed skepticism about federal proposals for future pandemic coverage based on the Terrorism Risk Insurance Act (TRIA) or other models.

Dir. Cameron stated that the following week, several Republican House Financial Services Committee members raised similar concerns in a separate letter sent to the President, as did Members of the House Freedom Caucus. That letter was intended to get the attention of their former colleague and now White House Chief of Staff Mark Meadows. In addition, two pieces of federal legislation have been introduced to be retroactive in nature: The Business Interruption Coverage Act – H.R. 6494 from Congressman Thompson of California; and the Never Again Small Business Protection Act – H.R. 6497 by Congressman Fitzpatrick of Pennsylvania. Both proposals seek to require insurers to make business interruption pandemic coverage available. In the case of the Fitzpatrick proposal, the certification of the Secretary of Treasury and the establishment of a federal backup program. In the case of the Thompson proposal, upon the effective date of the legislation. Both plans nullify pandemic exclusions once those conditions are met. Those proposals raise a lot of questions for the NAIC – questions regarding the potential of consumers and businesses being priced out of coverage and whether policyholders would even be able to purchase it.

In May, the House Business Committee held a virtual forum titled "Business Interruption Coverage: Are Policyholders Being Left Behind?" The NAIC submitted a letter to the Committee largely tracking the NAIC's March statement and making clear that the expectation of insurance regulators is that insurers pay claims covered under the policies but continued to raise concerns related to the retroactive application of the coverage. Several witnesses and Members of the Committee, both Republicans and Democrats, acknowledged the issue of retroactive application of business interruption coverage for viruses. Instead, the hearing largely focused on the need for a future program to cover such claims. The House Financial Services Committee was planning a hearing in June titled "Insuring Against Pandemic Challenges and Solutions for Policyholders" but it was postponed due to the House floor schedule. Currently, the NAIC believes that federal activity related to retroactive business interruption coverage is low because many Members of Congress understand the solvency issues that the industry would have to face.

The Hon. Glen Mulready, Oklahoma Insurance Commissioner, then spoke to the NAIC's business interruption COVID-19 data call. Cmsr. Mulready stated that the regulators came together and developed a data call to look into and collect information on these business interruption coverage issues and what is happening with the exclusions and claims losses related to COVID-19. Some of the information has been obtained while some of it continues to be collected. Results thus far show that nearly 8 million policies include business interruption coverage. Of that amount, 90% were for small businesses, defined as having 100 or fewer employees; 8% for medium businesses, defined as having 101 to 500 employees; and 2% for large businesses defined as having 500 or more employees. Of those policies, 83% of all policies included an exclusion for viral contamination, virus, disease or pandemic; 98% of the policies had a requirement for physical loss.

With regard to the claims, the latest estimates show nearly 200,000 have been reported by policyholders seeking lost income benefits under business interruption coverage. Less than 1% of the claims reported have been closed with a payment; 74% reported have closed without payment. The NAIC continues to collect data and that data collection will go through November of this year. Asm. Cooley thanked Dir. Cameron and Cmsr. Mulready and noted that it is extremely important to have the views of insurance experts heard on these issues, particularly on the federal level so that adverse long-term consequences are not felt by consumers. Cmsr. Mulready stated that 11 states have filed retroactive business interruption legislation. To date, none of the bills have moved forward or passed. At the federal level, the Pandemic Risk Insurance Act (PRIA), has been proposed. The American Property Casualty Insurance Association (APCIA), the National Association of Mutual Insurance Companies (NAMIC) and Independent Insurance Agents and Brokers of America (The Big I) also have a proposal, as do Chubb and Zurich. The only position NAIC has taken is to stand against retroactive coverage.

DISCUSSION ON PROPOSED CHANGES TO STATEMENT ON STATUTORY ACCOUNTING PRINCIPLE (SSAP) NO. 71

Asm. Cooley stated that an issue that has caught the attention of NCOIL is the NAIC's Statutory Accounting Principles Working Group's (WG) efforts to update SSAP No. 71 titled "Policy Acquisition Costs and Commissions." Without delving too deeply into the specifics of the principle itself, NCOIL has heard differing opinions as to whether the proposed changes are substantive as opposed to non-substantive. Asm. Cooley further stated that when NCOIL starts to hear of substantive changes being made via a handbook or manual, as legislators, their ears begin to burn, and they start to recall the debate surrounding incorporation by reference (IBR). Asm. Cooley noted that there is a constitutional provision in California that states no law shall be enacted except by statute and no statute except by bill.

Even if not substantive, there seems to be little debate that these changes could have a material and perhaps significant impact on insurers if adopted. If the impact is as large as some have told us, and we have heard impacts as high as 30% of risk based capital (RBC), which would place some companies below the regulatory action level, it strikes NCOIL as bad timing to implement such changes as the entire global economy is suffering during this global pandemic. Asm. Cooley asked if an update could be provided as to the status of the proposed changes, whether they are indeed substantive in nature, and what financial impact the NAIC believes they would have on the companies it regulates.

Cmsr. White stated that this is an accounting issue that has generated some discussion of late and it has to do with something that is called commission funding agreements that some insurance companies are entering into with third parties. The issue really is whether the

arrangement should affect the commissions that insurers pay to their agents under statutory accounting principles really by deferring recognition of that liability. Before going any further, it will help to set the table to discuss some very core, basic statutory principles that the WG looked at with this issue. A basic rule of statutory accounting is that funds which have been spent or obligated as far as liabilities are no longer available to pay policyholder claims, and acquisition costs incurred with the issuance of a new policy must be expensed upfront. That is basically the core, statutory principles that are being dealt with.

With the issuance of an insurance policy, a liability to pay full commissions is required to be paid upfront and expensed at that time – that is SSAP No. 5. SSAP No. 71 requires expensing of policy acquisition costs and these include commission costs, and this is true if full repayment to the third party is not guaranteed. Cmsr. White stated that he looks at these as straightforward accounting concepts, but it has become an issue. The NAIC has learned that, and this is not believed to be widespread, there have been certain third party capital companies that have gone to insurance companies and said that they will take on the act of paying commissions to the agents and on behalf of that insurance company, the insurance company will then pay the third parties (sometimes called super-agents). The advantage for the insurance company is that they will no longer have to recognize those full acquisition costs at the inception of the policy.

Cmsr. White stated that the NAIC looks at that as a flawed arrangement because it assumes the third-party arrangements eliminates the insurance company's obligation that results from the issuance of the policy. As a reminder, acquisition costs such as commissions have to be expensed upfront – that is a core concept of statutory accounting. The idea of by inserting a third party into that arrangement through the structure or design of a contract could change that is not viewed by the NAIC as being consistent with core statutory concepts in terms of recognizing liabilities and expensing policy acquisitions.

Cmsr. White stated that this is important because if insurance companies can defer expense recognition through insertion of a third party it is really going to impact the comparability between entities when you are looking at their financial statements. Using third parties this way will create more favorable financial statements as it will make it appear that they have more assets available than they actually do because they are already obligated to pay commissions for previously sold policies. This came to the attention of the WG and they have been discussing the issue since August 2019. The WG has created an exposure to clarify the original intent of SSAP No. 71.

Cmsr. White then summarized what the NAIC believes are the core points that need to be made in SSAP No. 71. All policy expenses must be recognized upfront. Commission funding agreements cannot be used to defer recognition and that gets to the overall statutory accounting concepts of conservatism and comparability and requiring that financial statements reflect assets available for policyholder claims with comparable financial information. The NAIC does not believe contract designs should determine expense recognition. The proposed effective date for the change proposed by the WG is year-end 2020. The NAIC is recognizing for those insurance companies that have entered into these arrangements a correction of an error for entities that have used a third party to defer commission expenses. Comments on the current exposure were due on September 18. There is going to be full discussion on any comments that were submitted on a conference call either before the NAIC Fall National Meeting or at the Fall National Meeting itself.

Asm. Cooley thanked Cmsr. White for his statements stressing the importance of having a clear understanding of capital and its availability and when it's recognized. Nonetheless, some of the

practices discussed probably emerged from companies trying to make sure they are financially strong. Asm. Cooley asked Cmsr. White how he views the change to SSAP No. 71 as it relates to the companies themselves. Cmsr. White stated that the NAIC did reach out to some of third party capital companies and tried to assess the scope and what the impact would be and the NAIC was told that there might be a material impact on some of the companies if they couldn't defer recognition of the commission costs. Cmsr. White stated that gets back to his earlier point in terms of it misrepresents the assets available to pay future policyholder claims and it misrepresents their overall financial condition. That is a concern, and it goes against core principles of statutory accounting that have served the NAIC and served state regulators so well. That is why this issue itself is something that the NAIC has looked at very carefully and it is concerning.

It gets back to comparability – you can't have one state's regulator looking at a company's financial statement with a \$1,500 commission fee and then looking at another company that has used a third party arrangement and they don't have the same assets available and they are not read comparably. That goes against core principles of statutory accounting and the NAIC believes clarification is needed with SSAP No. 71 to correct that, fully understanding the impact that it might have on companies that have entered into those third party agreements in good faith. The NAIC is not suggesting that anything improper was done and the NAIC has given them time until the end of the year to hopefully make that change and correct the recognition of the acquisition costs so they are done upfront consistent with the way it has always been done.

Sen. Holdman stated that there is an overarching issue here of IBR which was a key issue during his term as NCOIL President in 2016. Sen. Holdman stated that one of the concerns he has relates to corrections being made and having those corrections apply retroactively which means there is a pretty hefty adjustment to a financial statement for an insurance company to make. By saying that they are being given time to make the change sounds like it has already been decided that this is the way it is going to be.

Sen. Holdman stated that for those legislators in the room who may not be aware, back in 1996 there was something that needed to pass in legislatures called IBR which said that whatever the NAIC says and approves will become the law in that state. That is ok as long as it is a procedural matter but when it becomes a substantive matter, those are issues that call to mind what Asm. Cooley said earlier regarding only legislators can make the law. Sen. Holdman stated that legislators have given up the right to make law to the NAIC. That is not right but he is not sure that clock can get turned back. Sen. Holdman stated that he talked to a lobbyist in Indiana that was around when this legislation came to Indiana and she said she told legislators at the time "be careful what you vote for because one day you may regret doing this." Sen. Holdman stated that this is an example of when that day has arrived for legislators and there have been other examples throughout the past two decades of lawmaking being abdicated to the NAIC and in most instances the NAIC consists of unelected officials.

Sen. Holdman stated that discussing this issue with colleagues in the legislature is often difficult because they find it boring and don't understand what it means. Sen. Holdman stated that he and Rep. Lehman were successful a few years ago in getting legislation on IBR passed but the most that they could do was to require the Commissioner to report to the legislature on an annual basis all of the changes that were made to current procedure and process and what might be considered substantive changes to the NAIC manuals that impact Indiana process and procedure and substantive law. That is all that could be done because a point of no return has been reached because if a state doesn't make the changes that the NAIC has made, then the state doesn't receive accreditation and there is nobody in the insurance industry that wants a

state to lose accreditation because then it becomes more work for them to have to get approval for every change they want to make instead of going through the NAIC clearinghouse to get that done. This is a complicated issue but it goes to the very heart of IBR because it looks like an accounting procedure but in fact it is going to have substantive changes and a substantive impact on the insurance industry and represents decisions that should be made by legislators, not the NAIC.

Cmsr. White stated that he understands and respects Sen. Holdman's points and understands that IBR has been an issue at NCOIL for years, but stated that this is not a new, substantive rule. Rather, this is a clarification of several existing accounting procedures that have been in place since before 1998 and the NAIC believes that the clarification is needed because it was being mis-applied by insurance companies. The NAIC believes the language is clear and does not think a substantive change is being made. Cmsr. White further stated that this is not being done by the NAIC but rather the member states and the senior financial regulators are highly involved in the discussion of policy. The NAIC staff is relied upon for technical expertise but it is important to point out that it is almost necessary from a practical matter to address these new and emerging technical issues that arise from changes to state insurance laws in many cases.

The NAIC hopes that this dialogue around SSAP No. 71 is an open and transparent process that everyone can participate in and will make sure that it is done pursuant to documented procedures in order to get as much input as possible. It is different than the legislative process but the NAIC believes that when it comes to technical issues that arise – whether it be providing guidance to insurers on financial condition matters or on a handbook – it is something that NAIC has done for a long time and in Virginia that process is incorporated into its statutes while in other states there is a rulemaking procedure involved.

Rep. Lehman stated that if he is an insurance carrier and has been accounting for commissions in error, but he is solvent, and the proposed change to SSAP No. 71 threatens him to become insolvent, then is the proposed change really meeting its intent? Rep. Lehman further stated that the one thing about commissions is that there is no guarantee so if he writes a policy today and gets paid a certain amount and gets paid a certain amount of commission for the policy period, he doesn't get paid if the policy ends for whatever reason. So, how does a company actuarially account for renewal commissions? Rep. Lehman stated that he is a little confused as to how frontloading all of the potential expense is actually going to be possible, and noted that the conversation thus far sounds like substantive changes are being made to SSAP No. 71 that could threaten some insurer's solvency.

Cmsr. White stated that the concern is that expenses have to be recognized upfront. Even though there is a possibility that the policy could lapse and that would impact the commission, that is accounted for currently in terms of recognizing liability at that time – SSAP No. 5. It is a basic principle with the issuance of a policy – a liability to pay full commissions is required even if there is a possibility that the policy may lapse you have to recognize the liability upfront.

That has always been the rule. The NAIC is looking at by inserting a third party in the process and changing the design of the payment structure, that somehow should change the requirement that the acquisition costs have to be expensed up front and that is a dangerous road to go down because it doesn't take away from that insurance company's obligation to pay those commissions and to the extent that is hidden in the third party payment structure, it is not reflective of available assets and it misrepresents the financial condition of the company and it gets away from conservative principles of statutory accounting. Again, the situation should be avoided of having a company not using a third party having two different sets of books that the

regulators can't look at and get an accurate picture of what their financial condition is. The NAIC is not doing anything other than clarifying existing statutory accounting principles based on conservatism and comparability.

Cmsr. Mulready stated that similar to the conversation regarding avoiding federal preemption in the area of reinsurance, having consistency here is a good thing. With that said, Oklahoma has its own concerns because it has heard from carriers saying that the change or clarification could be hurtful. Ongoing dialogue on this issue will be helpful.

Dir. Cameron thanked Cmsr, White for doing a good job explaining the issue and stated that he looks forward to bringing some of the concerns raised today back to the NAIC in an effort to circle back and have a continuing dialogue on the issue. The NAIC's goal is to treat all carriers the same and analyze books the same and understand and make sure that they have adequate resources to pay all of their claims including the potential paying commissions. If there is a mechanism or loophole that is allowing for some carriers to take advantage then that discussion should take place. It is certainly not the NAIC's intention to work around state legislators as the NAIC has consumer safety and insurer solvency as the top priority. Dir. Cameron suggested that another discussion on this issue take place after the NAIC has had time to further discuss the issue along with the topics raised today.

Cmsr. White stated that the NAIC has received letters from at least one Commissioner raising some of the concerns noted today. Cmsr. White stated that he agreed with Dir. Cameron that further discussion is warranted and the NAIC understands the concerns of the clarification having a material impact on certain carriers. One thing that the NAIC does not want is that if there are certain carriers utilizing this practice, and it is the NAIC's understanding that there are not many, it puts pressure on other carriers to go in that direction if they view it as being at a competitive disadvantage, especially if it is not an accurate reflection of the availability to pay future policyholder claims and it doesn't accurately reflect their financial condition. That is the concern of the WG and of the E Committee.

Asm. Cooley stated that when you boil down the entirety of insurance regulation, it is really focused upon the solvency of the companies. If the companies are solvent they will perform their promises and if they perform their promises the customer is taken care of. Guaranty funds are the second line of defense. If you don't have a solvent carrier you need a way to pay the claims and that is where guaranty funds come in. If we have something where it is felt that there is something in the marketplace that jeopardizes the solvency of carriers, then that is an issue to bring to the legislature because the expectancy is that the statutory laws of each state, not regulations, are the framework within which an insurance company should be able to operate safely and solvently whether in CA, VA or ID or OK or WA. Asm. Cooley stated that this is an important issue that warrants further discussion and it raises an issue of if you believe there is a solvency issue then we really need to be talking about how is the law setup and are adjustments necessary. That forces a broader conversation to weigh and evaluate what constitutes fairness in the practice of the insurance business and what may not.

DISCUSSION ON NAIC'S CASUALTY ACTUARIAL AND STATISTICAL TASK FORCE (CASTF)

Asm. Cooley stated that throughout the past several months, CASTF has been developing a white paper to identify best practices for the regulatory review of predictive models and analytics filed by insurers to justify rates, and provide state guidance for review of rate filings based on predictive models. The White Paper was actually just adopted by CASTF last week. Before

adoption, NCOIL and NAIC discussed the White Paper at great length, culminating in NCOIL adopting a Resolution Urging the NAIC to Refrain from Intruding on the Constitutional Role of State Legislators – a Resolution which Asm. Cooley sponsored and which essentially opposes the White Paper.

However, while NCOIL did distribute the Resolution to NAIC leadership, NCOIL did not distribute it to all the Resolution's listed recipients – notably all state Insurance Commissioners, state legislative leaders, and members of the committees with jurisdiction over insurance public policy – because of assurances from NAIC leadership that language would be inserted into the White Paper clarifying that nothing in the White Paper is intended to, or could, change the applicable legal and regulatory standards for approval of rating plans. Asm. Cooley, as sponsor of the Resolution, and on behalf of his fellow officers, thanked the NAIC for including that important language as it addresses NCOIL's concerns and therefore maintains the lack of a requirement to distribute the Resolution any further. Asm. Cooley asked if an update could be provided as to the road ahead for the White Paper

Cmsr. White stated that there has been a lot of work on the White Paper and the NAIC appreciates NCOIL's comments which were included in the latest version. The theme is that the White Paper is intended to provide best practices and guidance to regulators when they are interpreting very complex predictive models that underly rating plans. CASTF was first put together in 2018 and the White Paper has been exposed at least three times, the last time in June, and CASTF has met at each NAIC national meeting since then. The White Paper was adopted by CASTF on September 15 and it now goes to the Property and Casualty (C) Committee for consideration and adoption. Cmsr. White stated that the NAIC received a lot of comments on the White Paper from industry, regulators, and consumer representatives. There were about seven or eight different themes in the comments.

Cmsr. White stated that it is important to emphasize that the White Paper is not establishing rate filing requirements, nor is it usurping legislative authority. The NAIC looks at it from the standpoint that the best practices of states that were already looking at these issues were gathered and incorporated into the White Paper so that there is something all states can use. A lot of states just don't have the resources to properly analyze complex predictive models and they don't have an in-house actuary. The approach is to identify considerations to look at that might be helpful moving forward.

Cmsr. White stated that another issue that is important to address that he is often asked about is what the role of the NAIC is when it comes to assisting states in the review of complex predictive models. The role of the NAIC in that instance could be compared to the role of a consultant with two big exceptions, the first being that the NAIC will not override a recommendation but rather provide technical support to the extent needed and the NAIC will not work or communicate directly with insurance companies. The states are going to utilize the White Paper and Cmsr. White stated that his staff believes it will be very helpful and help speed to market because it lays out the information the modeling companies need to put in their filings. That will aid the process in getting the information to regulators and getting it reviewed that much more quickly.

Rep. Lehman stated that he would like to personally thank the NAIC, particularly Dir. Farmer and Dir. Cameron, for getting the White Paper to a place that eased NCOIL's concerns.

DISCUSSION ON NAIC CLIMATE AND RESILIENCY (EX) TASK FORCE

Asm. Cooley stated that he remembers when the NAIC used to meet quarterly and at those meetings everyone used to hear from global reinsurers who really put a spotlight on climate worries early on. It really is incredible what has happened in recent years with regard to the increased frequency of climate-related risk events such as hurricanes, flooding, and wildfires. California is battling unprecedented wildfires right now and it truly is shocking what has been going on; the smoke from the current CA wildfires had travelled via the jet stream to darken the northeastern skies last week. Asm. Cooley asked for an update as to what specifically the Task Force will be working on and what its timeline is. Asm. Cooley also noted the work of The Hon. Mike Kreidler, Washington Insurance Commissioner, in this area as Cmsr. Kreidler has scheduled a virtual Climate Summit on October 7 in order to highlight the latest climate science, private sector best practices, and regulatory environments related to climate change.

Cmsr. Kreidler stated that Washington has been severely impacted by the smoke and there were a number of days where the state was pretty much off the charts and had the worst air pollution in almost the entire world along with Oregon and many parts of California. It was a West coast phenomenon that all west coast states were contributing to because of the fires that were involved. Cmsr. Kreidler stated that he looks at this as a change that is taking place that the insurers must adapt to and he believes that is where the NAIC will end up as an association in terms of increasingly looking at what it can do to make sure that the kind of investments that are being made by insurance companies are ones that are going to be sustainable. We don't want to see stranded assets and insurance companies winding up with liabilities on their books that look good today but tomorrow are not. The NAIC needs to be on top of this.

Cmsr. Kreidler stated that the other part of it is going to be making sure everything is being done to make sure that insurance companies are kept in the market. California is also concerned about being able to keep homeowners insurance available in areas that are going to be more prone to fires. That is something that is unacceptable. We need to do a better job of making sure that the kind of construction and where homes are being built are going to be ones that are sustainable and insurable. Cmsr. Kreidler stated that the last thing he wants to see is companies backing away from markets because of fires, tornadoes or hurricanes and not offering the public an opportunity to have insurance.

As a former state legislator and Member of Congress, Cmsr. Kreidler stated that policymakers must do everything they can to make sure insurers stay in the market but when you start dictating to companies to stay in markets that is kind of like saying to insurers in the midst of a pandemic that they have to retroactively go back and underwrite the fact that you didn't cover a virus and now you have to add the coverage. It is the same thing when telling insurance companies to go to certain markets as you will put them at risk financially and that is a huge part of the economy. This is going to be important to make sure to keep the industry fully engaged and competitive and offering good prices in the market regardless of where the risk is and also making sure that their investments are ones that will be sound and sustainable over time. It is not an easy task but it's not one that you can walk away from – change is happening. It is not worth arguing about what the cause of the change is as the bottom line is that change is happening, and we need to adapt to it.

Asm. Cooley stated that regarding the issue of insurer investment portfolios, there are a couple of ways to think about that. One is whether they are making investments in businesses that are going to be run aground and hard hit because of climate issues? Another aspect is in California, a small thing was done a few years ago where generally speaking, investments have to be a certain quality to be recognized by the regulator in the way financial accounting is established. In some cases, an investment might appear to have high utility which can be from

a social standpoint on issues of justice and equality and fairness and that gets to the issue of where something might be very meritorious but it may not seem to meet the standard of an insurance company investment. But California also has issues of investments in "green" which is something that appears laudable and appropriate and of the character to move the nation forward and yet also it may not fall squarely within what is considered a traditional insurance company investment.

Asm. Cooley stated that he hopes that the NAIC Task Force on this issue will look at whether there is a way to recognize what can be seen as an appropriate investment whether on the justice or climate side of things. In California, dating back to the mid-1990s there is a program and statutory system that deals with that and it started initially in the wake of some of the civil unrest in California in the early 1990s and it was extended in the last 10 years to climate issues. It gives the insurance regulator a little more flexibility to look at the type of investment the carrier might make and determining if it is a recognized and legitimate investment even though it is not exactly within the four corners of what has been traditionally looked at. It is about using the power of companies to invest to become change agents in a constructive way and a very good model to consider.

Rep. Lehman stated that he is concerned about the investment issue because as we go down that path, where is that line of controlling a company and their function and their solvency. If a company is totally solvent and has been for years and will be for years but it burns 100% coal and all of its adjusters drive in non eco-friendly trucks, is the department of insurance going to look at that company differently as not being environmentally sound? Rep. Lehman stated he is concerned about how deep regulators are getting into the philosophy of a company as opposed to the regulating of a company.

Cmsr. Kreidler stated that the NAIC has always been a very conservative place from the standpoint of what type of investments will be recognized. But the fear is what happens if you wind up making an investment, for example, as a big bet tied to municipal bonds tied to electrical power generation powered from coal. If you do that, right now because of the cheap rates of natural gas the price isn't there. What else is going to be tied to the future? Regulators will continue to be conservative in their investment recognition. The NAIC is looking at this issue from a standpoint of safety and soundness of the companies themselves in order to make sure they are making sound investments and the NAIC does not want to be an impediment for them. If a company sees a green investment out there, the NAIC does not want to be an impediment to them even if the investment is sound. The NAIC just wants to make sure they are making safe and sound investments and not tied to things that, just because historically municipal bonds from electrical coal generated power was a safe investment, to stay with it. If that status quo remains, we could be in trouble with the safety and soundness of some companies.

ANY OTHER BUSINESS

Sen. Bob Hackett (OH) stated that The Hon. Jillian Froment, recently resigned from her position as Ohio Insurance Commissioner. Sen. Hackett noted that Cmsr. Froment did a great job and is highly respected for the work she did.

ADJOURNMENT

Upon a Motion made by Rep. Lehman and seconded by Del. Steve Westfall (WV), the Committee adjourned at 3:30 p.m.