

EXECUTIVE (EX) COMMITTEE AND PLENARY

Executive (EX) Committee and Plenary, Aug. 16, 2023, Minutes

Adopted the Amendments to the 2024 *Valuation Manual* (Attachment One)

Adopted Revisions to the *Nonadmitted Insurance Model Act* (#870) (Attachment Two)

Adopted the *Regulatory Guide: Understanding the Market for Cannabis Insurance: 2023 Update* (Attachment Three)

Adopted Life RBC Proposals 2023-09 IRE (Residuals Factor) and 2023-10-IRE (Residual Sensitivity Test Factor for Residuals) (Attachment Four)

Adopted Revisions to the *Mortgage Guaranty Insurance Model Act* (#630) (Attachment Five)

Report on the States' Implementation of NAIC-Adopted Model Laws and Regulations (Attachment Six)

Draft Pending Adoption

Draft: 8/29/23

Executive (EX) Committee and Plenary
Seattle, Washington
August 16, 2023

The Executive (EX) Committee and Plenary met in Seattle, WA, Aug. 16, 2023. The following Committee and Plenary members participated: Chlora Lindley-Myers, Chair (MO); Andrew N. Mais, Vice Chair (CT); Jon Godfread, Vice President (ND); Scott A. White, Secretary-Treasurer, represented by Don Beatty (VA); Dean L. Cameron, Most Recent Past President (ID); Lori K. Wing-Heier (AK); Mark Fowler (AL); Alan McClain represented by Russ Galbraith (AR); Peni Itula Sapini Teo (AS); Barbara D. Richardson (AZ); Ricardo Lara represented by Lucy Wang (CA); Michael Conway represented by Peg Brown (CO); Karima M. Woods represented by Sharon Shipp (DC); Trinidad Navarro (DE); John F. King represented by Martin Sullivan (GA); Doug Ommen (IA); Dana Popish Severinghaus represented by Bruce Sartain (IL); Amy L. Beard represented by Victoria Hastings (IN); Vicki Schmidt represented by Justin McFarland (KS); Sharon P. Clark (KY); James J. Donelon (LA); Gary D. Anderson (MA); Kathleen A. Birrane (MD); Timothy N. Schott represented by Sandra Darby (ME); Anita G. Fox (MI); Grace Arnold (MN); Troy Downing (MT); Mike Causey represented by (NC); Eric Dunning (NE); D.J. Bettencourt (NH); Justin Zimmerman (NJ); Alice T. Kane (NM); Scott Kipper (NV); Adrienne A. Harris represented by John Finston (NY); Judith L. French represented by Matt Peters (OH); Glen Mulready (OK); Andrew R. Stolfi (OR); Michael Humphreys (PA); Elizabeth Kelleher Dwyer (RI); Michael Wise (SC); Larry D. Deiter (SD); Carter Lawrence (TN); Cassie Brown (TX); Jon Pike (UT); Tregenza A. Roach (VI); Kevin Gaffney (VT); Mike Kreidler (WA); Allan L. McVey represented by Melinda Kiss (WV); Nathan Houdek represented by Timothy Cornelius (WI); and Jeff Rude (WY).

1. Received the Report of the Executive (EX) Committee

Director Lindley-Myers reported that the Executive (EX) Committee met Aug. 14. During this meeting, it adopted the Aug. 13 report of the joint meeting of the Executive (EX) Committee and the Internal Administration (EX1) Subcommittee.

The Committee also adopted its May 23 and March 31 minutes, which included the following action: 1) approved Commissioner White to serve on the International Association of Insurance Supervisors (IAIS) Executive Committee; and 2) approved the 2027 national meeting locations: Spring National Meeting, Kansas City, MO; Summer National Meeting, New York, NY; and Fall National Meeting, Nashville, TN.

The Committee adopted the reports of its task forces: 1) the Climate and Resiliency (EX) Task Force; 2) the Government Relations (EX) Leadership Council; 3) the Long-Term Care Insurance (EX) Task Force; and 4) the Special (EX) Committee on Race and Insurance.

The Committee received a status report on the *State Connected* strategic plan.

The Committee received a status report on model law development efforts for amendments to: 1) the *Model Regulation to Implement the Accident and Sickness Insurance Minimum Standards Model Act* (#171); 2) the *Property and Casualty Insurance Guaranty Association Model Act* (#540); 3) the *Mortgage Guaranty Insurance Model Act* (#630); 4) the *Nonadmitted Insurance Model Act* (#870); 5) the *Unfair Trade Practices Act* (#880); and 5) the new *Insurance Consumer Privacy Protection Model Law* (#674).

The Committee heard reports from the National Insurance Producer Registry (NIPR) and the Interstate Insurance Product Regulation Commission (Compact).

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2. Adopted by Consent the Committee, Subcommittee, and Task Force Minutes of the Spring National Meeting

Commissioner Godfread made a motion, seconded by Commissioner Mais, to adopt by consent the committee, subcommittee, and task force minutes of the Spring National Meeting. The motion passed unanimously.

3. Received the Report of the Life Insurance and Annuities (A) Committee

Commissioner Lawrence reported that the Life Insurance and Annuities (A) Committee met Aug. 15. During this meeting, the Committee adopted its July 19 minutes, which included the following action: 1) adopted its Spring National Meeting minutes; 2) adopted 2024 *Valuation Manual* amendments; and 3) adopted revised Life Actuarial (A) Task Force charges.

The Committee adopted the report of the Life Actuarial (A) Task Force.

The Committee also: 1) heard a presentation from Noble Consulting Services Inc. on risks facing the life and annuity industry; 2) heard a presentation from the United States Automobile Association (USAA) on the unique life insurance needs of the military; and 3) heard an update on the Life Workstream of the Special (EX) Committee on Race and Insurance.

4. Adopted the Amendments to the 2024 *Valuation Manual*

Commissioner Lawrence reported that the *Valuation Manual* includes 12 amendments adopted by the Life Insurance and Annuities (A) Committee during its July 19 meeting.

The majority of the amendments add additional reporting disclosures, clarify requirements, or correct typos in the *Valuation Manual*. However, some of the amendments were substantive, including: 1) reducing the reporting lag for the VM-51, Experience Reporting Formats Table of Contents, mortality experience data collection to allow for more timely creation of mortality tables; 2) allowing alternative hedge treatment for variable annuities with index credit hedging programs; and 3) reducing the governance requirements for variable annuity products not subject to complex modeling.

Commissioner Lawrence made a motion, seconded by Commissioner Donelon, to adopt the amendments to the 2024 *Valuation Manual* (Attachment One). The motion was adopted by 50 jurisdictions, representing 89.48% of the applicable premiums written. Director Lindley-Myers confirmed that the vote satisfied the requirements to amend the *Valuation Manual*. The motion passed.

5. Received the Report of the Health Insurance and Managed Care (B) Committee

Director Fox reported that the Health Insurance and Managed Care (B) Committee met Aug. 14. During this meeting, the Committee adopted its June 29 and Spring National Meeting minutes. During its June 29 meeting, the Committee took the following action: 1) heard presentations on Maryland, Michigan, and Nebraska state appeal programs; and 2) received an update on the Consumer Information (B) Subgroup's work to educate consumers on their claim appeal rights.

The Committee adopted its subgroup, working group, and task force reports and their interim meeting minutes.

The Committee heard an update on the work of the Improper Marketing of Health Insurance (D) Working Group to amend the *Unfair Trade Practices Act* (#880) to address regulatory and enforcement issues with health insurance lead generators.

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The Committee received an update on the Consumer Information (B) Working Group's work to educate consumers on their claim appeal rights.

The Committee also heard from panelists Anna Schwamlein Howard (American Cancer Society Cancer Action Network—ACS CAN), Carl Schmid (HIV+Hepatitis Policy Institute), and Amy Killelea (Killelea Consulting) on preventive services from a consumer-focused perspective.

The Committee heard a status update on the Medicaid redetermination process following the end of the COVID-19 public health emergency (PHE). The update included key findings from the first batch of Medicaid redeterminations data reported by the federal Centers for Medicare & Medicaid Services (CMS) in accordance with the federal Consolidated Appropriations Act, 2023.

The Committee received an update on the work of the Special (EX) Committee on Race and Insurance Health Workstream. The Workstream is continuing its meetings on health equity issues. It recently had a meeting focused on lowering barriers to preventive care, particularly with respect to chronic disease. The Workstream has planned upcoming meetings on the evolution of federal Affordable Care Act (ACA) Section 1332 waivers and state reinsurance programs, as well as reducing disparities in mental health services. The Workstream is also piloting a new collaboration space on the NAIC Connect platform to allow Workstream members and other NAIC members to discuss issues related to health equity and other topics.

6. Received the Report of the Property and Casualty Insurance (C) Committee

Director Deiter reported that the Property and Casualty Insurance (C) Committee met Aug. 15. During this meeting, the Committee adopted its Spring National Meeting minutes.

The Committee adopted the reports of its task forces and working groups: 1) the Casualty Actuarial and Statistical (C) Task Force; 2) the Surplus Lines (C) Task Force; 3) the Title Insurance (C) Task Force; 4) the Workers' Compensation (C) Task Force; 5) the Cannabis Insurance (C) Working Group; 6) the Catastrophe Insurance (C) Working Group; 7) the Terrorism Insurance Implementation (C) Working Group; and 8) the Transparency and Readability of Consumer Information (C) Working Group.

The Committee adopted a white paper entitled *Regulatory Guide: Understanding the Market for Cannabis Insurance: 2023 Update*, which is an update to a 2019 white paper concerning regulatory issues related to insuring cannabis.

The Committee heard a presentation from the Consumer Federation of America (CFA) on telematics and the need for regulatory guidance regarding transparency, actuarial support for variables, limits on data collection and use, privacy standards, and testing for bias.

The Committee also heard a presentation from a consumer representative on the issue of underinsured homeowners and a recommendation that insurers provide one quote for premiums using an algorithm's estimated reconstruction costs and another quote reflecting the reconstruction cost corrected for the error rate.

The Committee discussed public school insurance, including high losses and rising rates. The Committee will discuss the issue in more detail during a future meeting.

Finally, the Committee reported that in order to meet its charge to assist state insurance regulators in better assessing their markets by developing property market data intelligence, it plans to issue a data call to collect granular data from insurers that will allow state insurance regulators to study coverage issues.

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7. Adopted Revisions to the *Nonadmitted Insurance Model Act (#870)*

Director Deiter reported that the Surplus Lines (C) Task Force was charged with amending and modernizing the *Nonadmitted Insurance Model Act (#870)* to conform to the federal Nonadmitted and Reinsurance Reform Act of 2010, which is part of the federal Dodd-Frank Wall Street Reform Act of 2010 (Dodd-Frank Act).

Some of the more significant amendments deal with the integration of the “home state” method of tax allocation and the new “Domestic Surplus Lines Insurer” status. The revisions to Model #870 provide the necessary alignment with federal legislation.

The Surplus Lines (C) Task Force adopted its revisions to Model #870 on March 21. The Property and Casualty (C) Committee adopted the amendments on March 24.

Director Deiter made a motion, seconded by Commissioner Donelon, to adopt the revisions to Model #870 (Attachment Two). The motion passed. New York abstained.

8. Adopted the *Regulatory Guide: Understanding the Market for Cannabis Insurance: 2023 Update*

Director Deiter reported that the Cannabis Insurance (C) Working Group published a white paper, *Regulatory Guide: Understanding the Market for Cannabis Insurance*, in 2019. At that time, the cannabis industry was in its infancy, and there were many insurance gaps for cannabis-related businesses. Since 2019, the cannabis industry has become more sophisticated. It has also continued to expand rapidly, driving new product development, infrastructure changes, and the need for businesses to provide ancillary services. The state of cannabis regulation, particularly at the state and local levels, has evolved significantly since the white paper was adopted. For these reasons, the white paper needed to be updated.

The Working Group was officially tasked with providing an updated white paper in 2022. Since then, it has explored emerging issues, primarily in the commercial cannabis space, through presentations, panel discussions, and hearings held during open meetings.

The Working Group designated a drafting group to develop the white paper after it reviewed and approved an outline in an open meeting. The drafting group held bi-weekly drafting sessions until completion.

The white paper avoids advocacy-oriented discussion and focuses on issues affecting the affordability and availability of insurance for cannabis-related risks in states that have legalized its use. The white paper finds that although capacity has improved since the first white paper’s publishing, most of the commercial insurance for cannabis-related businesses is still found in the nonadmitted market. This affects smaller industry players most as the nonadmitted market does not offer the “off-the-shelf” insurance solutions typically available in the admitted market.

The Working Group adopted the *Regulatory Guide: Understanding the Market for Cannabis Insurance: 2023 Update* during an open meeting July 18. The adoption followed an extensive public comment period.

Director Deiter made a motion, seconded by Commissioner Conway, to adopt the *Regulatory Guide: Understanding the Market for Cannabis Insurance: 2023 Update* (Attachment Three). The motion passed. Idaho, Indiana, Louisiana, Nebraska, and New York abstained.

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9. Received the Report of the Market Regulation and Consumer Affairs (D) Committee

Commissioner Pike reported that the Market Regulation and Consumer Affairs (D) Committee met Aug. 15. During this meeting, the Committee adopted its July 27 minutes, which included the following action: 1) adopted a new Pet Insurance Market Conduct Annual Statement (MCAS) data call and definitions; 2) adopted a new charge for the Producer Licensing (D) Task Force to review and amend, as needed, the *Public Adjuster Licensing Model Act* (#228) to enhance consumer protections in the property and casualty (P/C) claims process; and 3) adopted the “Continuing Education Recommended Guidelines for Instructor Approval.”

The Committee adopted revisions to the collaboration actions chapter of the *Market Regulation Handbook*. The focus of these revisions is to provide greater transparency to states about the Multistate Settlement Agreement process.

The Committee adopted revisions to the Voluntary Market Regulation Certification Program. The revisions are a result of a pilot program involving 18 states. The mission of the Voluntary Market Regulation Certification Program is to establish and maintain minimum standards that promote sound practices relating to market conduct examination, market analysis, and related continuum activity functions performed for insurance consumer protection.

Commissioner Pike also reported that the Improper Marketing of Health Insurance (D) Working Group adopted revisions to the *Unfair Trade Practices Model Act* (#880) on Aug. 14. The goal of the revisions is to expand Model #880 to provide greater authority for state insurance departments to regulate lead generators. The Antifraud (D) Task Force and Committee will consider the adoption of Model #880 prior to the Fall National Meeting.

The Committee adopted the reports of its task forces and working groups: 1) the Antifraud (D) Task Force; 2) the Market Information Systems (D) Task Force; 3) the Producer Licensing (D) Task Force; 4) the Advisory Organization (D) Working Group; 5) the Market Analysis Procedures (D) Working Group; 6) the Market Conduct Annual Statement Blanks (D) Working Group; 7) the Market Conduct Examination Guidelines (D) Working Group; 8) the Market Regulation Certification (D) Working Group; and 9) the Speed to Market (D) Working Group.

The Committee heard an update on international issues from NAIC international policy support staff. The presentation covered the activities of the IAIS’ Market Conduct Working Group, which included a paper on the use of conduct indicators in insurance supervision and a diversity, equity, and inclusion (DE&I) project.

The Committee heard a presentation from Missouri on the use of data visualization for market analysis, which included information on data needs, how to pick the right visualization, best practices for data visualization, and specific examples of market analysis.

10. Received the Report of the Financial Condition (E) Committee

Superintendent Dwyer reported that the Financial Condition (E) Committee met Aug. 15. During this meeting, the Committee adopted its July 19 and Spring National Meeting minutes. During its July 19 meeting, the Committee took the following action: 1) adopted life risk-based capital (RBC) proposal 2023-09-IRE (Residuals Factor) and proposal 2023-10-IRE (Residual Sensitivity Test Factor for Residuals); 2) adopted amendments to the *Mortgage Guaranty Insurance Model Act* (#630); 3) adopted a new group, the Generator of Economic Scenarios (E/A) Subgroup of the Life Risk-Based Capital (E) Working Group, with the following charges: a) monitor the economic scenario governance to ensure the framework is being appropriately followed by all relevant stakeholders involved in scenario delivery; b) review material economic scenario generator updates, either driven by periodic model maintenance or changes to the economic environment and provide recommendations; c) regularly review key economic conditions and metrics to evaluate the need for off-cycle or significant economic scenario generator

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updates and maintain a public timeline for economic scenario generator updates; d) support the implementation of an economic scenario generator for use in statutory reserve and capital calculations; and e) develop and maintain acceptance criteria that reflect history as well as more extreme scenarios.

The Committee also: 1) adopted the Macroprudential Reinsurance Worksheet; and 2) adopted *Interpretation (INT) 23-01: Net Negative (Disallowed) Interest Maintenance Reserve (IMR)*.

The Committee adopted the reports of its task forces and working groups: 1) the Accounting Practices and Procedures (E) Task Force; 2) the Capital Adequacy (E) Task Force; 3) the Examination Oversight (E) Task Force; 4) the Financial Stability (E) Task Force; 5) the Receivership and Insolvency (E) Task Force; 6) the Reinsurance (E) Task Force; 7) the Valuation of Securities (E) Task Force; 8) the Group Capital Calculation (E) Working Group; 9) the Mortgage Guaranty Insurance (E) Working Group; 10) the Restructuring Mechanisms (E) Working Group; and 11) the Risk-Focused Surveillance (E) Working Group.

The Committee also: 1) received a presentation regarding the use of artificial intelligence (AI) by Canadian insurance regulators; and 2) discussed a framework for insurer investment regulation.

Note: Items adopted within the Financial Condition (E) Committee's task force and working group reports that are considered technical, noncontroversial, and not significant by NAIC standards—i.e., they do not include model laws, model regulations, model guidelines, or items considered to be controversial—will be considered for adoption by the Executive (EX) Committee and Plenary through the Financial Condition (E) Committee's technical changes report process. Pursuant to this process, which was adopted by the NAIC in 2009, a listing of the various technical changes will be sent to NAIC Members shortly after completion of the national meeting, and the Members will have 10 days to comment with respect to those items. If no objections are received with respect to a particular item, the technical changes will be considered adopted by the NAIC membership and effective immediately.

11. Adopted Life RBC Proposals 2023-09-IRE (Residuals Factor) and 2023-10-IRE (Residual Sensitivity Test Factor for Residuals)

Superintendent Dwyer reported that the core of the life RBC proposals 2023-09-IRE and 2023-10-IRE is the RBC treatment of residual investments in a structured security, which means these are the last tranche of many others in a structured security.

Generally, when assets of a pool of such securities do not perform, the residual security holder absorbs these losses first. Thus, there is the potential need for more capital to be held. With that as a backdrop, the 2023 factor for these securities will be 30%, with a factor of 45% for 2024 unless data can be presented to show that a different factor (either higher or lower) is more appropriate.

Additionally, this adds a sensitivity test set at 15% for year-end 2023 that allows the regulator to see the RBC impact as if a full 45% had been used instead. Consequently, there is a sensitivity test of 0% for 2024.

Both proposals were unanimously adopted by the Working Group, the Task Force, and the Committee.

Superintendent Dwyer made a motion, seconded by Commissioner Ommen, to adopt life RBC Proposals 2023-09-IRE (Residuals Factor) and 2023-10-IRE (Residual Sensitivity Test Factor for Residuals) (Attachment Four). The motion passed. New York abstained.

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12. Adopted Revisions to the *Mortgage Guaranty Insurance Model Act* (#630)

Superintendent Dwyer reported that amendments to the *Mortgage Guaranty Insurance Model Act* (#630) were initiated in 2013 to address some of the concerns that arose during the great financial crisis in mortgage insurance in 2008.

Early on, the development of a capital model to accompany Model #630 was the focus of the Financial Condition (E) Committee. At that time, the Mortgage Guaranty Insurance (E) Working Group used two different consulting firms over several years to attempt to build a capital model. However, this approach was met with several challenges.

As a result, the capital work was paused in 2022, and the focus shifted to improving financial reporting in the annual statement (which is now effective) and finalizing the amendments to Model #630, including revisions to the reserve requirements and contingency reserves, as well as waivers with respect to in-force insurance.

During the past year and a half, the drafting group met 12 times, and Model #630 was exposed for public comment Oct. 7, 2022; Feb. 27, 2023; and May 11, 2023. Comments from both industry and consumers were considered.

Superintendent Dwyer made a motion, seconded by Commissioner Ommen, to adopt the revisions to Model #630 (Attachment Five). The motion passed. New York abstained.

13. Received the Report of the Financial Regulation Standards and Accreditation (F) Committee

Director Wing-Heier reported that the Financial Regulation Standards and Accreditation (F) Committee met Aug. 12 in regulator-to-regulator session, pursuant to paragraph 7 (consideration of individual state insurance department's compliance with NAIC financial regulation standards) of the NAIC Policy Statement on Open Meetings, and: 1) discussed state-specific accreditation issues; and 2) voted to award continued accreditation to the insurance departments of Missouri, New Hampshire, South Dakota, and Texas.

The Committee met Aug. 13. During this meeting, the Committee adopted its Spring National Meeting minutes.

The Committee adopted the 2020 revisions to the *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450) as significant elements of Part A accreditation standards. The revisions implement a group capital calculation (GCC) for the purpose of group solvency supervision and a liquidity stress test (LST) for macroprudential surveillance. The amendments also include provisions allowing the commissioner to grant exemptions to GCC for groups meeting standards set forth in Sections 21A and 21B of Model #450 without the requirement to file at least once. This exemption applies primarily to risk retention groups (RRGs). States should adopt the amendments by the effective date, Jan. 1, 2026, in order to comply with the accreditation standard.

The Committee adopted its 2024 proposed charges, which remain unchanged from its 2023 charges.

14. Received the Report of the International Insurance Relations (G) Committee

Commissioner Anderson reported that the International Insurance Relations (G) Committee met Aug. 13. During this meeting, the Committee adopted its April 13 and Spring National Meeting minutes, which included a discussion on NAIC comments on the IAIS public consultation on the *Issues Paper on the Roles and Functioning of Policyholder Protection Schemes* (PPSs).

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The Committee heard an update on international insurance developments and activities in Canada from Jacqueline Friedland (Government of Canada's Office of the Superintendent of Financial Institutions—OSFI).

The Committee also heard an update on recent activities and priorities of the IAIS, including: 1) review of the June 2023 Global Seminar and recent committee meetings; 2) the upcoming comparability assessment process for the aggregation method (AM) and the release for feedback of a U.S.-produced document describing the Provisional AM for use in the comparability assessment; and 3) continuing work at various IAIS forums and steering groups.

The Committee heard an update on international activities, including: 1) workstreams of the European Union (EU)-U.S. Insurance Dialogue Project and its recent public stakeholder session in June 2023; 2) recent meetings, events, and speaking engagements with international insurance regulators; 3) recent meetings of the Organisation for Economic Co-operation and Development (OECD) Insurance and Private Pensions Committee; and 4) recent bilateral meetings.

15. Received the Report of the Innovation, Cybersecurity, and Technology (H) Committee

Commissioner Birrane reported that the Innovation, Cybersecurity, and Technology (H) Committee met Aug. 13. During this meeting, the Committee adopted its Spring National Meeting minutes.

The Committee adopted the reports of its working groups. The report from the Privacy Protections (H) Working Group included a status report on the continued work on the NAIC's *Insurance Consumer Privacy Protections Model Law* (#674). The Working Group is in the process of drafting the next version of Model #674. Once the draft is complete and released for exposure, the Working Group will request an extension to continue its work on Model #674.

The Committee received initial public comments on the NAIC's *Model Bulletin: Use of Algorithms, Predictive Models, and Artificial Intelligence Systems by Insurers*. Comments were provided by 10 speakers, which included trade groups and consumer representatives. Initial observations were offered on the model bulletin's language on third-party oversight, definitions, and principles-based approach to setting governance expectations.

16. Received a Report on the States' Implementation of NAIC-Adopted Model Laws and Regulations

Director Lindley-Myers referred attendees to the written report for updates on the states' implementation of NAIC-adopted model laws and regulations (Attachment Six).

17. Discussed Other Matters

Commissioner Downing made a motion, seconded by Commissioner Fowler, to distribute the environmental, social, and governance (ESG) for the insurance industry statement to the Membership. The motion passed. Connecticut opposed, and New York abstained.

Having no further business, the Executive (EX) Committee and Plenary adjourned.

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Adopted by the Life Insurance and Annuities (A) Committee July 19, 2023
Adopted by the Executive (EX) Committee and Plenary, Aug. 16, 2023

Amendments for the 2024 Valuation Manual

LATF VM Amendment	Valuation Manual Reference	Valuation Manual Amendment Proposal Descriptions	LATF Adoption Date	Page Number
2022-06	VM-31 Section 3.D.5	This amendment adds in a VM-31 requirement to disclose the inflation assumption for Life PBR.	10/6/22	3
2022-07	VM-20 Section 3.C.1.g, VM-20 Section 6.B.5.d.	This amendment clarifies the intent and calculation of the mortality adjustments to the CSO table when anticipated mortality exceeds the prescribed CSO table. The current wording of Section 3.C.1.g has led to confusion by many and a lack of consistent interpretations.	1/26/23	6
2022-08	VM-21 Section 3.E, VM-31 Section 2.A, VM-G Section 1 and Section 4.A.3.	Clarify requirements on groups of contracts that use the Alternative Method/AG33 in VM-21 and are not subject to a principles-based valuation. Such contracts should not be subject to VM-G but still require a sub-report under VM-31.	1/26/23	12
2022-09	VM-21 and VM-31	This amendment includes a series of reporting requirement enhancements related to VM-21 and fixes some errors in the VM language.	3/2/23	16
2022-10	VM-20 Section 2.A.2, Section 3.B.5, and Section 3.B.6	The purpose of this amendment is to add language to address the possibility of policies in the ULSG Reserving Category having a non-material secondary guarantee, and thus becoming excluded from both DR and SR calculations if they pass both the DET and the SET.	2/23/23	22
2023-02	VM-21 4.D.1.a	This amendment adds disclosure requirements in VM-31 and clarifies language in the Annual Statement Instructions related to reporting in the VM-20 Reserves Supplement.	2/23/23	25
2023-03	VM-20 Section 7.E.2 and Guidance Note below, VM-21 Section 4.D.4.c, VM-20 Section 7.K.3, VM-31 Section 3.D.6.f, VM-20 Section 9.A.4	This amendment would do the following: <ul style="list-style-type: none"> • Add a consideration on the assumed cost of borrowing in VM-20 and VM-21, • Clarification of VM-20 hedge modeling, and • Add additional considerations for risk factors other than interest and equities that are stochastically modeled. 	3/21/23	29
2023-01	VM-21 4.D.1.a	The purpose of this amendment is to make the explanation of the starting asset amount consistent in VM-21 section 4.D.1.a.	3/21/23	34
2023-04	VM-31 Section 3.D.3.1.iv	Clarifies requirements where regulators were seeing an issue with PBR Actuarial Reports and inadequate support showing compliance with the requirement that “the company experience mortality rates shall not be lower than the mortality rates the company expects to emerge”.	4/20/23	36
2021-08	VM-51 Section 2.D.	Revisions to VM-51 to allow for the data experience reporting observation calendar year to be one year prior to the reporting calendar year.	5/11/23	39
2023-05	VM-01, VM-21 Section 4.A.4, VM-21 Section 9, VM-21 Section 9.C.2, VM-31 Section 3.F.8.d	Since the reforms of VM-21 and C3P2, ILVA products have experienced major market growth. Several carriers, with the agreement of regulators and auditors, have interpreted the current VM-21 guidance as permitting the effects of index credit hedging to be reflected in product cash flows instead of within the “best efforts” and “adjusted” scenarios. This amendment clarifies those requirements.	6/1/23	42
2023-07	VM-21 Section 6.A.1	The standard projection amount drafting group found that there is very little use of the Company-Specific Market Path (CSMP) method for the VM-21 standard projection amount. Therefore, we recommend removing this method from VM-21 starting in 2025, which gives time to transition for the few companies that currently employ the CSMP method.	6/1/23	49

REQUEST FOR NAIC MODEL LAW DEVELOPMENT

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

Please check whether this is: New Model Law or Amendment to Existing Model

1. Name of group to be responsible for drafting the model:

Surplus Lines (C) Task Force

2. NAIC staff support contact information:

Andy Daleo, Senior Financial Analysis Manager (adaleo@naic.org)

Dan Schelp, Chief Counsel, Regulatory Affairs (dschelp@naic.org)

3. Please provide a brief description of the proposed new model or the amendment(s) to the existing model. If you are proposing a new model, please also provide a proposed title. If an existing model law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.

Nonadmitted Insurance Model Act (#870) – See Attached

On August 5, 2020, the Surplus Lines (C) Task Force discussed revisions to Model #870, and directed NAIC staff to form an informal Drafting Group composed of regulators from Louisiana, Oklahoma and Washington to produce a summary document that outlines the significant updates to modernize Model #870 and present a recommendation to the Task Force at a future national meeting. The attached Model #870 contains the Drafting Group's recommendations with respect to modification of Model #870 to both bring it into compliance with the *Nonadmitted and Reinsurance Reform Act (NRRA)* as well as other amendments to modernize the model.

4. Does the model law meet the Model Law Criteria? Yes or No (Check one)

(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).

a. Does the subject of the model law necessitate a national standard and require uniformity amongst all states? Yes or No (Check one)

If yes, please explain why

The *Nonadmitted Insurance Model Act (#870)* has been adopted in 31 states, with other states adopting older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. Every state, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands have surplus lines guidance in place.

The NRRA was adopted July 21, 2011, and is contained within the *Dodd-Frank Wall Street Reform and Consumer Protection Act (Act)*. The NRRA requirements and the mandate of the federal Act create uniformity for the collection of surplus lines tax payments through the implementation of the "Home State" requirement. All states comply with the NRRA's home state tax approach.

Model 870 was not modified because of the implementation of the NRRRA. However, on October 11, 2011, a *Nonadmitted Insurance Reform Sample Bulletin* (copy attached) was adopted by Executive/Plenary and subsequently distributed to the state insurance departments. It is important to provide guidance for uniformity among the states in order to ensure compliance with the NRRRA.

- b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law?

Yes or No (Check one)

5. What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Due to the previous adoption of the *Nonadmitted Insurance Reform Sample Bulletin* by the NAIC, there is already uniformity of intent with respect to key areas addressed by the NRRRA. The Surplus Lines (C) Task Force should be able to leverage that agreement to quickly and efficiently finish revisions to Model #870.

6. What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Surplus Lines is an important industry in every state and U.S. Territory, and it is important to provide uniform guidance to the NAIC members to ensure compliance with the federal NRRRA.

7. What is the likelihood that state legislatures will adopt the model law in a uniform manner within three years of adoption by the NAIC?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Model #870 is not an accreditation requirement, but as previously stated it is important to provide uniform guidance to the states to ensure compliance with the NRRRA.

8. Is this model law referenced in the NAIC Accreditation Standards? If so, does the standard require the model law to be adopted in a substantially similar manner?

No

9. Is this model law in response to or impacted by federal laws or regulations? If yes, please explain.

Yes, the proposed revisions to Model #870 are in direct response to the federal NRRRA, which would preempt inconsistent state law.

Draft 3/1/23

Adopted by the Property and Casualty Insurance (C) Committee—3/24/23

NONADMITTED INSURANCE MODEL ACT

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Section 1. Short Title

This Act shall be known and may be cited as “The Nonadmitted Insurance Act.”

Section 2. Purpose—Necessity for Regulation

This Act shall be liberally construed and applied to promote its underlying purposes which include:

- A. Protecting persons seeking insurance in this state;
- B. Permitting surplus lines insurance to be placed with reputable and financially sound nonadmitted insurers and exported from this state pursuant to this Act;
- C. Establishing a system of regulation which will permit orderly access to surplus lines insurance in this state and encourage admitted insurers to provide new and innovative types of insurance available to consumers in this state;
- D. Providing a system through which persons may purchase insurance other than surplus lines insurance, from nonadmitted insurers pursuant to this Act;
- E. Protecting revenues of this state; and
- F. Providing a system pursuant to this Act which subjects nonadmitted insurance activities in this state to the jurisdiction of the insurance commissioner and state and federal courts in suits by or on behalf of the state.

Section 3. Definitions

As used in this Act:

- A. “Admitted insurer” means an insurer licensed to ~~do engage in an~~ [the business of insurance-business](#) in this state.
- B. [“Affiliate” means, with respect to an insured, any entity that controls, is controlled by, or is under common control with the insured.](#)

C. ~~“Affiliated group” means any group of entities that are all affiliated. “Capital,” as used in the financial requirements of Section 5, means funds paid in for stock or other evidence of ownership.~~

~~DC.~~ “Commissioner” means the insurance commissioner of [insert name of state], or the commissioner’s deputies or staff, or the ~~c~~Commissioner, ~~d~~Director or ~~s~~Superintendent of insurance in any other state.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term “commissioner” appears.

E. ~~“Control” means with respect to an insured:~~

~~(1) A person, either directly or indirectly, or acting through one or more other persons, owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the other entity; or~~

~~(2) The entity controls in any manner the election of a majority of the directors or trustees of the other entity.~~

F. ~~[OPTIONAL: ~~“Domestic surplus lines insurer” means a surplus lines insurer domiciled in this state, that which may write insurance in this state on as if it were a surplus lines insurer basis domiciled in another state.~~]~~

G. “Eligible surplus lines insurer” means a nonadmitted insurer with which a surplus lines licensee may place surplus lines insurance pursuant to Section 5 of this Act.

H. ~~“Exempt commercial purchaser” means any person purchasing commercial insurance that, at the time of placement, meets the following requirements:~~

~~(1) ~~n-H~~has paid aggregate nationwide commercial property and casualty insurance premiums in excess of \$100,000 in the immediately preceding 12 months; and-~~

~~(2) (a) ~~The person m~~Meets at least one~~l~~ of the following criteria:~~

~~(i) ~~The person P~~possesses a net worth in excess of \$20,000,000;:-~~

~~(ii) ~~The person G~~generates annual revenues in excess of \$50,000,000;:-~~

~~(iii) ~~The person E~~employs more than 500 full-time or full-time equivalent employees per individual insured or is a member of an affiliated group employing more than 1,000 employees in the aggregate;:-~~

~~(iv) ~~The person I~~is a not-for-profit organization or public entity generating annual budgeted expenditures of at least \$30,000,000; or-~~

~~(v) ~~The person i~~is a municipality with a population in excess of 50,000 persons.~~

~~(b) ~~Effective on July 21, 2010, every five years and each fifth January 1 occurring thereafter on January 1, the amounts in S~~ubsections~~Items~~ (i), (ii), and (iv) of ~~S~~ubparagraph~~Section~~ 3H(32)(a) of this Paragraph shall be adjusted to reflect the percentage change for such ~~five~~ year period in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor.~~

Drafting Note: ~~The~~is definition of “Exempt commercial purchaser” follows the language of the federal Nonadmitted and Reinsurance Reform Act (NRRA). ~~Some states have chosen not to adopt the inflation adjustment. The NRRA uses the term “municipality,” which some states may find limiting. States may choose to use terminology consistent with state law to expand this provision to include counties and other public entities.~~

~~EI.~~ “Export” means to place surplus lines insurance with a nonadmitted insurer.

~~F. “Foreign decree” means any decree or order in equity of a court located in any United States jurisdiction, including a federal court of the United States, against any person engaging in the transaction of insurance in this state.~~

J. ~~“Home state,” means with respect to an insured, means:~~

~~(1) The state in which an insured maintains its principal place of business or, in the case of a natural person, the person’s principal place of residence;~~

~~(2) If 100 percent of the insured risk is located out of the state referred to in ~~subParagraph (1)~~Section 3J(1), the state to which the greatest percentage of the insured’s taxable premium for that insurance contract is allocated; ~~or~~~~

~~(3) If the insured is an affiliated group with more than one member listed as a named insured on a single nonadmitted insurance contract, the home state is the home state of the member of the affiliated group that has the largest percentage of premium attributed to it under the insurance contract; ~~or~~~~

~~(4) [Option 1] In the case of an unaffiliated group policy:~~

~~(a) If a group policyholder pays 100% of the premium from its own funds, then the home state is determined according to paragraphs (1) and (2).~~

~~(b) If a group policyholder does not pay 100% of the premium from its own funds, then the home state is determined according to paragraphs (1) and (2) for each member of the group.~~

~~[Option 2] In the case of an unaffiliated group policy, the home state shall be the home state of the group policyholder as determined by the application of paragraphs (1) and (2).~~

Drafting Note:

Comment: The NRRA definition of “home state” includes ~~Subsections Paragraphs (1), (2), and (3) of Section 3J.~~ The NRRA definition does not expressly cover unaffiliated groups. States have taken different approaches to the taxation of unaffiliated group policies. Some states tax based on the “home state” of the group policyholder. Other states tax based on the “home state” of the group member or certificate holder under the unaffiliated group policy. Some states assess tax on the “home state” of the person that pays the premium. Not all states have an express provision to address unaffiliated group policies. ~~The Drafting Group could not arrive at language to address each possibility and opted to omit it from the Model. such as risk purchasing groups model language contains two options for addition of that are expressly covering unaffiliated group treating the members of such a group as individual insureds for purposes of placement and taxation.~~

~~K. “Insurer” means any person, corporation, association, partnership, reciprocal exchange, interinsurer, Lloyds insurer, insurance exchange syndicate, fraternal benefit society, and any other legal entity engaged in the business of insurance.~~

~~H. “Kind of insurance” means one of the types of insurance required to be reported in the annual statement which must be filed with the commissioner by admitted insurers.~~

~~K. “Nonadmitted insurance” means any insurance written on properties, risks or exposures, located or to be performed in this state, by an insurer not licensed to engage in the ~~transaction~~ business of insurance in this state [or a domestic surplus lines insurer].~~

~~LI. “Nonadmitted insurer” means an insurer not licensed to ~~do an~~engage in the ~~transaction~~ business of insurance ~~business~~ in this ~~state~~ but does not include a risk retention group pursuant to the federal Liability Risk Retention Act of 1986.~~

~~MJ. “Person” means any natural person or ~~other-business~~ entity, including, but not limited to, ~~individuals,~~ partnerships, associations, trusts or corporations.”~~

~~N. “Premium” means any payment made as consideration for an insurance contract.~~

~~N.O.~~ “Principal place of business” means:

- ~~(1) The state where a person maintains its headquarters and where the person’s high-level officers direct, control, and coordinate the business activities; or~~
- ~~(2) If the person’s high-level officers direct, control, and coordinate the business activities in more than one state, or if the person’s principal place of business is located outside any state, then it is the state to which the greatest percentage of the person’s taxable premium for that insurance contract is allocated.~~

~~P.O.~~ “Principal residence” means:

- ~~(1) The state where the person resides for the greatest number of days during a calendar year; or~~
- ~~(2) If the person’s principal residence is located outside any state, the state to which the greatest percentage of the person’s taxable premium for that insurance contract is allocated.~~

~~“State” includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa. K. “Policy” or “contract” means any contract of insurance, including but not limited to annuities, indemnity, medical or hospital service, workers’ compensation, fidelity or suretyship.~~

~~L. “Reciprocal state” means a state that has enacted provisions substantially similar to:~~

- ~~(1) Sections 5F, 5I(5), 5Q(10), 5R(4) and Section 6; and~~
- ~~(2) The allocation schedule and reporting form contained in [cite the regulation on surplus lines taxation].~~

~~M. “Surplus,” as used in the financial requirements of Section 5, means funds over and above liabilities and capital of the company for the protection of policyholders.~~

~~Q.R.N. “Surplus lines insurance” means any property and casualty insurance in this state on properties, risks or exposures, located or to be performed in this state, permitted to be placed through a surplus lines licensee with an nonadmitted insurer eligible surplus lines insurer to accept such insurance, pursuant to Section 5 of this Act.~~

~~Drafting Note: If a state chooses to adopt the alternative Section 5B, this definition of “surplus lines insurance” should be consistent with the acceptable coverage listed in Section 5B. States may choose to extend the definition of “surplus lines insurance” beyond property/casualty insurance. NAIC.~~

~~RS. “Surplus lines insurer” means a nonadmitted [or domestic surplus lines] insurer that is eligible to accept the placement of surplus lines insurance pursuant to Section 5 of this Act.~~

~~STO. “Surplus lines licensee” means any person individual, firm or corporation licensed under Section 5 of this Act to place surplus lines insurance on properties, risks or exposures located or to be performed in this state with an nonadmitted insurers eligible surplus lines insurersto accept such insurance.~~

~~TU. “Taxable premium” means any premium less return premium that is not otherwise exempt from tax pursuant to this Act. [OPTIONAL:]Premium on property risk or exposure that is properly allocated to federal or international waters or is under the jurisdiction of a foreign government is not taxable in this state.]~~

~~UVS. “Transaction of insurance”~~

- ~~(+) (1) For purposes of this Act, any of the following acts in this state effected by mail or otherwise by a nonadmitted insurer or by any person acting with the actual or apparent authority of the insurer, on behalf of the insurer, is deemed to constitute the transaction of an insurance business in or from this state:~~

- (a) The making of or proposing to make, as an insurer, an insurance contract;
 - (b) The making of or proposing to make, as guarantor or surety, any contract of guaranty or suretyship as a vocation and not merely incidental to any other legitimate business or activity of the guarantor or surety;
 - (c) The taking or receiving of an application for insurance;
 - (d) The receiving or collection of any premium, commission, membership fees, assessments, dues or other consideration for insurance or any part thereof;
 - (e) The issuance or delivery in this state of contracts of insurance to residents of this state or to persons authorized to do business in this state;
 - (f) The solicitation, negotiation, procurement or effectuation of insurance or renewals thereof;
 - (g) The dissemination of information as to coverage or rates, or forwarding of applications, or delivery of policies or contracts, or inspection of risks, the fixing of rates or investigation or adjustment of claims or losses or the transaction of matters subsequent to effectuation of the contract and arising out of it, or any other manner of representing or assisting a person or insurer in the transaction of risks with respect to properties, risks or exposures located or to be performed in this state;
 - (h) The transaction of any kind of insurance business specifically recognized as transacting an insurance business within the meaning of the statutes relating to insurance;
 - (i) The offering of insurance or the transacting of insurance business; or
 - (j) Offering an agreement or contract which purports to alter, amend or void coverage of an insurance contract.
- (2) The provisions of this subsection shall not operate to prohibit employees, officers, directors or partners of a commercial insured from acting in the capacity of an insurance manager or buyer in placing insurance on behalf of the employer, provided that the person's compensation is not based on buying insurance.
- (3) The venue of an act committed by mail is ~~at the~~ point location where the matter transmitted by mail is delivered or issued for delivery or takes effect.

Drafting Note: States may need to alter this subsection to reflect their decision as to whether they intend to permit citizens to directly purchase coverage within the state from a nonadmitted insurer, or if self-procurement of coverage will be permitted only when it occurs outside the state. States electing to allow direct procurement will need to insert an appropriate exemption in Section 4A of this Act. Additionally, states should consider whether the preceding definition of “transaction of insurance” is consistent with other statutory definitions of this phrase in the state. Finally, states may want to consider whether group insurance purchases or the maintenance of insurance books and records in this state should fall within the scope of the definition of “transaction of insurance.”

~~Q.~~ —“Type of insurance” means coverage afforded under the particular policy that is being placed.

~~V.F.~~ “Wet marine and transportation insurance” means:

- (1) Insurance upon vessels, crafts, hulls and other interests in them or with relation to them;
- (2) Insurance of marine builder's risks, marine war risks and contracts of marine protection and indemnity insurance;

~~(1)(3)~~ Insurance of freight and disbursements pertaining to a subject of insurance within the scope of this subsection; and

~~(2)~~

(4) Insurance of personal property and interests therein, in the course of exportation from or importation into any country, or in the course of transportation coastwise or on inland waters, including transportation by land, water or air from point of origin to final destination, in connection with any and all risks or perils of navigation, transit or transportation, and while being prepared for and while awaiting shipment, and during any incidental delays, transshipment, or reshipment; provided, however, that insurance of personal property and interests therein shall not be considered wet marine and transportation insurance if the property has:

- (a) Been transported solely by land; or
- (b) Reached its final destination as specified in the bill of lading or other shipping document; or
- (c) The insured no longer has an insurable interest in the property.

Comment: The language added in 1994 to the end of the definition of “wet marine and transportation insurance” {Subparagraphs 4(a), 4(b), and 4(c)} is intended to clarify the scope of the definition, which ultimately affects the exemption of certain risks from this Act. The 1994 amendments address current regulatory concerns and concerns raised by those who drafted the 1983 amendments to the Model Surplus Lines Law. The 1983 drafters wrote: “Several [drafters] felt the term ‘storage’ should not appear in... [the wet marine definition] to ensure that warehousemen and other types of insurance covering risks of storage are not interpreted to be within the purview of this definition. The term ‘delays’ is sufficiently broad to cover temporary storage while in the course of transit.”

Drafting Note: In addition to the definitions provided in this section, individual states may wish to consider adopting definitions for “agent,” “broker” or “producer” in a manner consistent with its other laws. Additionally, states may want to cross-reference the definition of “insurance” as it appears elsewhere in the state insurance code. The definition of insurance should reach illegal unauthorized activities.

Section 4. Placement of Insurance Business

- A. An insurer shall not engage in the transaction of insurance unless authorized by a license in force pursuant to the laws of this state, or exempted by this Act or ~~otherwise exempted by~~ the insurance laws of this state.
- B. A person shall not ~~directly or indirectly~~ engage in a transaction of insurance ~~with or on behalf of or shall in this state directly or indirectly act as agent for, or otherwise represent or aid on behalf of another, a nonadmitted insurer in this state, in the solicitation, negotiation, procurement or effectuation of insurance, or renewals thereof, or forwarding of applications, or delivery of policies or contracts or inspection of risks, or fixing of rates, or investigation or adjustment of claims or losses, or collection or forwarding of premiums, or in any other manner represent or assist the insurer in the transaction of insurance.~~
- C. A person who represents or aids a nonadmitted insurer in violation of this section shall be subject to the penalties set forth in Section 7 of this Act. No insurance contract entered into in violation of this section shall preclude the insured from enforcing his rights under the contract in accordance with the terms and provisions of the contract of insurance and the laws of this state, to the same degree those rights would have been enforceable had the contract been lawfully procured.
- D. If the nonadmitted insurer fails to pay a claim or loss within the provisions of the insurance contract and the laws of this state, a person who assisted or in any manner aided directly or indirectly in the procurement of the insurance contract, shall be liable to the insured for the full amount under the provisions of the insurance contract.

- E. Section 4B or 4D shall not apply to a person in regard to an insured who independently procures insurance as provided under Section 6. This section shall not apply to a person, properly licensed as an agent or broker in this state who, for a fee and pursuant to a written agreement, is engaged solely to offer to the insured advice, counsel or opinion, or service with respect to the benefits, advantages or disadvantages promised under any proposed or in-force policy of insurance if the person does not, directly or indirectly, participate in the solicitation, negotiation or procurement of insurance on behalf of the insured.

Drafting Note: If a state collects tax on unlicensed transactions which violate this Act, it may consider imposing liability for payment of those taxes on persons who violate this Act by assisting in the procurement of nonadmitted insurance.

Drafting Note: Some states permit other licensed professionals to engage in these activities as provided in their insurance statutes or other state statutes. Those states may want to amend Section 4E to include those professionals, to the extent they act within the scope of their licenses.

- F. This section shall not apply to a person acting in material compliance with the insurance laws of this state in the placement of the types of insurance identified in Paragraphs (1), (2), (3) and (4) below:

- (1) Surplus lines insurance as provided in Section 5. For the purposes of this subsection, a licensee shall be deemed to be in material compliance with the insurance laws of this state, unless the licensee committed a violation of Section 5 that proximately caused loss to the insured;
- (2) Transactions for which a certificate of authority to do business is not required of an insurer under the insurance laws of this state;

~~**Drafting Note:** A number of states exempt from licensing and premium taxation nonprofit educational insurers insuring only nonprofit educational institutions and their employees. Some states require certificates of authority while others require licensing, and the appropriate language should be used in Paragraph (2) above. Additionally, some states may want to consider adding language to establish an option of allowing persons to file for an exemption with the Department of Insurance.~~

- (3) Reinsurance provided that, unless the commissioner waives the requirements of this subsection:
 - (a) The assuming insurer is authorized to ~~do engage in the business of an~~ insurance or reinsurance ~~business by in~~ its domiciliary jurisdiction and is authorized to write the type of reinsurance in its domiciliary jurisdiction; and
 - (b) The assuming insurer satisfies all legal requirements for such reinsurance in the state of domicile of the ceding insurer;
- (4) The property and operation of railroads or aircraft engaged in interstate or foreign commerce, wet marine and transportation insurance;
- (5) Transactions subsequent to issuance of a policy not covering properties, risks or exposures located, or to be performed in this state at the time of issuance, and lawfully solicited, written or delivered outside this state.

Drafting Note: States may also wish to consider exempting from Section 4A of this Act self-procured insurance or industrial insurance purchased by a sophisticated buyer who does not necessarily require the same regulatory protections as an average insurance buyer. Additionally, some states allow other insurance transactions with nonadmitted insurers. Examples include certain aviation and railroad risks. Other states may want to narrow the scope of the exemptions above or reserve the right to approve exemptions on a case-by-case basis.

Section 5. Surplus Lines Insurance

- A. Surplus lines insurance may be placed by a surplus lines licensee if:

- (1) Each insurer is ~~an~~-eligible to write surplus lines insurance~~insurer~~; and
- (2) Each insurer is authorized to write the type of insurance in its domiciliary jurisdiction; and
- (3) Other than for exempt commercial purchasers, ~~t~~The full amount or type of insurance cannot be obtained from insurers who are admitted to ~~do~~engage in the business of insurance in this state. The full amount or type of insurance may be procured from eligible surplus lines insurers, provided that a diligent search is made among the insurers who are admitted to transact and are actually writing the particular type of insurance in this state if any are writing it; and
- (4) All other requirements of this Act are met.

Drafting Note: ~~States may prefer to reference “kind of insurance” rather than “type of insurance” in Section 5A(3). The term utilized should be defined within the Act.~~ The diligent search requirement of Section 5A(3) must be satisfied in accordance with the statutes and regulations of the governing state. ~~Such Diligent search~~ statutes and regulations ~~might~~ vary from state to state in terms of the number of declinations required and the person designated to conduct the search. ~~Several states permit surplus lines placement without a diligent search for or without regard to the availability of admitted coverage. States may want to consider changing diligent search requirements in light of electronic transactions.~~ Section 5A(3) does not prohibit a regulatory system in which a surplus lines licensee may place with an eligible nonadmitted insurer any coverage listed on a current “~~E~~export ~~L~~ist” maintained by the commissioner. The ~~e~~Export list would identify types of insurance for which no admitted market exists. The commissioner may waive the diligent search requirement for any such type of insurance.

Drafting Note: Utilizing the “full amount” standard in Section 5A(3) of this Act may have certain market implications. An alternative to this approach would be to require that whatever part of the coverage is attainable through the admitted market be placed in the admitted market and only the excess part of the coverage may be exported.

- B. Subject to Section 5A(3) of this Act, a surplus lines licensee may place any coverage with an ~~an~~ nonadmitted eligible surplus lines insurer-eligible to accept the insurance, unless specifically prohibited by the laws of this state.

[Alternative Subsection B]

- ~~[C~~B. Subject to Section 5A(3) of this Act, a surplus lines licensee may place only the following types of coverage with an ~~an~~ nonadmitted eligible surplus lines insurer-eligible to accept insurance: (list acceptable coverage).]

Drafting Note: The two statutory alternatives described in Section 5B represent different regulatory approaches to defining those coverages which may be placed in the nonadmitted market and they would impact the admitted market in different manners.

- C. A surplus lines licensee shall not place ~~surplus lines insurance coverage with a nonadmitted insurer~~, unless, at the time of placement, the surplus lines licensee has determined that the ~~nonadmitted insurer~~ is eligible to write surplus lines insurance under one of the following subsections:

~~(1) Has established satisfactory evidence of good repute and financial integrity; and~~

~~(2) Qualifies is eligible to write surplus lines insurance under one of the following subparagraphs:~~

1. **Drafting Note:** Current numbering is retained in this Model to remain consistent with the reference within the NRRA.

2. Is eligible to write surplus lines insurance under one of the following subsections:

(a) For a nonadmitted insurer domiciled in another United States jurisdiction, the insurer shall have both of the following:

(i) ~~is~~ The authority to write the type of insurance in its domiciliary jurisdiction; and

~~(ii)~~ (iii) Has eCapital and surplus or its equivalent under the laws of its domiciliary jurisdiction ~~which~~that equals the greater of:

~~(I)~~ (i) ~~(A)~~ (1) The minimum capital and surplus requirements under the law of this -state; or

~~(B)~~ (B) \$15,000,000;

Drafting Note: ~~States that have not previously increased capital and surplus requirements may wish to consider implementation of the capital and surplus requirements in this subparagraph in a series of phases over a period of up to three (3) years. In some circumstances, implementation of a \$15,000,000 capital and surplus requirement may represent a dramatic increase over existing requirements. States may wish to allow insurers which are eligible under existing law some period of time to increase their capital and surplus to meet the new standards. Current numbering is retained in this Model to remain consistent with the reference within the NRRA.~~

~~(ii)~~ (ii) The requirements of Subparagraph ~~(a)~~(i) ~~(1)~~ may be satisfied by an insurer's possessing less than the minimum capital and surplus upon an affirmative finding of acceptability by the commissioner. The finding shall be based upon such factors as quality of management, capital and surplus of any parent company, company underwriting profit and investment income trends, market availability and company record and reputation within the industry. In no event shall the commissioner make an affirmative finding of acceptability when the nonadmitted insurer's capital and surplus is less than \$4,500,000; or

~~a.~~ a. ~~For a nonadmitted insurer domiciled outside the United States, the insurer shall be listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the National Association of Insurance Commissioners (NAIC); [or]~~

~~(b)~~

~~(c)~~ (c) ~~For an insurer domiciled in this state, the insurer is a domestic surplus lines insurer.]~~

~~(b)~~ (b) In the case of an insurance exchange created by the laws of a state other than this state:

~~(i)~~ (i) The syndicates of the exchange shall maintain under terms acceptable to the commissioner capital and surplus, or its equivalent under the laws of its domiciliary jurisdiction, of not less than \$75,000,000 in the aggregate; and

~~(ii)~~ (ii) The exchange shall maintain under terms acceptable to the commissioner not less than fifty percent (50%) of the policyholder surplus of each syndicate in a custodial account accessible to the exchange or its domiciliary commissioner in the event of insolvency or impairment of the individual syndicate; and

~~(iii)~~ (iii) In addition, each individual syndicate to be eligible to accept surplus lines insurance placements from this state shall meet either of the following requirements:

~~(I)~~ (I) For insurance exchanges which maintain funds in an amount of not less than \$15,000,000 for the protection of all exchange policyholders, the syndicate shall maintain under terms acceptable to the commissioner minimum capital and surplus, or its equivalent under the laws of the domiciliary jurisdiction, of not less than \$5,000,000; or

~~(II)~~ (II) For insurance exchanges which do not maintain funds in an amount of not less than \$15,000,000 for the protection of all exchange

~~policyholders, the syndicate shall maintain under terms acceptable to the commissioner minimum capital and surplus, or its equivalent under the laws of its domiciliary jurisdiction, of not less than the minimum capital and surplus requirements under the laws of its domiciliary jurisdiction or \$15,000,000, whichever is greater; or~~

Drafting Note: Some states may want to cross reference statutory provisions in their own states which provide a grandfather clause for syndicates established with a lower capital and surplus requirement.

- ~~(c) In the case of a Lloyd's plan or other similar group of insurers, which consists of unincorporated individual insurers, or a combination of both unincorporated and incorporated insurers:
 - ~~(i) The plan or group maintains a trust fund that shall consist of a trustee account representing the group's liabilities attributable to business written in the United States; and~~
 - ~~(ii) In addition, the group shall establish and maintain in trust a surplus in the amount of \$100,000,000; which shall be available for the benefit of United States surplus lines policyholders of any member of the group.~~
 - ~~(iii) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of solvency regulation and control by the group's domiciliary regulator as are the unincorporated members.~~
 - ~~(iv) The trust funds shall be maintained in an irrevocable trust account in the United States in a qualified financial institution, consisting of cash, securities, letters of credit or investments of substantially the same character and quality as those which are eligible investments for the capital and statutory reserves of admitted insurers to write like kinds of insurance in this state and, in addition, the trust required by item (ii) of this paragraph shall satisfy the requirements of the Standard Trust Agreement required for listing with the National Association of Insurance Commissioners (NAIC) International Insurers Department; or~~~~
- ~~(d) In the case of a group of incorporated insurers under common administration, which has continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to this time, and which submits to this state's authority to examine its books and records and bears the expense of the examination:
 - ~~(i) The group shall maintain an aggregate policyholders' surplus of \$10,000,000,000; and~~
 - ~~(ii) The group shall maintain in trust a surplus in the amount of \$100,000,000; which shall be available for the benefit of United States surplus lines policyholders of any member of the group; and~~
 - ~~(iii) Each insurer shall individually maintain capital and surplus of not less than \$25,000,000 per company.~~
 - ~~(iv) The trust funds shall satisfy the requirements of the Standard Trust Agreement requirement for listing with the NAIC International Insurers Department, and shall be maintained in an irrevocable trust account in the United States in a qualified financial institution, and shall consist of cash, securities, letters of credit or investments of substantially the same character and quality as those which are eligible investments for the capital and statutory reserves of admitted insurers to write like kinds of insurance in this state.~~~~

- ~~(v) — Additionally, each member of the group shall make available to the commissioner an annual certification of the member’s solvency by the member’s domiciliary regulator and its independent public accountant; or~~
- ~~(e) — Except for an exchange or plan complying with Subparagraph (b), (c) or (d), an insurer not domiciled in one of the United States or its territories shall satisfy the capital and surplus requirements of Subsection C(2)(a) of this section and shall have in force a trust fund of not less than the greater of:

 - ~~(i) — \$5,400,000; or~~
 - ~~(ii) — Thirty percent (30%) of the United States surplus lines gross liabilities, excluding aviation, wet marine and transportation insurance liabilities, not to exceed \$60,000,000, to be determined annually on the basis of accounting practices and procedures substantially equivalent to those promulgated by this state, as of December 31 next preceding the date of determination, where:

 - ~~(I) — The liabilities are maintained in an irrevocable trust account in the United States in a qualified financial institution, on behalf of U.S. policyholders consisting of cash, securities, letters of credit or other investments of substantially the same character and quality as those which are eligible investments pursuant to [cite insurance investment law] for the capital and statutory reserves of admitted insurers to write like kinds of insurance in this state. The trust fund, which shall be included in any calculation of capital and surplus or its equivalent, shall satisfy the requirements of the Standard Trust Agreement required for listing with the NAIC International Insurers Department; and~~
 - ~~(II) — The insurer may request approval from the commissioner to use the trust fund to pay valid surplus lines claims; provided, however, that the balance of the trust fund is never less than the greater of \$5,400,000 or thirty percent (30%) of the insurer’s current gross U.S. surplus lines liabilities, excluding aviation, wet marine and transportation insurance liabilities; and~~
 - ~~(III) — In calculating the trust fund amount required by this subsection, credit shall be given for surplus lines deposits separately required and maintained for a particular state or U.S. territory, not to exceed the amount of the insurer’s loss and loss adjustment reserves in the particular state or territory;~~~~~~

Drafting Note: The commissioner may wish to establish the authority to set a higher level on a case by case basis.

- ~~(f) — An insurer or group of insurers meeting the requirements to do a surplus lines business in this state at the effective date of this law shall have two (2) years from the date of enactment to meet the requirements of Subparagraph (c), as follows:~~

Year Following Enactment	Trust Fund Requirement
1	15% of U.S. surplus lines liabilities, excluding aviation, wet marine and transportation insurance, with a maximum of \$30,000,000

2

~~30% of U.S. surplus lines liabilities, excluding aviation, wet marine and transportation insurance, with a maximum of \$60,000,000.~~

- ~~(g) — The commissioner shall have the authority to adjust, in response to inflation, the trust fund amounts required by Subparagraph (e).~~
- ~~(3) — In addition to all of the other requirements of this subsection, an insurer not domiciled in the United States or its territories shall be listed by the NAIC International Insurers Department. The commissioner may waive the requirement in Paragraph (3) or the requirements of Section 5C(2)(e)(ii) may be satisfied by an insurer's possessing less than the trust fund amount specified in Section 5C(2)(e)(ii) upon an affirmative finding of acceptability by the commissioner if the commissioner is satisfied that the placement of insurance with the insurer is necessary and will not be detrimental to the public and the policyholder. In determining whether business may be placed with the insurer, the commissioner may consider such factors as:~~
- ~~(a) — The interests of the public and policyholders;~~
- ~~(b) — The length of time the insurer has been authorized in its domiciliary jurisdiction and elsewhere;~~
- ~~(c) — Unavailability of particular coverages from authorized insurers or unauthorized insurers meeting the requirements of this section;~~
- ~~(d) — The size of the company as measured by its assets, capital and surplus, reserves, premium writings, insurance in force or other appropriate criteria;~~
- ~~(e) — The kinds of business the company writes, its net exposure and the extent to which the company's business is diversified among several lines of insurance and geographic locations; and~~
- ~~(f) — The past and projected trend in the size of the company's capital and surplus considering such factors as premium growth, operating history, loss and expense ratios, or other appropriate criteria; and~~
- ~~(4) — Has caused to be provided to the commissioner a copy of its current annual statement certified by the insurer and an actuarial opinion as to the adequacy of, and methodology used to determine, the insurer's loss reserves. The statement shall be provided at the same time it is provided to the insurer's domicile, but in no event more than eight (8) months after the close of the period reported upon, and shall be certified as a true and correct copy by an accounting or auditing firm licensed in the jurisdiction of the insurer's domicile and certified by a senior officer of the nonadmitted insurer as a true and correct copy of the statement filed with the regulatory authority in the domicile of the nonadmitted insurer. In the case of an insurance exchange qualifying under Paragraph (2)(b) of this subsection, the statement may be an aggregate combined statement of all underwriting syndicates operating during the period reported; and~~

Drafting Note: The following paragraph is for use by those states which desire to adopt a "white list" for determining the eligibility of nonadmitted insurers to write surplus lines insurance.

- ~~(5) — In addition to meeting the requirements in Paragraphs (1) to (4) of this subsection an insurer shall be an eligible surplus lines insurer if it appears on the most recent list of eligible surplus lines insurers published by the commissioner from time to time but at least semiannually. Nothing in this paragraph shall require the commissioner to place or maintain the name of any nonadmitted insurer on the list of eligible surplus lines insurers.~~
- ~~(6) — Notwithstanding Section 5A, only that portion of any risk eligible for export for which the full amount of coverage is not procurable from listed eligible surplus lines insurers may be placed with any other nonadmitted insurer which does not appear on the list of eligible surplus lines insurers published by the commissioner pursuant to Paragraph (5) of this subsection but nonetheless meets the requirements set forth in Sections 5C(1) and 5C(2) and any regulations of the commissioner. The surplus lines licensee seeking to provide coverage through an unlisted nonadmitted insurer shall make a filing specifying the amounts and~~

~~percentages of each risk to be placed, and naming the nonadmitted insurers with which placement is intended. Within [insert number] days after placing the coverage, the surplus lines licensee shall also send written notice to the insured or the producing broker that the insurance, or a portion thereof, has been placed with the nonadmitted insurer.~~

D. ~~The placement of surplus lines insurance shall be subject to the statutory and regulatory requirements solely of the insured's home state.~~

Drafting Note: Section 522(d) of the federal Nonadmitted and Reinsurance Reform Act provides a workers' compensation exception to home state authority; specifically, that this section may not be construed to preempt any State law, rule, or regulation that restricts the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer. In addition, Section 527(9) of the NRRRA provides that the term "nonadmitted insurance" means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance and is not applicable to accident and health insurance. States may consider whether to add language making these exceptions explicit when codifying Section 5D into state law.

~~E.D.~~ Insurance procured under this section shall be valid and enforceable as to all parties.

~~E.E.~~ Withdrawal of Eligibility as a Surplus Lines Insurer

F.

If at any time the commissioner has reason to believe that a surplus lines insurer is no longer eligible under Section 5C,

- ~~(1) — Is in unsound financial condition or has acted in an untrustworthy manner;~~
- ~~(2) — No longer meets standards set forth in Section 5C of this Act;~~
- ~~(3) — Has willfully violated the laws of this state; or~~
- ~~(4) — Does not conduct a proper claims practice.~~

~~The~~ commissioner may, after notice and an opportunity for a hearing, declare it ineligible. The commissioner shall promptly ~~mail~~ publish notice of all such declarations in a timely manner reasonably calculated to reach to each surplus lines licensee or surplus lines advisory organization, for distribution to all surplus lines licensees.

Drafting Note: Individual states should consider whether such declarations of ineligibility are appropriate in view of the state's other due process and administrative procedure requirements. Eligibility criteria are independent of other considerations such as compliance with other laws, for example, 18 USC 1033, relating to felons participating in the insurance business.

~~G.F.~~ Surplus Lines Tax

- ~~(1)~~ ~~(1)~~ — In addition to the full amount of gross premiums charged by the insurer for the insurance, every person licensed pursuant to Section 5H of this Act shall collect and pay to the commissioner a sum equal to [insert number] percent of the gross premiums charged, less any return premiums, for surplus lines insurance provided by the licensee pursuant to the license. Where the insurance covers properties, risks or exposures located or to be performed both in and out of this state, the sum payable shall be ~~computed on that portion of the gross premiums allocated to this state pursuant to Paragraph (4) of this subsection less the amount of gross premiums allocated to this state and returned to the insured~~ paid entirely to the hHome sState of the insured. The tax on any portion of the premium unearned at termination of insurance having been credited by the state to the licensee shall be returned to the policyholder directly by the surplus lines licensee or through the producing broker, if any. The surplus lines licensee is prohibited from rebating, for any reason, any part of the tax.
- (2) At the time of filing the [insert monthly, quarterly, annual] report as set forth in Subsection ~~S.R.~~

this section, each surplus lines licensee shall pay the premium tax due for the policies written during the period covered by the report.

- ~~(3) — If a surplus lines policy procured through a surplus lines licensee covers properties, risks or exposures only partially located or to be performed in this state, the tax due shall be computed on the portions of the premiums which are attributable to the properties, risks or exposures located or to be performed in this state. In determining the amount of premiums taxable in this state, all premiums written, procured or received in this state shall be considered written on properties, risks or exposures located or to be performed in this state, except premiums which are properly allocated or apportioned and reported as taxable premiums of a reciprocal state. In no event shall the tax payable to this state be less than the tax due pursuant to Paragraph (4) of this subsection; provided, however, in the event that the amount of tax due under this provision is less than \$50 in any jurisdiction, it shall be payable in the jurisdiction in which the affidavit required in Subsection K of this section is filed. The commissioner shall, at least annually furnish to the commissioner of a reciprocal state, as defined in Section 3L, a copy of all filings reporting an allocation of taxes as required by this subsection.~~
- ~~(4) — In determining the amount of gross premiums taxable in this state for a placement of surplus lines insurance covering properties, risks or exposures only partially located or to be performed in this state, the tax due shall be computed on the portions of the premiums which are attributable to properties, risks or exposures located or to be performed in this state and which relates to the kinds of insurance being placed as determined by reference to an allocation schedule duly promulgated in a regulation by the commissioner.~~
- ~~(a) — If a policy covers more than one classification:~~
- ~~(i) — For any portion of the coverage identified by a classification on the Allocation Schedule, the tax shall be computed by using the Allocation Schedule for the corresponding portion of the premium;~~
- ~~(ii) — For any portion of the coverage not identified by a classification on the Allocation Schedule, the tax shall be computed by using an alternative equitable method of allocation for the property or risk;~~
- ~~(iii) — For any portion of the coverage where the premium is indivisible, the tax shall be computed by using the method of allocation which pertains to the classification describing the predominant coverage.~~
- ~~(b) — If the information provided by the surplus lines licensee is insufficient to substantiate the method of allocation used by the surplus lines licensee, or if the commissioner determines that the licensee's method is incorrect, the commissioner shall determine the equitable and appropriate amount of tax due to this state as follows:~~
- ~~(i) — By use of the Allocation Schedule where the risk is appropriately identified in the schedule;~~
- ~~(ii) — Where the Allocation Schedule does not identify a classification appropriate to the coverage, the commissioner may give significant weight to documented evidence of the underwriting bases and other criteria used by the insurer. The commissioner may also consider other available information to the extent sufficient and relevant, including the percentage of the insured's physical assets in this state, the percentage of the insured's sales in this state, the percentage of income or resources derived from this state, and the amount of premium tax paid to another jurisdiction for the policy.~~

Drafting Note: Subparagraph (b) above may be included in the Act or in a separate regulation at the option of the

~~state. It is highly recommended that the model Allocation Schedule and reporting form be adopted by regulation in conjunction with the adoption of the above language. In order for the model law to work effectively, the allocation schedules used by the states should be as uniform as possible.~~

HG. Collection of Tax

If the tax owed by a surplus lines licensee under this section has been collected and is not paid within the time prescribed, the same shall be recoverable in a suit brought by the commissioner against the surplus lines licensee and the surety on the bond filed under Subsection HI of this section. The commissioner may charge interest at the rate of [insert number] percent per year for the unpaid tax.

IH. Surplus Lines Licenses

- (1) A person shall not procure a contract of surplus lines insurance with a ~~nonadmitted~~ surplus lines insurer unless the person possesses a current surplus lines insurance producer license issued by the commissioner.
- (2) The commissioner may issue a resident surplus lines license to a qualified holder of ~~a current underlying~~ property and casualty ~~agent's or broker's or general agent's~~ licenses, but only when the ~~broker or agent~~ producer has:
 - (a) Remitted the \$[insert amount] annual fee to the commissioner;
 - (b) Submitted a completed license application on a form supplied by the commissioner;
 - ~~(c) Passed a qualifying examination approved by the commissioner, except that all holders of a license prior to the effective date of this Act shall be deemed to have passed such an examination;~~
 - ~~(c)~~ In the case of a resident agent, filed with the commissioner, and continues to maintain during the term of the license, in force and unimpaired, a bond or errors and omissions (E&O) policy in favor of this state in the penal sum of \$[insert amount] aggregate liability, with corporate sureties approved by the commissioner. The bond or E&O policy shall be conditioned that the surplus lines licensee will conduct business in accordance with the provisions of this Act and will promptly remit the taxes as provided by law. No bond or E&O policy shall be terminated unless at least thirty (30) days prior written notice is given to the licensee and commissioner;

Drafting note: Under Public Law No. 106-102 (the “Gramm-Leach-Bliley Act”), it is believed that a requirement for a nonresident agent to file a bond may contravene the reciprocity provisions. The requirement for a resident agent to file a bond would not, seemingly, contravene these provisions, and there may be methodologies whereby such resident bonds could become reciprocal between states. Some states have expressed concern that their bonding requirements constitute important consumer protections, and that elimination of these simply to comply with Gramm-Leach-Bliley may result in unintended consequences, and a lack of ~~control~~ over possibly unscrupulous nonresident agents.

- ~~(de)~~ If a resident, established and continues to maintain an office in this state, ~~and~~
 - ~~(f) Designated the commissioner as agent for service of process, thereby designating the commissioner to be the licensee's true and lawful attorney upon whom may be served all lawful process in a proceeding instituted by or on behalf of an insured or beneficiary arising out of any contract of insurance, and shall signify its agreement that such service of process is of the same legal force and validity as personal service of process in this state upon the licensee.~~
- (3) A nonresident person shall receive a nonresident surplus lines license if:

- (a) The person is currently licensed as a surplus lines licensee and in good standing in his or her home state;
- (b) The person has submitted the proper request for licensure and has paid the fees required by [insert appropriate reference to state law or regulation];
- (c) The person has submitted or transmitted to the insurance commissioner the application for licensure that the person submitted to his or her home state, or in lieu of the same, a completed Uniform Application; and
- (d) The person's home state awards nonresident surplus lines licenses to residents of this state on the same basis.

Drafting Note: In accordance with Public Law No. 106-102 (the "Gramm-Leach-Bliley Act") states should not require any additional attachments to the Uniform Application or impose any other conditions on applicants that exceed the information requested within the Uniform Application.

- (4) The insurance commissioner may verify the person's licensing status through the Producer Database maintained by the ~~NAICational Association of Insurance Commissioners~~, its affiliates or subsidiaries.
- (5) A nonresident surplus lines licensee who moves from one state to another state or a resident surplus lines licensee who moves from this state to another state shall file a change of address and provide certification from the new resident state within thirty (30) days of the change of legal residence. No fee or license application is required.
- (6) The insurance commissioner shall waive any requirements for a nonresident surplus lines license applicant with a valid license from his or her home state, except the requirements imposed by this subsection, if the applicant's home state awards nonresident surplus lines licenses to residents of this state on the same basis.
- (76) Each surplus lines license shall expire on [insert date] of each year, and an application for renewal shall be filed before [insert date] of each year upon payment of the annual fee and compliance with other provisions of this section. A surplus lines licensee who fails to apply for renewal of the license before [insert date] shall pay a penalty of \$[insert amount] and be subject to penalties provided by law before the license will be renewed.

Drafting Note: States may wish to reference their specific licensing statutes in this section.

Drafting Note: Some states allow surplus lines licensees to hold binding authorities on behalf of ~~eligible~~ surplus lines insurers. States which allow such binding authorities might want to establish minimum standards for the related agreements. In addition, states might want to consider requiring surplus lines licensees with such binding authorities to submit the related agreements to state regulators for review and approval.

J. Suspension, Revocation or Nonrenewal of Surplus Lines Licensee's License

The commissioner may suspend, revoke or refuse to renew the license of a surplus lines licensee after notice and an opportunity for a hearing as provided under the applicable provision of this state's laws ~~for upon one or more of the following grounds:~~

- (1) ~~Removal of the resident surplus lines licensee's office from this state;~~
- (2) ~~Removal of the resident surplus lines licensee's office accounts and records from this state during the period during which the accounts and records are required to be maintained under Subsection Q of this section;~~
- (3) ~~Closing of the surplus lines licensee's office for a period of more than thirty (30) business days;~~

~~unless permission is granted by the commissioner;~~

~~(4) Failure to make and file required reports;~~

~~(5) Failure to transmit required tax on surplus lines premiums to this state or a reciprocal state to which a tax is owing;~~

~~(6) Failure to maintain required bond;~~

~~(17) Violation of any provision of this Act; or~~

~~(28) For any cause for which an insurance license could be denied, revoked, suspended or renewal refused under Sections [insert applicable citation].~~

~~K.~~ K.J. Actions Against Eligible Surplus Lines Insurers Transacting Surplus Lines Business

(1) An eligible surplus lines insurer may be sued upon a cause of action arising in this state under a surplus lines insurance contract made by it or evidence of insurance issued or delivered by the surplus lines licensee. A policy issued by the eligible surplus lines insurer shall contain a provision stating the substance of this section and designating the person to whom the commissioner shall mail process.

(2) The remedies provided in this section are in addition to any other methods provided by law for service of process upon insurers.

~~L.~~ L.K. Duty to File Evidence of Insurance and Affidavits

Within [insert number] days after the placing of any surplus lines insurance, each producing broker shall execute and each surplus lines licensee shall execute where appropriate, and file a written report regarding the insurance which shall be kept confidential by the commissioner, including the following:

(1) The name and address of the insured;

(2) The identity of the insurer or insurers;

(3) A description of the subject and location of the risk;

(4) The amount of premium charged for the insurance;

(5) Such other pertinent information as the commissioner may reasonably require; and

(6) An affidavit on a standardized form promulgated by the commissioner as to the diligent efforts to place the coverage with admitted insurers and the results of that effort ~~or the insured is an exempt commercial purchaser~~. The affidavit shall be open to public inspection. The affidavit shall affirm that the insured was expressly advised in writing prior to placement of the insurance that:

(a) The surplus lines insurer with whom the insurance was to be placed is not licensed in this state and is not subject to its supervision; and

(b) In the event of the insolvency of the surplus lines insurer, losses will not be paid by the state insurance guaranty fund.

Drafting Note: Surplus lines licensees will frequently communicate with the insured through a producing broker rather than communicate with the insured directly. In preparing affidavit forms, states may wish to recognize that, as a result of communications passing through the producing broker, the surplus lines licensee may not be in a position to affirm, based upon personal knowledge, that the insured received from the producing broker the written information required by this subsection.

ML. Surplus Lines Advisory Organizations

- (1) There is hereby created a nonprofit association to be known as the [insert name]. All surplus lines licensees shall be deemed to be members of the association. The association shall perform its functions under the plan of operation established pursuant to Paragraph (3) of this subsection and must exercise its powers through a board of directors established under Paragraph (2) of this subsection. The association shall be supervised by the commissioner. The association shall be authorized and have the duty to:

Drafting Note: The preceding paragraph provides that all surplus lines licensees are “deemed” to be members of the association. Some states, however, may choose not to establish a surplus lines advisory organization; in those states Subsection M would not be necessary.

- (a) Receive, record, and subject to Subparagraph (b) of this paragraph, stamp all surplus lines insurance documents which surplus lines brokers are required to file with the association pursuant to the plan of operation;

Drafting Note: Subparagraph (a) of this paragraph authorizes the association to receive, record and stamp all surplus lines documents which must be submitted to the association pursuant to the plan of operation. Documents to be submitted to the association for stamping are likely to vary by state.

- (b) Refuse to stamp submitted insurance documents, if the association determines that a nonadmitted insurer does not meet minimum state financial standards of eligibility, or the commissioner orders the association not to stamp insurance documents pursuant to Paragraph (9) of this subsection. The association shall notify the commissioner and provide an explanation for any refusal to stamp submitted insurance documents other than a refusal based upon the order of the commissioner;
 - (c) Prepare and deliver annually to each licensee and to the commissioner a report regarding surplus lines business. The report shall include a delineation of the classes of business procured during the preceding calendar year, in the form the board of directors prescribes;
 - (d) Encourage compliance by its members with the surplus lines law of this state and the rules and regulations of the commissioner relative to surplus lines insurance;
 - (e) Communicate with organizations of agents, brokers and admitted insurers with respect to the proper use of the surplus lines market;
 - (f) Employ and retain persons as necessary to carry out the duties of the association;
 - (g) Borrow money as necessary to effect the purposes of the association;
 - (h) Enter contracts as necessary to effect the purposes of the association; and
 - (i) Provide such other services to its members as are incidental or related to the purposes of the association.
- (2) The association shall function through a board of directors elected by the association members, and officers who shall be elected by the board of directors.
 - (a) The board of directors of the association shall consist of not less than five (5) nor more than nine (9) persons serving terms as established in the plan of operation. The plan of operation shall provide for the election of a board of directors by the members of the association from its membership. The plan of operation shall fix the manner of voting and may weigh each member’s vote to reflect the annual surplus lines insurance premium written by the member.

- (b) The board of directors shall elect officers as provided for in the plan of operation.
- (3) The association shall establish a plan of operation. The plan of operation shall provide for the formation, operation and governance of the association. The plan and any amendments shall be effective upon approval by the commissioner, which shall not be unreasonably withheld or delayed. All association members shall comply with the plan of operation or any amendments to it. Failure to comply with the plan of operation or any amendments shall constitute a violation of the insurance law and the commissioner may issue an order requiring discontinuance of the violation.
- (4) The association shall file with the commissioner:
 - (a) A copy of its plan of operation and any amendments to it;
 - (b) A current list of its members revised at least annually;
 - (c) The name and address of a resident of this state upon whom notices or orders of the commissioner or processes issued at the direction of the commissioner may be served; and
 - (d) An agreement that the commissioner may examine the association in accordance with the provisions of Paragraph (5) of this subsection.
- (5) The commissioner shall, at least once in [insert number] years, make or cause to be made an examination of the association. The reasonable cost of an examination shall be paid by the association upon presentation to it by the commissioner of a detailed account of each cost. The officers, managers, agents, and employees of the association may be examined at any time, under oath, and shall exhibit all books, records, accounts, documents or agreements governing its method of operation. The commissioner shall furnish a copy of the examination report to the association and shall notify the association that it may request a hearing within thirty (30) days on the report or on any facts or recommendations contained in it. If the commissioner finds the association to be in violation of this section, the commissioner may issue an order requiring the discontinuance of the violation. A director may be removed from the association's board of directors by the commissioner for cause, stated in writing, after an opportunity has been given to the director to be heard.
- (6) There shall be no liability on the part of and no causes of action of any nature shall arise against the association, its directors, officers, agents or employees for any action taken or omitted by them in the performance of their powers and duties under this section, absent gross negligence or willful misconduct.
- (7) Within [insert number] days after a surplus lines policy is procured, a licensee shall submit to the association for recording and stamping all documents which surplus lines brokers are required to file with the association. Every insurance document submitted to the association pursuant to this subsection shall set forth:
 - (a) The name and address of the insured;
 - (b) The gross premium charged;
 - (c) The name of the nonadmitted insurer; and
 - (d) The class of insurance procured.

Drafting Note: The appropriate time limits for submitting documents required for stamping will vary by state.

- (8) It shall be unlawful for an insurance agent, broker or surplus lines broker to deliver in this state any insurance document which surplus lines brokers are required to file with the association unless the

insurance document is stamped by the association or is exempt from such requirements. However, a licensee's failure to comply with the requirements of this subsection shall not affect the validity of the coverage.

- (9) The services performed by the association shall be funded by a stamping fee assessed for each premium-bearing document submitted to the association. The stamping fee shall be established by the board of directors of the association from time to time. The stamping fee shall be paid by the insured.
- (10) The commissioner may declare a nonadmitted insurer ineligible and order the association not to stamp insurance documents issued by the nonadmitted insurer and issue any other appropriate order.

NM. Evidence of the Insurance and Subsequent Changes to the Insurance

- (1) Upon placing surplus lines insurance, the surplus lines licensee shall promptly deliver to the insured or the producing broker the policy, or if the policy is not then available, a certificate as described in Paragraph (4) of this subsection, cover note, binder or other evidence of insurance. The certificate described in Paragraph (4) of this subsection, cover note, binder or other evidence of insurance shall be executed by the surplus lines licensee and shall show the description and location of the subject of the insurance, coverages including any material limitations other than those in standard forms, a general description of the coverages of the insurance, the premium and rate charged and taxes to be collected from the insured, and the name and address of the insured and surplus lines insurer or insurers and proportion of the entire risk assumed by each, and the name of the surplus lines licensee and the licensee's license number.
- (2) A surplus lines licensee shall not issue or deliver any evidence of insurance or purport to insure or represent that insurance will be or has been written by any ~~eligible~~ surplus lines insurer, or a nonadmitted insurer ~~pursuant to Section 5C(4)~~, unless the licensee has authority from the insurer to cause the risk to be insured or has received information from the insurer in the regular course of business that the insurance has been granted.
- (3) If, after delivery of any evidence of insurance, there is any change in the identity of the insurers, or the proportion of the risk assumed by any insurer, or any other material change in coverage as stated in the surplus lines licensee's original evidence of insurance, or in any other material as to the insurance coverage so evidenced, the surplus lines licensee shall promptly issue and deliver to the insured or the original producing broker an appropriate substitute for, or endorsement of the original document, accurately showing the current status of the coverage and the insurers responsible for the coverage.
- (4) As soon as reasonably possible after the placement of the insurance, the surplus lines licensee shall deliver a copy of the policy or, if not available, a certificate of insurance to the insured or producing broker to replace any evidence of insurance previously issued. Each certificate or policy of insurance shall contain or have attached a complete record of all policy insuring agreements, conditions, exclusions, clauses, endorsements or any other material facts that would regularly be included in the policy.
- ~~(5) A surplus lines licensee who fails to comply with the requirements of this subsection shall be subject to the penalties provided in this Act.~~
- ~~(56)~~ The surplus lines licensee shall give the following consumer notice to every person, ~~other than exempt commercial purchasers~~, applying for insurance with a nonadmitted insurer. The notice shall be printed in 16-point type on a separate document affixed to the application. The applicant shall sign and date a copy of the notice to acknowledge receiving it. The surplus lines licensee shall maintain the signed notice in its file for a period of five (5) years from expiration of the policy. The surplus lines licensee shall tender a copy of the signed notice to the insured at the time of delivery of each policy the licensee transacts with a nonadmitted insurer. The copy shall be a separate document

affixed to the policy.

~~“Notice: 1. A “nonadmitted” or “surplus lines insurer that is not licensed in this state is issuing the insurance policy that you have applied to purchase. These companies are called “nonadmitted” or “surplus lines” insurers. 2. The insurer is not subject to the financial solvency regulation and enforcement that applies to licensed insurers in this state. 3. These insurers generally do not participate in insurance guaranty funds created by state law. These guaranty funds will not pay your claims or protect your assets if the insurer becomes insolvent and is unable to make payments as promised. 4. Some states maintain lists of approved or eligible surplus lines insurers and surplus lines brokers may use only insurers on the lists. Some states issue orders that particular surplus lines insurers can not be used. 5. For additional information about the above matters and about the insurer, you should ask questions of your insurance agent, broker or surplus lines broker. You may also contact your insurance department consumer help line.”~~

Drafting Note: This notice is intended to inform personal lines customers and smaller commercial risks of the nature of the coverage they are purchasing. A state may wish to add language to this statute providing that this notice need not be given to commercial risks meeting defined criteria for size and insurance expertise.

ON. Licensee’s Duty to Notify Insured

- (1) No contract of insurance placed by a surplus lines licensee under this Act shall be binding upon the insured and no premium charged shall be due and payable until the surplus lines licensee or the producing broker ~~shall have~~has notified the insured in writing, in a form acceptable to the commissioner, a copy of which shall be maintained by the licensee or the producing broker with the records of the contract and available for possible examination, that:
 - (a) The insurer [other than a domestic surplus lines insurer] with which the licensee places the insurance is not licensed by this state and is not subject to its supervision; and
 - (b) In the event of the insolvency of the surplus lines insurer, losses will not be paid by the state insurance guaranty fund.
- (2) Nothing herein contained shall nullify any agreement by any insurer to provide insurance.

Drafting Note: To ensure the meaningfulness of the notice required by this subsection, the commissioner might want to establish criteria related to readability, type face~~font~~, and type~~size~~ of the notice.

PO. Effect of Payment to Surplus Lines Licensee

A payment of premium to a surplus lines licensee acting for a person other than itself in procuring, continuing or renewing any policy of insurance procured under this section shall be deemed to be payment to the insurer, whatever conditions or stipulations may be inserted in the policy or contract notwithstanding.

QP. Surplus Lines Licensees May Accept Business from Other Producers

A surplus lines licensee may originate surplus lines insurance or accept such insurance from any other producing broker duly licensed as to the kinds of insurance involved, and the surplus lines licensee may compensate the producing broker for the business.

RQ. Records of Surplus Lines Licensee

- (1) Each surplus lines licensee shall keep ~~in this state~~ a full and true record of each surplus lines insurance contract placed by or through the licensee, including a copy of the policy, certificate, cover note or other evidence of insurance showing each of the following items applicable:
 - (~~1~~a) Amount of the insurance, risks and perils insured;

- (2b) Brief description of the property insured and its location;
- (3c) Gross premium charged;
- (4d) Any return premium paid;
- (5e) Rate of premium charged upon the several items of property;
- (6f) Effective date and terms of the contract;
- (7g) Name and address of the insured;
- (8h) Name and address of the insurer;
- (9i) Amount of tax and other sums to be collected from the insured;
- ~~(10) Allocation of taxes by state as referred to in Subsection F of this section;~~ and
- (11j) Identity of the producing broker, any confirming correspondence from the insurer or its representative, and the application.

(2) The record of each contract shall be kept open at all reasonable times to examination by the commissioner without notice for a period not less than five (5) years following termination of the contract. In lieu of maintaining offices in this state, each nonresident surplus lines licensee shall make available to the commissioner any and all records that the commissioner deems necessary for examination.

Drafting Note: States may wish to extend the five-year period prescribed for open access to insurance records because of the long-term nature of this business.

SR. Reports—Summary of Exported Business

On or before the end of the month following each [insert month, quarter, year], each surplus lines licensee shall file with the commissioner, on forms prescribed by the commissioner, a verified report in duplicate of all surplus lines insurance transacted during the preceding period, showing:

- (1) Aggregate gross premiums written;
- (2) Aggregate return premiums;
- (3) Amount of aggregate tax remitted to this state; and
- (4) Amount of aggregate tax due or remitted to each other state for which an allocation is made pursuant to Subsection ~~GF~~ of this section.

Drafting Note: States desiring to have taxes remitted annually may call for more frequent detailed listing of business.

T. [OPTIONAL: Domestic Surplus Lines Insurers]

(1) The commissioner may designate a domestic insurer as a domestic surplus lines insurer upon its application, which shall include, as a minimum, an authorizing resolution of the board of directors and evidence to the commissioner's satisfaction that the insurer has capital and surplus of not less than fifteen million dollars.

(2) A domestic surplus lines insurer:

- (a) ~~(a)~~ Shall be limited in its authority in this state to providing surplus lines insurance.
- (b) May be authorized to write any type of property and casualty [or accident and health] insurance in this state that may be placed with a surplus lines insurer pursuant to this Subpart.
- (c) Be subject to the legal and regulatory requirements applicable to domestic insurers, except for theas following:
 - (i) Premium taxes, fees, and assessments applicable to admitted insurance;
 - (ii) ~~Regulation of rates and formss requiring the filing of rates and forms for approval;~~
 - (iii) ~~Assessment or coverage by insurance guaranty funds.]~~

Section 6. Insurance Independently Procured—Duty to Report and Pay Tax

- A. Each insured whose home state is in this state, who procures or continues or renews insurance with a nonadmitted insurer ~~on properties, risks or exposures located or to be performed in whole or in part in this state~~, other than insurance procured through a surplus lines licensee, shall, within [insert number] days after the date the insurance was so procured, continued or renewed, file a written report with the commissioner, upon forms prescribed by the commissioner, showing the name and address of the insured or insureds, name and address of the insurer, the subject of the insurance, a general description of the coverage, the amount of premium currently charged, and additional pertinent information reasonably requested by the commissioner.
- ~~For the purposes of this subsection, properties, risks or exposures only partially located or to be performed in this state, which are covered under a multistate policy placed by a surplus lines licensee in another state, shall be deemed to be insurance independently procured unless the insurer is an admitted insurer.~~

Drafting Note: Subsection A may need to be revised in those states exempting from taxation insurance procured by nonprofit educational institutions and their employers, from nonprofit educational insurers.

- B. ~~Gross~~ Premiums charged for the insurance, less any return premiums, is subject to a tax at the rate of [insert number] percent. At the time of filing the report required in Subsection A of this section, the insured whose home state is this state shall pay the tax on all taxable pPremium to the commissioner, who shall transmit the same for distribution as provided in this Act.

Drafting Note: Existing state laws and procedures may require that the tax report be forwarded to another state agency, such as the Department of the Treasury, rather than to the commissioner. In addition, some states may require the tax to be paid on a periodic basis (e.g., annually) rather than at the time of the filing required by Subsection A. Subsections A and B may need to be revised in these states.

- ~~C. If an independently procured policy covers properties, risks or exposures only partially located or to be performed in this state, the tax payable shall be computed on the portion of the premium properly attributable to the properties, risks or exposures located or to be performed in this state, as set forth in Sections 5F(3) and 5F(4) of this Act.~~

~~C~~D. Delinquent taxes hereunder shall bear interest at the rate of [insert number] percent per year.

~~D~~E. This section does not abrogate or modify; and shall not be construed or deemed to abrogate or modify any other provision of this Act.

Section 7. Penalties

- A. A person who in this state represents or aids a nonadmitted insurer in violation of this Act may be found guilty of a criminal act and subject to a fine not in excess of \$[insert amount].

Drafting Note: Some states might want to specify “misdemeanor” or “felony” rather than “criminal act” in Section 7A.

- B. In addition to any other penalty provided herein or otherwise provided by law, including any suspension, revocation or refusal to renew a license, any person, firm, association or corporation violating any provision of this Act shall be liable to a civil penalty not exceeding \$[insert amount] for the first offense, and not exceeding \$[insert amount] for each succeeding offense.
- C. The above penalties are not exclusive remedies. Penalties may also be assessed under [insert citation to trade practices and fraud statute] of the insurance code of this state.

Section 8. Violations

Whenever there is evidence satisfactory to the commissioner believes, from evidence satisfactory to him or her, that a person is violating or about to violate the provisions of this Act, the commissioner may cause a complaint to be filed in the [insert appropriate court] Court for restitution and to enjoin and restrain the person from continuing the violation or engaging in or doing any act in furtherance thereof. The court shall have jurisdiction of the proceeding and shall have the power to make and enter an order of judgment awarding such preliminary or final injunctive relief and restitution as in its judgment is proper.

Section 9. Service of Process

- A. Any act of transacting insurance by an unauthorized person or a nonadmitted insurer is equivalent to and shall constitute an irrevocable appointment by the unauthorized person or insurer, binding upon it, its executor or administrator, or successor in interest of the [insert title of appropriate state official] or his or her successor in office, to be the true and lawful attorney of the unauthorized person or insurer upon whom may be served all lawful process in any action, suit or proceeding in any court by the commissioner or by the state and upon whom may be served any notice, order, pleading or process in any proceeding before the commissioner and which arises out of transacting insurance in this state by the unauthorized person or insurer. Any act of transacting insurance in this state by a nonadmitted insurer shall signify its acceptance of its agreement that any lawful process in such court action, suit or proceeding and any notice, order, pleading or process in such administrative proceeding before the commissioner so served shall be of the same legal force and validity as personal service of process in this state upon the unauthorized person or insurer.
- B. Service of process in the action shall be made by delivering to and leaving with the [insert title of appropriate state official], or some person in apparent charge of the office, two (2) copies thereof and by payment to the [insert title of appropriate state official] of the fee prescribed by law. Service upon the [insert title of appropriate state official] as attorney shall be service upon the principal.

Drafting Note: Existing state laws and procedures may require that service of process be made upon either the commissioner or another state official.

- C. The [insert title of appropriate state official] shall forward by certified mail one of the copies of the process or notice, order, pleading or process in proceedings before the commissioner to the defendant in the court proceeding or to whom the notice, order, pleading or process in the administrative proceeding is addressed or directed at its last known principal place of business and shall keep a record of all process so served on the commissioner which shall show the day and hour of service. Service is sufficient, provided:
 - (1) Notice of service and a copy of the court process or the notice, order, pleading or process in the administrative proceeding are sent within ten (10) days by certified mail by the plaintiff or the plaintiff’s attorney in the court proceeding or by the commissioner in the administrative proceeding to the defendant in the court proceeding or to whom the notice, order, pleading or process in the administrative proceeding is addressed or directed at the last known principal place of business of the defendant in the court or administrative proceeding; and
 - (2) The defendant’s receipt or receipts issued by the post office with which the letter is registered, showing the name of the sender of the letter and the name and address of the person or insurer to

whom the letter is addressed, and an affidavit of the plaintiff or the plaintiff's attorney in a court proceeding or of the commissioner in an administrative proceeding, showing compliance are filed with the clerk of the court in which the action, suit or proceeding is pending or with the commissioner in administrative proceedings, on or before the date the defendant in the court or administrative proceeding is required to appear or respond, or within such further time as the court or commissioner may allow.

- D. A plaintiff shall not be entitled to a judgment or a determination by default in any court or administrative proceeding in which court process or notice, order, pleading or process in proceedings before the commissioner is served under this section until the expiration of forty-five (45) days from the date of filing of the affidavit of compliance.
- E. Nothing in this section shall limit or affect the right to serve any process, notice, order or demand upon any person or insurer in any other manner now or hereafter permitted by law.
- F. Each nonadmitted insurer assuming insurance in this state, or relative to property, risks or exposures located or to be performed in this state, shall be deemed to have subjected itself to this Act.
- G. ~~Notwithstanding~~Notwithstanding conditions or stipulations in the policy or contract, a nonadmitted insurer may be sued upon any cause of action arising in this state, or relative to property, risks or exposures located or to be performed in this state, under any insurance contract made by it.
- H. ~~Notwithstanding~~Except with regard to exempt commercial purchasers, independently procured insurance, [aviation], and wet marine and transportation insurance, conditions or stipulations in the policy or contract ~~notwithstanding,~~ a nonadmitted insurer subject to arbitration or other alternative dispute resolution mechanism ~~arising in this state or relative to property, risks or exposures located or to be performed in this state under an insurance contract made by it~~ shall conduct the arbitration or other alternative dispute resolution mechanism ~~in this state in the home state of the insured.~~

Drafting Note: Provisions of a state's constitution, statutes, regulations, and public policy may necessitate amendment of the prior ~~sub~~Section 9H. States should consider adoption or modification of priorSection 9H in light of their own laws on arbitration or other alternative dispute resolution in insurance and commercial transactions. States should cross-reference their state insurance code to verify the inclusion of "Aviation" within this provision.

- I. A policy or contract issued by the nonadmitted insurer or one which is otherwise valid and contains a condition or provision not in compliance with the requirements of this Act is not thereby rendered invalid but shall be construed and applied in accordance with the conditions and provisions which would have applied had the policy or contract been issued or delivered in full compliance with this Act.

Section 10. Legal or Administrative Procedures

- A. Before any nonadmitted insurer files or causes to be filed any pleading in any court action, suit or proceeding or in any notice, order, pleading or process in an administrative proceeding before the commissioner instituted against the person or insurer, by services made as provided in this Act, the insurer shall either:
 - (1) Deposit with the clerk of the court in which the action, suit or proceeding is pending, or with the Commissioner of Insurance in administrative proceedings before the commissioner, cash or securities, or file with the clerk or commissioner a bond with good and sufficient sureties, to be approved by the clerk or commissioner in an amount to be fixed by the court or commissioner sufficient to secure the payment of any final judgment which may be rendered in the action or administrative proceeding; or
 - (2) Procure a certificate of authority to transact the business of insurance in this state. In considering the application of an insurer for a certificate of authority, for the purposes of this paragraph the commissioner need not assert the provisions of [insert sections of insurance laws relating to retaliation] against the insurer with respect to its application if the commissioner determines that the

company would otherwise comply with the requirements for a certificate of authority.

- B. The Commissioner of Insurance, in any administrative proceeding in which service is made as provided in this Act, may in the commissioner's discretion, order such postponement as may be necessary to afford the defendant reasonable opportunity to comply with the provisions of Subsection A of this section and to defend the action.
- C. Nothing in Subsection A of this section shall be construed to prevent a nonadmitted insurer from filing a motion to quash a writ or to set aside service thereof made in the manner provided in this Act, on the ground that the nonadmitted insurer has not done any of the acts enumerated in the pleadings.
- D. Nothing in Subsection A of this section shall apply to placements of insurance which were lawful in the home state of the insured in which the placement took place and which were not unlawful placements under the laws of this state. Without limiting the generality of the foregoing, nothing in Subsection A shall apply to a placement made pursuant to Section 5 of this Act.

Section 11. Enforcement

- A. The commissioner shall have the authority to proceed in the courts of this state or any other United States jurisdiction to enforce an order or decision in any court proceeding or in any administrative proceeding before the commissioner of Insurance.

~~A. Filing and Status of Foreign Decrees~~

~~A copy of a foreign decree authenticated in accordance with the statutes of this state may be filed in the office of the clerk of any [insert proper court] Court of this state. The clerk, upon verifying with the commissioner that the decree or order qualifies as a "foreign decree" shall treat the foreign decree in the same manner as a decree of a [insert proper court] Court of this state. A foreign decree so filed has the same effect and shall be deemed a decree of a [insert proper court] Court of this state, and is subject to the same procedures, defenses and proceedings for reopening, vacating or staying as a decree of a [insert proper court] Court of this state and may be enforced or satisfied in like manner.~~

~~B. Notice of Filing~~

- ~~(1) At the time of the filing of the foreign decree, the plaintiff shall make and file with the clerk of the court an affidavit setting forth the name and last known post office address of the defendant.~~
- ~~(2) Promptly upon the filing of the foreign decree and the affidavit, the clerk shall mail notice of the filing of the foreign decree to the defendant at the address given and to the commissioner of this state and shall make a note of the mailing in the docket. In addition, the plaintiff may mail a notice of the filing of the foreign decree to the defendant and to the commissioner of this state and may file proof of mailing with the clerk. Lack of mailing notice of filing by the clerk shall not affect the enforcement proceedings if proof of mailing by the plaintiff has been filed.~~
- ~~(3) No execution or other process for enforcement of a foreign decree filed hereunder shall issue until thirty (30) days after the date the decree is filed.~~

~~**Drafting Note:** This section presumes that the commissioner has authority to proceed without the cooperation of the state's attorney general. Governing state laws might require that a person other than the commissioner or the attorney general serve as the plaintiff. The title of that person shall be substituted for "commissioner" or "plaintiff" in Section 11 whenever required by state law.~~

~~C. Stay of the Foreign Decree~~

- ~~(1) If the defendant shows the [insert proper court] Court that an appeal from the foreign decree is pending or will be taken, or that a stay of execution has been granted, the court shall stay enforcement of the foreign decree until the appeal is concluded, the time for appeal expires, or the stay of execution expires or is vacated, upon proof that the defendant has furnished the security for~~

~~the satisfaction of the decree required by the state in which it was rendered.~~

~~(2) — If the defendant shows the [insert proper court] Court any ground upon which enforcement of a decree of any [insert proper court] Court of this state would be stayed, the court shall stay enforcement of the foreign decree for an appropriate period, upon requiring the same security for satisfaction of the decree which is required in this state.~~

~~B. D.~~ — It shall be the policy of this state that the insurance commissioner shall cooperate with regulatory officials in other United States jurisdictions to the greatest degree reasonably practicable in enforcing lawfully issued orders of such other officials subject to public policy and the insurance laws of the state. Without limiting the generality of the foregoing, the commissioner may enforce an order lawfully issued by other officials provided the order does not violate the laws or public policy of this state.

Section 12. Suits by Nonadmitted Insurers

A nonadmitted insurer may not commence or maintain an action ~~in~~ at law or in equity, including arbitration or any other dispute resolution mechanism, in this state to enforce any right arising out of any insurance transaction except with respect to:

- A. Claims under policies lawfully placed pursuant to the law of the home state of the insured~~written in this state~~;
- B. Liquidation of assets and liabilities of the insurer (other than collection of new premium), resulting from its former authorized operations in this state;
- C. Transactions subsequent to issuance of a policy not covering domestic risks at the time of issuance, and lawfully procured under the laws of the jurisdiction where the transaction took place;
- D. Surplus lines insurance placed by a licensee under authority of Section 5 of this Act;
- E. Reinsurance placed under the authority of [insert citations of state's reinsurance intermediary act and other reinsurance laws];
- F. The continuation and servicing of life insurance, health insurance policies or annuity contracts remaining in force as to residents of this state where the formerly authorized insurer has withdrawn from the state and is not transacting new insurance in the state;
- G. Servicing of policies written by an admitted insurer in a state to which the insured has moved but in which the company does not have a certificate of authority until the term expires;
- H. Claims under policies covering wet marine and transportation insurance;
- I. Placements of insurance which were lawful in the jurisdiction in which the transaction took place and which were not unlawful placements under the laws of this state.

Drafting Note: Provisions of a state's constitution, statutes, regulations, and public policy may necessitate amendment of the opening paragraph of this section.

Section 13. ~~Separability Severability Clause of Provisions~~

If any provisions of this Act, or the application of the provision to any person or circumstance, shall be held invalid, the remainder of the Act and the application of the provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

Section 14. Effective Date

This Act shall take effect [insert appropriate date].

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1994 Proc. 3rd Quarter 14, 16-17, 24, 28-46 (adopted).
1996 Proc. 3rd Quarter 9, 42, 1110, 1168, 1169-1173, 1189-1190 (amended).
1997 Proc. 4th Quarter 25, 27-28, 1004, 1029 (amended).
1999 Proc. 3rd Quarter 25, 26, 1080, 1135, 1151-1153 (amended).
2002 Proc. 2nd Quarter 14, 250-251, 344, 347, 349-350 (amended).

This model draws from and replaces three earlier NAIC models:

Model Surplus Lines Law

1983 Proc. I 6, 36, 834, 900, 913-922 (adopted).
1985 Proc. II 11, 24, 702, 722, 723-724 (amended).
1986 Proc. I 9-10, 24, 799, 813, 814-821 (amended).
1990 Proc. I 6, 30, 840-841, 897-898, 900-901 (amended).
1991 Proc. I 9, 18, 908, 949, 950, 952-961 (amended and reprinted).

Unauthorized Insurers Model Act

1969 Proc. I 168, 218, 222-227, 271 (adopted).
1978 Proc. I 13, 15, 348, 350 (amended).
1990 Proc. II 7, 13-14, 159-160, 187-191 (amended and reprinted).

Model Nonadmitted Insurance Act

1983 Proc. I 6, 36, 834, 899-900, 923-926 (adopted).

PROJECT HISTORY

NONADMITTED INSURANCE MODEL ACT (#870)

1. Description of the Project, Issues Addressed, etc.

The 2023 revisions to the NAIC *Nonadmitted Insurance Model Act* (#870) are intended to conform Model #870 to the federal Nonadmitted and Reinsurance Reform Act of 2010 (NRRRA), which was part of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The current Model #870 was adopted in 1994 to combine three NAIC models that date as far back as 1969: 1) the Unauthorized Insurers Model Act; 2) the Model Surplus Lines Law; and 3) the Model Nonadmitted Insurance Act. Since the adoption of Model #870 on Sept. 18, 1994, the NAIC has amended it on the following dates: 1) Dec. 16, 1996; 2) March 18, 1998; 3) Dec. 6, 1999; and 4) Sept. 10, 2002. The 2002 modifications resulted from the passage of the federal Gramm-Leach-Bliley Act (GLBA) by the U.S. Congress (Congress). Currently, 31 states have adopted Model #870.

The most recent activity regarding Model #870 is related to the NRRRA. Model #870 was not modified as a result of the implementation of the NRRRA. On Oct. 11, 2011, the *Nonadmitted Insurance Reform Sample Bulletin* (Bulletin), which was distributed to the state insurance departments, was adopted by the Executive (EX) Committee and Plenary. The Bulletin outlined federally mandated regulatory changes that affect the placement of nonadmitted insurance. Specifically, the Bulletin addressed the scope of the NRRRA, the application of “Home State” for the purposes of jurisdictional authority and paying premium tax, licensure requirements for brokers, diligent search requirements, and eligibility requirements for nonadmitted insurers.

During the implementation of the NRRRA, the Surplus Lines (C) Task Force and NAIC staff were working on state tax allocation proposals. The leading proposals were the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT), which predated the NRRRA, and the Nonadmitted Insurance Multistate Agreement (NIMA), which was developed by the Task Force in response to the NRRRA. The SLIMPACT failed to obtain the 10 states needed to become operative. The NIMA clearinghouse operated for only a few years before the NIMA was dissolved in 2016. With the focus on achieving a system of tax allocation before the NRRRA deadline in July 2012, the decision was made to draft the Bulletin rather than amend Model #870.

During the 2020 Summer National Meeting of the Task Force, the chair directed staff to develop a drafting group to produce a summary document that outlined significant updates needed to modernize Model #870 and present a recommendation to the Task Force at a future national meeting. The drafting group consisted of Tom Travis (LA), Jeff Baughman (WA), Eli Snowbarger (OK), Andy Daleo (NAIC), and Dan Schelp (NAIC). The drafting group met Sept. 30 and Oct. 27, 2020. As a result of those meetings, the drafting group outlined numerous proposed revisions to Model #870.

During the 2020 Fall National Meeting, the Task Force adopted the Request for NAIC Model Law Development. During the 2021 Spring National Meeting, the Executive (EX) Committee approved the Request for NAIC Model Law Development.

2. Name of Group Responsible for Drafting the Model and States Participating

The Surplus Lines (C) Task Force and the drafting group consisting of Louisiana, Chair; Colorado; Illinois; Texas; and Washington.

3. Project Authorized by What Charge and Date First Given to the Group

The charges of the Surplus Lines (C) Task Force state, “Develop or amend relevant NAIC model laws, regulations, and/or guidelines.” Also, as described in charge #1, the Request for NAIC Model Law Development was approved by the Executive (EX) Committee during the 2021 Spring National Meeting.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

During the 2021 Summer National Meeting, the Surplus Lines (C) Task Force formally developed the Model #870 Drafting Group that consisted of Travis, chair; Rolf Kaumann (CO); Marcy Savage (IL); Jamie Walker (TX); and Jeff Baughman (WA).

The Drafting Group began its work on Model #870 on Aug. 19, 2021. During that call the Drafting Group discussed the overall approach to updating the model, initial comments received, and a timeline.

5. A General Description of the Due Process (e.g., exposure periods; public hearings; or any other means by which widespread input from industry, consumers, and legislators was solicited)

The Drafting Group met Aug. 19, 2021, for a regulator-only planning session. Following the initial meeting, the Drafting Group met in open session Sept. 28, Oct. 20, Nov. 4, and Dec. 1, 2021. During these sessions, interested state insurance regulators and parties submitted comment letters to the Drafting Group. The Drafting Group held regulator-only discussion and planning calls on Jan. 10, March 15, and May 3, 2022. During a Surplus Lines (C) Task Force call on May 23, 2022, Model #870 was exposed for a 60-day public comment period. Comments were received from the American Property Casualty Insurance Association (APCIA), CRC Group: Wholesale and Specialty Insurance; Lloyd's of London; McDermott Will & Emery; the National Risk Retention Association (NRRRA); Surplus Line Association of Illinois (SLAI); the Council of Insurance Agents & Brokers (CIAB); and the Wholesale & Specialty Insurance Association (WSIA). The Drafting Group held a regulator-only discussion and planning call on Aug. 3, 2022 and the Task Force held a call on Oct. 17 to discuss the comments received and on Oct. 27, 2022 it exposed Model #870 for a 30-day public comment period. Comments were received from the Maine Bureau of Insurance; the APCIA; Lloyd's of London; and the WSIA. During the Fall National Meeting, the Task Force heard a summary of the comments received. The Drafting Group held a regulator-only discussion and planning call on Jan. 18, 2023 to discuss comments received and on Jan. 23 exposed a new draft of Model #870 for a 14-day public comment period. Comments were received from the California Department of Insurance; the APCIA; the CIAB; Lloyd's of London; McDermott Will & Emery; and the WSIA. On Feb. 10 the drafting group held a regulatory-only discussion and planning call and integrated edits into Model #870.

6. A Discussion of the Significant Issues (e.g., items of some controversy raised during the due process and the group's response)

The most significant issue raised was related to the methodology of determining the "Home State" for unaffiliated groups as outlined within Section 2 of the model. Following comments from various interested parties and discussion among Drafting Group members, an agreed-upon revision resulted in clarification via a drafting note.

7. List the Key Provisions of the Model (e.g., sections considered most essential to state adoption)

Section 5C(2)(b) – Non-U.S. Insurers

- For a Nonadmitted Insurer domiciled outside the U.S., the insurer shall be listed on the *Quarterly Listing of Alien Insurers* maintained by the International Insurers Department (IID) of the NAIC.

Section 5G – Surplus Lines Tax

- In addition to the full amount of gross Premium charged by the insurer for the insurance, every Person licensed pursuant to Section 5J of this Act shall collect and pay to the commissioner a sum equal to [insert number] percent of the gross Premium charged, less any return Premium, for Surplus Lines Insurance provided by the licensee pursuant to the license. Where the insurance covers properties, risks or exposures located or to be performed both in and out of this state, the sum payable shall be paid entirely to the Home State of the insured. The tax on any portion of the Premium unearned at the termination of insurance having been credited by the state to the licensee shall be returned to the policyholder directly by the Surplus Lines Licensee or through the producing broker, if any. The Surplus Lines Licensee is prohibited from rebating, for any reason, any part of the tax.

Section 5T – Domestic Surplus Lines Insurer

- The commissioner may designate a domestic insurer as a domestic Surplus Lines Insurer upon its application, which shall include, as a minimum, an authorizing resolution of the board of directors and evidence to the commissioner's satisfaction that the insurer has capital and surplus of not less than \$15 million. (Although this was added to the model as optional, it remains an important part of the model.).

8. Any Other Important Information (e.g., amending an accreditation standard)

There were no discussions held regarding making Model #870 an accreditation standard.

Adopted by the Cannabis Insurance (C) Working Group—July 18, 2023
Adopted by the Property and Casualty Insurance (C) Committee, Aug. 15, 2023
Adopted by the Executive (EX) Committee and Plenary, Aug. 16, 2023

REGULATORY GUIDE
UNDERSTANDING THE MARKET FOR CANNABIS INSURANCE: 2023 UPDATE

NAIC White Paper

Drafted by the
Cannabis Insurance (C) Working Group
of the
Property and Casualty Insurance (C) Committee

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I. INTRODUCTION

The cannabis industry continues to evolve and expand both in structure and in the number of states with legalized cannabis. The National Association of Insurance Commissioners (NAIC) Cannabis Insurance (C) Working Group's original white paper adopted in 2019, *Regulatory Guide Understanding the Market for Cannabis Insurance*, found there are substantial gaps in insurance coverage for the cannabis industry. While gaps remain, much has transpired since the writing of the original white paper. This white paper seeks to provide an update on activities and trends since the adoption of the previous white paper.

The original white paper focused on the cannabis industry's architecture, insurance needs and gaps, and insurance regulator best practices to encourage insurers to enter the market. The cannabis industry has become more sophisticated since the original white paper was published in 2019. It has also continued to rapidly expand. The maturation and expansion of the cannabis market are driving new product development, infrastructure changes, and the need for businesses to provide ancillary services. It is in these areas where insurance gaps most persist. As such, this white paper will include discussion on emerging insurance issues in these areas of the cannabis industry.

Additionally, the current state of cannabis regulation in the United States (U.S.) will be explored. States and U.S. jurisdictions continue to legalize cannabis, but it remains federally illegal under the Controlled Substances Act (CSA). This tension between federal and state law creates uncertainty about the insurability of cannabis and how policy language will be applied to coverages. Municipal bans on cannabis in states where cannabis has been legalized further complicate this issue. For these reasons, insurers remain reluctant to enter the cannabis space. Although capacity has improved since the first white paper's publishing, most of the commercial insurance for cannabis-related businesses is still found in the excess and surplus lines (also known as the non-admitted) market. Potential paths forward to these issues, including best regulatory practices and addressing the needs of states regulating insurance and cannabis operators under state law.

This white paper will outline the complexities of the cannabis industry, explaining the different designs of cannabis businesses, jurisdictional variations, current insurance types and offerings, potential future insurance products, differences presented by insuring hemp versus cannabis, and the importance of developing consistent regulatory practices for state cannabis insurance regulators. It will also cover cannabis history and terminology, cannabis policy trends at the state and national levels, current landscapes of cannabis regulation, licensing and education, cannabis business operating structures, and cannabis industry insurance market considerations. It will

conclude with a brief discussion on the future state of cannabis insurance, including possible next steps for all affected parties.

The need for accessible, affordable, and adequate insurance for the cannabis industry will only continue to increase. Therefore, it will be vitally important for state insurance regulators to fully comprehend and carefully consider the needs and risks of this industry. Regulators can play an important role in encouraging insurance participation in the new cannabis-related industry, which can help all affected parties achieve risk mitigation with proper financial management. This will lead to increases in consumer protections, as well as better functioning cannabis and insurance markets.

II. UNDERSTANDING CANNABIS CONCEPTS AND TERMS

Cannabis, also known as marijuana, is an annual herbaceous plant in the Cannabis genus under the Cannabaceae family.¹ Cannabis has been referred to as consisting of three species of plants: cannabis ruderalis, cannabis sativa, and cannabis indica. The properties of the plant depend on and are determined by the type of cannabis being produced. Each plant type differs in size, shape, and production yield. Many plants utilized in modern-day cannabis industries are hybrid species that have been selected for certain plant traits.²

Cannabis ruderalis has a naturally high composition of Cannabidiol (CBD), an anti-inflammatory non-psychoactive component, and low concentrations of delta-9 Tetrahydrocannabinol (THC) (the psychoactive substance associated with cannabis).³ This type of plant tends to be short and stalky and has the ability to begin the flowering cycle automatically at a certain point in the plant's lifespan, regardless of lighting.⁴ Cannabis ruderalis produces smaller yields when comparing it to the indica or sativa variants.⁵

¹ John M. McPartland, National Library of Medicine: National Center for Biotechnology Information – Cannabis Systematics at the Levels of Family, Genus, and Species (October 1, 2018) – <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6225593/>

² David Gloss, National Library of Medicine: National Center for Biotechnology Information – An Overview of Products and Bias in Research (July 23, 2015) – <https://pubmed.ncbi.nlm.nih.gov/26202343/>
<https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4604179/#:~:text=Cannabis%20is%20often%20divided%20into,of%20the%20same%20parent%20species>

³ *Id.*

⁴ *Id.*

⁵ *Id.*

Cannabis sativa grows taller and more highly branched than the other two species.⁶ Cannabis sativa also grows narrow leaves and tends to produce higher yields than cannabis ruderalis.⁷ Additionally, it can produce high levels of THC composition.

Cannabis indica grows with short and dense branch structures.⁸ Cannabis indica generally has the shortest flowering period of the species.⁹ Cannabis indica also produces higher yields than cannabis ruderalis and can produce high levels of THC.¹⁰

Historically, the terms indica and sativa were introduced in the 18th Century to define different species of cannabis.¹¹ Sativa was used to describe cannabis hemp plants, which were cultivated for plant fibers and seeds.¹² Indica was used to describe intoxicating cannabis, which was harvested for seeds and hashish.¹³ The terms have been adapted to modern-day usage by allowing sativa to refer to cannabis with energizing properties and indica to be synonymous with cannabis that relaxes the consumer.

Recently, scientists have discovered that the effects of a cannabis plant on a consumer result from cannabinoids and terpenes. Cannabinoids are various naturally occurring, biologically active chemical constituents of cannabis, including some that possess psychoactive properties.¹⁴ Examples of cannabinoids include delta-9 THC, a chemical psychoactive component of cannabis, and CBD, a non-psychoactive and anti-inflammatory chemical component. THC is one of many chemical compounds found in the resin secreted by the glands of the cannabis plant. THC can stimulate cells in the brain to release dopamine, creating euphoria.¹⁵ CBD is non-impairing and non-euphoric, meaning it does not cause impairment or intoxication to the consumer.¹⁶

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ Collective-Cannabis Education: Cannabis Strains: Indica, Sativa, & Hybrid (accessed June 27, 2022) – [https://collective-cannabis.com/cannabis-strains-indica-sativa-hybrid/#:~:text=Cannabis%20Indica%20was%20used%20to,high%20THC%20\(tetrahydrocannabinol\)%20content](https://collective-cannabis.com/cannabis-strains-indica-sativa-hybrid/#:~:text=Cannabis%20Indica%20was%20used%20to,high%20THC%20(tetrahydrocannabinol)%20content)

¹² *Id.*

¹³ *Id.*

¹⁴ Merriam-Webster: Defined Term Cannabinoid (December 13, 2021) – <https://www.merriam-webster.com/dictionary/cannabinoid>

¹⁵ Alina Bradford, Live Science: What is THC? (May 18, 2017) – <https://www.livescience.com/24553-what-is-thc.html>

¹⁶ Kimberly Holland, Healthline: Sativa vs Indica: What to Expect Across Cannabis Types and Strains (March 22, 2021) – <https://www.healthline.com/health/sativa-vs-indica>

Cannabis also contains terpenes, which are aromatic chemical compounds produced and commonly found in plants. Each cannabis plant has a different terpene profile, and the profile of each plant can cause varied effects on the consumer.¹⁷

Usable cannabis and hemp are derived from the same species of plant. However, hemp is defined as cannabis that has a THC concentration of no greater than .3% total, as measured in dry weight.¹⁸ Hemp is cultivated for use in the production of a various assortment of products, including foods and beverages, personal care products, nutritional supplements, fabrics and textiles, paper, construction materials, and other manufactured and industrial goods.¹⁹

Cannabis is produced in several different forms: seeds, clones, plant tissue, plants, harvested materials (i.e., leaves, flowers, stalks, stems, pollen, and concentrates), and consumer products (consumable flowers, concentrates (i.e., hash, kief, waxes, oils, and vapor), topical goods, and infused consumables). The main categories of consumer cannabis products include flowers; concentrates; and infused goods.²⁰

- Cannabis Flower – THC in cannabis plants is produced by resinous glands that tend to concentrate in the plant’s flowers or buds.²¹ Cannabis farmers harvest the flower from the plant (removing bulky leaves and stems with less THC concentration) and dry the plant material of any moisture so it is prepared for consumption. Generally, cannabis flower is often smoked in pipes or hand-rolled cigarettes called joints, pre-rolled joints, or pre-rolls. Cannabis flowers can also be smoked in a cigar or combined with tobacco and smoked as a cigarette.²²
- Cannabis Concentrates – Cannabis can be harvested and processed through methods that produce cannabis concentrates. These products have been grown, harvested, and processed in a way to maximize cannabinoid, THC, and terpene content. Cannabis concentrates can take the form of hash, kief, waxes, or oils. The cannabis in these products has been concentrated through different scientific extraction and processing methods, including but not limited to: screens, sifts, bags, mechanical separation,

¹⁷ Leafly: Indica vs Sativa: understanding the differences between weed types (June 9, 2022) - <https://www.leafly.com/news/cannabis-101/sativa-indica-and-hybrid-differences-between-cannabis-types#:~:text=The%20common%20understanding%20of%20indicas,social%20gatherings%2C%20and%20creative%20projects>

¹⁸ Amy Abernethy, MD, PhD, U.S. Food & Drug Administration: Hemp Production and the 2018 Farm Bill (July 25, 2019) – <https://www.fda.gov/news-events/congressional-testimony/hemp-production-and-2018-farm-bill-07252019>

¹⁹ Congressional Research Service: Defining Hemp: A Fact Sheet (March 22, 2019) – <https://sgp.fas.org/crs/misc/R44742.pdf>

²⁰ Weedmaps: A Guide to Cannabis Product Types (accessed June 27, 2022) – <https://weedmaps.com/learn/introduction/guide-cannabis-product-types>

²¹ *Id.*

²² *Id.*

chemical extractions, distillation, and pressurized heat applications. These methods employ different scientific strategies to extract, at highly concentrated ratios, THC from the cannabis plant. The final product of these extraction processes can result in a range of forms, from a dry and granular pollen powder similar to hash or kief to a sticky, resinous wax material, which can resemble plant sap, and is known as cannabis wax (i.e., budders, shatters, crumbles, sugars, distillates, or oils). These forms vary in properties, such as viscosity and density, and are named accordingly. For example, a cannabis concentrate wax marketed as a budder is likely to have the same consistency as household butter, being pliable and not too rigid. However, a cannabis concentrate wax marketed as shatter would have extremely rigid properties, and the wax could break into pieces or shatter if pulled or bent.²³

- **Infused Goods** – Cannabis can also be processed into topical products and infused consumables. Topical products are those that are placed directly on the consumer’s skin. Infused consumables include beverages, edibles, and suppository products that have been infused with cannabis, including cannabinoids such as THC or CBD. Topical products are not associated with impairment or intoxication to the consumer. However, infused consumable products will lead to intoxication or impairment of the consumer, as these products contain cannabis concentrates, including THC and CBD. Examples of infused consumable products include cannabis beverages and edibles.²⁴

III. THE EXPANSION OF STATES LEGALIZING CANNABIS

A. Medical-Use and Recreational-Use Legalization in States

California was the first state in the United States (U.S.) to legalize cannabis for medical use.²⁵ In 1996, California passed Proposition 215, allowing for the sale and medical use of cannabis for patients with AIDS, cancer, and other serious, painful diseases. Currently, as of February 3, 2022, 37 states, the District of Columbia (D.C), and three territories allow for the medical use of

²³ National Institute on Drug Abuse: Cannabis (Marijuana) Concentrates Drug Facts (accessed June 27, 2022) – <https://nida.nih.gov/publications/drugfacts/cannabis-marijuana-concentrates>

²⁴ Leafly: Cannabis Glossary – Topical (accessed June 27, 2022) – <https://www.leafly.com/learn/cannabis-glossary/topical>

²⁵ California Department of Cannabis Control: California’s Cannabis Laws (September 13, 2022) – [https://cannabis.ca.gov/cannabis-laws/laws-and-regulations/#:~:text=California%20became%20the%20first%20state,and%20adult%20\(recreational\)%20use](https://cannabis.ca.gov/cannabis-laws/laws-and-regulations/#:~:text=California%20became%20the%20first%20state,and%20adult%20(recreational)%20use)

cannabis.²⁶ In 2021, 25 years after California first authorized medical cannabis, the majority of states in the U.S. now allow the use of cannabis for medical purposes.

Colorado was the first state in the U.S. to legalize cannabis for recreational purposes in 2012.²⁷ Washington also passed marijuana reform legislation shortly after Colorado, in 2012, legalizing the recreational use of cannabis.²⁸ As of November 9, 2022, 21 states, two territories, and D.C. have enacted legislation to regulate cannabis for nonmedical or recreational use.²⁹ According to 2020 U.S. Census Bureau apportionment numbers, more than 145 million Americans now live in a state that has legalized cannabis.³⁰

The path toward legalization is not necessarily straight, nor is it quick. The following are examples of this experience.

Today, cannabis laws in Alaska allow adult use. The state first legalized medical marijuana in 1998, though for many years, there was no way for patients to legally purchase it.³¹ Alaska was the second state in the U.S. to decriminalize possession of up to one ounce and the third to legalize recreational marijuana.³² Residents over 21 years old with a valid state ID can legally grow up to six plants at home and purchase up to one ounce of marijuana or 7 grams of concentrates from regulated dispensaries.³³ Only cash is accepted.³⁴

²⁶ National Conference of State Legislators: State Cannabis Laws (September 12, 2022) – <https://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>

²⁷ Claire Hansen, Horus Alas, and Elliott Davis Jr., US News: Where is Marijuana Legal? A Guide to Marijuana Legalization (October 14, 2021) – <https://www.usnews.com/news/best-states/articles/where-is-marijuana-legal-a-guide-to-marijuana-legalization>

²⁸ The Marijuana Policy Project - Colorado and Washington: Life After Legalization and Regulation (2023) – <https://www.mpp.org/issues/legalization/colorado-and-washington-life-after-legalization-and-regulation/#:~:text=In%202012%2C%20Colorado%20and%20Washington,halfof%20the%20U.S.%20population>

²⁹ National Organization for the Reform of Marijuana Laws (NORML): Legalization and State Laws Website (November 28, 2022) – [Legalization - NORML](https://www.norml.org/legalization); The Marijuana Policy Project: State Policy Website (November 28, 2022) – <https://www.mpp.org/states/>

³⁰ United States Census Bureau: 2020 Census Apportionment Results (September 12, 2022) – <https://www.census.gov/data/tables/2020/dec/2020-apportionment-data.html>

³¹ Alaska Medical Marijuana Act, Measure 8 (1998) (Accessed August 19, 2022) – [https://ballotpedia.org/Alaska_Medical_Marijuana_Act,_Measure_8_\(1998\)#:~:text=The%20Alaska%20Medical%20Marijuana%20Initiative,marijuana%20for%20certain%20medical%20purposes.%22](https://ballotpedia.org/Alaska_Medical_Marijuana_Act,_Measure_8_(1998)#:~:text=The%20Alaska%20Medical%20Marijuana%20Initiative,marijuana%20for%20certain%20medical%20purposes.%22)

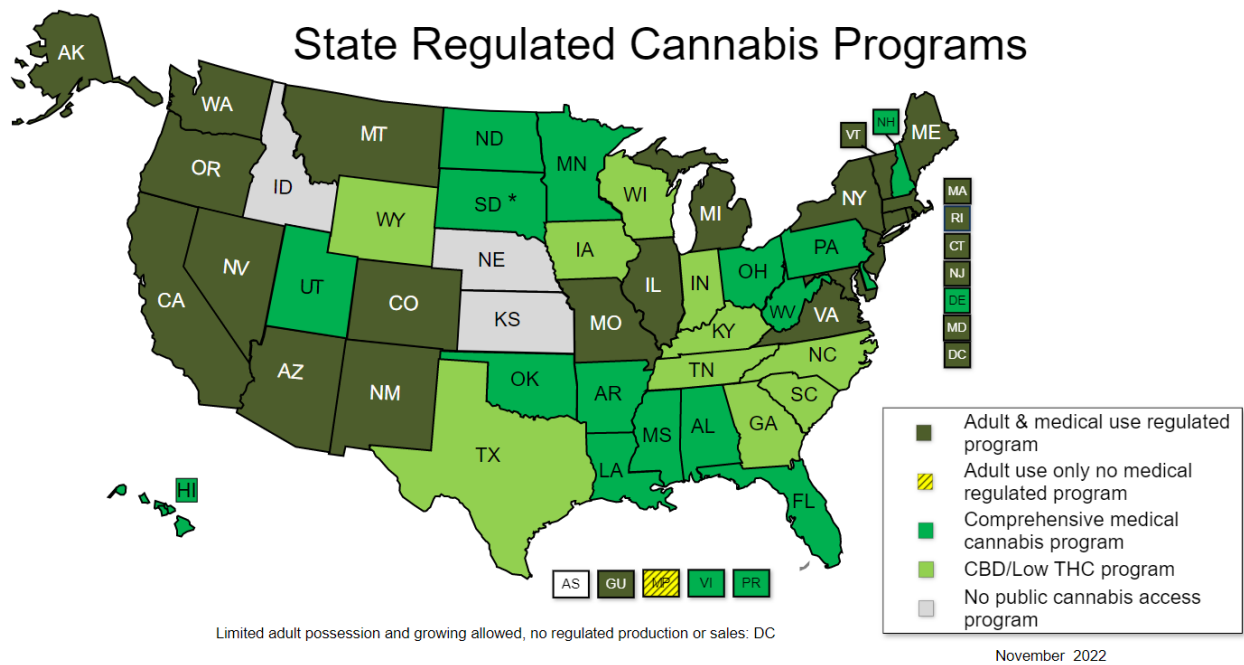
³² Alaska Marijuana Legalization, Ballot Measure 2 (2014) (Accessed August 19, 2022) – [https://ballotpedia.org/Alaska_Marijuana_Legalization,_Ballot_Measure_2_\(2014\)](https://ballotpedia.org/Alaska_Marijuana_Legalization,_Ballot_Measure_2_(2014)), and Michael Hartman, National Conference of State Legislatures, Cannabis Overview, Alaska Legalization (May 31, 2022) – <https://www.ncsl.org/research/civil-and-criminal-justice/marijuana-overview.aspx>

³³ Weedmaps: Alaska, Laws and Regulations (September 12, 2022) – <https://weedmaps.com/learn/laws-and-regulations/alaska>

³⁴ Laurel Andrews, Alaska Official Visitor's Guide, a Tourist's Guide to Legal Marijuana in Alaska (May 2, 2018) – <https://www.adn.com/alaska-visitors-guide/2018/05/02/a-tourists-guide-to-legal-marijuana-in-alaska/>

Some states did not see cannabis legalized overnight. For example, Oregon’s Measure 80 (Oregon Cannabis Tax Act Initiative) in 2012 did not receive enough “yes” votes.³⁵ Measure 80 would have permitted cannabis to be sold at state-licensed stores and would have permitted adults to purchase cannabis at such stores without a license. Oregon did not legalize such recreational cannabis use until July 2016.³⁶ This is a consistent experience among the states where there is a majority support for legalization, but it may take multiple attempts.

The nature of cannabis being regulated on a state-by-state basis permits state systems on cannabis regulation to differ quite drastically. The below map outlines the different states and their varied approaches to cannabis regulation:



* National Conference of State Legislatures: State Cannabis Laws – Map of State Regulated Cannabis Programs (November 2022 - <https://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>)

B. Public Opinion Supports Legality Expansion

As discussed in the previous white paper, the majority of Americans now support legalized cannabis.³⁷ In fact, public support for legalizing cannabis is increasingly favorable. Over 90% of

³⁵ Ballotpedia: Oregon Cannabis Tax Act Initiative, Measure 80 (2012) (July 15, 2022) – [https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative,_Measure_80_\(2012\)](https://ballotpedia.org/Oregon_Cannabis_Tax_Act_Initiative,_Measure_80_(2012))

³⁶ Travel Portland Website: Legal Cannabis in Portland and Oregon (March 4, 2022) – <https://www.travelportland.com/culture/legal-marijuana-portland-oregon/>

³⁷ NAIC: Regulatory Guide – Understanding the Market for Cannabis Insurance (May 24, 2019) – https://content.naic.org/sites/default/files/inline-files/cmte_c_cannabis_wg_exposure_understanding_cannabis_marketplace_0.pdf

U.S. adults in 2021 believe cannabis should be legal for either medical or recreational purposes.³⁸ Here, 60% support the legalization of cannabis for medical and recreational use, and 31% support the legalization of cannabis for medical use only.³⁹ Public opinion on cannabis and cannabis legalization have changed significantly since President Richard Nixon signed the Controlled Substances Act (CSA) of 1970 into law. Once associated with the war on drugs, cannabis now presents business opportunities, with the state-legal cannabis markets expected to reach over \$40 billion in the U.S. by 2026.⁴⁰

Public opinions and perspectives on cannabis are shifting to a level of lower scrutiny than experienced under the previous zero-tolerance approach adopted by the federal government and individual states. For example, U.S. Congress has considered replacing the statutory term of reference from marijuana or marihuana to cannabis.⁴¹ The changing of terms from marijuana to cannabis is being pursued in part because there are potentially negative connotations associated with the history and origin of the term marihuana.⁴² States have also sought similar legislation for the switching of statutory references from marijuana to cannabis.⁴³ The increasing legislative reformation of cannabis at the federal and state levels, as well as less scrutiny from the public, combine to show that cannabis is likely trending toward regulation versus outright prohibition.

IV. FEDERAL LEGISLATION ACTIVITY INTENSIFIES

Conflicting individual state and federal laws on cannabis have largely discouraged insurers from participating in coverage of the market. To illustrate this conundrum, cannabis is an illegal substance under the Classified Substances Act (CSA).⁴⁴ The CSA classifies cannabis as a Schedule I drug that has no currently accepted medical use in the U.S.⁴⁵ A 2018 Farm Bill provision removed hemp from the list of Schedule I controlled substances.⁴⁶ Therefore, the U.S. Drug Enforcement Administration (DEA) will not consider hemp-derived cannabinoids as a controlled substance that

³⁸ Ted Van Green, PEW Research Center: Americans overwhelmingly say marijuana should be legal for recreational or medical use (November 15, 2021) – <https://www.pewresearch.org/fact-tank/2022/11/22/americans-overwhelmingly-say-marijuana-should-be-legal-for-medical-or-recreational-use/>

³⁹ *Id.*

⁴⁰ Alex Malyshev and Sarah Ganley, Reuters: Reading the tea leaves: What might federal legalization of marijuana look like? (November 15, 2021) – <https://www.reuters.com/legal/litigation/reading-tea-leaves-what-might-federal-legalization-marijuana-look-like-2021-11-15/2021> – <https://www.pewresearch.org/fact-tank/2021/04/16/americans-overwhelmingly-say-marijuana-should-be-legal-for-recreational-or-medical-use/>

⁴¹ Congress.Gov: H.R. 3617 – MORE Act of 2021 – <https://www.congress.gov/bill/117th-congress/house-bill/3617>

⁴² Matt Thompson, NPR: The Mysterious History of ‘Marijuana’, (July 22, 2021) –

<https://www.npr.org/sections/codeswitch/2013/07/14/201981025/the-mysterious-history-of-marijuana>

⁴³ Washington State: Chapter 16, Laws of 2022 (67th Legislature, 2022 Regular Session) –

<https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Session%20Laws/House/1210-S2.SL.pdf>

⁴⁴ U.S. DEA Website, The Controlled Substances Act ([Title 21 United States Code \(USC\) Controlled Substances Act](https://www.dea.gov/drug-information/csa)) – <https://www.dea.gov/drug-information/csa>

⁴⁵ *Id.*

⁴⁶ U.S. Department of Agriculture Website, Farm Bill – <https://www.usda.gov/farmbill>

is subject to the CSA. However, cannabis and CBD (irrespective of being sourced from cannabis or hemp) are subject to Federal Drug Administration (FDA) approval under the federal Food, Drug, and Cosmetic Act (FD&C Act).⁴⁷ The FDA has not yet approved a cannabis drug for medical use or treatment. The FDA has approved CBD medicines for the treatment of epilepsy. Federal law currently prohibits CBD from being added to any food or drink product. On July 22, 2019, the FDA issued formal letters making the determination that certain CBD products were sold in violation of the FD&C Act.⁴⁸ Despite this prohibition, products containing CBD are generally widely available in the retail marketplace in formulations ranging from nutritional supplements to cosmetics and for both human and veterinary use.

Companies functioning within state-legal cannabis industries generally experience banking restrictions due to federal regulations.⁴⁹ This causes many cannabis businesses and cannabis-related businesses (CRBs) to function on a cash-only basis. Current estimates show that approximately 70% of CRBs operate solely as a cash-only business and have no formal relationship with a bank.⁵⁰ This causes CRBs to possess and process large amounts of money in cash form, which can create a higher risk of theft and additional liabilities.⁵¹ More on this and the federal authorities limiting the abilities of cannabis businesses to engage in financial transactions can be found in the NAIC's White Paper on *Understanding the Market for Cannabis Insurance (2019)*.

There is an ongoing concern about entities supporting cannabis businesses being charged with violation of the federal Racketeer Influenced and Corrupt Organizations (RICO) Act. In addition, the federal Internal Revenue Code 280E prevents cannabis businesses from taking advantage of tax deductions for actual economic expenses incurred in the ordinary course of business. This can prevent cannabis businesses from taking deductions related to insurance and premiums or costs, such as for workers' compensation and health insurance.

Recently, the federal government has been considering cannabis reform legislation at a record-setting pace. During the 117th Congress (in 2021 – 2022), at least five different pieces of national

⁴⁷ U.S. Food & Drug Administration Website (FD&C Act) – <https://www.fda.gov/regulatory-information/laws-enforced-fda/federal-food-drug-and-cosmetic-act-fdc-act>

⁴⁸ NAIC – CIPR Topics: Cannabis and Insurance (August 18, 2021) – https://content.naic.org/cipr_topics/topic_cannabis_and_insurance.htm

⁴⁹ NAIC: Regulatory Guide – Understanding the Market for Cannabis Insurance (May 24, 2019) – https://content.naic.org/sites/default/files/inline-files/cmte_c_cannabis_wg_exposure_understanding_cannabis_marketplace_0.pdf

⁵⁰ NAIC – CIPR Topics: Cannabis and Insurance (August 18, 2021) – https://content.naic.org/cipr_topics/topic_cannabis_and_insurance.htm

⁵¹ *Id.*

cannabis reform legislation were introduced.⁵² Each bill took a different approach to altering the federal government’s position on cannabis. The bills include the federal Safe and Fair Enforcement (SAFE) Banking Act, the Clarifying Law Around Insurance of Marijuana (CLAIM) Act, the Marijuana Opportunity Reinvestment and Expungement (MORE) Act of 2021, the Cannabis Administration and Opportunity (CAOA) Act, and the States Reform Act of 2021.

The CLAIM Act would provide a safe harbor from penalties or other adverse agency action for insurance companies that provide services to cannabis-related legitimate businesses in jurisdictions where such activity is legal. The U.S. Government Accountability Office (GAO) must report on barriers to marketplace entry for minority-owned and women-owned cannabis-related businesses.⁵³

The NAIC submitted a letter in support of the CLAIM Act on June 17, 2021. The letter acknowledged the bill would provide a safe harbor from violations of federal law for those engaged in the business of insurance participating in cannabis industry activity that is permissible under state law. By removing barriers, the CLAIM Act would permit insurers to provide insurance coverage options for these commercial policyholders.⁵⁴

The SAFE Banking Act would remove constraints on depository institutions to provide banking services to a legitimate cannabis-related business. Under the SAFE Banking Act, proceeds would not be considered unlawful activity and not run afoul of anti-money laundering laws. Under this act, depository institutions would not be at risk of forfeiting financial assets for providing a loan or other financial services to a legitimate cannabis-related business. The NAIC also submitted a letter in support of the SAFE Banking Act on June 17, 2021.

The MORE Act would decriminalize cannabis. Specifically, it removes cannabis from the list of scheduled substances under the CSA and eliminates criminal penalties for an individual who manufactures, distributes, or possesses cannabis. The States Reform Act of 2021 would remove the legal obstacles preventing U.S. cannabis companies from accessing the financial system and allow for interstate commerce of cannabis. The bill also requests the release and expungement of people convicted of nonviolent cannabis-only crimes.⁵⁵

⁵² Julie Hyman, Yahoo! Finance: Weed is Likely to Remain Federally Illegal, but ‘Cannabis Banking’ Could Pass this Year (March 31, 2022) – <https://finance.yahoo.com/news/weed-is-likely-to-remain-federally-illegal-but-cannabis-banking-could-pass-this-year-132330251.html>

⁵³ Congress.Gov: H.R. 2068 – CLAIM Act – <https://www.congress.gov/bill/117th-congress/house-bill/2068>

⁵⁴ NAIC Support Letter – Claim Act 2021 (June 17, 2021) – <https://content.naic.org/sites/default/files/government-affairs-letter-support-claim-act-2021.pdf>

⁵⁵ Congress.Gov: H.R. 5977 – To amend the Controlled Substances Act regarding marihuana, and for other purposes. – <https://www.congress.gov/bill/117th-congress/house-bill/5977?s=1&r=5>

On July 21, 2022, Senate Majority Leader Chuck Schumer introduced the CAO Act.⁵⁶ The CAO Act attempts to accomplish significant reformation of federal cannabis policy, allowing states to lead on cannabis regulation and establishing a federal regulatory paradigm similar to that of alcohol and tobacco.⁵⁷ The CAO would expunge federal cannabis-related records and create funding for law enforcement departments to fight illegal cannabis cultivation.⁵⁸

On October 6, 2022, President Biden asked the Secretary of Health and Human Services and the Attorney General to review how marijuana is categorized under federal law.⁵⁹ President Biden also signed the Medical Marijuana and Cannabidiol Research Expansion Act (Statute at Large 136 Stat. 4178 - Public Law No. 117-215) in December 2022. This new law is anticipated to increase access to the scientific study of cannabis by streamlining the government issuance of permits to scientists who want to study the substance and expediting applications for cannabis producers (including universities) that grow the substance for research purposes.⁶⁰ None of these laws were passed in the previous Congress, but it is anticipated that discussion will continue on these issues.

V. CANNABIS BUSINESS REGULATORY, LICENSING, AND EDUCATION LANDSCAPE

A. States Legalize Cannabis Around the Cole Memorandum

Colorado and Washington were the first states to legalize cannabis for recreational use in 2012. At that time, 19 states had already legalized cannabis for medical use. To address the growing legalization of cannabis use by the states, the federal Department of Justice (DOJ) issued the Cole Memorandum in 2013. The Cole Memorandum provided states with the federal position on the enforcement of marijuana under the Classified Substances Act (CSA). Specifically, it provided that the federal government would not prioritize enforcement or interference with state implementation of regulated cannabis programs if states upheld the Department of Justice's (DOJ's) and federal government's priorities.⁶¹ These priorities included:

⁵⁶ Natalie Fertig, Politico: Schumer's Legal Weed Bill is Finally Here, (July 21, 2022) – <https://www.politico.com/news/2022/07/21/schumer-legal-weed-bill-00047058>

⁵⁷ John Schroyer and Jeff Smith, MJBizDaily: Schumer Marijuana Legalization Bill Finally Introduced in Senate, (July 22, 2022) – https://mjbizdaily.com/schumer-marijuana-legalization-bill-finally-introduced-in-senate/?utm_medium=email&utm_source=newsletter&utm_campaign=MJD_20220722_NEWS_Daily&nowprocket=1

⁵⁸ Natalie Fertig, Politico: Schumer's Legal Weed Bill is Finally Here, (July 21, 2022) – <https://www.politico.com/news/2022/07/21/schumer-legal-weed-bill-00047058>

⁵⁹ The White House: Briefing Room Website – Statement from President Biden on Marijuana Reform, (October 6, 2022) – <https://www.whitehouse.gov/briefing-room/statements-releases/2022/10/06/statement-from-president-biden-on-marijuana-reform/>

⁶⁰ Meredith Wadman, Science Insider: New U.S. Law Promises to Light Up Marijuana Research, (December 2, 2022) – <https://www.science.org/content/article/new-u-s-law-promises-light-marijuana-research>

⁶¹ *Id.*

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

Many states that voted to legalize the sale and use of cannabis designed their regulated cannabis systems to carefully consider the DOJ and federal government priorities outlined in the Cole Memorandum. Each state took an individualized approach to implementing cannabis regulation. This has led to individual cannabis industries across the country that operate under separate and distinct authorities for their jurisdictions. The differences in state cannabis regulations are evident in the varied cannabis business licensing programs, regulation authorities, consumer experiences, and associated practices for CRBs. For example, Colorado has implemented a regulatory system where cannabis businesses can vertically integrate their businesses, including agriculture, retail sales, and manufacturing. Washington has implemented a prohibition on vertical integration, requiring licensed cannabis businesses to operate in their licensed business classification, such as a cannabis retailer, cannabis producer, or cannabis processor.

The Cole Memorandum was rescinded by the federal government in 2018.⁶² This created a gray area for states with legal cannabis operations. The United States Attorney General issued new guidance in 2018 under Attorney General Jefferson B. Sessions. The new guidance directed U.S. state attorneys to use their discretion, as well as well-established principles that govern all federal prosecutions, in cannabis enforcement.⁶³ The current administration has expressed views to return to a Cole-like environment but has not taken an official position.

⁶² Office of the Attorney General: Memorandum for All US Attorneys (January 4, 2018) – <https://www.justice.gov/opa/press-release/file/1022196/download>

⁶³ *Id.*

B. The Role of CANNRA

States have been striving to work toward best policies and practices in the cannabis and insurance industries by working through the Cannabis Regulators Association (CANNRA). CANNRA is a national not-for-profit organization of cannabis regulators that provides policymakers and regulatory agencies with the resources to make informed decisions when considering whether and how to legalize and regulate cannabis.⁶⁴ It is a support association for regulatory agencies, not a cannabis advocacy group. As such, it takes no formal position for or against cannabis legalization but rather seeks to provide government jurisdictions with unbiased information to help make informed decisions when considering whether or how to legalize or expand regulated cannabis.⁶⁵ Membership in CANNRA is limited to regulators and representatives from relevant government offices.⁶⁶ CANNRA is funded by member agencies and does not receive funding from industry or advocacy groups.⁶⁷

CANNRA strives to create and promote harmony and, where possible, standardization across jurisdictions that legalize and regulate cannabis.⁶⁸ CANNRA helps interested parties find objective data and evidence-based approaches to policymaking and implementation.⁶⁹ CANNRA also works to ensure federal officials benefit from the vast experiences of states across the nation so that any changes to federal law adequately address states' needs and priorities.⁷⁰

C. Cannabis Impairment and Insurance Considerations

Insurers rely on data to help them understand the risks they indemnify. However, there is still much to know about impairment and cannabis use. Cannabis shares the Schedule I classification along with some of the most serious drugs, including heroin, LSD, and meth. As such, cannabis used for studies must come from federally approved facilities. Historically, the University of Mississippi was recognized as the only institution federally approved to cultivate cannabis for research, with the license awarded in 1968.⁷¹ The cannabis that is produced in this facility does

⁶⁴ CANNRA: Home Website Page (accessed June 27, 2022) – <https://www.cann-ra.org/>

⁶⁵ *Id.*

⁶⁶ CANNRA: Membership Website Page (accessed June 27, 2022) – <https://www.cann-ra.org/leadership>

⁶⁷ CANNRA: News and Events Website Page (accessed June 27, 2022) – <https://www.cann-ra.org/news-events>

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ Omar Sacirbey, MJ Biz Daily: DEA close to allowing companies to grow cannabis for scientific research (December 17, 2021) – <https://mjbizdaily.com/dea-preparing-to-ok-companies-to-grow-cannabis-for-scientific-research/#:~:text=Currently%2C%20the%20University%20of%20Mississippi,awarded%20its%20license%20in%201968.>

not resemble the cannabis in modern-day retailers. In fact, the cannabis produced in the federally approved facilities does not mimic the appearance nor potency of state-regulated cannabis.⁷²

Recently, the federal government, through the Drug Enforcement Administration (DEA), approved registrations for two other companies to produce cannabis for research purposes.⁷³ This is a historic development for the research of cannabis and allows the DEA to oversee the production of research-grade cannabis at a level not previously achieved by the University of Mississippi.⁷⁴ The two companies include Groff North America Hemplex and the Biopharmaceutical Research Company, which began harvesting their first crops by January 2022.⁷⁵

The limitations on human studies, with limited accessibility to cannabis that resembles that same substance in state-legal medical and retail markets, create substantial complications to the scientific research of cannabis, including long-term studies on the effects or dangers of impairment and usage. Thus, they provide limited information from which to develop policy or make informed decisions.

Testing for cannabis impairment is difficult due to the limits of drug testing technology, as well as the lack of a recognized limit to determine impairment. For example, the nationally recognized level of impairment for alcohol is set at .08 g/mL of blood alcohol concentration, which is well-founded in scientific research. However, there is no similar national standard set for driving under the influence of cannabis. Cannabis may not affect all people consistently. Cannabis may remain in a person's body for weeks after consumption, and may still appear in drug tests, even though it may no longer be causing impairment to the consumer. As a practical matter, because of these problems, drivers may be tested for high blood alcohol concentrations but may not be tested for other impairing substances.

The states of Illinois, Montana, Nevada, Ohio, and Washington have all adopted specific per se limits for THC present in a driver's body, with ranges between two nanograms and five nanograms per milliliter of blood.⁷⁶ These authorities provide that when a person has reached or

⁷² Christopher Ingraham and Tauhid Chappell, The Washington Post: Government marijuana looks nothing like the real stuff. See for yourself. (March 13, 2017) – <https://www.washingtonpost.com/news/wonk/wp/2017/03/13/government-marijuana-looks-nothing-like-the-real-stuff-see-for-yourself/>

⁷³ Kyle Jaeger, Marijuana Moment: Federal Marijuana Monopoly Finally Ends as Two Companies Harvest Cannabis Approved by DEA (January 4, 2022) – <https://www.marijuanamoment.net/dea-finally-breaks-federal-marijuana-grower-monopoly-with-two-new-companies-harvesting-cannabis-approved-by-agency/>

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ National Conference of State Legislatures (NCSL): Drugged Driving | Marijuana-Impaired Driving (September 23, 2021) – <https://www.ncsl.org/research/transportation/drugged-driving-overview.aspx>

exceeded the legal threshold, that person is considered impaired under law. The state of Colorado has a reasonable inference law that outlines that in instances where THC is identified in a driver's blood, at quantities of 5ng/ml or more, it is assumed that the driver was under the influence.⁷⁷ The reasonable inference laws are different from the per se laws, as they allow drivers who are charged to raise an affirmative defense showing that despite having tested at or above the legal limit, they were not actually impaired. There are also 12 states that have zero-tolerance laws for THC, including Arizona, Delaware, Georgia, Indiana, Iowa, Michigan, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Utah, and Wisconsin.⁷⁸

Complicating this issue is the lack of technologies, scientific methodologies, or accepted best practices in discovering or determining cannabis impairment. New technologies are being developed and generally involve biological screening or field sobriety tests. Here, examples of technologies used to detect cannabis impairment include saliva, urine, and blood testing machines. A few states, including Alabama and Michigan, have adopted active oral fluid roadside tests for drivers suspected to be impaired by cannabis use, among other drugs, which could negatively impact their driving.⁷⁹ Law enforcement officers in most states also generally possess discretion to determine whether an individual is impaired and presents a risk to themselves or others, whether using cannabis or other impairing substances in public, the workplace, or in driving situations. Many law enforcement agencies employ Drug Recognition Experts (DREs), who rely on professional experience and training to discover and determine whether an individual is impaired by cannabis usage. The use of new technology, scientific methodology, and best practices among law enforcement agencies will be critical in mitigating the risks of cannabis impairment in our workplaces and on our roadways.

1. Cannabis Driving Impairment – Cannabis DUI

Preventing cannabis users from driving while impaired was a top priority enumerated in the Cole Memorandum and an issue that each state with a regulated cannabis industry has considered. Cannabis is the second leading substance present in cases of driving under the influence, trailed only by alcohol.⁸⁰ Scientists and law enforcement are still seeking a reliable DUI test to identify impairment from cannabis use. While there are blood tests that can detect some of cannabis's components, such as THC, there is no scientifically accepted standardized method of testing or

⁷⁷ Colorado Department of Transportation: FAQs on Impaired Driving (September 13, 2022) – <https://www.codot.gov/safety/impaired-driving/druggeddriving/faqs>

⁷⁸ National Conference of State Legislatures (NCSL): Drugged Driving | Marijuana Impaired Driving (September 23, 2021) – <https://www.ncsl.org/research/transportation/drugged-driving-overview.aspx>

⁷⁹ *Id.*

⁸⁰ National Institute on Drug Abuse: Drugged Driving DrugFacts (September 13, 2022) – <https://nida.nih.gov/publications/drugfacts/drugged-driving>

determining the level of impairment from a cannabis user's blood or breath. Law enforcement officers may also have the discretion of completing a field sobriety test with any person they suspect is driving under the influence.

The National Association of Mutual Insurance Companies (NAMIC) analyzed this issue in 2021 with its research on the *Cannabis Conundrum: The Intersection of Property/Casualty Insurance and Cannabis-Impaired Driving*.⁸¹ NAMIC's research revealed that the states that have legalized cannabis for medical and recreational use will only continue to grow as ballot initiatives and legislation are codified. This places a focus on scientific research, funding, and technology development that will assist all parties in better understanding and ability to mitigate risks that cannabis-impaired driving may present. Educational campaigns to educate drivers of all ages and backgrounds on the potential risks associated with cannabis consumption will be needed.

Some studies, including studies associated with NAMIC and the American Property Casualty Insurance Association (APCIA), show a direct relation between cannabis regulation and increased auto accidents, as well as an associated increase in auto insurance premiums.^{82,83} Other studies focus on data that shows an increase in cannabis DUIs and related car accidents, whether related to recreational or medical cannabis legalization.^{84,85} Multiple insurance periodicals have recorded similar increases in car insurance claims and accident rates after states have regulated cannabis.^{86,87} Obviously, increased accident rates and claims have an effect on premiums; however, at this point, research is inconclusive on whether the relationship is a correlation or a direct causation.

Education for those outside of the cannabis industry can be conducted through public service announcements, government-sponsored education efforts, informative websites, and news media. For example, the U.S. Department of Transportation (DOT), the National Highway Traffic Safety Administration (NHTSA), and the Ad Council have recently started a campaign

⁸¹ Tony Cotto and Andrew Malin, NAMIC Advocacy: Cannabis Conundrum – The Intersection of Property/Casualty Insurance and Cannabis-Impaired Driving (May 10, 2021) – https://www.namic.org/pdf/publicpolicy/210510_cannibus_conundrum.pdf

⁸² Tony Cotto and Andrew Malin, NAMIC Advocacy: Cannabis Conundrum – The Intersection of Property/Casualty Insurance and Cannabis-Impaired Driving (May 10, 2021) – https://www.namic.org/pdf/publicpolicy/210510_cannibus_conundrum.pdf

⁸³ Stephanie Strategos Polis, American Property Casualty Insurance Association: Marijuana Legalization Reaffirms Auto Safety as Top Priority for Insurers (November 17, 2020) – <https://www.apci.org/media/news-releases/release/64148/>

⁸⁴ Angela Eichelberger, National Library of Medicine: Marijuana use and driving in Washington State: Risk perceptions and behaviors before and after implementation of retail sales (March 1, 2019) – <https://pubmed.ncbi.nlm.nih.gov/30822133/>

⁸⁵ The Highway Loss Data Institute: Recreational Marijuana and Collision Claim Frequency, Vol. 24, No. 14 (April 2017) – https://www.iihs.org/media/806f7c38-4594-4bbe-82ff-df4a749f5153/9fjfcw/HLDI%20Research/Bulletins/hldi_bulletin_34-14.pdf

⁸⁶ Insurance Journal: First States to Legalize Marijuana See Rise in Car Insurance Claims, Research Shows (January 7, 2019) – <https://www.insurancejournal.com/magazines/mag-features/2019/01/07/513762.htm>

⁸⁷ Jim Sams, Claims Journal: Insurance Group Says Data Suggests Cannabis is Increasing Accident Rates (March 14, 2019) – <https://www.claimsjournal.com/news/national/2019/03/14/289753.htm>

communicating the dangers of driving while under the influence of cannabis, called *Drug Impaired Driving: If You Feel Different, You Drive Different*.⁸⁸

2. Cannabis Workplace Impairment

Currently, two out of three Americans live in a state that has approved the sale and use of recreational cannabis.⁸⁹ Cannabis can appear in drug tests and remain in a consumer for 30 days or longer.⁹⁰ Therefore, cannabis users could lawfully consume the substance during their off-work hours but still be affected by cannabis or THC in their systems during work. Employers must assess if their staff present a risk of liability to themselves or others. Problems include issues with pre-employment drug testing, determining employee impairment, establishing reasonable accommodations, and maintaining medical privacy.

It should be noted that there is little data on the impact of legal market cannabis consumption on everyday life. There is a huge range of products available on the legal market that have never touched a research lab. Cannabis consists of a few primary cannabinoids and hundreds of minor cannabinoids and terpenes, and many are still being discovered. There is also a huge variation in potency across strains. Different products have different levels of major and minor cannabinoids, and each looks distinct. For these reasons, the study of cannabis is unlike the study of other drugs, where one is pretty much focused on a dose-dependent effect of a single pharmacological agent.⁹¹

Overlapping authorities and developments in case law on the topic have revealed that employers lack consistent and developed guidelines for cannabis drug testing in the workplace. Case law in several states, including California, Oregon, and Washington, has established that a private employer can terminate an employee for failing a company's drug test, even if that employee is authorized under state law to use cannabis as a medicine.⁹² Multiple states, including Arizona, Arkansas, Connecticut, Delaware, Maine, Minnesota, Oklahoma, Pennsylvania, Rhode Island, and

⁸⁸ U.S. Department of Transportation (NHTSA) (April 3, 2023) – <https://www.nhtsa.gov/campaign/if-you-feel-different-you-drive-different#:~:text=Several%20scientific%20studies%20show%20that,will%20be%20arrested%20for%20DUI>.

⁸⁹ Justin McCarthy, Gallup: Two in Three Americans Now Support Legalizing Marijuana (October 22, 2018) –

<https://news.gallup.com/poll/243908/two-three-americans-support-legalizing-marijuana.aspx>

⁹⁰ Zawn Villines, Medical News Today: How long can you detect marijuana (cannabis) in the body (February 21, 2022) –

<https://www.medicalnewstoday.com/articles/324315>

⁹¹ Cinnamon Bidwell, Presentation from the University of Colorado on Emerging Scientific Issues in the Cannabis Space (December 1, 2021)

⁹² Sachi Clements, Esq., NOLO Legal: State Laws on Off-Duty Marijuana Use (September 13, 2022) –

<https://www.nolo.com/legal-encyclopedia/state-laws-on-off-duty-marijuana-use.html>

West Virginia, prohibit employers from refusing to employ an applicant or terminate an existing employee based only on a positive drug test for cannabis.⁹³

Recently, some employers in the private sector have been reducing the scrutiny placed on cannabis use and impairment in the workplace. In September 2021, Amazon made the corporate decision to no longer deny employment, or terminate employees, due to failed drug tests due to cannabis use.⁹⁴ Amazon even emphasized that the company would reinstate employment eligibility for previous applicants and staff who were terminated or deferred during random or pre-employment cannabis screenings.⁹⁵ However, this policy has exceptions, where employees involved in transportation may be required to prove they have not used and will not be impaired by cannabis.⁹⁶ The shift from a zero-tolerance policy on drug testing for cannabis use to one of acceptance is further evidenced by the developments in professional sports industries. Four of the biggest professional sports in America, including the NBA, NHL, MLB, and NFL, have all relaxed their drug testing policies as it pertains to cannabis.⁹⁷

3. Other Cannabis Impairment Considerations

Cannabis businesses are attempting to capitalize on the trend of increased usage by bringing ingenuity to their products and services.⁹⁸ While many consumers historically smoked the substance in private settings, there are now other innovative forms of cannabis in the regulated markets which allow consumers to eat or vaporize the substance discreetly in public environments.⁹⁹ These trends of increased exposure, additional usage, as well as ingenuity in the cannabis industry, combine to create complications with regulating and insuring the risks of cannabis impairment.

Prior to legalization, cannabis users would need to consume their cannabis products in private locations, out of view from the public and law enforcement. Cannabis users employed these strategies to secretly consume the illegal cannabis products for effect while also avoiding the risk of penalties from law enforcement. However, with the legalization of cannabis came the ability for consumers to use cannabis in different forms and settings. For example, a current medical

⁹³ *Id.*

⁹⁴ Janis I. Jeffreys, Cannabis Law PA: Why Amazon.com is no Longer Pre-employment Drug Testing for Marijuana (September 13, 2022) – <https://cannabislawpa.com/why-amazon-com-is-no-longer-pre-employment-drug-testing-for-marijuana/>

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ Jeffrey Draluck, Athletes for Care: Which Major Sports Leagues Have Relaxed Their Cannabis Policies? (July 13, 2021) – <https://athletesforcare.org/news/573160/Which-Major-Sports-Leagues-Have-Relaxed-Their-Cannabis-Policies.htm>

⁹⁸ Heesun Wee, NBC News: Growing the Pot Industry: A Test of American Business Ingenuity (January 14, 2014) – <https://www.nbcnews.com/business/business-news/growing-pot-industry-test-american-business-ingenuity-flna2d11923844>

⁹⁹ *Id.*

cannabis patient in Las Vegas can lawfully use a cannabis vaporizer at a cannabis consumption lounge to administer their prescribed medications.¹⁰⁰

Cannabis legalization and ingenuity possess potential to increase the frequency, exposure, and risks of cannabis impairment. Cannabis is now offered in newer and varied mediums, such as beverages and edibles, and can be created with concentrated forms of cannabis that are much more potent. Cannabis consumers run the risk of being uninformed on if the product has been scientifically researched or studied for long-term side effects and what level of impairment it is likely to produce.

The risks posed by cannabis impairment must be carefully considered in the underwriting process to ensure adequate coverage and appropriate premiums. Risk selection and risk classification play important roles in insurance underwriting systems. The current state of cannabis research may not provide the insurance industry with a sufficient understanding of cannabis impairment and how it can impact underwriting. An incomplete understanding of the increased risks associated with cannabis impairment could lead to circumstances of underinsured policyholders or a lack of sustainable insurer solvency.

D. Cannabis Education Landscape

Education could help address complications and gaps experienced in the cannabis and insurance industries caused by the recent and rapid rate of state regulation. Those needing to maintain currency include cannabis business owners, employees and licensees, regulators, and the insurance industry, such as insurers, claims adjusters, agents, and producers. Many involved in the cannabis industry and businesses would be better able to mitigate their risks with insurance by keeping current on applicable authorities and their requirements.

Regulators and other interested parties should enhance their knowledge by understanding industry trends, such as current and future state cannabis or insurance market conditions. For example, pre-license training for insurance producers does not touch on the topic of cannabis, but the insurance producers may be engaged in providing coverage to the cannabis industry. A producer of insurance should be well educated about the industry they provide coverage for in order to ensure the procured policy is appropriate, adequate, and lawful. Additionally, claims adjusters may need specialized training on cannabis-related claims.

¹⁰⁰ Patrick Maravelias, MJBizDaily: Las Vegas Cannabis Industry Preps for Launch of Consumption Lounges (August 8, 2022) – <https://mjbizdaily.com/las-vegas-cannabis-industry-preps-for-launch-of-consumption-lounges/>

E. Vaping Regulations and Their Impact on Cannabis

As cannabis is legalized and regulated in different states across the country, ingenuity in cannabis products and technologies continues to create complications for regulators, insurers, businesses, and consumer populations alike. An example of this is the increased use of and access to cannabis vaping or vaporization products.

Vaping technology was developed to provide a noncombustible nicotine delivery system to help cigarette and tobacco smokers. Vaping devices heat liquid into an aerosol that can be inhaled. This method of vaporization has now been adapted for cannabis use and is the method often used to consume cannabis products. Studies have shown that cannabis users believe vaping the substance is less harmful to their health than the consumption alternative of combustible smoking methods.¹⁰¹ This theory is based on the reduction of ingesting harmful contaminants present in cannabis smoke, which are less present in cannabis vapors.¹⁰² The significant increase in vaping has raised concern about the health and safety of this practice. Of particular concern is the increase in vaping among teenagers.

A large illicit cannabis market continues to exist without concern for product safety and exacerbates issues of product liability coverage. Illicit products containing substances not allowed in a regulated market are part of the challenge. Current scientific research provides inadequate information to understand the effects of acute and long-term inhalation of aerosols emitted by vaping devices. A lack of studies on the substance itself or the consumption methodologies means the consequences of vaping cannabis are largely unknown. While many choose to vape, believing it is a safer method of consumption, studies are needed to determine whether vaporizing cannabis truly offers a safer experience for the consumer.

Millions of Americans have consumed cannabis from vaporization devices over the past decade, and the possibly dangerous effects are now being observed.¹⁰³ In 2019, the U.S. experienced an outbreak of e-cigarette, or vaping, product use-associated lung injuries (EVALI).¹⁰⁴ The Centers for Disease Control and Prevention (CDC) established a link between EVALI and cannabis users, where a substance called Vitamin E Acetate was added to cannabis vaporization products, which

¹⁰¹ Dustin C. Lee, Benjamin S. Crosier, Jacob T. Borodovsky, James D. Sargent, and Alan J. Budney, National Center for Biotechnology Information, U.S. National Library of Medicine: Online Survey Characterizing Vaporizer Use among Cannabis Users (December 30, 2015) – <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4745650/>

¹⁰² *Id.*

¹⁰³ Centers for Disease Control and Prevention: Outbreak of Lung Injury Associated with the Use of E-Cigarette, or Vaping, Products (December 6, 2021) – https://www.cdc.gov/tobacco/basic_information/e-cigarettes/severe-lung-disease.html#what-we-know

¹⁰⁴ *Id.*

can interfere with normal lung functioning.¹⁰⁵ Since this outbreak was the result of an additive, it does not speak to the impact of vaping itself but does speak to the need for regulation.

Governments in jurisdictions with regulated cannabis industries took alternative approaches to respond to the outbreak of EVALI cases in cannabis consumers. Washington and Oregon enacted emergency bans on cannabis vaping product additives, whereas Massachusetts temporarily stopped the sale of all vaping products.¹⁰⁶ While many jurisdictions were concerned about EVALI's association with consumers who vaporized cannabis, some states were confident in the safety of products being produced within their regulated systems. For example, Pennsylvania released a position in response to the EVALI outbreak, explaining that none of the EVALI cases experienced in the state were connected to the state's medical cannabis program.¹⁰⁷

F. Licensing Takes a Focus on Social and Economic Equality

The prohibition of cannabis in America has disproportionately and adversely impacted people of color.¹⁰⁸ Studies have shown that "... on average Black people are almost 4 times more likely to be arrested for pot than white people."¹⁰⁹ This racial disparity in law enforcement is present in all areas of the country, regardless of the demographics of the jurisdiction.¹¹⁰

State-legal cannabis industries are now estimated to be worth over \$18 billion and provide for hundreds of thousands of full-time jobs.¹¹¹ However, minority populations that were most adversely impacted by the war on drugs and the prohibition of cannabis are being excluded from

¹⁰⁵ Centers for Disease Control and Prevention: Severe Lung Disease FAQ (December 6, 2021) –

https://www.cdc.gov/tobacco/basic_information/e-cigarettes/severe-lung-disease/faq/index.html

¹⁰⁶ Will Stone, NPR: Some States with Legal Weed Embrace Vaping Bans, Warn of Black Market Risks (October 26, 2019) –

<https://www.npr.org/sections/health-shots/2019/10/26/770377080/some-states-with-legal-weed-embrace-vaping-bans-warn-of-black-market-risks>

¹⁰⁷ Tony Rhodin, Lehigh Valley Live The Express-Times: With 149 Illnesses in U.S. Linked to Vaping Pennsylvania Says its Medical Marijuana Vape Products are Safe (August 23, 2019) – <https://www.lehighvalleylive.com/news/2019/08/with-153-illnesses-in-us-linked-to-vaping-pennsylvania-says-its-medical-marijuana-vape-products-are-safe.html>

¹⁰⁸ Robert Hoban, Forbes: The Critical Importance of Social Equity in the Cannabis Industry (August 31, 2020) –

<https://www.forbes.com/sites/roberthoban/2020/08/31/the-critical-importance-of-social-equity-in-the-cannabis-industry/?sh=41a7ba0d1a6d>

¹⁰⁹ Sagiv Galai, ACLU: Equity Must Be at the Heart of Marijuana Legalization (June 26, 2019) –

<https://www.aclu.org/blog/criminal-law-reform/drug-law-reform/equity-must-be-heart-marijuana-legalization>

¹¹⁰ ACLU: Report: The War on Marijuana in Black and White (published June 2013) – <https://www.aclu.org/report/report-war-marijuana-black-and-white?redirect=criminal-law-reform/war-marijuana-black-and-white>

¹¹¹ Alex Malyshev and Sarah Ganley, Reuters: The Challenges of Getting Social Equity Right in the State-Legal Cannabis Industry (July 22, 2021) – <https://www.reuters.com/legal/litigation/challenges-getting-social-equity-right-state-legal-cannabis-industry-2021-07-22/>

the industry. In 2021, African Americans represented roughly 13% of the U.S. population, yet only 1.2% to 1.7% were business owners in the cannabis industry.¹¹²

States legalizing cannabis have recently taken efforts to resolve the racial disparity in cannabis business ownership by employing social and economic equity provisions into their laws. Social and economic equity in cannabis licensing can vary by jurisdiction, but includes reducing barriers, improving access, and assisting cannabis business license applicants who are from certain communities that have been adversely and disproportionately impacted by cannabis prohibition. These groups can include but are not limited to women-owned businesses, minority-owned businesses, distressed farmers, and service-disabled veterans. The intended goal of social and economic equity provisions in cannabis business authorities is to achieve participation in the legalized industry for those who were most negatively affected by the war on drugs.

States that have experienced cannabis reform legislation, either recreationally or medically, have taken different approaches to implementing social and economic equity provisions in their regulated cannabis markets. For example, Michigan, in processing recreational cannabis business licenses, will reduce licensing fees for prospective business owners living in cities where residents were disproportionately impacted by the war on drugs.¹¹³ California offers a statewide program for recreational cannabis to assist local governments with equity provisions in providing loans, grants, and technical assistance to cannabis entrepreneurs and employers.¹¹⁴ It is too early to know the effect on the insurance market for cannabis businesses of these regulatory policies. However, there are efforts to address social and economic equity concerns in insurance generally.

VI. CANNABIS OPERATING AND ORGANIZATIONAL STRUCTURES EVOLVE

The industry's growing legitimization has intensified merger and acquisition activity to gain market share. The year 2021 is generally acknowledged in both the financial and cannabis

¹¹² *Id.*

¹¹³ MJBizDaily: MI Marijuana rules changes include new licenses, lower fees, social equity (September 1, 2021) – <https://mjbizdaily.com/michigan-marijuana-rules-changes-include-new-licenses-lower-fees-social-equity/>

¹¹⁴ Alex Malyshev and Sarah Ganley, Reuters: The Challenges of Getting Social Equity Right in the State-Legal Cannabis Industry (July 22, 2021) – <https://www.reuters.com/legal/litigation/challenges-getting-social-equity-right-state-legal-cannabis-industry-2021-07-22/>

industry press as one of overall sales growth marked by rising incidence of consolidation.¹¹⁵ The significant amount of consolidation in the industry continues to produce frequent ownership changes and business structure modifications.¹¹⁶ There are varying aspects through which this cannabis market evolution can be viewed, and each has implications for insurance coverage availability. As noted in his article “The Year of Cannabis Industry Consolidation,”¹¹⁷ Robert Hoban writes: “There are loosely four common phases of an industry’s life cycle –introduction, growth, maturity, and decline. The cannabis industry is not yet mature across the board but is largely stuck in the growth phase. The step between the later stages of the growth phase and the beginning of maturity comes down to one word: *consolidation*. That is the mantra for 2021.”

There are some indications that more vertically integrated—or common ownership along the supply chain—is occurring. It is viewed that larger-scale cultivation operations permit greater consistency in raw material availability. Some of this can be demonstrated by the increasing prevalence of indoor or greenhouse cultivation, which permits a more controlled growing environment and avoids some of the risks associated with traditional outdoor grow operations (e.g., use of clones rather than seed; environmental controls for light, heat, water, pest control; multiple harvests per year in a smaller footprint; more accessible warehousing/storage for processing; etc.). Such physical consolidation is much more friendly to vertical integration of ownership. This integration also permits more risk management along with scale to support the acquisition of insurance coverage. Greater scale and integration of cannabis businesses also allow the purchase of more comprehensive coverage through the excess and surplus lines market. The downside is that there are indications that the reinsurance market to cover such risks continues to be constrained, resulting in policy limits that may not reflect the scale or potential risk of the business.

Larger, and more vertically integrated, cannabis businesses are able to seek out and negotiate more comprehensive insurance packages and can pay higher premiums for tailored coverage. In contrast, cottage industry players (e.g., independent retailers) tend to look for more “off-the-

¹¹⁵ Ellen Chang, US News and World Report: Upcoming Mergers in the Cannabis Industry to Watch (March 8, 2021) – [Upcoming Mergers in the Cannabis Industry to Watch \(usnews.com\)](https://www.usnews.com/story/news/health/2021/03/08/upcoming-mergers-in-the-cannabis-industry-to-watch); Robert Hoban, Forbes: The Year of Cannabis Industry Consolidation (March 22, 2021) – <https://www.forbes.com/sites/roberthoban/2021/03/22/the-year-of-cannabis-industry-consolidation/?sh=48d003db7715>; Michael Berger, Technical420.com: The Consolidation of the US Cannabis Market is About to Kick into High Gear (September 3, 2021) – [The Consolidation Of The U.S. Cannabis Market Is About To Kick Into High Gear - Technical420 | Technical420](https://www.technical420.com/news/the-consolidation-of-the-us-cannabis-market-is-about-to-kick-into-high-gear-technical420-technical420); and Tommy Wood, [Boulder, CO] Daily Camera: Robust sales, expanding legalization lead to increased mergers, acquisitions in Boulder County cannabis industry (Sept. 5, 2021) – <https://www.dailycamera.com/2021/09/05/robust-sales-expanding-legalization-lead-to-increased-mergers-acquisitions-in-boulder-county-cannabis-industry/>

¹¹⁶ Oregon Liquor Control Commission (OLCC): Update on Marijuana Licensing (August 30, 2018) – www.oregon.gov/olcc/marijuana/Documents/Bulletins/Licensing_Delay_DirectorsMessage.pdf

¹¹⁷ Robert Hoban, Forbes: The Year of Cannabis Industry Consolidation (March 22, 2021) – <https://www.forbes.com/sites/roberthoban/2021/03/22/the-year-of-cannabis-industry-consolidation/?sh=48d003db7715>

shelf” insurance solutions, as would typically be available in the admitted market (but appears to be not widely available). Some admitted insurance coverage is available for discrete types of insurance. A good example is workers’ compensation insurance, which is widely available for employers in the cannabis industry—but such niches are limited.

Another aspect of this consolidation is changes in the ownership and sophistication of the industry. In 2019, the Colorado legislature changed state law to allow people who live outside Colorado to own cannabis businesses in the state, and it permitted publicly traded companies and private capital funds to invest in Colorado cannabis businesses.¹¹⁸ This “opening” of the market for cannabis businesses was ostensibly premised on increased access to capital for cannabis businesses, but it also fueled merger and acquisitions (M&A) activity with concomitant insurance aspects. In particular, the availability of directors’ and officers’ liability coverage is often cited as a challenge for cannabis businesses.

VII. CANNABIS INSURANCE NEEDS AND COVERAGE AVAILABILITY

A. Admitted vs. Excess and Surplus Lines Market

While there are a few states with admitted carriers, most of the cannabis industry is purchasing insurance through the excess and surplus lines market. Some admitted carriers, mostly in specific lines, such as required workers’ compensation, will write coverage for cannabis businesses. However, for more comprehensive or package coverage, the substantial majority is written through excess and surplus carriers, which are generally exempt from state regulation, and in many to most cases, state laws. One result of this is that it is challenging, if not virtually impossible, for state regulators to assess the size and extent of insurance coverage, in both availability and affordability, along with coverage for cannabis businesses. Some admitted carriers do write coverage primarily in their domiciliary state or immediate region, or for a specific component of the marketplace (e.g., retail dispensaries) for general liability.

What state insurance regulators do know is that there is a burgeoning market for cannabis coverage in the excess and surplus lines and managing general agent/underwriter program arena. There are also a few other structures to provide coverages, such as captives and risk

¹¹⁸ Tommy Wood, [Boulder, CO] Daily Camera: Robust sales, expanding legalization lead to increased mergers, acquisitions in Boulder County cannabis industry (Sept. 5, 2021) – <https://www.dailycamera.com/2021/09/05/robust-sales-expanding-legalization-lead-to-increased-mergers-acquisitions-in-boulder-county-cannabis-industry/>

retention groups (RRGs) being explored.¹¹⁹ Estimates range from a handful to in excess of 30 insurers and managing general agents/underwriters are providing services in this area.¹²⁰ Nonetheless, a Google search of commercial insurance for cannabis business will yield several references to entities, primarily surplus lines brokers or managing general agents/underwriters, which “specialize” in writing coverage for cannabis businesses or have an insurance “program” for cannabis businesses. Review of some of these indicates the majority are surplus lines brokers who are providing excess and surplus lines coverage.

As more insurance companies feel comfortable writing insurance in this industry, it is anticipated the market will move from excess and surplus lines to the admitted market, similar to other products in the past.¹²¹ At one point, there were insurance companies that did not want anyone to know they were providing coverage for these exposures, and now they are openly providing this coverage.¹²² However, there is a chance that not all segments of the cannabis industry will move from the excess and surplus lines to the admitted market. We may see certain segments, like retail or dispensary, moving to the admitted market because the risks associated with those are less than with other segment areas.¹²³

B. Insurance Needs and Considerations from Seed-To-Market

Though most coverage is in the excess and surplus lines market, access to commercial insurance for cannabis businesses varies significantly by the market segment of the seed-to-sale continuum. For some market segments, there are an increasing number of options in areas such as general commercial liability or basic property coverage. In many cases, businesses in the cannabis space

¹¹⁹ According to IRMI.com an MGA is Managing General Agent (MGA) — a specialized type of insurance agent/broker that, unlike traditional agents/brokers, is vested with underwriting authority from an insurer. Accordingly, MGAs perform certain functions ordinarily handled only by insurers, such as binding coverage, underwriting and pricing, appointing retail agents within a particular area, and settling claims. Typically, MGAs are involved with unusual lines of coverage, such as professional liability and surplus lines of insurance, in which specialized expertise is required to underwrite the policies. However, MGAs also write some personal lines business, especially in geographically isolated Areas (e.g., western Oklahoma, North Dakota) where there are accessibility concerns. MGAs benefit insurers because the expertise they possess is not always available within the insurer's home or regional offices and would be more expensive to develop on an in-house basis. —

<https://www.irmi.com/term/insurance-definitions/managing-general-agent>

¹²⁰ Steve Hallo, National Underwriter Property and Casualty 360: Is cannabis the next insurance opportunity? (January 6, 2021) — <https://www.propertycasualty360.com/2021/01/06/is-cannabis-the-next-insurance-opportunity/>; and Alwyn Scott, Reuters: US cannabis insurers get ready to roll as federal legalization nears (August 19, 2021) — [U.S. cannabis insurers get ready to roll as federal legalization nears | Reuters](https://www.reuters.com/business/finance/us-cannabis-insurers-get-ready-to-roll-as-federal-legalization-nears-2021-08-19/); and New Dawn Risk, Broker at LLOYD: Understanding and opening up the US cannabis insurance market (accessed February 21, 2023) — https://www.newdawnrisk.com/wp-content/uploads/2020/05/Cannabis_report-FINAL.pdf

¹²¹ Alicja Grzadzowska, Insurance Business Canada (insurancebusinessmag.com): An insurance learning curve for all as cannabis legalization looms (March 2, 2018) — <https://www.insurancebusinessmag.com/ca/news/broker-perspective/an-insurance-learning-curve-for-all-as-cannabis-legalization-loom-93822.aspx>

¹²² Presentation Panel Discussion: Admitted and Nonadmitted Coverage Across the Cannabis Business Sectors (July 19, 2021) — [Webex Enterprise Site - Replay Recorded Meeting — https://naic.webex.com/webappng/sites/naic/recording/225c7bfecae91039aafd0050568f5657/playback](https://naic.webex.com/webappng/sites/naic/recording/225c7bfecae91039aafd0050568f5657/playback)

¹²³ *Id.*

are facing more expensive coverage than other similar businesses. While they can get some insurance, a common complaint is that the limits available are constrained, e.g., \$1 million per occurrence, \$2 million aggregate capped. A further challenge is the anticipated explosive business growth for established cannabis businesses year over year.¹²⁴

What follows is some discussion about the various cannabis business market segments, particular insurance needs and availability, and some of the particular risk considerations that make availability and affordability challenging.

1. Cultivation

Coverage for cannabis has several aspects. First, hemp was included as a “legal” crop in the 2018 Farm Bill.¹²⁵ As it currently stands, federal multi-peril crop insurance is available in certain states and communities with conditions. The cultivator must: 1) be licensed and meet all requirements of state, tribal, and federal authorities, 2) have at least one year of history producing the crop, and 3) have a contract for the purchase of the hemp crop at the policy inception.¹²⁶ Hemp has the additional risk of becoming “hot hemp” due to environmental causes (THC above the 0.3 compliance level). Additionally, hemp does not qualify for replant payments or prevented plant payments.¹²⁷

Second, for hemp that does not qualify and cannabis cultivation, the insurance coverage availability is much less clear. There appears to be a small market for private crop insurance, though reports are that it is prohibitively expensive until more data and experience is available to support underwriting. An option that is emerging is parametric coverage for outdoor cannabis crops with triggers including: recorded rainfall over a specified time, wind, early freeze, hail, and drought.¹²⁸

¹²⁴ Alexander T. Brown, see generally, Lathrop GPM: Five Insurance Considerations for Cannabis-Related Businesses (July 21, 2021) – [Five Insurance Considerations for Cannabis-Related Businesses: Lathrop GPM](https://www.lathropgpm.com/TheRoadToInsuranceRecovery/five-insurance-considerations-for-cannabis-related-businesses) –

<https://www.lathropgpm.com/TheRoadToInsuranceRecovery/five-insurance-considerations-for-cannabis-related-businesses>
¹²⁵ Amy Abernethy, MD, PhD, U.S. Food & Drug Administration: Hemp Production and the 2018 Farm Bill (July 25, 2019) – <https://www.fda.gov/news-events/congressional-testimony/hemp-production-and-2018-farm-bill-07252019>

¹²⁶ USDA, Risk Management Agency, A Hemp Q&A with Andrew Kowalski (accessed February 21, 2023) – <https://www.rma.usda.gov/en/News-Room/Digital/RMA-Stories/Ask-the-Expert---A-Hemp-Questions-and-Answers-with-Andrew-Kowalski>

¹²⁷ USDA Farmers: Hemp and Farm Programs (accessed February 21, 2023) – <https://www.farmers.gov/your-business/row-crops/hemp>

¹²⁸ Evan Stait, Cannabis Industry Journal: Why You Should Consider Parametric Insurance to Protect Your Outdoor Cannabis Crop, (Sept. 22, 2020) – <https://cannabisindustryjournal.com/column/why-you-should-consider-parametric-insurance-to-protect-your-outdoor-cannabis-crop/>

More broadly, a primary differentiator amongst cannabis cultivators is whether the grow is outdoor or indoor (greenhouse). The two methods have significantly different risk profiles, leading to differing accessibility and affordability. Outdoor cultivation brings not only the traditional multi-peril concerns of crop insurance for destructive weather (hail, frost, damaging wind), disease, drought, fire, flooding, and insect damage.¹²⁹ The more controlled environment of an indoor grow protects from some of the environmental risks but presents its own array of challenges, including electrical, plumbing, security, and contaminants, including but not limited to mold, mildew, and pesticides. Anecdotally, coverage is more available for indoor cannabis cultivation, though it is undeterminable whether this is because the grow environment can be more easily managed, or whether the scale of a greenhouse grow permits several “crops” per year with increased proceeds.

2. Processing and Manufacturing

Cannabis products are available in a rising number of derivations. Cannabis is commercially available in flower (similar to loose tobacco), pre-rolled joints, vapes, dabable concentrates (highly concentrated extracts aka wax, shatter, or other appellations), edibles (including gummies, chocolates, taffy, beverages, and more), tinctures, topical applications, and more. Usage and the reasons for usage likewise can vary greatly by product format. According to IRI, a data analytics firm focused on consumer-packaged goods (CPGs), 43% of adults in fully legal states are cannabis consumers. Of those, 72% consume inhalable products, and 62% of those inhalable users are consuming cannabis at least once daily. Topical cannabis is more associated with pain relief, as the top reported relief communicated by consumers of those products. Better sleep is the top reported relief communicated for consumers of edibles. Users of CBD cite a myriad of health-related reasons for their use, the top four being pain relief, better sleep, and management of anxiety and stress.¹³⁰

As the number and variety of products/uses grows, so do the processing and manufacturing systems to produce a retail product. Traditional cannabis consumption relies on “flower” or “bud,” which is ground and then packed into a pipe or rolled. To achieve this basic formulation, the cannabis plant must be harvested, dried, sorted, trimmed to remove the flower from leaves and stalks, and then cured. Obviously, premises for drying, sorting, trimming, and curing are required, and some portions of these processes may be supported by mechanization. Under the Colorado cannabis regulatory structure, the premises used must be licensed as a “Regulated

¹²⁹ Insurance Information Institute (III): Understanding Crop Insurance (accessed February 21, 2023) – <https://www.iii.org/article/understanding-crop-insurance>

¹³⁰ Jessica Lukas, BDSA, and Larry Levin, IRI, Blog on BDSA and IRI: The Rise of Legal Cannabis as a Consumer Packaged Good, (September 30, 2021) – <https://www.iriworldwide.com/en-us/insights/blog/rise-of-cannabis-as-a-consumer-packaged-good>

Marijuana Business Operation,” which carries extensive rules about possession and access to the premises, security and lock standards, signage, floor plans, shared facilities (medical and adult use), waste disposal, inventory tracking, health and safety measures, audits, and prohibited chemicals and practices.¹³¹

Insurance for cannabis manufacturing premises is reportedly becoming more widely available, but pricing can be more expensive than for other sectors. The extensive regulation of the premises must be balanced against the enhanced risks, including potentially high-value raw materials, inventory in-process, risks of fire, theft, contamination, etc., and the potential of mishandling waste in violation of state law. Against this higher base level of premises, coverage can be increased risks from processing to make cannabis derivative products such as edibles, topicals, and dabs. For many of these derivative products, the raw material (including cannabis or the <.3% THC hemp) must be processed using solvents, pressure, heat, distillation/crystallization, or combinations thereof. Each adds an aspect of risk that should be considered and accounted for in the underwriting process.

3. Testing

State-mandated testing schemes are substantial and detailed to ascertain if the regulated cannabis (as either raw material or finished product) is: 1) contaminated or mislabeled, 2) is in violation of any product safety, health or sanitary statute, rule, or regulation, or 3) whether the results of a test raise questions requiring further investigation. The most significant area of liability will be professional liability if someone suffers legal injury due to a negligently erroneous test result. As an erroneous test could require the destruction of an entire crop or product run, the economic injury is obvious. From a consumer perspective, a test result indicating safety when a product is contaminated or varies from potency standards could lead to substantial recovery for personal injury. Consequently, professional liability or errors and omissions coverage is an important part of a testing facility’s portfolio.¹³²

4. Distribution

There are effectively two levels of distribution concern. One is raw material transport between cultivator and manufacturer/processor (and testing labs), and the other is consumer delivery. However, at the base, in Colorado, both levels rely on a comprehensive seed-to-sale tracking

¹³¹ Code of Colorado Regulations, Department of Revenue, Marijuana Enforcement Division, 1 CCR 212-3, Part 3 - Regulated Marijuana Business Operations

¹³² See subsequent section under Products Liability for further discussion of aspects of liability for a defective product.

system, which can be used to provide manifests documenting the transport of cannabis products throughout the state. In Colorado, this requirement is stated in statute as:

“To ensure that no marijuana grown or processed by a retail marijuana establishment is sold or otherwise transferred except by a retail marijuana store or as authorized by law, the state licensing authority shall develop and maintain a seed-to-sale tracking system that tracks retail marijuana from either seed or immature plant stage until the marijuana or retail marijuana product is sold to a customer at a retail marijuana store[.] . . .”¹³³

The seed-to-sale tracking system in Colorado is based on a Radio Frequency Identification (RFID) tag, which is affixed to a plant and, with aggregation of the information on it, follows the plant through cultivation, harvest, manufacturing, and distribution. For licensed operators who are transporting legal product, this permits explicit manifests that can be reconciled with the cargo between cultivator and manufacturer/processor. Both medical and retail cannabis in Colorado require a transporter’s license, which is obtained from the state’s regulatory authority, the Marijuana Enforcement Division of the Colorado Department of Revenue.

Insurance concerns of transporters include cargo coverage for an often high-value commodity that can be subject to theft/hijacking and spoilage. As described in a Reuters article, “Low coverage limits on cargo insurance, for example, can force companies to split shipments up, said Gene Brown, an insurance agent in Carmel, California, who specializes in cannabis coverage.”¹³⁴ Similarly, the cash-based current consumer economics of the industry has substantial security needs and a high risk of theft.

Recently, delivery to consumers through purchase on an app has been authorized in Colorado and has generated significant interest. This interest was likely accelerated by the expansion of other delivery services, such as Uber Eats, and similar services during the COVID-19 pandemic. This direct-to-consumer delivery has similar liability concerns as other delivery services (e.g., damage to third-party vehicles and parties, and the potential for theft, misdirection, or deception).

5. Retailers

When someone says, “legal cannabis,” the mental picture most people have is of a local dispensary in a state where it is legalized. Certainly, for most people a dispensary or store is how

¹³³ §44-12-202(1), Colo. Rev. Stat. - Powers and duties of state licensing authority - rules. § (1). Note: an almost identical provision is located in Colorado’s medical marijuana code.

¹³⁴ Alwyn Scott, Reuters: U.S. cannabis insurers get ready to roll as federal legalization nears (August 19, 2021) – <https://www.reuters.com/article/us-usa-insurance-cannabis-focus-idCAKBN2FK1AO>

they experience the industry. As storefronts, retailers have many of the same business insurance needs as other commercial establishments (e.g., premises/property and general liability coverage, inventory, employee benefits and employment practices liability insurance, business income/interruption, umbrella, commercial auto, and cybersecurity). Generally, insurance coverage is increasingly becoming available for these risks, albeit often at higher rates than for other types of retailers.

Primary among the risks is those of theft – both cash and product. In 2020, one of Colorado’s largest cannabis retailers, with 21 locations, reported 15 burglary attempts in 90 days.¹³⁵ Because most cannabis outlets deal almost exclusively in cash, there is ample opportunity for burglaries and robberies. Also, because the product for sale is high value itself, criminals do not go for just the cash. It is common for retailers to have substantially increased security, including around-the-clock guards, video screening, and extensive training and monitoring of their staff, to mitigate their enhanced risk.¹³⁶

In addition to the risk of damage to premises from break-ins for theft, personal injury to employees, customers, and bystanders is also a concern. As noted previously, workers’ compensation coverage is more available for cannabis retailers since it is a state-mandated coverage. However, questions of consistent occupational subclassification and experience rating may develop and have premium impacts.¹³⁷ In Colorado, complaints or concerns are not generally received about employee benefit coverages (primarily health). This is likely due to the federal Affordable Care Act (ACA) and the expansion of guaranteed availability to the individual health insurance market. On the employment practices liability aspect, there are anecdotal reports of challenges in finding coverage. At this time, additional information is needed to ascertain whether there is out-of-the-ordinary employment practices liability that is not mitigated by state regulatory schemes. This includes requiring criminal background checks and licensure of all persons employed in a business that possesses, cultivates, dispenses, transfers, transports, offers to sell, manufactures, or tests regulated cannabis.

6. Products Liability

One of the thorniest insurance issues for cannabis businesses is that of products liability coverage. As products liability claims may be made against any, and potentially all, entities in the supply chain from retailer or distributor, manufacturer, tester, or cultivator. The costs of defense

¹³⁵ Thomas Mitchell, Westword: Colorado’s Largest Dispensary Chain: Fifteen Burglary Attempts in Ninety Days Last Year (October 28, 2021) – <https://www.westword.com/marijuana/colorado-livwell-burglary-cash-cannabis-banking-12660338>

¹³⁶ *Id.*

¹³⁷ Insurance Information Institute: Spotlight on: marijuana and employment (November 24, 2020) For discussion of other aspects of marijuana in the broader employment context – <https://www.iii.org/article/spotlight-on-marijuana-and-employment>

in a products liability action alone make this coverage “in demand.” Moreover, the breadth of circumstances that can lead to a products liability claim raises legitimate concerns for all parts of the industry. By way of refresher, there are three basic theories of product liability: 1) design defect, which could include pesticide, mold, or biological contamination; 2) manufacturing defect, which can include contamination introduced during processing, or by faulty testing and results; and 3) warning/instruction defect, including product labeling violations or omissions, advertising misrepresentation, and packaging defects (i.e., child-resistant packages). It is easy to imagine the potential liability concerns of an industry involving an intoxicant that, until relatively recently, was comprehensively banned throughout the United States.

Reliance on a standard policy for products liability coverage for CRBs may not provide the full protection a business would anticipate. Most standard policies contain broad exclusions for Schedule 1 federally prohibited substances or criminal/fraudulent or dishonest acts or claims arising from violation of statute, code, rule, regulation, procedure, or guidance. Most standard policies do not include products completed, operations, and health hazard exclusions for cannabis businesses. Coverage for defense costs in a products liability action against a cannabis business is particularly key. The experience in the vaping crisis, referred to as “Vape-Gate,” is instructive. While it was ultimately found that most of the vaping injuries involved illicit or black market vape products, the potential for substantial and broad liability led to tighter risk management in the cannabis supply chain, including identification of unapproved or potentially dangerous additives resulting in adulterated products.¹³⁸ It is recommended that cannabis businesses specifically discuss with their insurer about coverage for products liability to ensure they understand the coverage provided and any limitations on it.

VIII. MARKET CONSIDERATIONS FOR COMMERCIAL CANNABIS INSURANCE

As noted above, the availability of insurance coverage for cannabis businesses is overwhelmingly found in the excess and surplus lines market at present. In part, this is due to the evolving nature of the commercial cannabis industry, and the lack of generally agreed upon data, measurement, and experience to support insurance underwriting. It is anticipated that just as the cannabis commercial industry evolves, so will the associated commercial insurance options in the admitted market. This evolution is anticipated and may be driven by how the cannabis business market

¹³⁸ Steve Hallo, National Underwriter Property and Casualty 360 Market Insights: Vape Gate and today’s cannabis product liability market (December 16, 2020) – <https://www.propertycasualty360.com/2020/12/16/vape-gate-and-todays-cannabis-product-liability-market/>

develops (e.g., vertical integration and consolidation versus continuation of niche commercial entities in the cannabis supply and distribution market).

A. Cannabis as a Client (and Consumer Beliefs)

As more states legalize cannabis for either recreational use or medical use, more insurance companies may enter the market to write cannabis businesses. The cannabis industry is a new aspect for insurance companies. Thus, they will need to understand the risks and exposures, as well as the needs of cannabis businesses as clients.¹³⁹

It is also important for producers to be educated on the cannabis market to serve this demographic. For example, it would be beneficial for a producer to be educated on the risks and exposures at each segment from seed to sale so that they can explain to their client what would be best suited for their needs. They may also help explain the differences between legal requirements and best practices. A cannabis business may not purchase coverage because it is not legally required; however, it may be a good business practice.

The cannabis business as a client has a similar learning curve. The cannabis business owner must have done their due diligence to obtain a license, be educated on cannabis products and processes, and know the applicable laws surrounding cannabis. However, a cannabis business as an insurance client may need some help with insurance terms and coverage options as they may not know what options are suitable for their needs.¹⁴⁰ Vocabulary from region to region or state to state also differs. This can be challenging for an insurance company when trying to explain coverage options to a cannabis business as a client.

Misconceptions also play a part when cannabis businesses seek insurance. When cannabis businesses first opened (around 1996 in California) there was fear that due to the federal illegality, they could be subject to criminal charges at any moment.¹⁴¹ There are concerns from the cannabis industry that the information provided to insurers can be accessed by the federal

¹³⁹ Jason Howard, CRC Group Wholesale & Specialty: Understanding the Issues Around Insuring Cannabis-Related Businesses (accessed February 21, 2023) – [Understanding the Issues Around Insuring Cannabis-Related Businesses - News - Tools & Intel | CRC Group](https://www.crcgroup.com/Tools-Intel/post/understanding-the-issues-around-insuring-cannabis-related-businesses) – <https://www.crcgroup.com/Tools-Intel/post/understanding-the-issues-around-insuring-cannabis-related-businesses>

¹⁴⁰ Don Jergler, Insurance Journal: Insuring Cannabis Summit: Talking to Clients About Risk Starts with Education (December 28, 2020) – [Insuring Cannabis Summit: Talking to Clients About Risk Starts with Education \(insurancejournal.com\)](https://www.insurancejournal.com/news/national/2020/12/28/10398fd70050568f0567/)

¹⁴¹ Brenda Wells, Ph.D., Presentation on Balancing Actual and Perceived Risks (East Carolina University). (July 27, 2021). See: [Webex Enterprise Site - Replay Recorded Meeting](https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback) – <https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback>

government.¹⁴² Some businesses in the industry may believe that insurance is not worth the cost or that coverage is not available.¹⁴³ Such misconceptions fuel belief that coverage is not available but, more recently, the concerns have been about the cost and limitations of coverage. Among the inherent limitations of excess and surplus lines are the higher costs of coverage and restrictions on the coverage beyond cannabis licensure requirements.

B. The Role of Data

Cannabis businesses are just like any other business; however, they continue to pay several times more than what other industries pay for insurance.¹⁴⁴ For example, a small mercantile general liability policy might run about \$1,000, but for a cannabis business, that policy could run about \$10,000 without products liability.¹⁴⁵ A directors and officers policy (D&O) for \$1 million in coverage could cost a cannabis business well into the six-figure range.¹⁴⁶ The difference in pricing may largely be due to the federal versus state treatment and the concomitant risks involved with cannabis businesses.¹⁴⁷ One major issue that persists for cannabis businesses and insurance is the lack of consistent and verifiable market data across market segments to inform of potential risks.¹⁴⁸ Insurers know very little about the losses and expenses associated with this industry, and therefore, it is difficult to price. An insurer can acquire information from their potential customer, but there is not a public source of comparative data that insurers can use to evaluate risks.¹⁴⁹

The lack of data relating to losses and expenses is a major issue, but data from similarly situated businesses can be used to assist in the underwriting process. When looking at dispensaries, an insurer can look at a pharmacy for medical use cannabis and liquor stores or vape shops for recreational use of cannabis to learn about underwriting a cannabis business. Similarly, cannabis processors and growers can look to processors from other similarly situated industries. Cannabis businesses need insurance at every point from seed to sell. Although data is lacking, there is

¹⁴² Jason Howard, CRC Group Wholesale & Specialty: Understanding the Issues Around Insuring Cannabis-Related Businesses (accessed February 21, 2023) – [Understanding the Issues Around Insuring Cannabis-Related Businesses - News - Tools & Intel | CRC Group](https://www.crcgroup.com/Tools-Intel/post/understanding-the-issues-around-insuring-cannabis-related-businesses) – <https://www.crcgroup.com/Tools-Intel/post/understanding-the-issues-around-insuring-cannabis-related-businesses>

¹⁴³ Brenda Wells, Ph.D., Presentation on Balancing Actual and Perceived Risks (East Carolina University). (July 27, 2021) – [Webex Enterprise Site - Replay Recorded Meeting](https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback) – <https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback>

¹⁴⁴ Wendel Rosen, Wendel Rosen: Cannabis Insurance Presents Tough Choices. (March 28, 2017) – <https://www.fennemorelaw.com/cannabis-insurance-presents-tough-choices/>

¹⁴⁵ Brenda Wells, Ph.D., Presentation on Balancing Actual and Perceived Risks. (East Carolina University). (July 27, 2021) – [Webex Enterprise Site - Replay Recorded Meeting](https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback) – <https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback>

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

information available to begin the underwriting process and to get a sense of what is needed by a cannabis-related business.

Insurers can also consider various factors during underwriting depending on the type of cannabis business. For processors, the results from a third-party inspection, the type of security system, and whether they are wired to outside monitoring stations, fire suppression systems, and the sufficiency of the electrical system with proper wattage and circuits all could be factors in the underwriting process. For retailers, the type of safe storing cash or product can also be considered when in the underwriting process, as there may be a regulatory requirement that a safe has to be so heavy as to not be easily moved, or the insurer may impose one. Overall, the insurer may want to know more about the owner/operator of the cannabis-related business. For instance, it may want to know if they are a member of a trade association or what education and training they have, and what they require of their staff. All this information can play a role in the risk involved with the cannabis-related business. What insurers would like to see is the risk be reduced. For example, the risk to insure someone who just decided to open a shop would be much higher than a person who took the time to get trained and educated in cannabis.

C. Developing Commercial Policy Forms

Most insurance policies, particularly those in the admitted market, are standardized. Advisory organizations help develop these forms that are used by property and casualty companies. The standardization of forms ensures: 1) the legal requirements from each state are taken into consideration; 2) premium rates are based on actuarial studies of insurable risks; and 3) case law is taken into consideration to prevent ambiguities in contract terms. Additionally, standardized forms using familiar terms and vocabulary may reduce the potential for disparate interpretations. Prior to legalization, insurance policies would typically exclude cannabis-related activities from a policy due to the illegality of the product as a federally listed Schedule 1 substance.¹⁵⁰ As states implement new cannabis laws, insurers will need to modify their contract forms to achieve compliance. Striving for consistent terminology and language is part of the normal work of advisory organizations.

¹⁵⁰ Heather Howell Wright, National Underwriter Property and Casualty 360: ISO Revises Policy Forms to Address Cannabis (November 1, 2019) – [ISO revises policy forms to address cannabis | PropertyCasualty360](https://www.propertycasualty360.com/2019/11/01/insurance-services-organization-revises-policy-forms-to-address-cannabis/) – <https://www.propertycasualty360.com/2019/11/01/insurance-services-organization-revises-policy-forms-to-address-cannabis/>

1. Insurance Services Office (ISO)

ISO is an insurance advisory organization that shares actuarial information with its customers, including insurance companies, actuaries, agents and brokers, and government entities.¹⁵¹ ISO gathers large amounts of loss data from various insurance companies to develop advisory prospective loss costs. Licensing carriers may use these loss costs to develop their ultimate insurance rates.¹⁵² ISO also creates insurance policy forms and endorsements often viewed by many as an industry standard.¹⁵³ ISO-created policy forms and endorsements often include policy language that has been tested in the courts, providing licensing carriers with potentially less volatility in interpretation than if an insurer creates its own form.¹⁵⁴

ISO insurance programs are available to provide insurance coverage to or exclude coverage with respect to cannabis-related businesses and exposures through policy endorsements.¹⁵⁵ An insurance endorsement can be used at policy inception or after a policy is issued to add, delete, exclude, or otherwise alter coverage.¹⁵⁶

Previously, neither the ISO Commercial General Liability (CGL), Commercial Property (Property), nor Commercial Auto (CA) forms expressly addressed cannabis. However, ISO developed several endorsements to specifically address the cannabis exposure in these and other insurance programs. The related endorsements can enhance an insurer's flexibility to tailor their product by expressly addressing coverage with respect to cannabis-related exposures.

If an insurance carrier prefers to avoid providing coverage with respect to cannabis-related exposures in any of the related insurance programs, ISO makes available several exclusionary endorsements to exclude coverage. However, if there is interest in providing coverage for a cannabis-related exposure, ISO has made available several endorsements for that purpose.

ISO's CGL and Property programs include options for the carrier to extend certain coverage with respect to the cannabis exposure. Carriers also have the option to extend limited coverage with respect to only the hemp exposure using a cannabis exclusion with an exception applying to

¹⁵¹ Marianne Bonner, The Balance: Insurance Services Office (ISO) (May 16, 2019) – [What Is the Insurance Services Office \(ISO\)? – thebalancesmb.com](#)

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ Heather Howell Wright, National Underwriter Property and Casualty 360: ISO Revises Policy Forms to Address Cannabis (November 1, 2019) – [ISO revises policy forms to address cannabis | PropertyCasualty360 – https://www.propertycasualty360.com/2019/11/01/insurance-services-organization-revises-policy-forms-to-address-cannabis/](#)

¹⁵⁶ Mila Araujo, The Balance: What Is an Insurance Endorsement (May 4, 2022) – [What Is an Insurance Endorsement? – thebalance.com](#)

hemp. Additionally, the CGL program includes options for insurance carriers to exclude liability for specifically listed products.

Within the commercial general liability program, ISO developed liability coverage endorsements with an aggregate limit for cannabis, a cannabis exclusion with a hemp exception aggregate limit, and a cannabis liability exclusion with designated product or work exception subject to an aggregate limit.¹⁵⁷

Lastly, ISO developed the defense within limits endorsement specific to products liability coverage that allows the carrier to limit the cost of defense related to products covered by the coverage form. Similar options are available for ISO's Businessowners, Commercial Flood, and Commercial Inland Marine programs.

2. American Association of Insurance Services (AAIS)

AAIS, a not-for-profit advisory organization governed by its member insurance companies, provides insurance forms, rules, and loss costs to the property casualty insurance industry.¹⁵⁸ AAIS provides policy forms and manuals in commercial lines, inland marine, farm and agriculture business lines, as well as personal lines to more than 700 insurance carriers.¹⁵⁹ As a licensed statistical agent in 51 jurisdictions, AAIS collects data that helps members meet regulatory statistical reporting responsibilities, which also supports loss cost development and ratemaking activities.¹⁶⁰

AAIS' cannabis business owners' policy (CannaBOP) product was developed at the request of the California Department of Insurance (DOI) to strengthen carrier participation for coverage of commercial cannabis operations. The CannaBOP is a package policy that provides property and liability coverages for qualifying cannabis dispensaries, storage, distributors, processors, manufacturers, and private cannabis testing facilities and laboratories.¹⁶¹ Rather than providing coverage to legal cannabis businesses through an endorsement, AAIS advocates for cannabis-specific product development and cannabis-specific programs.¹⁶² The CannaBOP program also

¹⁵⁷ *Id.*

¹⁵⁸ AAIS: An Unwavering Commitment to our Members...and to the Success of the Insurance Industry (accessed February 21, 2023) – [Our Role in Insurance - AAIS Online](https://aaisonline.com/our-role-in-insurance) – <https://aaisonline.com/our-role-in-insurance>

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ AAIS Solutions Kit: CANNABOP: Cannabis - Businessowners (January 2020) – [30f1bcd6-6b5d-921f-ce64-654b16f08b88](https://aaisonline.com) – aaisonline.com

¹⁶² AAIS: Arizona Approves AAIS CannaBOP, Cannabis Business Owners Insurance Policy (March 9, 2021) – [Arizona Approves AAIS CannaBOP, Cannabis Business Owners Insurance Policy - AAIS Online](https://aaisonline.com/press-arizona-approves-aais-cannabop-cannabis-businessowners-insurance-policy) – <https://aaisonline.com/press-arizona-approves-aais-cannabop-cannabis-businessowners-insurance-policy>

includes the rules, loss costs, and a suite of optional endorsements to be used by an insurance company.¹⁶³ The program also offers technology support so that CannaBOP can be quickly distributed and AAIS dedicated personnel keeping a keen eye on the “legs & regs” to help carriers remain compliant within this space.¹⁶⁴

3. Filing Process and Adoption of ISO and AAIS Forms

AAIS and ISO are advisory organizations that submit advisory loss costs, rules, and forms to the respective regulating agency for review and approval. These advisory organizations have member or subscriber requirements to use their approved forms, rules, rates, or loss costs. Loss costs are the data on claims that have been paid out.

In some states, advisory organizations file on behalf of insurers that have given them authorization, and other states may have varying filing requirements, as in the case of California. In the absence of a filing made on behalf of an insurer, the insurance company submits a separate filing to adopt the product or endorsement before it can use what has been created by the advisory organization. For example, in California, insurer XYZ wanted to start writing a Cannabis Business Owners policy. As a member of an advisory organization, XYZ could use the advisory organization’s forms and data for what coverages to offer, forms to use, rules to apply, and rates (loss costs multiplied by a loss cost multiplier to account for the insurer expenses) to use. Insurer XYZ would submit a prior approval new program filing with the California DOI to adopt the portions of the advisory organization material they wanted to use. The filing would then be reviewed and approved before insurer XYZ could start writing cannabis business owners’ risks using the advisory organization’s filing as a foundation. So, two separate filing approvals are needed: first, the approval of the filing containing the advisory organization product; and then, after the advisory organization’s product is approved, the insurance company(s) filings requesting adoption of the already approved advisory organization’s product.

ISO’s Cannabis Endorsements were approved for use in a majority of the states in September 2019.¹⁶⁵ According to AAIS, CannaBOP was first filed and approved in California in 2018.¹⁶⁶ Since then, CannaBOP has been approved in Colorado, Nevada, Illinois, Michigan, and Washington.¹⁶⁷ In March 2021, CannaBOP was adopted by Golden Bear in Arizona.¹⁶⁸

¹⁶³ *Id.*

¹⁶⁴ AAIS: Introducing CannaBOP (accessed February 21, 2023) – [CannaBOP\(old\) - AAIS Online](https://aaisonline.com/cannabopold#:~:text=Introducing%20CannaBOP%20The%20AAIS%20CannaBOP%20program%20is%20a%20of%20licensed%20cannabis%20dispensaries%2C%20distributors%20and%20testing%20labs.) – <https://aaisonline.com/cannabopold#:~:text=Introducing%20CannaBOP%20The%20AAIS%20CannaBOP%20program%20is%20a%20of%20licensed%20cannabis%20dispensaries%2C%20distributors%20and%20testing%20labs.>

¹⁶⁵ Heather Howell Wright, National Underwriter Property and Casualty 360: ISO Revises Policy Forms to Address Cannabis (November 1, 2019) – [ISO revises policy forms to address cannabis | PropertyCasualty360](https://www.propertycasualty360.com/2019/11/01/insurance-services-organization-revises-policy-forms-to-address-cannabis/) – <https://www.propertycasualty360.com/2019/11/01/insurance-services-organization-revises-policy-forms-to-address-cannabis/>

¹⁶⁶ AAIS: Arizona Approves AAIS CannaBOP, Cannabis Business Owners Insurance Policy (March 9, 2021) – [Arizona Approves AAIS CannaBOP, Cannabis Business Owners Insurance Policy - AAIS Online](https://aaisonline.com/press-arizona-approves-aais-cannabop-cannabis-businessowners-insurance-policy) – <https://aaisonline.com/press-arizona-approves-aais-cannabop-cannabis-businessowners-insurance-policy>

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

IX. RESPONDING TO EMERGING TRENDS

Emerging trends in the cannabis industry provide opportunities for next steps in policy, regulation, and insurance. Cannabis product innovation is expanding past edibles to infuse cannabis into beverages, baking staples, crafts, and luxury products. New formulas and strengths are also being introduced with these new products. Innovation brings both new insurance needs and risks. For instance, states issued recalls in 2022 for cannabis edibles for mislabeling and contamination, resulting in litigation.¹⁶⁹

Growing demand for ancillary services and infrastructure in the cannabis space will also likely impact cannabis-related insurance. Ancillary services include those that complement the cannabis industry and are often non-plant touching. This includes marketing, transportation and delivery, financing, breathalyzers, product packaging, accountants, landlords, staffing firms, nutrient suppliers, and equipment companies.

Insurance regulators should also be informed of the emergence of on-site social consumption lounges. A few states have started issuing licenses for these establishments. On-site social cannabis lounge sites may operate similarly to bars, where consumers would gather to socially consume cannabis at a place of business. These businesses will face liability and insurance issues akin to businesses serving alcohol, like bars, breweries, and wineries.

X. CONCLUSIONS

A major aspect of obtaining insurance coverage for cannabis-related businesses is the complexity of limitations to interstate commerce hampering multi-state expansion. The current cannabis marketplaces are contained in individualized state jurisdictions without competition from other state marketplaces.¹⁷⁰ There have been state legislative authorizations in California (2022) and Oregon (2019) to create legal cannabis interstate commerce through trade pacts with other states. However, these laws require Congressional authorization or a memorandum from the DOJ allowing for interstate transfers of cannabis products. Federal legislation was introduced in 2021 with the States Reform Act (SRA). The SRA would decriminalize cannabis at the federal level while deferring to state powers over prohibition and commercial regulation.

¹⁶⁹ Jay Virdi, Cannabis Industry Journal: Challenges Abound for Cannabis Industry Growth in 2023 (November 30, 2022) – https://cannabisindustryjournal.com/feature_article/challenges-abound-for-cannabis-industry-growth-in-2023/

¹⁷⁰ Tommy Tobin and Andrew Kline, Yale Law & Policy Review: A sleeping Giant: How the Dormant Commerce Clause Looms Over the Cannabis Marketplace (January 3, 2022) – https://ylpr.yale.edu/inter_alia/sleeping-giant-how-dormant-commerce-clause-looms-over-cannabis-marketplace

Insurers are likely to continue to be cautious about entering the cannabis space in the absence of federal safe harbor provisions, legalization, decriminalization, or rescheduling. The federal prohibition has the effect of inhibiting access to vital ancillary services, such as banking with financial institutions and mitigating risk through insurance. States may look to add safe harbor laws into their authorities to ensure vital ancillary businesses can legally service the cannabis industry within state laws. The goal of safe harbor authorities is to seek and grant protections from liabilities or penalties, so long as certain conditions are met. For example, California recently passed a bill that states an individual or firm providing insurance or related services to a state legal cannabis business does not commit a crime under California law solely for providing that insurance or related service.¹⁷¹ The NAIC has supported federal legislation to provide a safe harbor for financial institutions and insurers serving cannabis-related businesses operating in states that have legalized cannabis.

Currently, most commercial insurance coverage for cannabis-related businesses is in the excess and surplus market. There is, however, growing interest among admitted carriers in entering this area. Among the potential structures to facilitate cannabis-related business coverage are: the use of state-based commercial insurance programs, risk retention groups (RRGs), captives, and joint underwriting associations (JUAs). States may want to look at their state laws to identify and remediate any restrictions in use of such programs for cannabis-related businesses.

Fair Access to Insurance Requirements (FAIR) plan programs afford opportunities for difficult risks to be underwritten by certain insurers when other insurance is not feasible. Sometimes known as insurers of last resort, the availability of these plans varies by jurisdiction. While commonly limited to personal lines, some states include commercial coverage. Generally, these programs help to provide insurance for those unable to acquire it from the admitted or excess and surplus insurance markets. FAIR plans are shared market plans, where several insurance companies provide coverage for the property, limiting the amount of risk that any one company assumes.

Risk retention groups and captive insurers also provide additional options for cannabis-related business insurance coverage. Governed by state law, there are many nuances that a state must consider. For example, Washington identified 17 businesses using captive insurance but not

¹⁷¹ Assembly Member Cooley, AB 2568 (Chapter 393, Statutes of 2022).

paying premium taxes to the state the captive was operating in. This was due to legal framework for captive registration and taxation had not yet been established.¹⁷²

Joint underwriting associations (JUAs) could be created to alleviate the lack of availability and affordability for state mandated cannabis-related commercial insurance coverage. A joint underwriting association is a nonprofit risk-pooling association established by a state legislature in response to availability crises in respect to certain kinds of insurance coverage. For example, a number of states have established JUAs to provide medical malpractice insurance for physicians who are unable to obtain affordably priced insurance coverage in the standard marketplace.

Addressing black-market cannabis operations could also help support capacity for cannabis-related commercial insurance. Black-market operations can take the form of illegal grows, unlicensed production and processing facilities, and criminal retailers. Black-market operations compete with the regulated markets and remove revenue that would be taxed and generated with the legal retailers. Black-market products are also not subject to any regulations for advertising, marketing, retail sales, or consumer safety. This creates risk than can spill over into the state-legal cannabis market. For example, during Vape Gate, insurers increased pricing and added product liability exclusions for unapproved additives. Many of the vape issues were found to be due to black market products. However, insurers' apprehension on writing vape-related risks lingered for a few years following the event.¹⁷³

Some states are already taking steps to address black market operations. For example, Oregon and Washington each involve their law enforcement agencies in a collaborative effort with their cannabis regulatory bodies to seek and enforce against illegal cannabis operations. Oregon even coordinates its enforcement efforts in collaboration with California agencies in these efforts. Colorado coordinates between law enforcement and the cannabis regulatory agencies. In Washington, state tax revenue generated at regulated cannabis retailers is also distributed to local law enforcement agencies, which can help fund their enforcement efforts against black-market operations. The cannabis and insurance industries, as well as consumers, benefit from these enforcement activities, as well as the removal of the unregulated black-market.

As the number of states legalizing cannabis continues to grow, so will the need for cannabis-related commercial insurance. Insurance regulators must stay current with the rapidly changing landscape. There has been a rapid introduction of new cannabis products whose product liability

¹⁷² Joel S. Chansky, FCAS, MAAA Craig R. Brophy, FCAS, MAAA David R. Kennerud, FCAS, MAAA Joseph T. Holahan, JD, Milliman Report: Captive Insurance Study (January 18, 2021) – <https://www.insurance.wa.gov/sites/default/files/documents/captive-insurance-study.pdf>

¹⁷³ Steve Hallo, Market Insights: Vape Gate and today's cannabis product liability market (December 16, 2020) – <https://www.propertycasualty360.com/2020/12/16/vape-gate-and-todays-cannabis-product-liability-market/>

needs and risks are still unknown. The insurance needs of ancillary businesses will also need to be understood. Finally, insurance regulators will need to access the capacity for new business models, such as on-site consumption lounges, to find insurance coverage and address associated educational needs.

XI. APPENDIX:

ADDITIONAL CANNABIS INFORMATIONAL RESOURCES

- **Americans for Safe Access:** <https://www.safeaccessnow.org/>
- **Cannabis Business Times:** <https://www.cannabisbusinesstimes.com/>
- **Cannabis Now:** <https://cannabisnow.com/>
- **Cannabis Regulators Association:** <https://www.cann-ra.org/>
- **Drug Policy Alliance:** <http://www.drugpolicy.org/>
- **Global Commission on Drug Policy:** <http://www.globalcommissionondrugs.org/>
- **Insurance Journal: Attaining Compliance in the Cannabis Universe:**
<https://www.insurancejournal.com/research/research/attaining-compliance-in-the-cannabis-universe/>
- **Law Enforcement Action Partnership:** <https://lawenforcementactionpartnership.org/>
- **Marijuana Policy Project (MPP):** <https://www.mpp.org/>
- **MJ Business Daily:** <https://mjbizdaily.com/>
- **NAIC - Cannabis Insurance Hearings:**
 - Hearing 1:
<https://naic.webex.com/webappng/sites/naic/recording/225c7bfecae91039aafd0050568f5657/playback>
 - Hearing 2:
<https://naic.webex.com/webappng/sites/naic/recording/fe42d865d13210398fd70050568f0567/playback>
- **NAIC: Regulatory Guide – Understanding the Market for Cannabis Insurance:**
https://content.naic.org/sites/default/files/inline-files/cmte_c_cannabis_wg_exposure_understanding_cannabis_marketplace_0.pdf

- **National Cannabis Industry Association:** <https://thecannabisindustry.org/>
- **National Conference of State Legislatures:** <https://www.ncsl.org/research/civil-and-criminal-justice/marijuana-overview.aspx>
- **National Highway Traffic Safety Administration:** <https://www.nhtsa.gov/drug-impaired-driving/understanding-how-marijuana-affects-driving#:~:text=Though%2033%20states%20have%20changed,the%20wheel%20of%20a%20vehicle>
- **National Organization for the Reform of Marijuana Laws:** <https://norml.org/>
- **Patients out of Time:** <https://www.medicalcannabis.com/>
- **Smart Approaches to Marijuana:** <https://learnaboutsam.org/>
- **Students for Sensible Drug Policy:** <https://ssdp.org/>
- **Transform Drug Policy Foundation:** <https://transformdrugs.org/>
- **United States Department of Agriculture – Hemp:** <https://www.ams.usda.gov/rules-regulations/hemp>
- **United States Drug Enforcement Administration – Marijuana:** <https://www.dea.gov/factsheets/marijuana>
- **Veterans for Cannabis:** <https://www.vetscp.org/>
- **White House, Office of National Drug Control Policy:** <https://www.whitehouse.gov/ondcp>

PROJECT HISTORY

REGULATORY GUIDE TO UNDERSTANDING THE MARKET FOR CANNABIS INSURANCE: 2023 UPDATE WHITE PAPER

1. Description of the Project, Issues Addressed, etc.

The *Regulatory Guide to Understanding the Market for Cannabis Insurance: 2023 Update* white paper explores emerging insurance issues in the cannabis industry and the current state of cannabis regulation in the United States (U.S.).

2. Name of Group Responsible for Drafting the Model and States Participating

The Cannabis Insurance (C) Working Group drafted the white paper. The following states are on the Working Group: California, Colorado, Alaska, Arkansas, Delaware, District of Columbia, Illinois, New Mexico, Mississippi, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, Nevada, Vermont, New Jersey, and Washington.

3. Project Authorized by What Charge and Date First Given to the Group

The white paper was authorized through the Property and Casualty (C) Insurance Committee's addition of a charge to the Cannabis Insurance Working Group's 2022 charges. Specifically, the charge asked the Working Group to use information gained through exploring potential sources of constraint to coverage limits and availability of cannabis insurance products in the P/C insurance lines to develop an updated white paper.

An updated white paper was needed because the cannabis industry has become more sophisticated since the original white paper was published in 2019. It has also continued to rapidly expand, driving new product development, infrastructure changes, and the need for businesses to provide ancillary services. The state of cannabis regulation, specifically at the state and local levels, has also evolved significantly since the last white paper.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

The Cannabis Insurance (C) Working Group designated a drafting group to develop the white paper after it reviewed and approved an outline. The drafting group met in drafting sessions approximately bi-weekly until completion. Drafting group member states included California, Colorado, Illinois, Oregon, Vermont, and Washington. The Insurance Services Office (ISO) and American Association of Insurance Services (AAIS) contributed educational materials and revisions to the sections of the white paper that discuss their products and services. The Working Group was presented with updates on the working drafts so they could provide feedback.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The white paper was exposed on April 11, 2023, for a 45-day public comment period ending May 26, 2023. Notification of the exposure was redistributed on June 6, 2023, to include the Property and Casualty Insurance (C) Committee's distribution list and the comment period was extended to July 7.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)

The white paper focuses on issues impacting affordability and availability of insurance for cannabis-related risks in states that have legalized its use. It avoids advocacy-oriented discussion. As such, no controversy occurred during its drafting or exposure period.

7. List the key provisions of the model (sections considered most essential to state adoption)

While this is a white paper, not a model, state insurance regulators will find the Conclusions section helpful in understanding the unique activities states are taking or contemplating to address the need for cannabis-related insurance.

8. Any Other Important Information (e.g., amending an accreditation standard)

Capital Adequacy (E) Task Force RBC Proposal Form

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|---|--|--|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input checked="" type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4/20/23</u></p> <p>CONTACT PERSON: <u>Dave Fleming</u></p> <p>TELEPHONE: <u>816-783-8121</u></p> <p>EMAIL ADDRESS: <u>dfleming@naic.org</u></p> <p>ON BEHALF OF: <u>RBC Inv. Risk & Eval. (E) Working Group</u></p> <p>NAME: <u>Philip Barlow</u></p> <p>TITLE: <u>Associate Commissioner for Insurance</u></p> <p>AFFILIATION: <u>District of Columbia</u></p> <p>ADDRESS: <u>1050 First Street, NE Suite 801</u> <u>Washington, DC 20002</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <hr/> <p>Agenda Item # <u>2023-09-IRE</u> Year <u>2023</u></p> <hr/> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>6/30</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>6/14</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal applies a .45 base RBC factor in the life RBC formula for residual tranches.

Additional Staff Comments:

DF – The Working Group adopted a factor of .30 for yearend 2023 to be replaced by .45 beginning with yearend 2024 with consideration of positive or negative adjustment based on additional information.
EY- The Task Force adopted this proposal and 2023-10-IRE together during June 30 meeting.

**** This section must be completed on all forms.**

Revised 2-2023

OTHER LONG-TERM ASSETS (CONTINUED)

	<u>Annual Statement Source</u>	(1) <u>Book / Adjusted Carrying Value</u>	(2) <u>Unrated Items ‡</u>	(3) <u>RBC Subtotal †</u>	(4) <u>Factor</u>	(5) <u>RBC Requirement</u>
<u>Schedule BA - Unaffiliated Common Stock</u>						
(42)	Schedule BA Unaffiliated Common Stock-Public	AVR Equity Component Column 1 Line 65			X	\$
(43)	Schedule BA Unaffiliated Common Stock-Private	AVR Equity Component Column 1 Line 66			X	0.3000
(44)	Total Schedule BA Unaffiliated Common Stock (pre-MODCO/Funds Withheld)	Line (42) + (43)				
(45)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)				
(46)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)				
(47)	Total Schedule BA Unaffiliated Common Stock (including MODCO/Funds Withheld.)	Lines (44) - (45) + (46)				
<u>Schedule BA - All Other</u>						
(48.1)	BA Affiliated Common Stock - Life with AVR	AVR Equity Component Column 1 Line 67				
(48.2)	BA Affiliated Common Stock - Certain Other	AVR Equity Component Column 1 Line 68				
(48.3)	Total Schedule BA Affiliated Common Stock - C-1o	Line (48.1) + (48.2)			X	0.3000
(49.1)	BA Affiliated Common Stock - All Other	AVR Equity Component Column 1 Line 69				
(49.2)	Total Sch. BA Affiliated Common Stock - C-1cs	Line (49.1) + AVR Equity Component Column 1 Line 93			X	0.3000
(50)	Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999			X	0.0680
(51)	Total Residual Tranches or Interests	AVR Equity Component Column 1 Line 93			X	0.3000
(52.1)	NAIC 01 Working Capital Finance Notes	AVR Equity Component Column 1 Line 94			X	0.0050
(52.2)	NAIC 02 Working Capital Finance Notes	AVR Equity Component Column 1 Line 95			X	0.0163
(52.3)	Total Admitted Working Capital Finance Notes	Line (52.1) + (52.2)				
(53.1)	Other Schedule BA Assets	AVR Equity Component Column 1 Line 96				
(53.2)	Less NAIC 2 thru 6 Rated/Designated Surplus Notes and Capital Notes	Column (1) Lines (23) through (27) + Column (1) Lines (33) through (37)				
(53.3)	Net Other Schedule BA Assets	Line (53.1) less (53.2)			X	0.3000
(54)	Total Schedule BA Assets C-1o (pre-MODCO/Funds Withheld)	Lines (11) + (21) + (31) + (41) + (48.3) + (50) + (52.3) + (53.3)				
(55)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)				
(56)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)				
(57)	Total Schedule BA Assets C-1o (including MODCO/Funds Withheld.)	Lines (54) - (55) + (56)				
(58)	Total Schedule BA Assets Excluding Mortgages and Real Estate	Line (47) + (49.2) + (51) + (57)				

† Fixed income instruments and surplus notes designated by the NAIC Capital Markets and Investment Analysis Office or considered exempt from filing as specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* should be reported in Column (3).

‡ Column (2) is calculated as Column (1) less Column (3) for Lines (1) through (17). Column (2) equals Column (3) - Column (1) for Line (53.3).

§ The factor for Schedule BA publicly traded common stock should equal 30 percent adjusted up or down by the weighted average beta for the Schedule BA publicly traded common stock portfolio subject to a minimum of 22.5 percent and a maximum of 45 percent in the same manner that the similar 15.8 percent factor for Schedule BA publicly traded common stock in the Asset Valuation Reserve (AVR) calculation is adjusted up or down. The rules for calculating the beta adjustment are set forth in the AVR section of the annual statement instructions.

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|--|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input checked="" type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4/20/23</u></p> <p>CONTACT PERSON: <u>Steve Clayburn</u></p> <p>TELEPHONE: <u>(202)624-2197</u></p> <p>EMAIL ADDRESS: <u>steveclayburn@acli.com</u></p> <p>ON BEHALF OF: <u>American Council of Life Insurers (ACLI)</u></p> <p>NAME: <u>Steve Clayburn</u></p> <p>TITLE: _____</p> <p>AFFILIATION: _____</p> <p>ADDRESS: _____</p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <hr/> <p>Agenda Item # <u>2023-10-IRE</u></p> <p>Year <u>2023</u></p> <hr/> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>6/30</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>6/14</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

The adoption by the Working Group of proposal 2023-04-IRE provides the structure for this sensitivity test. This proposal is to address the factor to be applied in that test.

Additional Staff Comments:

DF – The Working Group adopted a factor of .15 for yearend 2023.
EY- The Task Force adopted this proposal and 2023-09-IRE together during June 30 meeting.

** This section must be completed on all forms.

SENSITIVITY TESTS - AUTHORIZED CONTROL LEVEL

Sensitivity Tests Affecting Authorized Control Level <u>Risk-Based Capital</u>	<u>Source</u>	(1) <u>Statement Value</u>	Additional Sensitivity <u>Factor</u>	(2) <u>Additional RBC</u>	(3) <u>Authorized Control Level Before Test</u>	(4) <u>Authorized Control Level After Test</u>
(1.1) Other Affiliates: Company	LR042 Summary for Affiliated Investments Column (1) Line (13)		0.700			
(1.2) Other Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (1.2)		0.700			
(1.99) Total Other Affiliates			0.700			
(2.1) Noncontrolled Assets - Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (15)		0.020			
(2.2) Noncontrolled Assets - Subsidiaries	LR038 Additional Information Required Column (1) Line (2.2)		0.020			
(2.99) Total Noncontrolled Assets			0.020			
(3.1) Guarantees for Affiliates: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (24)		0.020			
(3.2) Guarantees for Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (3.2)		0.020			
(3.99) Total Guarantees for Affiliates			0.020			
(4.1) Contingent Liabilities: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (25)		0.020			
(4.2) Contingent Liabilities: Subsidiaries	LR038 Additional Information Required Column (1) Line (4.2)		0.020			
(4.99) Total Contingent Liabilities			0.020			
(5.1) Long-Term Leases: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (26)		0.030			
(5.2) Long-Term Leases: Subsidiaries	LR038 Additional Information Required Column (1) Line (5.2)		0.030			
(5.99) Total Long-Term Leases			0.030			
(7.1) Affiliated Investments†: Company	LR038 Additional Information Required Column (1) Line (7.14)		0.100			
(7.2) Affiliated Investments†: Subsidiaries	LR038 Additional Information Required Column (1) Line (7.2)		0.100			
(7.99) Total Affiliated Investments			0.100			
(8.1) Total Residual Tranches or Interests	LR038 Additional Information Required Column (1) Line (11.1)		0.150			

† Excluding affiliated preferred and common stock

Denotes items that must be manually entered on the filing software.

REQUEST FOR MODEL LAW DEVELOPMENT

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

Please check whether this is: New Model Law or Amendment to Existing Model

1. Name of group to be responsible for drafting the model:

Mortgage Guaranty Insurance Working Group

2. NAIC staff support contact information:

Dan Daveline, (816)783-8134, ddaveline@naic.org
Andy Daleo, (816)783-8141, adaleo@naic.org

3. Please provide a description and proposed title of the new model law. If an existing law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.

Mortgage Guaranty Insurance Model Act (#630)

Amendments will be made to the following sections, but not limited to:

- Section 3 - Capital Requirements – Paid-in Capital
- Section 5 - Geographic Concentration
- Section 7 - Investment Limitations
- Section 8 - Reinsurance and the Use of Captive Reinsurance
- Section 12 - Modifications to Risk-to-Capital and Minimum Policyholders Position
- Section 16 - Contingency Reserves

4. Does the model law meet the Model Law Criteria? Yes or No (Check one)

(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).

a. Does the subject of the model law necessitate a national standard and require uniformity amongst all states? Yes or No (Check one)

If yes, please explain why

Due to the recent mortgage crisis spanning globally, the Working Group desires to proceed with the development of a Model. While there could be modest variations, substantial agreement is desirable.

b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law?

Yes or No (Check one)

5. **What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?**

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: May require an extension to 18 months total, due to possible need for outside expertise.

6. **What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?**

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary:

7. **What is the likelihood that state legislature will adopt the model law in a uniform manner within three years of adoption by the NAIC?**

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Primarily the key regulating mortgage guaranty states or the 15 states that are currently regulating mortgage guaranty insurers will adopt this Model or something substantially similar. It less likely for a state that does not have a domiciled mortgage guaranty insurer to adopt this Model.

8. **Is this model law referenced in the Accreditation Standards? If so, does the standard require the model law to be adopted in a substantially similar manner?**

No

9. **Is this model law in response to or impacted by federal laws or regulations? If yes, please explain.**

Not in response to Federal law, but it could be impacted by by Federal laws or GSE guidelines currently being developed.

Draft: 5/11/23

Adopted by Mortgage Guaranty Insurance (E) Working Group—7/13/23

Adopted by Financial Condition (E) Committee—7/19/23

MORTGAGE GUARANTY INSURANCE MODEL ACT

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Section 1. Title

This Act may be cited as the Mortgage Guaranty Insurance Act.

Section 2. Definitions

The definitions set forth in this Act shall govern the construction of the terms used in this Act but shall not affect any other provisions of the code.

~~A.~~ A. "Authorized ~~real estate security,~~ for the purpose of this Act, Real Estate Security" means ~~an:~~

(1) An amortized note, bond or other ~~evidence~~ instrument of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, evidencing a loan, not exceeding ~~ninety five~~ one hundred three percent (~~95~~103%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument that constitutes, or is equivalent to, a first lien or ~~charge on real estate~~ junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:

~~(a) (1) The real estate loan secured in this manner is one of a type that a bank, savings and loan association, or an insurance company creditor, which is supervised and regulated by a department of this any state or territory of the U.S or an agency of the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate;~~

~~(2b) The improvement on loan is to finance the acquisition, initial construction or refinancing of real estate that is a:~~

~~(i) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit development, or any other one-family residential unit as to which title may be conveyed freely; or~~

~~(ii) Mixed-use building with only one non-residential use and one one-family dwelling unit; or~~

~~(iii) Building or buildings designed for occupancy as specified by Subsections A(1) and A(2) of this section; and by five (5) or more families or designed to be occupied for industrial or commercial purposes.~~

~~(3c) The lien on the real estate may be subject to and subordinate to the following:~~

~~(a) The lien of any public bond, assessment or tax, when no installment, call or payment of or under the bond, assessment or tax is delinquent; and~~

~~(b) Outstanding mineral, oil, water or timber other liens, leases, rights, rights of way, easements or rights of way of support, sewer rights, building restrictions or other restrictions or, easements, covenants, conditions or regulations of use, or outstanding leases upon the real property under which rents or profits are reserved to the owner thereof that do not impair the use of the real estate for its intended purpose.~~

~~(2) Notwithstanding the foregoing, a loan referenced in Section 2A(1) of this Act may exceed 103% of the fair market value of the real estate in the event that the mortgage guaranty insurance company has approved for loss mitigation purposes a request to refinance a loan that constitutes an existing risk in force for the company.~~

~~(3) An amortized note, bond or other instrument of indebtedness evidencing a loan secured by an ownership interest in, and a proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of real estate and at the time the loan does not exceed one hundred three percent (103%) of the fair market value of the ownership interest and proprietary lease, if the loan is one of a type that meets the requirements of Section 2A(1)(a), unless the context clearly requires otherwise, any reference to a mortgagor shall include an owner of such an ownership interest as described in this paragraph and any reference to a lien or mortgage shall include the security interest held by a lender in such an ownership interest.~~

~~B. “Bulk Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.~~

~~C. “Certificate of Insurance” means a document issued by a mortgage guaranty insurance company to the initial insured to evidence that it has insured a particular authorized real estate security under a master policy, identifying the terms, conditions and representations, in addition to those contained in the master policy and endorsements, applicable to such coverage.~~

~~D. “Commissioner” means [insert the title of the principal insurance supervisory official] of this state, or the [insert the title of the principal insurance supervisory official]’s deputies or assistants, or any employee of~~

~~the [insert name of the principal insurance regulatory agency] of this state acting in the [insert the title of the principal insurance supervisory official]’s name and by the [insert the title of the principal insurance supervisory official]’s delegated authority. “Commissioner.” The term “commissioner” shall mean the insurance commissioner, the commissioner’s deputies, or the Insurance Department, as appropriate.~~

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word “commissioner” appears.

E.

~~B.~~ B. “Contingency reserve” ~~“Contingency Reserve”~~ means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.

~~C.~~ C. ~~“Mortgage guaranty insurance” is~~ F. “Domiciliary Commissioner” means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled, ~~or that principal insurance supervisory official’s deputies or assistants, or any employee of the regulatory agency of which that principal insurance supervisory official is the head acting in that principal insurance supervisory official’s name and by that principal insurance supervisory official’s delegated authority.~~

G. “Effective Guaranty” refers to the assumed backing of existing or future holders of securities by virtue of their issuer’s conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.

H. “Loss” refers to losses and loss adjustment expenses.

I. “Master Policy” means a document issued by a mortgage guaranty insurance company that establishes the terms and conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.

J. “Mortgage Guaranty +

~~(1)~~ (1) ~~Insurance” is insurance~~ Insurance” is insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any ~~note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, provided the improvement on the real estate is a residential building or a condominium unit or buildings designed for occupancy by not more than four families;~~ authorized real estate security.

~~(2)~~ (2) ~~Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, providing the improvement on the real estate is a building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes; and~~

~~(3)~~ (3) ~~Insurance against financial loss by reason of nonpayment of rent or other sums agreed to be paid under the terms of a written lease for the possession, use or occupancy of real estate, provided the improvement on the real estate is a building or buildings designed to be occupied for industrial or commercial purposes.~~

K. “Mortgage Guaranty Quality Assurance Program” means an early detection warning system for potential underwriting compliance issues which could potentially impact solvency or operational risk within a mortgage guaranty insurance company.

L. “NAIC” means the National Association of Insurance Commissioners.

M. “Pool Mortgage Guaranty Insurance” means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.

N. “Right of Rescission” represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate, incomplete or misleading information provided to, or information omitted or concealed from, the mortgage guaranty insurance company in connection with the insurance application, resulting in an insured loan that did not meet the mortgage guaranty insurance company’s eligibility requirements in effect on the date of submission of the insurance application.

O. “Risk in Force” means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.

Section 3. Insurer’s Authority to Transact Business

A company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

Section 5. Risk Concentration

A mortgage guaranty insurance company shall not expose itself to any loss on any one authorized real estate security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

Section 6. Capital and Surplus

A. **Initial and Minimum Capital and Surplus Requirements.** A mortgage guaranty insurance company shall not transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least \$10,000,000 and paid-in surplus of at least \$15,000,000, or if a mutual insurance company, a minimum initial surplus of \$225,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders’ surplus of at least \$1,50020,000,000.

~~**Section 4. Insurer’s Authority to Transact Business**~~

~~No mortgage guaranty insurance company may issue policies until it has obtained from the commissioner of insurance a certificate setting forth that fact and authorizing it to issue policies.~~

B. ~~**Section 5. Minimum Capital Requirements Applicability.**~~ A mortgage guaranty insurance company formed prior to the passage of this Act may maintain the amount of capital and surplus or minimum policyholders’ surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.

C. **Minimum Capital Requirements Adjustments.** The domiciliary commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders’ surplus required under Section 6A under the following circumstances:

(1) For an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, provided that the affiliated reinsurer is in run-off and, in the domiciliary commissioner’s opinion,

the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

(2) For mortgage guaranty insurance companies that are in run-off and not writing new business that is justified in a business plan, in the domiciliary commissioner's opinion.

Section 7. Geographic Concentration

- A. A mortgage guaranty insurance company shall not insure loans secured by a single risk in excess of ten percent (10%) of the company's aggregate capital, surplus and contingency reserve.
- B. No mortgage guaranty insurance company shall have more than twenty percent (20%) of its total insurance in force in any one Standard Metropolitan Statistical Area (SMSA), as defined by the ~~United States~~U.S. Department of Commerce.
- C. The provisions of this section shall not apply to a mortgage guaranty insurance company until it has possessed a certificate of authority in this state for three (3) years.

Section 68. Advertising

No mortgage guaranty insurance company or an agent or representative of a mortgage guaranty insurance company shall prepare or distribute or assist in preparing or distributing any ~~brochure, pamphlet, report or any form of~~ advertising media or communication to the effect that the real estate investments of any financial institution are "insured investments," unless the ~~brochure, pamphlet, report or~~ advertising media or communication clearly states that the loans are insured by mortgage guaranty insurance companies possessing a certificate of authority to transact mortgage guaranty insurance in this state or are insured by an agency of the federal government, ~~as the case may be.~~

Section 79. Investment Limitation

~~A mortgage guaranty insurance company shall not invest~~Investments in notes or other evidences of indebtedness secured by a mortgage or other liens upon residential real property ~~shall not be allowed as assets in any determination of the financial condition of a mortgage guaranty insurer.~~ This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contracts of sale are acquired in the course of ~~the~~ good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired. This section shall not apply to investments backed by the full faith and credit of the U.S. Government or investments with the effective guaranty of the U.S. Government. This section shall not apply to investments held by a mortgage guaranty insurance company prior to the passage of this Act.

Section 8. Coverage Limitation10. Reserve Requirements

- A. Unearned premium Reserves, Loss Reserves, and Premium Deficiency Reserves. Financial reporting will be prepared in accordance with the Accounting Practices and Procedures Manual and Annual Financial Statement Instructions of the NAIC.
- B. Contingency Reserve. Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:
 - (1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.
 - (2) Except as provided within this Act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, to provide for reserve buildup. The portion of the contingency reserve established and maintained

for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:

(a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or

(b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts which are in excess of the requirements of Section 15 as required in [insert section of the mortgage guaranty Insurance model law requiring minimum policyholder's position] as filed with the most recently filed annual statement.

(i) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

C. **Miscellaneous.** Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.

Section 11. Reinsurance

A. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity owned or controlled by an insured or an insured's officer, director or employee or any member of their immediate family that has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

B. **Reinsurance Cessions.** A mortgage guaranty insurer may, by written contract, reinsure any insurance that it transacts, except that no mortgage guaranty insurer may enter into reinsurance arrangements designed to circumvent the compensating control provisions of Section 17 or the contingency reserve requirement of Section 10. The unearned premium reserve and the loss reserves required by Section 10 shall be established and maintained by the direct insurer or by the assuming reinsurer so that the aggregate reserves shall be equal to or greater than the reserves required by direct writer. The cession shall be accounted for as provided in the accounting practices and procedures prescribed or permitted by the applicable Accounting Practices and Procedures Manual of the NAIC.

Section 12. Sound Underwriting Practices

A. **Underwriting Review and Approval Required.** All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on an assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage. Delegated underwriting decisions shall be reviewed based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company's underwriting standards.

B. **Quality Control Reviews.** Quality control reviews for bulk mortgage guaranty insurance and pool mortgage guaranty insurance shall be based on a reasonable method of sampling of post-closing loan documentation

for delegated underwriting decisions to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company's underwriting standards.

C. **Minimum Underwriting Standards.** Mortgage guaranty insurance companies shall establish formal underwriting standards which set forth the basis for concluding that prudent underwriting standards have been met.

D. **Underwriting Review and Approval.** A mortgage guaranty insurance company's underwriting standards shall be:

(1) A mortgage guaranty insurance company shall limit its coverage net of reinsurance ceded to a reinsurer in which the company has no interest to a maximum of twenty five percent (25%) of the entire indebtedness to the insured or in lieu thereof, a mortgage guaranty insurance company may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security.

Section 9.—Reviewed and approved by executive management, including, but not limited to the highest-ranking executive officer and financial officer; and

(2) Communicated across the organization to promote consistent business practices with respect to underwriting.

E. **Notification of Changes in Underwriting Standards.** On or before March 1 of each year, a mortgage guaranty insurance company shall file with the domiciliary commissioner changes to its underwriting standards and an analysis of the changes implemented during the course of the immediately preceding year. The annual summary of material underwriting standards changes should include any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount which has resulted in a material impact on net premium written of +/- 5% from prior year to date.

Nondiscrimination. In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company

A. A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

B. A mortgage guaranty insurance that anywhere transacts the classes of insurance defined in Section 2A(2) or 2A(3) is not eligible for a certificate of authority to transact in this state the class of mortgage guaranty insurance defined in Section 2A(1). However, a mortgage guarantee insurance company that transacts a class of insurance defined in Section 2A may write up to five percent (5%) of its insurance in force on residential property designed for occupancy by five (5) or more families.

Section 10.—**Underwriting Discrimination**

A. Nothing in this chapter shall be construed as limiting the right of a mortgage guaranty insurance company to impose reasonable requirements upon the lender with regard to the terms of a note or bond or other evidence of indebtedness secured by a mortgage or deed of trust, such as requiring a stipulated down payment by the borrower may not =

~~B.~~ No mortgage guaranty insurance company may discriminate in the issuance or extension of mortgage guaranty insurance on the on the basis of the applicant's sex, marital status, race, color, creed or national origin, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

~~C. No policy~~**Drafting Note:** States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 12F.

Section 13. ~~mortgage guaranty insurance~~**Quality Assurance**

A. **Quality Assurance Program.** A mortgage guaranty insurance company shall establish a formal internal mortgage guaranty quality assurance program, which provides an early detection warning system as it relates to potential underwriting compliance issues which could potentially impact solvency or operational risk. This mortgage guaranty quality assurance program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting inadequacies or non-compliance. This shall include, but not limited to:

- (1) **Segregation of Duties.** Administration of the quality assurance program shall be delegated to designated risk management, quality assurance or internal audit personnel, who are technically trained and independent from underwriting activities that they audit.
- (2) **Senior Management Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to an enterprise risk management committee or other equivalent senior management level oversight body.
- (3) **Board of Director Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to the board of directors or a designated committee of directors established to facilitate board of director oversight.
- (4) **Policy and Procedures Documentation.** Mortgage guaranty quality assurance program, excluding policies and procedures of reinsurance, shall be formally established and documented to define scope, roles and responsibilities.
- (5) **Underwriting Risk Review.** Quality assurance review shall include an examination of underwriting risks including classification of risk and compliance with risk tolerance levels.
- (6) **Lender Performance Reviews.** Quality assurance monitoring provisions shall include an assessment of lender performance.
- (7) **Underwriting Performance Reviews.** Quality assurance monitoring provisions shall assess compliance with underwriting standard.
- (8) **Problem Loan Trend Reviews.** Quality assurance monitoring provisions shall assess prospective risks associated with timely loan payment including delinquency, default inventory, foreclosure and persistency trends.
- (9) **Underwriting System Change Oversight.** Underwriting system program changes shall be monitored to ensure the integrity of underwriting and pricing programs, which impact automated underwriting system decision making.
- (10) **Pricing and Performance Oversight.** Pricing controls shall be monitored to ensure that business segment pricing supports applicable performance goals.

(11) Internal Audit Validation. Periodic internal audits shall be conducted to validate compliance with the mortgage guaranty quality assurance program.

B. Regulator Access and Review of Quality Assurance Program. The commissioner shall be provided access to an insurer's mortgage guaranty quality assurance program for review at any reasonable and thorough examination of the evidence supporting credit worthiness of the borrower and the appraisal report reflecting market evaluation of the property and has determined that prudent underwriting standards have been met upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator's right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section ~~14~~14. Policy Forms and Premium Rates Filed

A. Policy Forms. All ~~policy forms and~~ endorsements, and modifications (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall be filed with and be subject to the approval of the commissioner. With respect to owner-occupied, single-family dwellings, ~~the mortgage guaranty insurance policy shall provide that or a mixed-use building described in Section 2A(1)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default,~~ the borrower shall not be liable to the insurance company for any deficiency arising from a foreclosure sale.

B. ~~In addition, each mortgage guaranty insurance~~ Premium Rates. Each mortgage guaranty insurance company (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall file with the ~~department~~ commissioner the rate to be charged ~~and the premium~~ including all modifications ~~of rates and premiums to be paid by the policyholder.~~

C. Premium Charges. Every mortgage guaranty insurance company shall ~~adopt, print and~~ make available a ~~schedule of~~ insureds the premium charges for mortgage guaranty insurance policies. ~~Premium charges made in conformity via a company website or an integration with the provisions of this Act shall not be deemed to be interest or other charges under any other provision of law limiting interest or other charges in connection with mortgage loans. a third-party system.~~ The ~~schedule~~ premium rate provided shall show the entire amount of premium charge for ~~each~~ the type of mortgage guaranty insurance policy to be issued by the insurance company.

Drafting Note: Open rating states may delete a portion or all of ~~this provision~~ Section 14 and insert their own rating law.

Section ~~12.~~ ~~Outstanding Total Liability~~ 15. Risk in Force and Waivers

A. ~~A mortgage guaranty insurance~~ Risk in Force. A mortgage guaranty insurance company shall not at any time have outstanding a ~~total liability~~ risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total ~~liability~~ risk in force exceeding twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total ~~liability~~ risk in force no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve. Total ~~outstanding liability~~ risk in force shall be calculated on a ~~consolidated~~ an individual entity basis ~~for all mortgage guarantee insurance companies.~~

B. Waiver. The commissioner may waive the requirement found in Section 15A at the written request of a mortgage guaranty insurer upon a finding that ~~are part of a holding company system~~ the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of Section 15A and shall, at a minimum, address the factors specified in Section 15C.

C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:

- (1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.
- (2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.
- (3) The nature and extent of the mortgage guaranty insurer's reinsurance program.

The quality, diversification, and liquidity of the

- (4) mortgage guaranty insurer's assets and its investment portfolio.
- (5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.
- (6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.
- (7) The adequacy of the mortgage guaranty insurer's reserves.
- (8) The quality and liquidity of investments in affiliates. The commissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.
- (9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.
- (10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.
- (11) The capital contributions which have been infused or are available for future infusion into the mortgage guaranty insurer.
- (12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including, but not limited to, the quality and type of the risks included in the aggregate insured risk.

D. **Authority to Retain Experts.** The commissioner may retain accountants, actuaries, or other experts to assist in the review of the mortgage guaranty insurer's request submitted pursuant to Section 15B. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. **Specified Duration.** Any waiver shall be:

- (1) For a specified period of time not to exceed two years; and
- (2) Subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by Section 15A.

Section 16. **Conflict of Interest**

A mortgage guaranty insurer may underwrite mortgage guaranty insurance on mortgages originated by the holding company

system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate only if the insurance is underwritten on the same basis, for the same consideration and subject to the same insurability requirements as insurance provided to nonaffiliated lenders. Mortgage guaranty insurance underwritten on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate shall be limited to 50% of the insurer's direct premium written in any calendar year, or such higher percentage established in writing for the insurer in the domiciliary commissioner's discretion, based on the domiciliary commissioner's determination that a higher percentage is not likely to adversely affect the financial condition of the insurer.

Section 17. Compensating Balances Prohibited

Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section. Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.

Section 18. Limitations on Rebates, Commissions, Charges and Contractual Preferences

- A. ~~insurance~~**Inducements.** A mortgage guaranty insurance company shall not pay or cause to be paid either directly or indirectly, to any owner, purchaser, lessor, lessee, mortgagee or prospective mortgagee of the real property that secures the authorized real estate security or that is the fee of an insured lease, or any interest therein, or to any person who is acting as an agent, representative, attorney or employee of such owner, purchaser, ~~lessor, lessee~~ or mortgagee, any commission, or any part of its premium charges or any other consideration as an inducement for or as compensation on any mortgage guaranty insurance business.
- B. **Compensation for Placement.** In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.
- C. ~~No mortgage guaranty insurance~~**Rebates.** A mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge, as shown by the schedule required by Section ~~14C. No mortgage guaranty insurance~~14C. No mortgage guaranty insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.
- D. **Undue Contractual Preferences.**
- (1) Any contract, letter agreement, or other arrangement used to clarify any terms, conditions, or interpretations of a master policy or certificate shall be documented in writing.
 - (2) Any contractual or letter agreements used to modify or clarify general business practices and administrative, underwriting, claim submission or other information exchange processes shall not contain provisions which override or significantly undermine the intent of key provisions of the

mortgage guaranty insurance model act, including mortgage insurer discretion, rights and responsibilities related to:

(a) Underwriting standards.

(b) Quality assurance.

(c) Rescission.

E. **Sanctions.** The commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company, or in his or her discretion, issue a cease and desist order to a mortgage guaranty insurance company that pays a commission, rebate, or makes any unlawful rebate conveyance of value under this section in willful violation of the provisions of this Act. In the event of the issuance of a cease and desist order, the commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company that does not comply with the terms thereof.

Section 14. **Compensating Balances Prohibited**

F. ~~Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section.~~ **Educational Efforts and Promotional Materials Permitted.** A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of Loss or promote its operational efficiency and may distribute promotional materials of minor value.

Section 19. **Rescission**

All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions, re-pricing, and cancellations, which specify the insurer's and insured's rights, obligations and eligibility terms under which those actions may occur to ensure transparency.

Section 20. **Records Retention**

A. **Record Files.** A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the commissioner to readily ascertain the insurer's compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer's management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices.

B. ~~Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.~~

Section 15. **Retention Period. Policy and claim records shall be retained for the period during which the certificate or claim is active plus five (5) years, unless otherwise specified by the insurance commissioner. Recordkeeping requirements shall relate to:**

(1) Records to clearly document the application, underwriting, and issuance of each master policy and certificate of insurance; and

(2) Claim records to clearly document the inception, handling, and disposition.

C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium.

D. **Record Maintenance.** Record maintenance under this Act shall comply with the following requirements:

- (1) Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.
- (2) Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

Conflict of Interest

~~A. If a member of a holding company system, a mortgage guaranty insurance company licensed to transact business in this state shall not, as a condition of its certificate of authority, knowingly underwrite mortgage guaranty insurance on mortgages originated by the holding company system or an affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly, by the holding company system or an affiliate.~~

~~A. B. A mortgage guaranty insurance company, the holding company system of which it is a part, or any affiliate shall not as a condition of the mortgage guaranty insurance company's certificate of authority, pay any commissions, remuneration, rebates or engage in activities proscribed in Sections 13 and 14.~~

~~Section 16. Reserves~~

~~A. Unearned Premium Reserves~~

~~A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as set forth by regulation adopted by the commissioner of insurance.~~

~~B. Loss Reserve~~

~~A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves that accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:~~

- ~~(1) Insured loans that have resulted in the conveyance of property that remains unsold;~~
- ~~(2) Insured loans in the process of foreclosure;~~
- ~~(3) Insured loans in default for four (4) months or for any lesser period that is defined as default for such purposes in the policy provisions; and~~
- ~~(4) Insured leases in default for four (4) months or for any lesser period that is defined as default for such purposes in policy provisions.~~

~~C. Contingency Reserve~~

~~Each mortgage guaranty insurance company shall establish a contingency reserve out of net premium remaining (gross premiums less premiums returned to policyholders net of reinsurance) after establishment of the unearned premium reserve. The mortgage guaranty insurance company shall contribute to the contingency reserve an amount equal to fifty percent (50%) of the remaining unearned premiums. Contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, except that withdrawals may be made by the company in any year in which the actual incurred losses exceed thirty five percent (35%) of the corresponding earned premiums, and no releases shall be made without prior approval by the commissioner of insurance of the insurance company's state of domicile.~~

~~If the coverage provided in this Act exceeds the limitations set forth herein, the commissioner of insurance shall establish a rate formula factor that will produce a contingency reserve adequate for the added risk assumed. The face amount of an insured mortgage shall be computed before any reduction by the mortgage guaranty insurance company's election to limit its coverage to a portion of the entire indebtedness.~~

~~D. Reinsurance~~

~~Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company that is properly licensed to provide reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this Act in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this Act.~~

~~E. Miscellaneous~~

- ~~(1) Whenever the laws of any other jurisdiction in which a mortgage guaranty insurance company subject to the requirement of this Act is also licensed to transact mortgage guaranty insurance require a larger unearned premium reserve or contingency reserve in the aggregate than that set forth herein, the establishment of the larger unearned premium reserve or contingency reserve in the aggregate shall be deemed to be in compliance with this Act.~~
- ~~(2) Unearned premium reserves and contingency reserves shall be computed and maintained on risks insured after the effective date of this Act as required by Subsections A and C. Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.~~

Section 1721. Regulations

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this Act.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1976 Proc. II 15, 17, 647, 686, 747-753 (adopted).

1979 Proc. I 44, 47-48, 49, 719, 968-969 (corrected).

PROJECT HISTORY – 2023

MORTGAGE GUARANTY INSURANCE MODEL ACT (#630)

1. Description of the Project, Issues Addressed, etc.

The current NAIC *Mortgage Guaranty Insurance Model Act* (#630) was first adopted in 1976 and amended in 1979. Model #630 was created to provide effective regulation and supervision of mortgage guaranty insurers. Model #630 defines mortgage guaranty insurance as insurance against financial loss by reason of nonpayment of principal, interest, or other sums agreed to be paid on any note secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate. Mortgage guaranty insurance may also cover against financial loss by reason of nonpayment of rent under the terms of a written lease. As of April 2012, eight states had adopted the most recent version of the model in a substantially similar manner. An additional 12 states have adopted an older version of the model, legislation, or regulation derived from other sources such as bulletins and administrative rulings.

The Mortgage Guaranty Insurance (E) Working Group was formed in November 2012. By early 2013, the Working Group developed a list of potential regulatory changes to Model #630 to address changes in mortgage lending and mortgage finance since the model's original approval in the 1970s and to respond to the lessons learned during the 2008 national recession and housing market downturn. As a result, a Request for NAIC Model Law Development was made and approved by the Executive (EX) Committee at the 2013 Summer National Meeting.

Development of the modernized model has a long history dating back to the fall of 2012. At that time, development of a capital model to accompany Model #630 was the key focus of attention. During 2013, mortgage guaranty insurers engaged Oliver Wyman to begin working on a Mortgage Guaranty Capital Model. Over the next several years, the Mortgage Guaranty Capital Model was developed. It was determined in December 2016 that a secondary contractor would need to be hired to further assess the reliability of the Mortgage Guaranty Capital Model. In September 2017, Milliman began its work to review and validate the Mortgage Guaranty Capital Model.

In March 2018, Milliman provided its assessment of the capital model to the Working Group. It indicated that inconsistencies and errors were found in the data preparation steps used to: 1) estimate the capital model coefficients and the application of the same capital model coefficients; and 2) forecast future loan performance. Milliman stated that these inconsistencies and errors were material to the capital model and would need to be addressed before the Mortgage Guaranty Capital Model could be implemented.

As a result, Milliman continued its work on the Mortgage Guaranty Capital Model, and in December 2019, it was exposed for public comment. The comments regarding the exposure were expected to be discussed during the 2020 Spring National Meeting. However, due to the COVID-19 pandemic, this meeting was cancelled. The Working Group also began working on an annual statement exhibit to begin collecting data for the capital model. In April 2021, the Mortgage Guaranty Insurance (E) Working Group referred the exhibit proposal to the Blanks (E) Working Group. The exhibit was finalized and implemented into the blank effective year-end 2021. In May 2022, the Mortgage Guaranty Insurance (E) Working Group decided to pause the development of the capital model and continue collecting data for further analysis in the future. As a result, the Working Group focused on finalizing the model.

2. Name of Group Responsible for Drafting the Model and States Participating

The Mortgage Guaranty Insurance (E) Working Group comprised the drafting Group and consisted of the following states during 2023: North Carolina (chair); Arizona; California; Florida, Missouri, New York, Pennsylvania; Texas; and Wisconsin.

3. Project Authorized by What Charge and Date First Given to the Group

The Executive (EX) Committee approved the Request for NAIC Model Law Development during the 2013 Summer National Meeting. Throughout the course of model development, the Financial Condition (E) Committee chair approved extensions due to extenuating circumstances.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated.

The Working Group formed a drafting group, which consisted of: Jackie Obusek (NC–Chair); Kurt Regner (AZ); Monica Macaluso (CA); Robert Ballard (FL); John Rehagen (MO); Margot Small (NY); Melissa Greiner (PA); Amy Garcia (TX); and Amy Malm (WI). Following the lengthy hiatus from the development of the model, due to work being completed on the Mortgage Guaranty Capital Model, the drafting group began finalization of model in May 2022 without consideration of the capital model. During its May meeting, the drafting group discussed the overall approach to finalizing the model and a rather aggressive timeline for completion.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The Working Group met in open session on Oct. 6 and Dec. 13, 2022, and March 22, 2023. During these sessions, interested regulators and parties submitted comment letters to the Working Group. The drafting group held nine regulator-only discussion and planning calls between May 2022 and March 2023. The Working Group exposed the model for public comment on Oct. 7, 2022, and again on Feb. 27, 2023, and May 11, 2023. Comments were received from: the California Department of Insurance (DOI); the Center for Economic Justice (CEJ); and the Mortgage Guaranty Consortium (Arch Mortgage Insurance Company, Enact Mortgage Insurance Corporation, Essent Guaranty Inc., Mortgage Guaranty Insurance Corporation, National Mortgage Insurance Corporation, and Radian Guaranty Inc).

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group’s response)

Section 10, Reserve Requirements – Contingency Reserve

The most significant issue raised during development was related to the recording of the contingency reserves when reinsurance is used. The specific provision is: “The Mortgage Guaranty Insurance company shall make an annual contribution to the Contingency Reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.” The mortgage insurers indicated that many reinsurers do not complete a statutory financial statement and would not have the ability to record the contingency reserve. The drafting group members discussed the topic and agreed to leave the provision as stated.

Section 21, No Private Right of Action Provision

The mortgage guaranty insurers proposed the following provision for inclusion in the model: “No Private Right of Action. Nothing in this Act is intended to, or does, create a private right of action based upon compliance or noncompliance with any of the Act’s provisions. Authority to enforce compliance with this Act is vested exclusively in the Commissioner.” Following discussion by the drafting group, the provision was added to the model and included in the Feb. 27, 2023, exposure. The drafting group received several comments on the provision. Following discussion, Section 21 was removed from the model.

7. List the Key Provisions of the Model (sections considered most essential to state adoption)

Section 10. Reserve Requirements

- A. **Unearned Premium Reserves, Loss Reserves, and Premium Deficiency Reserves.** Financial reporting will be prepared in accordance with the *Accounting Practices and Procedures Manual* (AP&P Manual) and Annual Financial Statement Instructions of the NAIC.
- B. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:
 - (1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve, which, in the aggregate, shall be equal to 50% of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.

- (2) Except as provided within this act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.
 - (3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:
 - (a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or
 - (b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts that are in excess of the requirements of Section 15 as required in (insert section of the mortgage guaranty insurance model law requiring minimum policyholder's position) as filed with the most recently filed annual statement.
 - (i) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.
- C. **Miscellaneous.** Unearned premium reserves and contingency reserves on risks insured before the effective date of this act may be computed and maintained as required previously.

Section 15. Risk in Force and Waivers

- A. **Risk in Force.** A mortgage guaranty insurance company shall not at any time have outstanding risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding 25 times its capital, surplus, and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total risk in force exceeding 25 times its capital, surplus, and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total risk in force no longer exceeds 25 times its capital, surplus, and contingency reserve. Total risk in force shall be calculated on an individual entity basis.
- B. **Waiver.** The commissioner may waive the requirement found in subsection (a) of this section at the written request of a mortgage guaranty insurer upon a finding that the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of subsection (a) of this section and shall, at a minimum, address the factors specified in subsection (j) of this section.
- C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:
 - (1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.
 - (2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.

- (3) The nature and extent of the mortgage guaranty insurer's reinsurance program.
- (4) The quality, diversification, and liquidity of the mortgage guaranty insurer's assets and its investment portfolio.
- (5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.
- (6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.
- (7) The adequacy of the mortgage guaranty insurer's reserves.
- (8) The quality and liquidity of investments in affiliates. The commissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.
- (9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.
- (10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.
- (11) The capital contributions that have been infused or are available for future infusion into the mortgage guaranty insurer.
- (12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including the quality and type of the risks included in the aggregate insured risk.

D. Authority to Retain Experts. The commissioner may retain accountants, actuaries, or other experts to assist the commissioner in the review of the mortgage guaranty insurer's request submitted pursuant to subsection (i) of this section. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. Specified Duration. Any waiver shall be (i) for a specified period of time not to exceed two years and (ii) subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by subsection (a) of this section.

8. Any Other Important Information (e.g., amending an accreditation standard)

None. It is not an accreditation standard, and the Working Group is not making a recommendation that it be considered as an accreditation standard.

State Implementation Reporting of NAIC-Adopted Model Laws and Regulations

Executive (EX) Committee

- Amendments to the ***Unfair Trade Practices Act (#880)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2021 Spring National Meeting. Fourteen jurisdictions have adopted revisions to this model.

Life Insurance and Annuities (A) Committee

- Amendments to the ***Annuity Disclosure Model Regulation (#245)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2021 Summer National Meeting. Four jurisdictions have adopted revisions to this model.
- Amendments to the ***Standard Nonforfeiture Law for Individual Deferred Annuities (#805)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2020 Fall National Meeting. Twenty-four jurisdictions have adopted revisions to this model.

Health Insurance and Managed Care (B) Committee

- Amendments to the ***Health Maintenance Organization Model Act (#430)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2020 Fall National Meeting. One jurisdiction has adopted revisions to this model.
- Amendments to the ***Insurance Holding Company System Regulatory Act (#440)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2020 Fall National Meeting. Twenty-six jurisdictions have adopted revisions to this model.
- Amendments to the ***Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)***—These revisions were adopted by the Executive (EX) Committee and Plenary at the 2020 Fall National Meeting. Thirteen jurisdictions have adopted revisions to this model.

Property and Casualty Insurance (C) Committee

- Adoption of the ***Real Property Lender-Placed Insurance Model Act (#631)***—This model was adopted by the Executive (EX) Committee and Plenary at the 2021 Spring National Meeting. One jurisdiction has adopted this model.
- Adoption of the ***Pet Insurance Model Act (#633)***—This model was adopted by the Executive (EX) Committee and Plenary at the 2022 Summer National Meeting. Three jurisdictions have adopted this model.