GreenbergTraurig

Emerging Issues in Insurance

Louisiana Insurers' Conference
2017 Louisiana Insurance Compliance Seminar & Legislative Review
New Orleans, Louisiana
June 23, 2017

Rich Fidei, Shareholder
Greenberg Traurig, P.A.

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GreenbergTraurig

Disclaimer

The materials in this presentation are intended to provide a general overview of the issues contained herein and are not intended nor should they be construed to provide specific legal or regulatory guidance or advice. If you have any questions or issues of a specific nature, you should consult with appropriate legal or regulatory counsel to review the specific circumstances involved.

GreenbergTraurig

Overview

- Corporate governance
- Developments in "Big Data"
- Flood insurance market update
- Long Term Care Insurance (LTCi)
  - Premium increases and litigation
- U.S.-EU Covered Agreement

 3

GreenbergTraurig

Corporate Governance

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GreenbergTraurig

NAIC Corporate Governance Annual Disclosure: *The Model Act and Model Regulation*

- NAIC's Financial Condition Committee adopted a Corporate Governance Annual Disclosure Model Act and supporting Model Regulation in November, 2014
- Together, the Models require insurers to file an annual Corporate Governance Annual Disclosure (CGAD) to their lead state or domestic regulator by June 1st of each year
- The CGAD is protected by strict confidentiality to encourage openness and transparency

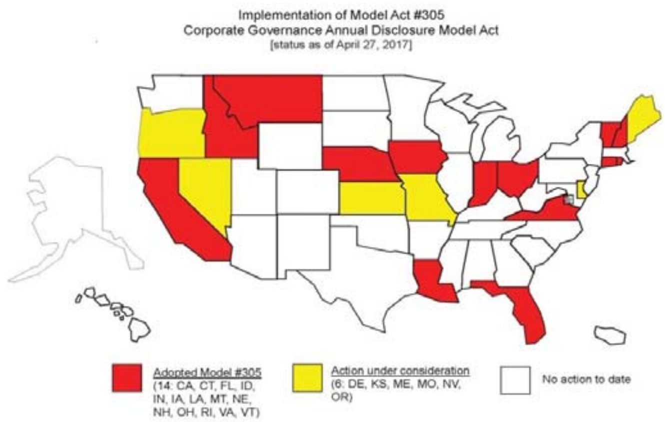
GreenbergTraurig

NAIC Corporate Governance Annual Disclosure: *The Model Act and Model Regulation*

- At a minimum, the CGAD must address:
  - Insurer's Corporate Governance framework and structure;
  - Policies and practices of Board of Directors and significant committees;
  - Policies and practices directing Senior Management; and
  - Processes by which Board of Directors, committees and senior Management ensure appropriate level of oversight to the critical risk areas impacting insurer's business activities

GT GreenbergTraurig

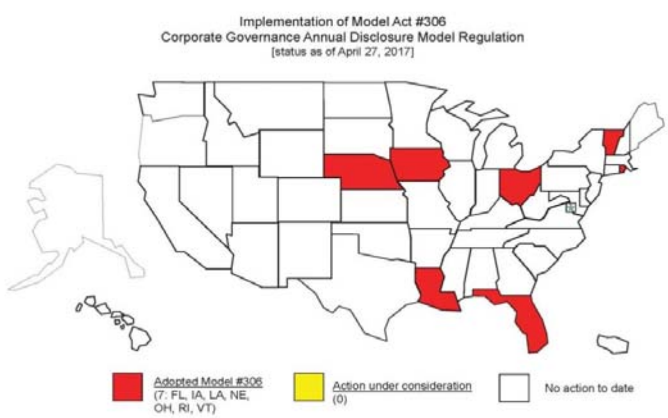
Model Act Adoption



Source: NAIC (http://www.naic.org/documents/committees_e_related_smi_dashBoard.pdf)

GT GreenbergTraurig

Model Regulation Adoption



Source: NAIC (http://www.naic.org/documents/committees_e_related_smi_dashBoard.pdf)

GreenbergTraurig

Key Reporting Metrics

- Corporate governance has also become an important focus for Financial Condition Examiners
- Examiners conduct on-site financial examinations of insurers on behalf of state insurance commissioners
- Regardless of a State's adoption of the CGAD models, regulatory scrutiny will be applied through the financial examination of insurers by Examiners

 9

GreenbergTraurig

Key Reporting Metrics

- Primary purpose of risk-based financial examination is to evaluate insurer's business processes to assess current financial condition and prospective solvency
- With respect to Corporate Governance, the Handbook, emphasize the importance of:
  - Establishing a self-sustaining risk management culture
  - That is composed of competent individuals
  - Who are independently involved in the insurer's risk management activities

 10

GT GreenbergTraurig

Corporate Governance Benchmarks for Examiners

> Key Components of Good Corporate Governance
  - Appropriate policies and procedures for Boards of Directors
  - Competency of Board of Directors
  - Independence of Board of Directors
  - Reliable risk-management processes across business, operations and control functions
  - Adoption of a code of conduct for senior Management
  - Effective internal oversight functions
  - Adoption of Sarbanes-Oxley provisions, regardless of whether mandated, including, but not limited to, auditor independence and whistle-blower provisions

GT GreenbergTraurig

Key Reporting Metrics – Examination of Holding Companies

> Key Issue in evaluating insurers in holding company structure:
  - At what level must annual disclosures be made?

> Group structure will determine whether disclosure must be filed by controlling party, intermediate holding company, insurer, or all three

> Focus is on level at which operations are directly overseen (e.g., parent company, holding company, or legal entity levels)

> Once appropriate level(s) is/are determined, Examiners will review each relevant company's Corporate Governance structure with particular focus on Board of Directors

GreenbergTraurig

Key Reporting Metrics – The Board of Directors

- Examiners will evaluate overall structure and operations of Board of Directors
- Meetings may be conducted with individual members of the Board
- In certain instances, Examiners may meet with the entire Board
- The goal of these meetings is to obtain an overview of the general functions of the Board and its responsibilities, as well as gaining a general understanding of the company's culture

 13

GreenbergTraurig

Key Reporting Metrics – The Board of Directors

- The importance of a competent and independent Board of Directors cannot be overstated
- Key Issues for Examiners when evaluating the Board:
  - Members must possess appropriate degree of industry experience, knowledge, and skill
  - Members should posses managerial, technical, or other expertise that will allow Board to perform effective governance and oversight
  - Board's independence from Management
  - The manner in which the Board selects and sets objectives for Management, and how they monitor Management's progress

 14

GT GreenbergTraurig

Key Reporting Metrics – Management

- Examiners will also interview Management, beginning with Senior Management and continuing through lower levels
- Interviews provide context to Examiners and help them focus on key issues, such as:
  - Corporate Strategic Initiatives
  - External/environmental factors of concern to Management
  - Political/regulatory changes that might affect business
  - Competitive advantages/disadvantages
  - Management of key functional activities
  - The manner in which Management establishes and monitors the achievement of objectives

GT GreenbergTraurig

Key Reporting Metrics – Management

- The determination of who will be interviewed and the scope of additional information that Examiners may require will be guided by company and market-specific factors
- Examiners ultimately want to understand the nature of processes and procedures employed by Management, from the development of business strategies through the implementation of operations
- They will want to inquire as to Board direction and oversight and the flow of the decision-making process within the organization
- Examiners will inquire into personnel and obtain information about their: (1) experience and background; (2) duties and responsibilities; (3) reporting structure; (4) ethics; (5) risk areas; (6) risk mitigation strategies; and (7) corporate strategies

GT GreenbergTraurig

Key Reporting Metrics – Management

- Ultimately, Examiners will seek a better understanding of Management's philosophy and operating style
- Factors such as Management's appetite for risk-taking, past business strategies, and results of any risky behavior will be key
- Management's attitudes toward financial reporting, conservative or aggressive selection of alternative accounting principles, conscientiousness and conservatism with which accounting estimates are developed, and attitudes toward information systems and accounting functions will be especially important.

 17 17

GT GreenbergTraurig

Developments in Big Data

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GreenbergTraurig

Overview

- Big Data: the change in the volume, velocity and variety of data available
  - Broad definition
- Insurance industry use
  - Set rates
  - Predict risks - underwriting
  - Marketing
  - Claims management
- How do you regulate?
  - NAIC Working Group

GreenbergTraurig

Sources of Data

- Government
  - Federal (U.S. Census, FBI crime statistics, NOAA/National Weather Service)
  - State (traffic safety agencies)
  - Local (land records and surveys)
- Data Vendors
  - Credit Rating Agencies
- Social media

GT GreenbergTraurig

Big Data and the Insurance Industry

- Rates and Underwriting
  - Automotive
  - Property & Casualty
  - Flood
- Marketing
- Fraud Detection & Prevention

GT GreenbergTraurig

Big Data and Insurance Regulation

- Use of Big Data by regulators
  - Collect data to assist in regulating the industry
  - Price transparency
- Setting legal standards on industry use
  - Privacy/confidentiality concerns
  - For what purpose is data used?
  - Issue of disclosure

GreenbergTraurig

NAIC Big Data Working Group

- Gathers information to assist state insurance regulations in understanding the collection and use of Big Data
  - Under the Innovation and Technology Task Force
- Comprehensive Approach to Big Data:
  - Defining "Big Data"
  - Learning how it is used by Insurance Companies and Regulators
- Conference held on June 9, 2017

 23

GreenbergTraurig

NAIC Big Data Working Group

2017 Charges:

A. Review current regulatory frameworks used to oversee insurers' use of consumer and non-insurance data. If appropriate, recommend modifications to model laws/regulations regarding marketing, rating, underwriting and claims, regulation of data vendors and brokers, regulatory reporting requirements, and consumer disclosure requirements.

B. Propose a mechanism to provide resources and allow states to share resources to facilitate states' ability to conduct technical analysis of and data collection related to states' review of complex models used by insurers for underwriting, rating, and claims. Such mechanism shall respect and in no way limit states' regulatory authority.

C. Assess data needs and required tools for regulators to appropriately monitor the marketplace and evaluate underwriting, rating, claims, and marketing practices. This assessment shall include gaining a better understanding of currently available data and tools and recommendations for additional data and tools as appropriate. Based upon this assessment, propose a means to collect, house, and analyze needed data.

 24

GreenbergTraurig

NAIC Big Data Working Group

- 2017 Work Plan
  - Provides guidelines for the Working Group
  - Focus on consumer protection, but balance with the need to innovate
  - Concentrate on Charge B for the personal automobile and homeowners lines of business
  - Hold regulator-only calls with subject matter experts as needed to discuss specific companies

GreenbergTraurig

Innovation and Technology Task Force

- Formed in March, 2017
  - Chaired by Michigan Director Patrick McPharlin
  - First met on April 10, 2017 at the 2017 NAIC Spring National Meeting
- Provides "a forum for regulator education and discussion of innovation and technology in the insurance sector"
- Oversees the Big Data Working Group, Cybersecurity Working Group, and Speed to Market Working Group
  - Will form mobility (autonomous vehicles) and micro-insurance groups

GreenbergTraurig

Flood Insurance Market Update

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GreenbergTraurig

Flood Insurance – Background

> The National Flood Insurance Program (NFIP) was created in 1968
  - Provides subsidized flood insurance to property owners
  - Administered by the Federal Emergency Management Agency (FEMA)

> Property owners purchase flood insurance through participating insurers
  - The federal government backs the policies

> As of January, 2017, the NFIP was $25 billion in debt to the U.S. Treasury
  - It suffered enormous losses in the past decade due to Hurricane Katrina, Superstorm Sandy and other major storms

 28 28

GreenbergTraurig

Background

> Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12)
  – Enacted reforms to make the National Flood Insurance Program (NFIP) more actuarially sound
  – Rate increases and removal of subsidies proved unpopular

> Homeowner Flood Insurance Affordability Act of 2014 (HIFAA)
  – Repealed and/or modified provisions of BW-12
  – Reinstated certain subsidies and lowered rate increases

 29 29

GreenbergTraurig

Private Flood Insurance

> BW-12 directed Fannie Mae and Freddie Mac to accept loans secured by mortgages on properties in flood zones if the property is covered by NFIP-compliant private flood insurance policy
  – Effectively opened the market to private flood insurance

> Private policies must be at least as broad as coverage under a standard NFIP policy, including when considering deductibles, exclusions, and conditions offered by the insurer

 30 30

GreenbergTraurig

The Private Market

> There are 5 million property owners in the NFIP, generating approximately $3 billion in premium each year
  - Only 20% to 30% of those who need flood insurance purchase flood insurance

> Advances in catastrophe modeling have allowed insurers to offer flood insurance to more homeowners
  - Detailed statistics on the private market are not available
  - Most private flood insurance policies are issued by surplus lines carriers

 31 31

GreenbergTraurig

Legislative Issues

> Legislative obstacles continue to impede growth in the private flood insurance market
  - BW-12 permits federal banking and housing agencies to impose their own solvency requirements on insurers from which these agencies will accept private flood insurance policies
  - NFIP rates may still be too low for private insurers to be competitive

> The Flood Insurance Market Parity and Modernization Act (H.R. 1422/S. 563) addresses some of these issues
  - Clarifies that private flood insurance should be treated the same as NFIP policies for federal mortgage lending purposes

 32 32

GreenbergTraurig

Legislative Issues

> On June 15, 2017, the House Financial Services Committee met to discuss seven NFIP-related bills
  - H.R. 1422, the "Flood Insurance Market Parity and Modernization Act"
  - H.R. 1558, the "Repeatedly Flooded Communities Preparation Act"
  - H.R. 2246, the "Taxpayer Exposure Mitigation Act of 2017"
  - H.R. 2565, To require the use of replacement cost value in determining the premium rates for flood insurance coverage under the National Flood Insurance Act, and for other purposes
  - H.R. 2868, the "National Flood Insurance Program Policyholder Protection Act of 2017"
  - H.R. 2874, the "21st Century Flood Reform Act"
  - H.R. 2875, the "National Flood Insurance Program Administrative Reform Act of 2017"

> All bills passed the Committee

GreenbergTraurig

Ongoing Issues

> Agents placing policies in the NFIP generally receive a 30% commission, but agents generally only receive a 10% commission for standard homeowners policies
  - Incentive for agents is to place policies with the NFIP

> Interaction with state guarantee funds

> How to develop the private market without undermining the NFIP

GT GreenbergTraurig

The Growing Need for Long-Term Care Insurance

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GT GreenbergTraurig

Significant Growth in Long-Term Care Insurance Industry Over 30 Years

> The long-term care insurance ("LTCi") market has grown significantly since first LTCi policies were marketed over 30 years ago

> In those days, Americans were spending less than $20 billion on long-term care ("LTC")

> Today, Americans are spending roughly $225 billion on LTC

> Overall expenditure on LTC is expected to grow as baby boomers reach retirement age

Source: National Association of Insurance Commissioners, Center for Insurance Policy and Research Study, The State of Long-Term Care Insurance: The Market, Challenges, and Future Innovations, May 2016.

GT GreenbergTraurig

Significant Growth in Long-Term Care Insurance Industry Over 30 Years

- Two key social factors driving the development of LTCi—Mortality Risk and Longevity Risk
- As overall health and mortality rates improve and people live longer, they will need to secure resources to cover the cost of LTC for longer periods of time
- Many have turned to LTCi, but the future of the product is in jeopardy as the industry endeavors to mitigate the impact of inaccurate pricing assumptions that have afflicted the industry

 37

37

GT GreenbergTraurig

Significant Growth in Long-Term Care Insurance Industry Over 30 Years

- Unique characteristics of LTCi have made it difficult for carriers to apply accurate rate assumptions when pricing the product.
  - State insurance laws generally require that LTCi policies may only be cancelled for non-payment of premium
  - LTCi policies are traditionally designed for premium stability during life of the policyholder
  - Policies generally cover the actual cost of care up to a daily maximum
  - Carriers may only adjust premiums after obtaining regulatory approval
- Collectively, these factors impair carriers' ability to respond to drastic changes in current and future demand for LTCi

 38

38

GreenbergTraurig

Limits Imposed by State Insurance Laws on LTCi

> Premium Stability

- State laws generally require that initial premiums on LTCi policies be designed to remain level for the life of the insured
  - Exception: Most states allow for non-level premium schedules below attained age 65

> Guaranteed Renewability of Policies

- State laws require that LTCi policies be guaranteed renewable, meaning they can only be cancelled for non-payment of premium

> Premium Rate Increases

- State laws require that LTCi providers seek regulatory approval before raising premium rates
- Rates may only be raised on a class-wide basis

39

GreenbergTraurig

Factors Affecting Demand for LTC

> Aging

- The likelihood of becoming disabled or cognitively impaired and triggering benefits under a LTCi policy increases exponentially with age

> Changes in Marital Status

- Married individuals usually provide care for their disabled spouses, which helps offset the cost of LTC among married couples
- The opposite is true for single people who live alone

> Inflation Protection

- State laws and regulations normally require insurers to offer an inflation protection rider that automatically increases benefits by 5% each policy anniversary

40

GreenbergTraurig

Stable Premiums and Increase in Claims Over Time

> Premiums will usually surpass cost of claims in early stages of a standard policy, when claims frequency and severity are at their lowest

> Opposite occurs later on – as policyholders age and frequency and severity of claims increase, cost of claims will surpass premiums

> Insurers create reserves to offset the disconnect between excess premium revenue in the early stages of a policy's life and increased claims costs in the later stages

41

GreenbergTraurig

Original Actuarial Assumptions Fail to Predict Future Claim Costs

> Original assumptions upon which older in-force policies were priced have not accurately predicted future claims costs

> As a result, an overwhelming majority of older policies in the market have not generated sufficient reserves to cover actual claims costs

> According to the Study, "[v]irtually all insurers issuing LTCI policies prior to the mid-2000s have observed adverse experience on these policies when compared to pricing assumptions"

42

GT GreenbergTraurig

Long-Term Care Insurance Premium Rate Increases: Threat of Class Action Litigation

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GT GreenbergTraurig

Toulon v. Continental Casualty Company

> Putative class action lawsuit filed against CNA in Illinois Federal Court challenging propriety of premium rate increase on certain CNA LTCi policies

> Plaintiff – Alleged:

- CNA intentionally priced policies at artificially low rates using unreasonable lapse rate assumptions to bait lower-income individuals to purchase policies
- CNA able to collect premiums while policyholders were unlikely to file claims
- CNA increased premiums to unaffordable levels at time when policyholders were more likely to file claims

 44 44

GreenbergTraurig

Toulon v. Continental Casualty Company

- Plaintiff alleged breach of contract, common law fraud, and consumer fraud claims
- Plaintiff supported fraud claims by relying on extrinsic materials (i.e., Personal Worksheet)
- Per Plaintiff, Worksheet was designed to deceive customers into believing CNA would cap future premium rate increases under its Preferred Solution policies to 20% or less
- Per CNA, Worksheet was intended to help determine whether LTCi policy was suitable for applicants and contained no false statements

 45

45

GreenbergTraurig

Toulon v. Continental Casualty Company

- The Court dismissed Plaintiff's Claims for:
  - Fraudulent Misrepresentation:
    - Plaintiff failed to point to any false statements
    - Policy & Worksheet conspicuously advised Plaintiff that CNA could raise premium rates
    - Reference to 20% increase was hypothetical
  - Fraudulent Omission:
    - No special fiduciary relationship existed & CNA did not have to disclose future rate increase plans
  - Consumer Fraud:
    - Court: "[a]n act will not be said to be deceptive when the plaintiff is explicitly alerted to the complained of result"

 46

46

GT GreenbergTraurig

U.S.-EU Covered Agreement

GREENBERG TRAURIG, LLP | ATTORNEYS AT LAW | WWW.GTLAW.COM

GT GreenbergTraurig

Credit for Reinsurance

> The Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is an NAIC-accredited state

> NAIC: Credit for Reinsurance Model Law and Regulation
  – Qualified Jurisdictions: Bermuda, France, Germany, Ireland, Japan, Switzerland, and the United Kingdom

 48

GreenbergTraurig

Credit for Reinsurance

> The NRRA allows the Federal Insurance Office to enter into covered agreements with foreign jurisdictions on behalf of the United States
  - Covered agreements may recognize certain prudential measures of the foreign jurisdiction's insurance regulator, and may preempt state credit for reinsurance laws
  - NAIC has opposed entry into a covered agreement

 49

GreenbergTraurig

U.S-EU Covered Agreement

> January 13, 2017: the U.S. and EU entered into a covered agreement
  - Eliminates local U.S. and EU requirements for reinsurers to post collateral
  - Clarifies that insurance groups will only be subject to international group supervision in their home jurisdiction
  - Encourages information sharing between U.S. and EU regulators

> Reinsurance provisions require state implementation

> The agreement may be terminated upon 180 days' notice

 50

GT GreenbergTraurig

Questions?

 51

GT GreenbergTraurig

Contact Information

Rich Fidei, Esq.

fideir@gtlaw.com

Greenberg Traurig, P.A.

401 East Las Olas Boulevard, Suite 2000

Fort Lauderdale, FL 33301

Tel: 954-768-8268

www.gtlaw.com

 52 52