

Draft: 8/20/21

Cannabis Insurance (C) Working Group
Virtual Meeting (*in lieu of meeting at the 2021 Summer National Meeting*)
July 27, 2021

The Cannabis Insurance (C) Working Group of the Property and Casualty Insurance (C) Committee met July 27, 2021. The following Working Group members participated: Ricardo Lara, Chair, represented by Melerie Michael (CA); Michael Conway, Vice Chair, represented by Peg Brown (CO); Austin Childs (AK); Jimmy Harris (AR); Angela King (DC); Tanisha Merced (DE); C.J. Metcalf (IL); Marlene Caride represented by Randall Currier (NJ); Gennady Stolyarov and Mark Garratt (NV); Shelly Scott (OK); Raven Collins (OR); Christina Rouleau (VT); and Michael Walker and Ned Gaines (WA). Also participating was: George Bradner (CT); and Benjamin Yardley (ME).

1. Heard a Presentation on Balancing Actual and Perceived Risks

Ms. Brown stated that the second day of the Fact-Finding Hearing on Insurance for Cannabis-Related Businesses will focus on barriers to affordability and moving forward. As much has transpired in this industry over last decade, the Working Group intends to use the information gained from the two-day hearing to update its white paper, *Understanding the Market for Cannabis Insurance*, through the addition of an appendix. Drafting sessions on the white paper appendix will begin in August. Working Group members interested in participating in these drafting sessions were directed to notify NAIC staff by Aug. 10. The Working Group also plans to leverage the feedback gained from the hearing to discuss at its next meeting how state insurance regulators can better collaborate with each other and other regulatory agencies.

Brenda Wells (East Carolina University) stated that cannabis businesses pay several times what other industries pay for insurance. Directors and officers liability insurance costs well into the six-figure range for \$1 million in coverage. A small mercantile general liability policy might cost around \$1,000, but a cannabis policy without products liability is about \$10,000. Consumer concerns and misperceptions include a belief that coverage is not available or not worth the cost. Additionally, there is a fear that information provided to the insurer can be accessed by the federal government or others. Some also have concerns about deceptive trade practices, like being initially promised coverage but then being denied by the insurer based on the federal illegality of cannabis.

This occurred in the *Green Earth Wellness Center LLC v. Atain Specialty Insurance Company* lawsuit. Green Earth, a retail medical marijuana business in Colorado Springs, CO, attained commercial insurance for its business from Atain effective on June 29, 2012. Several days later, Green Earth contended that the smoke and ash from a nearby fire caused damage to its ventilation system, eventually damaging its plants. In November 2012, Green Earth made a claim under the insurance policy to Atain. Atain denied the claim on the grounds that the policy expressly excluded coverage for contraband, and it was void as against public policy. Atain moved for summary judgment. The court agreed with Atain that possession of marijuana for distribution is a federal crime. However, Atain solely pointed to the federal statute and did not assert whether Green Earth's operation violates Colorado law. Therefore, due to Atain's neglect to assert that Green Earth's operation was a violation of Colorado law, the court found that there is a genuine issue of material fact and denied Atain's motion for summary judgment.

Ms. Wells stated that a major issue is lack of data. While cannabis has been used for thousands of years, the legal industry in the U.S. is in its infancy. We know very little about the losses and expenses associated with this industry. Ms. Wells plans to conduct a cannabis industry Cost of Risk Survey soon. Underwriting for cannabis has been extrapolating data from other industries where similarities exist. For instance, underwriters can look at pharmacies when evaluating medical cannabis and liquor stores when evaluating vape shops. Underwriting factors include third-party inspection results, security systems wired to an outside monitoring station, an adequate electrical system with proper wattage and circuits, fire suppression systems, the type of safe used for storing cash/product, motion detectors in the room where finished product is stored, membership in state trade associations, education and training of owners/operators, and use of related regulations.

2. Heard a Panel Discussion on Uncovering Obstacles to Offering Coverage

Ms. Brown asked what additionally needs to happen at state and federal levels to make insurers comfortable entering the cannabis insurance industry. She also asked if this would likely be under this administration.

Ian Stewart (Wilson Elser) stated that the status quo is not sustainable. There must be some clarity of cannabis' legality at the federal level. There have been comments from democratic senators that they should not allow a vote on the Secure and Fair

Enforcement (SAFE) Banking Act without a broader social equity and social justice provisions. Arguably the most conservative U.S. Supreme Court justice, Clarence Thomas, criticized the federal ban on marijuana and the U.S. government's inconsistent enforcement in a statement a couple weeks ago, questioning whether the government has the authority to "intrude on" state-legal cannabis markets. This indicates that time is limited for the U.S. Congress (Congress) to act before the U.S. Supreme Court does so. For carriers, Schedule One of the Controlled Substances Act (CSA) is the largest hinderance because it prevents primary protection of its banking relationships. The directives in the proposed U.S. Senate (Senate) bill for the federal government to study cannabis are needed to increase the data available to insurers.

Ms. Brown asked what additional actuarial and experience data is needed to help insurers write cannabis-related business coverages.

Tim McCarthy (Insurance Services Office—ISO) stated that cannabis is an emerging type of risk, and more public data on it is needed to better analyze information on a state-by-state basis because operations differ so much by state. It may take several years before there are sufficient court cases for products liability. Long-term studies on the impacts of cannabis are also needed. The ISO has introduced 10 new classifications related to cannabis that will be implemented in 40 jurisdictions later this year. The ISO will begin to collect data next month related to this to more uniformly analyze and update its commercial general liability cost information.

Lois J. Massa (G.J. Sullivan Co. Reinsurance—GJS Re) stated that in lieu of lack of data, carriers are benchmarking to similar industries and/or evaluating and aggregating their own data.

Ms. Brown asked how reputational concerns factor into insurers and reinsurers' willingness to participate in the cannabis space.

Mr. Stewart stated that reputational concerns are still relevant, but much less of a concern than they were just a couple years ago. Marijuana has become socially accepted over the past year or two. Conservative states are now enacting adult-use cannabis laws very quickly. However, a positional schism is beginning to form in the cannabis community between the regulated marijuana market and the hemp-derivatives market. There is reputation risk in hemp derivatives because they are not laboratory tested and regulated the same way as regulated cannabis companies' products.

Ms. Massa agreed and said the greater acceptance of cannabis is due to the cannabis industry's educational efforts. However, the impact of future claims going to court will determine if this industry sees payouts that might affect reputational risk. This happened with the liquor industry a decade ago. The Juul vaping case is a good example of this.

Michael Hall (Golden Bear) stated that many of the countries that the global reinsurers are from still view cannabis as an illicit drug. As a result, the global reinsurers have great concern on reputational risks that may stem from bad press in their respective countries.

Ms. Brown stated that Lloyd's of London stopped insuring in the U.S. cannabis industry due to the continuing legal uncertainty. She asked what this had on the insurers ability to buy reinsurance.

Ms. Massa stated that Llyod's syndicates had been the lead cannabis writers in the U.S. in 2015 because they are regulated by one entity. They decided as a group collectively to withdraw from the U.S. market due to legal uncertainty at the federal and state levels and concerns about U.S. banking regulations. The impact in the U.S. was on primary coverage and reinsurance support, as Llyods provided both. It was temporarily difficult to get primary policies; then, companies such as Golden Bear and James River stepped in to fill the void. Most global reinsurers are not based in the U.S. and operating in the U.S. cannabis market due to the aforementioned concerns. However, there is some exposure to cannabis through reinsuring portfolios. In October 2018, Canada passed the federal Cannabis Act. The bill amended the criminal code to remove it from the CSA, established cannabis operations as legal in Canada (only the second country to do so), and put in place a series of regulations to manage it in a similar manner as liquor liability. As a result, Llyod's and global reinsurers have entered their market. Some U.S. companies have bought or established Canadian carriers to write cannabis.

Ms. Brown asked to what extent exclusions and reinsurance contracts are impeding carriers' abilities to offer coverage to cannabis-related businesses.

Ms. Massa stated that reinsurance is insurance that insurance companies buy. So, insurers can choose to hold the risk on their books, but it is not advisable. There have been 30–40 new fronting companies in the past two years. There is some global reinsurance support through large treaty arrangements that include other pieces of business. However, reinsurance is difficult to obtain for new carriers.

Mr. Hall stated that the Bermuda Monetary Authority (BMA) issued a statement to reinsurers in late-2019, encouraging them to enter the now legal cannabis market in Canada. This implied to reinsurers that they should not enter markets, like the U.S., where cannabis still remains federally illegal. The result was a freeze in reinsurance capacity in the U.S. for cannabis operators.

3. Heard a Panel Discussion on Insurance Challenges

Ms. Brown asked what factors drive the lack of capacity for organizational coverage.

Norman Ives (Amwins) stated that the cannabis industry has been experiencing the same trends as the general insurance industry, just to a greater extent. The insurance market has been hardening. Professional lines risks were significantly affected when the Cole Memorandum was rescinded in January 2018. The market almost shrank in half overnight and rates rose. Since this time, the market has hardened.

Mr. Stewart stated that cannabis is a hard market inside of a hard market, especially for coverages like directors and officers. Compliance is very difficult for many of these companies leading to an uptick in securities litigation, shareholder and derivative suits, investor disputes and allegations of mismanagement actions by regulators. These cases are expensive and caused by the chaos surrounding the disparate regulation and lack of traditional financing. This leaves companies seeking private investment where they need to disclose all risks in a memo to investors, which is extremely difficult to do and leads to predictions that do not come to fruition. The genesis of the current suits is the foreign exchanges and reverse takeovers occurring in a very fragmented environment. A study in late-2000 by Stanford Law School found that there were 2008 securities class action lawsuits filed against U.S. and Canadian cannabis businesses. However, the majority of the suits had been filed within the previous two years. The filings are for failing to disclose weak demand for products, misstating inventory, failing to report operational problems, making revised earning reports that cause a stock drop, and allegedly misleading investors about contamination issues. There is a magnifying glass over the cannabis industry, resulting in several lawsuits all at once. Federal legalization in the form of the SAFE Banking Act could have a very positive impact because companies would start to operate more similarly to other industries. However, broad federal legalization may result in a temporary period of increased chaos due to the introduction of interstate commerce.

Ms. Brown stated that there are definite parallels between how insurance is regulated by states and how cannabis state-based regulation is evolving. She asked if there are gaps in products liability insurance coverage for cannabis-related businesses.

Mr. Stewart stated that the science and products are being developed concurrently, making it difficult to know what is unreasonably dangerous. This makes it hard for juries who must make decisions in product liability suits. There is a developing standard of care around agreed standards but not enough case law. The cannabis industry could see large uninsured risks materialize as tort cases get filed in the coming years. Recent science findings on vascular conditions arising out of high tetrahydrocannabinol (THC) edible products. However, insurance companies usually do good at insulating themselves with certain types of exclusions.

Mr. Hall stated that the cannabis industry has uninsured risks related to long-tail liability. Some carriers are covering things like mental illness, knowingly or unknowingly, and others are excluding it. There is a gap in the perception of what is covered and what is actually covered once you read deep into the 100-page policy.

Ms. Brown asked about products liability coverage for cannabis businesses.

Beth Medvedev (James River) stated that cannabis is very similar to other products, and underwriters can leverage similarities. One issue James River has encountered is that the industry is so unique it must anticipate the coverages. For example, on-site consumption cafes are not quite the same as alcohol because there is not a test to determine how much a person is impaired by cannabis. It is difficult to determine the effect of someone eating an edible on site and then leaving 30 minutes later. In the absence of a full understanding of all the risks, insurers may be covering unanticipated risks. Carriers also differ in their interpretations of coverage, like health hazard forms. Another issue is cannabis insureds must be aware of how the language in standard policy forms needs to be modified to remove exclusions for federal legal issues, or they could potentially face a declination of a claim.

Ms. Brown asked if there are alternate arrangements being developed or already being used in the market.

Mr. Stewart stated that there has been an increased interest in fronting over the past year. The market has also seen single cell captives being domiciled in a few states and offshore and some cannabis-specific group captives.

Mr. Ives asked Mr. Stewart if its federal legalization was needed before more progress occurs with captive risk retention groups (RRGs).

Mr. Stewart said there has been a natural reluctance to move money offshore because it gives people the impression of money laundering. There needs to be a banking solution. State insurance departments would likely have a greater comfort level with regard to actively domiciling cannabis captives if there was more certainty at the federal level.

Ms. Brown asked what risks in the cannabis industry affects property coverage.

Summer J. Jenkins (National Cannabis Industry Association [NCIA] and Cannasure) stated that an underwriter would consider the known risks. This would include anything that would increase frequency or severity of the loss; i.e., construction, occupancy, protection, and class exposure. Factors that will increase the frequency and severity include wind, hail, crime zone, and types of controls in place. Many of these questions are answered by the law. Cannabis businesses must have safe vaults and multiple secured access and entry points for areas where cash is stored. Unique to the cannabis industry is that businesses tend to be cash based. They also grow much more rapidly than other businesses, making business income an important factor. This could lead to their potential loss of revenue exceeding the amount of all other covered property from an insurance standpoint. Some carriers have a coinsurance penalty.

Mr. Hall stated that oftentimes, a fast-growing cannabis-related business will find it is maxed out on the capacity it has with its primary carrier. This is the main property exposure in the cannabis industry.

Mr. Stewart asked what can be done in cases where there is a disconnect between what was written and when the claim comes in the insured finds its underinsured.

Mr. Hall stated that some of the issue lies in educating brokers. However, the largest issue is businesses in this industry foregoing insurance because it is so expensive.

Ms. Jenkins stated that there are some coverage forms in the market for things like peak season limit endorsements, fluctuating valuation endorsements, and monthly reporting endorsements. The issue is carriers being able to navigate the administrative hurdles to implement them.

Peg Brown stated that if it were legal, there would likely be a lot of interest in interstate commerce for cannabis between California and Colorado.

Mr. Stewart stated that once interstate commerce is allowed, there is likely to be an increase in confusion due to the different state regulatory structures that require different things for their distributors. For example, in California, there are requirements that the vehicle must have a security cage or other type of protective equipment installed in the vehicle. There are restrictions that require drivers to be an employee of a certain age. Insurance provisions often go off what is required in the state. This can be an issue for cannabis businesses because they often only focus on complying with state regulations and do not read their policies. A problem will arise when the business operates in multiple states with just one system for its various distributors. The solution lies in achieving more consistency between state regulations.

4. Heard a Panel Discussion on What the Horizon Looks Like and How State Insurance Regulators Can Help

Ms. Michael asked how coverage will evolve from the surplus market to the admitted market in the coming years. She also asked if there was something that could be done to encourage this process.

Ms. Wells stated that it would take a long time for the admitted market to want to provide coverage to some of the exposures in the cannabis industry. It would need sufficient data in addition to a federal solution. Liquor liability coverage is still being provided for by the nonadmitted market.

Ms. Michael asked how cannabis businesses find insurers willing to provide coverage.

Mr. Ives stated that the internet is a good source to find information on insurers in the cannabis space. He also recommended that state insurance regulators provide a list of brokers similar to the one the California Department of Insurance (DOI) provides online.

Ms. Michael asked what supportive measures state insurance regulators can provide when reinsurance conditions and federal laws change.

Ms. Jenkins stated that state insurance regulators can help by making the filing rate approval process much easier, providing more clarifying documents, and implementing a more expedient process.

Ms. Medvedev stated support for promoting those regulations in the industry to attract more insurers and reinsurers into the market. The major hurdle is having more options of insurance coverage.

Ms. Michael asked how the NAIC can support availability and affordability of coverage.

Mr. Hall stated that lack of data currently has insurers making educated guesses. Providing more flexibility inside rate filings for rates to increase or decrease would allow more insurers to feel comfortable entering the market.

Ms. Jenkins stated that the availability of forms and rate justifications are big issues because of the nature of the industry. It would be greatly helpful if state insurance regulators established justification reasoning requirements more representative of the tenure of the industry. It would also be helpful if state insurance regulators accepted data from a similar industry in lieu of data that is directly applicable.

Ms. Medvedev stated that it is important that states remain welcoming to nonadmitted carriers, as they provide an important service to emerging industries by having more flexibility.

Ms. Michael asked what innovation can facilitate better availability of coverage.

Ms. Wells stated that it really all comes down to changes with federal regulation.

Ms. Michael asked how support for legalized cannabis will evolve in the future.

Ms. Wells stated that Pew Research's April poll showed over 90% of the U.S. population thinks cannabis should be legal in some form. However, there are well-funded campaigns pushing against its legalization.

Ms. Michael asked what private solutions exist for crop insurance.

Mr. Ives stated that the federal government allowed crop coverage to be available for hemp crops for the first time last year, but only if the insured had grown crops the previous year. The crop coverage that is available would not benefit businesses growing hemp or cannabidiol (CBD) products for human or animal consumption. Crop programs are based around a federal program and the commercial insurance policies available for crop are supplemental to coverage provided through the federal program. There will not be much movement on agricultural product coverage until there is a federal crop program that is really viable for hemp farmers. The only programs currently offered for crop coverage are parametric programs, which are very limited risk-specific programs.

Mr. Bradner asked if it would be likely that the tobacco and alcohol industry would enter the cannabis industry once the federal illegality is no longer an issue. He also asked if there is anything to learn from Canada's legalization of recreational cannabis.

Ms. Wells stated that the tobacco and alcohol industry are already diversifying into the space with things like infused alcohol drinks. They are also a force against the legalization of cannabis for competitive reasons.

Mr. Stewart stated that both industries are involved, and there will likely be a coalescent around a smaller number of brands in the future. The focus of the alcohol industry is to get control of those brands. Canada is regulated very differently than what federal regulation will end up looking like in the U.S.

Kristen Augustine (Colorado Marijuana Enforcement Division) asked if a business owner would be considered higher risk if he/she has a felony record for unlawful distribution.

Ms. Jenkins stated that from an underwriting standpoint, it is illegal to discriminate or give someone preference based on their application status. But underwriters can provide things like association membership or rating credits that apply directly to the decrease of exposure on the risk. In some instances, carriers will offer a 10% credit for social equity applicants that are also members of a trade association. Trade association members are required to go through more rigorous training. Underwriting is based a lot on the underwriter's personal perceptions.

Ms. Medvedev stated that it depends on the risk, the offense, and how much it affects what is being done. Offenses, such as embezzlement, would be looked at as a moral offense.

Mr. Yardley asked how valid experience data develops in the absence of a federal solution.

Ms. Medvedev stated that individual carriers will have their own data and experience. There is also a part of underwriting that looks at where lawsuits and claims are occurring.

Mr. Ives stated that it can be difficult to try to aggregate data, as claim data is still proprietary. Aggregating litigation data can be difficult because many state courts do not provide searchable databases. States need to provide good state-level data on cannabis regulatory schemes. Traceability systems and reporting capabilities within the states need to be upgraded to generate usable data, such as gross sales. The Washington State Liquor and Cannabis Board (WSLCB) makes this type of information available.

Mr. Bradner asked if the information is obtainable through a Freedom of Information Act (FOIA) request.

Mr. Stewart stated that to a certain extent, this information can be acquired through an FOIA request, but it would be time consuming and costly. The information would only be provided through redacted records, and there are some privacy concerns. California coordinated through its various agencies to amend regulations to make it easier to share data that insurers and banks need, such as the owners, financial interest holders, and background information. This has provided marked improvement in the turnaround time and amount of data that is provided to ancillary service providers. What is allowed to be disclosed and the system set-up varies by state.

Ms. Brown stated that state insurance regulators may need to take up coordinating with sister state agencies and the Cannabis Regulators Association (CANNRA) to help provide the needed data to the insurance industry.

Having no further business, the Cannabis Insurance (C) Working Group adjourned.

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