# Gotham Insurance Symposium 2017

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New York

# Welcome and Opening Remarks

Matthew Gaul, Dentons (New York)

# Efforts to Repeal and Replace the ACA

## Panelists:

Kathy Howell, Care Connect
Michael Kopko, Oscar

## Moderator:

Jeni Healy, Dentons (Washington, D.C.)

# Efforts to Repeal and Replace the ACA

- ACA Implementation - Where Are We?
  - 2014 "Full" implementation
  - Regulations drafted during Obama Administration
  - New York experience
- Repeal and Replace - Setting the Scene
  - Key bill terms anticipated
  - Industry responses
  - States and Exchanges
  - Politics and elections

# Six Years of ACA

- Patient Protection and Affordable Care Act enacted March 23, 2010; together with the Health Care and Education Reconciliation Act of 2010 (March 30, 2010) - the Affordable Care Act or "ACA"
- Single largest piece of domestic policy legislation since Great Depression
- Insurance market reforms
- Individual and employer mandates
- Creation of 51 health insurance exchanges
- Medicaid expansion and Medicare program changes
- New taxes and fees
- Delivery system reforms

# Six Years of ACA

- US Departments of Health and Human Services, Treasury, and Labor have implemented the law since 2010
- Dozens of regulations and thousands of pages of regulations
- Sub-regulatory guidance and notices
- Dozens of regulatory delays implemented - administrative flexibility or politics?

# Past ACA Regulatory Delays

- Employer mandate and related employer and insurer reporting obligations
- Initial and annual open enrollment period
- Federal SHOP exchange online enrollment and employee choice
- "If you like your health insurance plan, you can keep it…"
- Basic Health Plan

# Industry Implementation

- Big Picture. Federal regulatory law overlaying different state-based regulatory schemes in each state; different definitions of health insurance, exemptions, and group vs. individual markets, among others.
- Current Offerings. Fully ACA-compliant (for plans and policies effective on or after January 1, 2014).
- New Offerings and Strategies. Creative benefit plan designs, partnerships with competitors and other players, private exchanges.
- Future Offerings and Strategies?

# Presidential Executive Order

- "Executive Order Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal"
- On Inauguration Day

# Efforts to Repeal and Replace the ACA

THE ECONOMIC BURDEN OF THE PATIENT PROTECTION AND AFFORDABLE CARE ACT PENDING REPEAL

By the authority vested in me as President by the Constitution and the laws of the United States of America, it is hereby ordered as follows:

Section 1. It is the policy of my Administration to seek the prompt repeal of the Patient Protection and Affordable Care Act (Public Law 111-148), as amended (the "Act"). In the meantime, pending such repeal, it is imperative for the executive branch to ensure that the law is being efficiently implemented, take all actions consistent with law to minimize the unwarranted economic and regulatory burdens of the Act, and prepare to afford the States more flexibility and control to create a more free and open healthcare market.

Sec. 2. To the maximum extent permitted by law, the Secretary of Health and Human Services (Secretary) and the heads of all other executive departments and agencies (agencies) with authorities and responsibilities under the Act shall exercise all authority and discretion available to them to waive, defer, grant exemptions from, or delay the implementation of any provision or requirement of the Act that would impose a fiscal burden on any State or a cost, fee, tax, penalty, or regulatory burden on individuals, families, healthcare providers, health insurers, patients, recipients of healthcare services, purchasers of health insurance, or makers of medical devices, products, or medications.

Sec. 3. To the maximum extent permitted by law, the Secretary and the heads of all other executive departments and agencies with authorities and responsibilities under the Act, shall exercise all authority and discretion available to them to provide greater flexibility to States and cooperate with them in implementing healthcare programs.

Sec. 4. To the maximum extent permitted by law, the head of each department or agency with responsibilities relating to healthcare or health insurance shall encourage the development of a free and open market in interstate commerce for the offering of healthcare services and health insurance, with the goal of achieving and preserving maximum options for patients and consumers.

Sec. 5. To the extent that carrying out the directives in this order would require revision of regulations issued through notice-and-comment rulemaking, the heads of agencies shall comply with the Administrative Procedure Act and other applicable statutes in considering or promulgating such regulatory revisions.

Sec. 6. (a) Nothing in this order shall be construed to impair or otherwise affect:

(i) the authority granted by law to an executive department or agency, or the head thereof; or

(ii) the functions of the Director of the Office of Management and Budget relating to budgetary, administrative, or legislative proposals.

(b) This order shall be implemented consistent with applicable law and subject to the availability of appropriations.

(c) This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person.

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# March 2017 Ultimatum

President Donald Trump is giving House Republicans an ultimatum: Pass the American Health Care Act on Friday, or Obamacare stays.

Mick Mulvaney, the Office of Budget and Management director, made clear to Republicans on Thursday night that Trump wanted a vote Friday and that he was done negotiating on the bill to overhaul healthcare. If it is not passed, the president will move on from the bill, reports said.

President Donald Trump. AP

Source: http://www.businessinsider.com/trump-healthcare-pass-ahca-obamacare-2017-3

# April 20 Press: Replacement Bill Passed the Week Ending April 29

## *The Atlantic* Politics & Policy Daily: Repeal and Replace: Reloaded

President Trump said he'd like to pass a health-care reform bill by the end of next week.

Kevin Lamarque / Reuters

Source: https://www.theatlantic.com/politics/archive/2017/04/the-atlantic-politics-policy-daily-repeal-and-replace-reloaded/523785

# "MacArthur Amendment"

- Dated April 13, 2017, Published April 20

**Insurance Market Provisions**

The MacArthur Amendment would:

- Reinstate Essential Health Benefits as the federal standard
- Maintain the following provisions of the AHCA:
  - Prohibition on denying coverage due to preexisting medical conditions
  - Prohibition on discrimination based on gender
  - Guaranteed issue of coverage to all applicants
  - Guaranteed renewability of coverage
  - Coverage of dependents on parents' plan up to age 26
  - Community Rating Rules, except for limited waivers

**Limited Waiver Option**

The amendment would create an option for states to obtain Limited Waivers from certain federal standards, in the interest of lowering premium costs and expanding the number of insured persons. States could seek Limited Waivers for:

- Essential Health Benefits
- Community rating rules, except for the following categories, which are **not** waivable:
  - Gender
  - Age (except for reductions of the 5:1 age ratio previously established)
  - Health Status (unless the state has established a high risk pool or is participating in a federal high risk pool)

**Limited Waiver Requirements**

States must attest that the purpose of their requested waiver is to reduce premium costs, increase the number of persons with healthcare coverage, or advance another benefit to the public interest in the state, including the guarantee of coverage for persons with pre-existing medical conditions. The Secretary shall approve applications within 90 days of determining that an application is complete.

# Efforts to Repeal and Replace the ACA

- Panel Discussion
- Questions?

# Warranties, Service Contracts and Insurance: Theory, Practice and Potential

## Panelists:

Corinne Carr, Dentons (Chicago)
David Deal, Apple, Inc.
Christopher Karo, AIG

# Types of Consumer Protection Offerings (U.S.)

| | *Regulation* | *Participation* | *Cost* | *Offered by* | *Coverage* |
|---|---|---|---|---|---|
| **Warranty**<br><br>**(a/k/a "manufacturer's limited warranty")** | Federal Regulation<br><br>(Magnuson-Moss Warranty Act) | "Automatic" (i.e., not optional) | Free of charge | Manufacturers and suppliers | "Limited" to normal wear and tear and manufacturer's defect (*i.e.*, no coverage for loss or theft) |
| **Service Contracts**<br><br>**(a/k/a "extended warranties")** | State Regulation<br><br>(most states have specific regulation such as NAIC Model Act) | Must be optional | Separate discernible charge | Service Contract Provider or "Obligor"<br><br>(often a third-party) | Extends the basic product warranty for a specified period.<br><br>Normal wear and tear and manufacturer's defect (*i.e.*, no coverage for loss or theft) |
| **Insurance** | State Regulation<br><br>(all states have specific regulation) | Must be optional | Separate discernible charge | Licensed insurers through licensed producers | "Losses" resulting from fortuitous events (*i.e.*, no coverage for normal wear and tear or manufacturer's defect) |

# Warranties

# Warranties - Summary

- In the U.S., warranties are regulated by the Magnuson-Moss Warranty Act (MMWA) - a federal law enforced by the Federal Trade Commission (FTC).
- Warranties are often referred to as "limited" warranties to reflect the limited nature of the protection in terms of what is covered and for how long.
- Traditionally, under the MMWA, only a manufacturer or "supplier" of a consumer product is permitted to offer a warranty.
- Under the MMWA, a "supplier" is any person engaged in the business of making a consumer product directly or indirectly available to consumers.
- The warranty must be conveyed *at the time of sale* of the consumer product and be *free* or "*part of the basis of the bargain*."
- A warranty is *not* offered by a third party as such a third party offering would normally be either insurance or a service contract.
- Coverage must not exceed normal use and "wear and tear" of the product (*i.e.*, no loss or theft).

# Service Contracts

# Service Contracts - Summary

- A/k/a “extended warranties” when offered by manufacturers or suppliers.
- A fee-based agreement marketed to consumers by the manufacturer or seller of the product, or by a third-party service contract administrator, that extends the basic manufacturer's warranty for a specified period to guarantee repair or replacement of the product due to defects in materials or workmanship or attributable to wear-and-tear.
- Typically marketed by product manufacturers or retailers at point-of-sale, but also marketed by independent third-party service contract administrators having no connection to the underlying product sale.
- Common examples of service contracts include: consumer electronics; retail appliances; automobiles; and home warranty products.
- Expanding to include more products, industries and services.
- To avoid characterization as insurance, coverage must not extend to loss or damage attributable to fortuitous events or circumstances.

# Service Contracts - Summary of U.S. Regulation

- NAIC Guidelines: Service contracts not “insurance,” but nevertheless should be regulated by state insurance departments via Service Contracts Model Act (1995)
- Individual U.S. Jurisdictions - Patchwork regulatory infrastructure
  - 28 states have adopted NAIC Model Act;
  - 13 states exclude service contracts from regulation as “insurance” but no comprehensive regulatory parameters;
  - 8 states silent on service contract characterization; and
  - 1 state (Florida) has elaborate service contract parameters and licensure requirements that transcend NAIC guidelines.
- State specific analysis is required to identify specific requirements
- “Desk Drawer” rules play a large role.

# Service Contracts - Registration Requirements

- The “service contract provider” (sometimes referred to as the “obligor”) is the entity that is contractually obligated to the service contract holder under the terms of the service contract.
- Service contract providers are generally required to “register” with DOIs in states in which the provider intends to sell service contracts.
- Applications range in scope from one to several pages and may require the service contract provider to supply detailed biographical and operational information.
- In Illinois, service contract providers are only required to provide: (i) the name of the entity; (ii) a list of the entity’s executive officers directly responsible for the business; and (iii) if different than the service contract provider, the name and address of the service contract provider’s agent for service of process in the state.
- In Florida, the application must be accompanied by a detailed plan of operations, as well as biographical statements and fingerprints of the entity’s officers and directors.
- Registrations are subject to state-specific initial and renewal (typically annual) fees that range from $75 - $1000, or more.

# Service Contracts - Financial Responsibility

- Service contract providers must generally demonstrate (to each DOI) their financial responsibility in at least <u>one</u> of the following manners:
  - A "CLIP" issued by an insurer authorized to do business in the related state;
  - A trust account/security deposit (adjusted annually) of 5% of the gross consideration received, less claims paid, for all service contracts sold and then in force (but in no event less than $25,000 ($250,000 in Texas)) and funded reserve account (at least 40% of the gross consideration received, less claims paid, for all service contracts sold and then in force); or
  - A net worth or stockholders' equity of the service contract provider or its parent company of $100,000,000 (if the a parent is used to satisfy the financial requirement of the service contract provider, the parent must agree to guarantee the obligations of the service contract provider on service contracts issued in the related state).
- In Florida, in addition to obtaining a CLIP, service contract providers are required to demonstrate minimum net assets of $300,000 <u>and</u> establish a trust account in an amount not less $100,000.
- Ohio does not offer a "net worth" option for demonstrating financial responsibility.

# Service Contracts - Form/Filing Requirements

- Copies of all service contracts offered are typically required to be provided to the respective DOIs for review and approval.
- States generally require that all service contracts include, in clear and understandable language, certain minimum disclosures.
- In Illinois, the service contract must state the name and address of the service contract provider, the procedures for obtaining service, the existence and amount of a deductible (if any) and that the service contract holder is allowed to cancel the service contract at any time.
- Other states' laws require further disclosures, often related to the service contract holder's right to cancellation ("free look") and any applicable refunds to which it may be entitled in connection with such cancellation.
- In Georgia, service contracts must conspicuously include the text "THIS IS NOT A CONTRACT OF INSURANCE."
- In Washington, the DOI takes the position that the term of the service contract must be limited to 5 years.

# Service Contracts - Sample Case Law

- ***Ollendorf Watch Co. v. Pink***, 279 N.Y.32 (1938) - watch manufacturer held to be acting as unlicensed insurer by offering a service contract including coverage for theft. Watch company delivered to watch purchasers a "free" certificate and agreement in which the watch company agreed to replace the purchaser's watch if lost due to theft within one year from the date of purchase. The *Ollendorf* court noted: "The fact that the insurance comes out of the proceeds of all the income of the watch company cannot hide the reality of the transaction. The price which the purchaser of the watch pays is not only for the watch but for everything which the seller gives him. The seller would not give him the insurance if he did not buy the watch. The price he pays for the watch is the inducement for the insurance the same as the certificate of insurance."
- ***GAF Corp. v. County School Board of Washington County***, 629 F. 2d 891 (4th Cir. 1980) - roofing manufacturer held not to be acting as unlicensed insurer by offering to repair roofing leaks attributable to faulty workmanship.

# Service Contracts - Guidance from NYDFS

- Neither a warranty nor a service contract can provide coverage for theft or loss as such coverages are insurance coverages. OGC Opinion Nos. 92-99, 92-108 and 2003-140.
- Theft coverage offered in connection with a wireless handset protection program must be offered as a stand-alone insurance coverage (*i.e.,* on an optional basis) that is independent of the service contract and the customer must pay a separate/discernible premium (*i.e.,* it cannot be free or paid for by another party). OGC Opinion No. 08-05-15.
- Service contract offered by retail jeweler cannot include lifetime stone replacement protection even where the replacement coverage requires frequent inspections and does not cover loss or theft of the jewelry as repeated inspections “do not negate the element of fortuity” in the chipping of a gemstone. Note that providing coverage for the replacement of a stone that is lost *due to a defective setting* is acceptable as long as the stone is part of the jewelry that is being warranted. OGC Opinion 2003-140.

# Service Contracts - Non-U.S. Regulatory Regimes

- Global patchwork of inconsistent approaches to regulating (or not regulating) service contracts; similar to range of individual U.S. state approaches but typically governed solely at the national level (notable exception: Canada - - regulated at provincial/territorial levels).
- At more stringent end of range is the U.K., which, like the U.S., defines service contracts to exclude repair/replacement attributable to fortuitous events, and imposes a specific legislative/regulatory regime on electronic goods service contracts (*see **The Supply of Extended Warranties on Domestic Electrical Goods Order 2005***, administered by the U.K. Office of Fair Trading).
- Most other non-U.S. jurisdictions do not have specific laws or regulations governing service contracts, but afford broader latitude to manufacturers and sellers of products to expand the scope of their service contracts to include repair/replacement in the case of fortuitous loss, provided that the extended protection is linked to the original underlying warranty on the goods manufactured or sold by the service contract seller.

# Service Contracts - Other Global Considerations

- Complexities that have to be addressed:
  - Difference in regulatory philosophies (compare UK gold-plating to Japanese hands-off).
  - Interplay of common law and religious law (e.g., Sharia law in Muslim countries).
  - Inconsistencies between jurisdictions (EU directives versus local country implementation, US federal v. state, diametrically opposed approaches that can't be resolved).
  - Interplay of different concepts and bodies of law: warranty, service contract, insurance, finance.
- Keeping up with the kaleidoscope:
  - Dramatic landscape changes (Brexit, Trump, changing political alignments) bring tightening and loosening of interpretations for cross-border companies as trade relationships adjust).
  - Subtle landscape changes (philosophies that dramatically shift locally, *e.g.*, Puerto Rico).
  - Development of less developed countries (*e.g.*, Hong Kong's new insurance code, Vietnam's still undeclared status on many things).

# Service Contracts - Other Global Considerations (cont.)

- Severity issues in global programs
  - Fraud hot spots (*e.g.*, China).
  - Tax (*e.g.*, India's new rules, NY's day-count rules).
  - Criminal liability of employees and directors.
  - Limitations on shareholders.
  - Disclosure burdens on licensees.
  - Broad subpoena power of countries.
  - "Unusual" qualifications for staff.
  - Capital commitments.
- Cost containment issues for global programs.
  - Local presence requirements (complaints, entities, *etc.*).
  - Form customizations by country and state.
  - Electronic delivery/hard copy requirements.
  - Time zones.

# Service Contracts - Prospective Developments

- Service contract marketers continue to develop enhanced products that blend warranty and insurance features, “wrapping” such products with commercial insurance policies as and if necessary to satisfy patchwork regulatory standards in the U.S. and abroad.
- Future U.S. regulatory wild card: Consumer Financial Protection Bureau (“CFPB”), which has begun to focus (via subpoena) on vehicle service contracts (CFPB jurisdiction excludes “insurance”).
- Particularly concerning where covered goods have been financed.

# Insurance Offerings

# Insurance - Other Regulatory Concerns

- Must partner with an authorized insurance company to underwrite the product and most likely requires establishing a licensed insurance producer entity to allow for “front-end” profit (*i.e.,* commissions).
- A captive facility may be used to allow for “back-end” participation in underwriting profits.
- Concerns regarding “free” insurance
  - Marketing wireless handset protection insurance coverage as free is deceptive and misleading to customers. OGC Opinion No. 08-05-15 (citing *Ollendorf Watch Co. v. Pink*)
- Rate and Form Filing Requirements
  - May be subject to rate and form requirements, even if classified as inland marine
- Restrictions on group products in a number of states, including NY
  - 1 NYCRR Sect. 153.9 prohibits an insurer from providing coverage pursuant to a group insurance policy “if the purchase of insurance is contingent upon the purchase of any good or service . . .”. OGC Opinion No. 08-05-15

# Insurance - The Insurer's Perspective

- AIG's Goal: To be our clients' most valued insurer.
- "One-Stop Shopping" – Provide our clients with a global solution to offer a program seamlessly across all jurisdictions.
- Challenges:
  - ➢ Complex and disparate patchwork of regulatory schemes
    - Operational and Legal/Regulatory know-how to help make the clients' program viable
    - Local customs and other unique jurisdictional challenges
- Gaps in Coverage – Identifying areas requiring partners to provide primary coverage and assisting our clients with managing these relationships
- Financial considerations – Helping clients to understand the financial/regulatory ramifications of offering certain types of products
  - ➢ Limitations on pricing or distribution depending on the product and regulatory requirements by jurisdiction

# Break

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# Future of the DOL Fiduciary Rule

## Investment Advice Fiduciaries in Disarray: What the Rules Will Be and When

**Panelists:**

David Cowart, Dentons (Dallas)

Seth D. Harris, former Deputy Secretary of Labor, The Law Offices of Seth Harris

# Purposes of the New Rule

- Make an agent (or advisor) into a fiduciary, called an “***Investment Advice Fiduciary***;”
- Create a conflict of interest in the agent's advice and compensation;
- Make the agent liable for excise taxes (and sometimes damages);
- Make the supervisory broker (and further upstream) liable, too; and
- Create a distance between investment advisors and their retirement clients.

By so doing, the central aim is to transform the way investment advisors to IRAs (and some small ERISA plans) are paid.

# The Problem: Exposure

- Exposure (from making no changes) depends upon the retirement vehicle involved in the transaction.
- *If it is an IRA -*

(1) The agent (and maybe his affiliated broker and financial institution) will be liable for a two-tiered, annual excise tax to the IRS for engaging in a prohibited transaction. There is also a risk of disqualifying the IRA. *Code §§ 4975, 408(e)(2)*

(2) The excise tax grows geometrically over time, and after only a few years can be very expensive. Because it renews itself annually, it can go on for years without a normal limitations defense.

(3) The excise tax can be stopped only by correcting the prohibited transaction, which involves undoing the transaction. It is a self-assessing tax.

(4) The cost and necessity of correction can make the agent and others into guarantors of investments.

(5) But, ERISA will not complicate the risk. This new regulation applies but only under the Internal Revenue Code. *§2510.3-21(f)*

# Exposure

- *If it is an ERISA plan -*

(1) The described excise tax exposure to the IRS is there, plus

(2) ERISA will also apply, making the agent (and more easily, his affiliated broker and financial institution) personally liable for (i) damages arising from either breaching applicable fiduciary duties or engaging in transactions prohibited by ERISA and (sometimes) (ii) restoring profits realized from the breach or prohibited transaction.

(3) Correction under ERISA also involves reversing the prohibited transaction. Correction under ERISA and correction under the Internal Revenue Code are not necessarily the same thing.

# Delays

A Presidential Memorandum was directed to the Secretary of Labor on February 3, 2017. (82 Fed. Reg. 9675)

The Presidential Memorandum told the Secretary of Labor

- To determine whether the restated investment advice fiduciary rule might adversely affect how Americans gained access to retirement savings and financial advice; and
- To prepare an updated economic and legal analysis concerning the impact of the restated fiduciary rule, considering three specifically enumerated criteria.

Then, if the Secretary of Labor concluded at least one enumerated detriment existed or that the fiduciary rule was inconsistent with the Administration's stated priorities, the Secretary was required to publish "a proposed rule rescinding or revising" the fiduciary rule.

On February 3, the Secretary of Labor committed to "consider[ing] its legal options to delay the applicability date…".

# Delays

After publishing proposed changes on March 2, 2017 (82 Fed. Reg. 12319) that would amend both the final regulation and the related PTEs released with the final regulation on April 8, 2016, amendments were published on April 7, 2017 (82 Fed. Reg. 16902). The changes to the 2016 package of regulatory and PTE guidance (the "final rule")

- amended Labor Regulations section 2510.3-21 to remove "April 10, 2017" and to substitute "June 9, 2017" as the regulatory applicability date in the three places the date appeared in the regulation.
- amended Best Interest Contract Exemption (the "BICE") to (i) change the applicability date of the BICE to June 9, 2017; (ii) relax the applicability of the Level Fee Fiduciary exception in the BICE during transition; and (iii) allow enhanced access as a Level Fee Fiduciary for robo-advice providers.
- amended the "Transition Period" requirements in BICE Section IX to (i) run from June 9, 2017 to January 1, 2018, (ii) apply the transitional Impartial Conduct Standards beginning June 9, 2017; and (iii) prevent the application of the remaining Transition Period BICE standards during 2017.

# Delays

The changes to the 2016 final rule package of regulatory and PTE guidance also

- amended CPTE 84-24 (i) to change its applicability date to January 1, 2018; (ii) to apply the unique 84-24 Impartial Conduct Standards beginning June 9, 2017; and (iii) to apply needed definitions by June 9, 2017.
- amended a laundry list of other PTEs (that were amended on April 8, 2016) to extend their applicability dates to June 9, 2017).

# Delays

On March 10, 2017, the Department of Labor adapted a temporary nonenforcement policy, promising not to initiate an enforcement action based on a failure to satisfy the regulation or a related PTE “during the ‘gap period’.”
*Field Assistance Bulletin No. 2017-01 (March 10, 2017)*

- This enforcement relief was conditioned on the Department’s issuing “a final rule after April 10 implementing a delay in the applicability date.” The delay was issued before April 10.
- The only other circumstance where this policy would apply literally is if “the Department decides not to issue a delay…”. It did issue a delay.
- Does this nonenforcement policy apply?

At roughly the same time, the Treasury Department and the IRS adopted “a temporary excise tax non-applicability policy that conforms with the DoL’s temporary nonenforcement policy described in FAB 2017-01.” The IRS announced it “will not apply § 4975 and related reporting obligations [to] any transaction or agreement to which the DoL’s temporary nonenforcement policy, or other subsequent related enforcement guidance, would apply.”
*Announcement 2017-4*

# What To Do Now?

## If -

- there is no delay to the January 1, 2018 applicability date;
- there are no significant amendments to the investment advice fiduciary regulation or the related PTEs; and
- neither the investment advice fiduciary regulation nor the BICE (or related PTEs) are repealed; then

**…in the meantime,**

- one set of rules will apply until June 9, 2017;
- a markedly different set of rules will apply from June 9, 2017 through December 31, 2017; and
- another markedly different set of rules will apply beginning January 1, 2018.

The last set of rules beginning January 1, 2018 (and some about the later in 2017 rules) are explained in the rest of these slides.

# Exception to Exposure for Welfare Plans

When applying the new regulation, “investment property” will **not** include -

- health insurance policies;
- disability insurance policies;
- term life insurance policies; and
- other property

to the extent they do **not** have an investment component. *§2510.3-21(g)(4)**

* All citations are to final guidance published in the Federal Register on April 8, 2016.

# Exception for Executing Securities Transactions

A person who is (i) a broker or dealer registered under the Securities Exchange Act of 1933, (ii) a reporting dealer who makes primary markets in certain U.S. government securities or (iii) a bank supervised by the U.S. or a state will **not** be a fiduciary of any sort under ERISA or the Internal Revenue Code solely because the person executes purchase or sale transactions for securities of a plan or IRA as directed by a fiduciary of that plan or IRA, if -

- The fiduciary and its affiliates are not the executing broker, dealer or bank.
- The fiduciary's transaction execution instructions generally state (i) the security, (ii) a price range, (iii) a time span (not greater than five business days) and (iv) a quantity. *§2510.3-21(e)(1)*



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# More Exceptions

- A broker-dealer (registered under the Securities Exchange Act of 1933?), a reporting dealer (who makes primary markets in U.S. government or agency securities?), and a bank (supervised by the U.S. or a state?) which is a fiduciary of an ERISA plan or an IRA as a result solely of executing purchases and sales of securities for the plan or IRA will **not** be deemed to be an ERISA fiduciary with regard to any assets of the plan or IRA over which it has no discretionary authority, control or responsibility and is not otherwise an ERISA fiduciary. *§2510.3-21(e)(2)*
- If a "person" is an investment advice fiduciary for an ERISA plan or IRA, that person will **not** be deemed to be an ERISA fiduciary with regard to any assets of the plan or IRA over which it has no discretionary authority, control or responsibility and is not otherwise an ERISA fiduciary. *§2510.3-21(d)*
- Limits to these exceptions
  - (1) ERISA's co-fiduciary liability is not affected by these limits.
  - (2) These limits do not affect whether the person is otherwise a "party in interest" under ERISA or a "disqualified person" under the Code.



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# “Employee” Exception

An individual will not be an investment advice fiduciary if she -

- acts in her capacity as an employee of the sponsor (or its affiliate) of an ERISA plan (which does not include an IRA) and gives advice to another employee who is a participant or beneficiary, so long as (i) her job does not require giving such advice, (ii) she is not registered or licensed to give such advice (and does not have to be), and (iii) she does not receive direct or indirect compensation (above her normal compensation) for the advice. *§2510.3-21(c)(3)(ii)*
- acts in her capacity as an employee of the sponsor (or its affiliate) of an ERISA plan, as an employee of the ERISA plan, as an employee of the plan's fiduciary or as an employee of an employee organization and gives advice to a fiduciary, another employee (not as a participant or beneficiary) or an independent contractor if she does not receive direct or indirect compensation (above her normal compensation) for such advice. *§2510.3-21(c)(3)(i)*

# "Independent Fiduciary" Exception

- This "independent fiduciary on steroids" exception is limited to "true arm's length transactions between…professionals or…managers who do not have a legitimate expectation that they are in a relationship of trust and loyalty…". *Supplementary Information, 81 Fed. Reg. 20946, 20983 (April 8, 2016) ("Preamble").* It is "…designed to ensure that the parties…understand the nature of their relationships." *Id.* The burden of proof is on the advisor. *Preamble, at pg. 20984.* The Department of Labor has commented on this exception in its Conflict of Interest FAQs (Part II - Rule), released on January 16, 2017 ("FAQs II").
- Any advice given "to a fiduciary" about any investment-related transaction *(FAQs II, Q&A-22)* involving a plan or an IRA *(FAQs II, Q&A-25)* by an advisor -

    (1) Who knows the recipient is a fiduciary of an ERISA plan or IRA;

    (2) Who knows the recipient is "independent" *(FAQs II, Q&A-28)*;

    (3) Which is about a sale, purchase, loan, exchange or other transaction related to an investment; and

    (4) Which is about an "arm's length" transaction;



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# “Independent Fiduciary” Exception (cont.)

- will **not** make the advisor an investment advice fiduciary if, *before* the transaction, the advisor -
  - (5) Knows (or reasonably believes) the independent fiduciary is (i) a regulated bank, (ii) a qualified insurance carrier, (iii) an investment advisor registered under the Investment Advisor Act of 1940 (or a state's equivalent), (iv) a broker-dealer registered under the Securities Exchange Act of 1934, or (v) the manager (or holder) of at least $50,000,000;
  - (6) Knows (or reasonably believes) the independent fiduciary is capable of making individual evaluations of investment risks;
  - (7) Knows (or reasonably believes) the independent fiduciary is the fiduciary for this transaction;
  - (8) Knows (or reasonably believes) the independent fiduciary is responsible for exercising independent judgment about the transaction;

# “Independent Fiduciary” Exception (cont.)

(9) Informs the independent fiduciary the advice is **not** impartial and the advice is **not** fiduciary advice;

(10) Informs the independent fiduciary about the advisor's financial interests in the transaction;

(11) Does **not** receive a fee or other compensation directly from the plan, its fiduciary, participant or beneficiary, or from an IRA or an IRA owner in connection with the investment “(as opposed to other services);” and

(12) Has **not** admitted to fiduciary status. *§ 2510.3-21(c)(1)*

- The advisor may reply on appropriate written representations from the independent fiduciary for #5-#8 above. *§ 2510.3-21(c)(1)(i),(ii),(iv).* The representations must be in place at the time the transaction takes place and must cover the period during which the advice is given. *(FAQs II, Q&A-21)*



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# "Independent Fiduciary" Exception (cont.)

- The $50,000,000 may be any combination of plan and non-plan assets and the combined assets of several plans and non-plan investors. *(FAQs II, Q&A-20)*
- The independent fiduciary can be a representative of a registered investment advisor. *(FAQs II, Q&A-23)*
- An IRA owner cannot be his own independent fiduciary. *(FAQs II, Q&A-26)*
- A fee between financial intermediaries is not a disqualifying fee under #11 above, unless it is paid by a plan or an IRA or by using their assets. *(FAQs II, Q&A-29)*
- An employee of the plan sponsor who is a participant, an officer or a fiduciary committee member can also be this independent fiduciary if he receives the advice in his independent fiduciary status. *(FAQs II, Q&A-27)*



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# Participant/Owner Exception

A participant or beneficiary (or their relatives) of an ERISA-covered plan and an IRA owner (or a relative) cannot be a fiduciary for this purposes of this rule. *§2510.3-21(g)(7)*

# Investment Advice Fiduciary

- An "***Investment Advice Fiduciary***" is a person -

(1) Who gives certain, enumerated kinds of investment advice;

(2) Directly (or indirectly) to either (i) an ERISA plan, its fiduciary or its participant or beneficiary, or (ii) to an IRA or its owner;

(3) In exchange for compensation, received directly or indirectly; and

(4) Who admits to being a fiduciary of the ERISA plan or IRA for investments; or

(5) Who gives the advice under an agreement or understanding to make the advice individualized to the recipient for investments; or

(6) Who gives the advice under an agreement or understanding to provide advice specifically directed to the recipient's investment property. *§2510.3-21(a)*





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# Affected Investment Advice

"***Investment Advice***" is only -

- A recommendation (which means: a *suggestion*) to buy, hold, sell, or exchange securities or other investment property
- A recommendation to take a distribution, including its form and amount
- A recommendation to do a rollover or transfer, including its amount and destination.
- A recommendation about how to invest the proceeds after taking a distribution
- A recommendation about how to invest the proceeds after doing a rollover or transfer
- A recommendation about managing investments in securities or other property
- A recommendation of a person to give these kinds of investment advice
  *§ 2510.3-21(a)(1)(i)-(ii), (b)(1)*

Giving appraisals and other valuations is not investment advice, for now.



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# “Recommendation”

A “communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion” about a course of action. *§ 2510.3-21(b)(1)*

- Objective inquiry.
- A suggestion that is more individually tailored is more likely to be viewed as a recommendation.
- Recommendations can originate from a person or a computer.
- A selective list of securities for a particular recipient is a recommendation, even if no single security is recommended.
- A series of actions may be viewed as a recommendation, even if none of the single actions would be. *§ 2510.3-21(b)(1)*
- Use these criteria to determine if an action is a recommendation, subject only to a list of activities that are expressly not recommendations. *§ 2510.3-21(b)(2)*

# Carve-outs

These situations do not generate a recommendation.  They were called "carve-outs" in the proposed regulation, but that reference was abandoned.

- "Platform providers"
- Assistance with only investment selection or monitoring
- General communications
- Investment "education" that does not include recommendations of specific products or alternatives and does not provide recommendations about how to manage a particular investment.
  *§2510.3-21(b)(2)*

# "Platform Provider" Carve-out

A person can avoid being an investment advice fiduciary (by avoiding giving regulated recommendations) if its relationship with an ERISA plan (**not** an IRA) stays within these parameters:

(1) It markets or merely provides a menu of securities or other property to an ERISA plan.

(2) It uses a platform (or similar mechanism) to do so.

(3) The platform's offered choices do not take any individualized needs into account.

(4) The plan's fiduciary is independent of the platform provider.

(5) The plan's fiduciary makes any investment selections chosen from the platform's menu.

(6) The fiduciary's choice becomes an option that the plan's participants or beneficiaries may use to select a direct investment.

(7) The plan's fiduciary is told in writing that the platform provider is not attempting to give impartial investment advice and is not giving advice as a fiduciary. *§ 2510.3-21(b)(2)(i)*





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# "Selection/Monitoring" Carve-out

A person can also avoid giving regulated recommendations by limiting what it gives as a platform provider to an ERISA plan (**not** an IRA) to materials that -

- Identify investment alternatives that meet objective criteria selected by the ERISA plan's fiduciary, but only if the provider discloses any financial interest it has in any provided alternative. *§2510.3-21(b)(2)(ii)(A)*
- In response to a RFI, RFP or something similar, identifies a limited set of investment alternatives based on only (i) the size of the plan sponsor, (ii) the size of the plan, (iii) the plan's current investment alternatives, or (iv) a combination of those three, but only if the provider discloses any financial interest it has in any provided alternative. *§2510.3-21(b)(2)(ii)(B)*
- Provides the ERISA plan's fiduciary with objective financial data, comparisons with independent benchmarks, or both. *§2510.3-21(b)(2)(ii)(C)*

This carve-out does not extend to IRAs.



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# “General Communications” Carve-out

A person does not give regulated recommendations by furnishing general communications that a reasonable person would not view as an investment recommendation, such as -

- general circulation newsletters
- commentary in publicly broadcast talk shows
- comments in widely attended speeches and conferences
- research or news reports intended for general distribution
- general marketing materials; and
- general market data *§ 2510.3-21(b)(2)(iii)*

# "Investment Education" Carve-out

A person does not give regulated recommendations just because it provides any of four kinds of educational information or materials, if the information or materials do -

- **Not** include recommendations, solely or in combination, about specific investment products or specific plan or IRA alternatives; and
- **Not** include recommendations on investment or management of a particular security or securities or other property.

If this investment education carve-out would otherwise apply, it does not matter to whom the information or materials were given, who provided the information or materials, how often they were provided, the form in which they were communicated or whether the education materials or information were provided alone or in combination with other information or materials. *§2510.3-21(b)(2)(iv)*

The final guidance revoked Interpretative Bulletin 96-1 (§2509.96-1) and its guidance about investment-related education.



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# Four Allowed Kinds of Educational Materials

***#1:*** Information and materials that (without referring to the appropriateness of an individual item) only -

- Describe the terms or operation of the ERISA plan or IRA; or
- Inform the recipient about
  - (1) the benefits of participation
  - (2) the benefits of "increasing" contributions
  - (3) the impact of pre-retirement withdrawals
  - (4) retirement income needs
  - (5) available forms of distribution
  - (6) advantages or disadvantages and risks of available forms of distribution; or
- Describe for available investment alternatives (under the ERISA plan or IRA) (i) investment objectives and philosophies, (ii) risk and return characteristics, (iii) historical return information, (iv) product features, (v) investor rights and obligations, (vi) trading restrictions, (vii) fees and expenses, or (viii) prospectuses. *§2510.3-21(b)(2)(iv)(A)*



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# Four Allowed Kinds of Educational Materials (cont.)

***#2*:** Information or materials on financial, investment or retirement matters that -

- Do **not** address specific investment products
- Do **not** address specific ERISA plan or IRA alternatives
- Do **not** address available distribution options
- Do **not** address specific alternatives or services offered outside the ERISA plan or IRA; or

*§2510.3-21(b)(2)(iv)(B)*



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# Four Allowed Kinds of Educational Materials (cont.)

<u>#**2**</u>***:*** (cont.): Information or materials on financial, investment or retirement matters that -

- Inform the ERISA fiduciary, participant or beneficiary, or IRA owner about
  (1) General financial concepts
  (2) General investment concepts
  (3) Historical differences in rates of return among asset classes (using standard market indices)
  (4) Effects of fees and expenses
  (5) Effects of inflation
  (6) Estimating retirement income needs
  (7) Choosing investment time horizons
  (8) Assessing risk tolerance
  (9) Retirement-related risks; and
  (10) General methods and strategies for managing assets in retirement in and outside of the plan or IRA.

# Four Allowed Kinds of Educational Materials (cont.)

***#3:*** Information or materials that provide “models of asset allocation portfolios of hypothetical individuals with different time horizons… and risk profiles,” if the models -

- Are based on “generally accepted investments theories that take into account the historic returns of different asset classes…over defined periods of time;”
- Disclose all material facts and assumptions on which they are based;
- Do **not** include or identify any specific investment product or available specific alternative (other than in limited circumstances, a DIA under an ERISA plan); and
- Include a statement to the effect that users of the model should appropriately include and consider their other assets, income and investments outside the plan or IRA when using the model.

*§2510.3-21(b)(2)(iv)(C)*





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# Four Allowed Kinds of Educational Materials (cont.)

**#4:** Information and materials which allow an ERISA plan fiduciary, participant or beneficiary or an IRA owner a way to "[e]stimate future retirement income needs and assess the impact of…asset allocations on retirement income… to evaluate distribution options, products or vehicles (using allowed educational information) [or]… to estimate a retirement income stream" so long as -

- The materials are based on "generally accepted investment theories that take into account the historic returns of different asset classes… over defined periods of time;"
- There is an objective correlation between suggested asset allocations or income streams generated by the materials and data from the user;
- Material facts and assumptions are disclosed or provided by the user;
- Other assets and income are considered, or reference is made to them;
- No specific investment alternatives available in the ERISA plan or IRA are included or identified (unless provided or (in limited circumstances), is an ERISA plan's DIA); and
- Assets outside the ERISA plan or IRA are taken into account or there is a disclosure that they should be. *§2510.3-21(b)(2)(iv)(D)*



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# The Solution: An Exemption for Investment Advice Fiduciaries

It is a lot easier now to become an investment advice fiduciary. It is tough to find relief. The ***Best Interest Contract Exemption*** (“BICE”) lets investment advice fiduciaries - who (i) want to cause an ERISA plan or IRA to pay them additional compensation as a result of their investment advice, or (ii) want to receive additional compensation from third parties as a result of their investment advice - to receive that otherwise prohibited compensation.

- The BICE is a bear (but a smaller one than before).
- Its relief is optional, but its conditions and requirements for that relief are mandatory. It is changing the industry.
- It is intended to be the new normal, the default relief.
- Its relief is layered, and access is limited.
- Its details can feel endless, and its fondness for specific disclosures (in particular) is daunting.

# The BICE - Protected Transactions

- The BICE allows certain protected persons to be paid variable compensation from services provided

  (1) in connection with the purchase, sale or holding of an asset

  (2) to an ERISA plan or IRA

  even if the transaction and compensation were the result of investment advice by the protected person to a retirement investor.

- It provides relief from ERISA sections 406(a)(1)(D) and 406(b) and from sections 4975(c)(1)(D), (E) and (F) of the Internal Revenue Code. *§ I(b)*

- It does ***not*** provide relief if -

  (1) *All* of the BICE's applicable conditions are not met.

  (2) The plan is an ERISA plan, and

    (a) the protected person is the plan's sponsor, or

    (b) the protected person is a named fiduciary of the plan or its administrator who was selected for this purpose by a fiduciary who is not independent.



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# The BICE - Protected Transactions (cont.)

- It does ***not*** provide relief if -
  - (3) The compensation is from a transaction where the advisor was acting for its own account or that of an affiliate in a principal transaction.
  - (4) The compensation is from advice generated solely by an interactive web site without personal interaction or personal advice from an advisor ("robo-advice"), unless the provider is a level fee fiduciary.
  - (5) The advisor has discretion with respect to the recommendation. *I(c)*
  - (6) The general relief of the BICE does not apply when the recommendation is about investments in ERISA-covered plans. An exception could apply. *§ II(g)*



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# The BICE - Protected Persons

"***Advisors***" can use the BICE.  An advisor is an individual who -

- Is an investment advice fiduciary with respect to the assets involved in the recommended transaction;
- Is an "employee, independent contractor, agent or registered representative" of certain financial institutions; and
- Satisfies applicable governmental regulatory and licensing requirements with respect to the advice. *§ VIII(a)*

"***Financial Institutions***" can use the BICE.  A financial institution is an entity with a relationship to the advisor that is (i) registered as an investment advisor (under the Investment Advisors Act of 1940, as amended, or the state where it is located), (ii) certain banks or savings associations, (iii) certain insurance companies, (iv) a broker or dealer registered under the Securities Exchange Act of 1934, or (v) an entity described as such in later individual exemptions. *§ VIII(e)*

# The BICE - Retirement Investors

"***Retirement Investors***" are those who can get potentially conflicted advice from a protected person and can be only:

- A participant or beneficiary in an ERISA plan with the right to direct the investment of her account or take a distribution.
- The beneficial owner of an IRA (who is acting for the IRA).
- A fiduciary of an ERISA plan or an IRA who is not an investment advice fiduciary. *§ VIII(o),(n)*

If the investment advice is directed to any other entity or individual, the BICE cannot protect the transaction. The restriction limiting the BICE's relief available for ERISA plans to ERISA plans covering fewer than 100 participants has been removed from this definition.



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# The Layers of the BICE - The Conditions

To use the relief promised by the BICE for only *purchases* of an investment product (including an insurance policy or annuity contract) from some financial institutions -

- The transaction must be in the ordinary course of the financial institution's business.
- Only reasonable compensation can be paid to the financial institution (or its affiliates) out of the purchase.
- The terms must be at least as good as those generally available in an arm's length purchase with an unrelated party.

This relief is not available if (i) an ERISA plan is involved and the plan's sponsor or its tainted administrator is the advisor or financial institution, (ii) the compensation is from a principal transaction, (iii) the advice is robo-advice, or (iv) the advisor has discretion over the purchase. *§ VI*

# The Layers of the BICE - The Conditions (cont.)

To use the relief promised by the BICE for compensation from certain *pre-existing* investment transactions occurring before April 10, 2017 (or later as part of a systematic purchase program in effect before April 10, 2017) -

- The agreement to pay the compensation must have been in effect before April 10, 2017.
- The transaction must not have been prohibited at the time.
- The compensation now was not due to additional purchases (with an exception).
- The compensation received has been reasonable.
- Investment advice given after April 10, 2017 in this situation adhered to the best interest standard. *§ VII*

# The Layers of the BICE - The Conditions (cont.)

To use the relief promised by the BICE for recommendations about investments in *ERISA-covered plans* -

- Before or at the time of the transaction, the financial institution and advisor must affirmatively acknowledge fiduciary status with respect to investment advice about the recommended transaction. *§II(g)(1), §II(b)*
- The financial institution and advisor must comply with the "Impartial Conduct Standards." *§II(g)(2), §II(c)*
- The financial institution must adopt policies and procedures that implement three required warranties, and it and the advisor must comply. *§II(g)(3), §II(d)(1)-(3)*
- The financial institution must disclose mandated information early and often. *§II(g)(4), §II(e)*
- The financial institution and advisor may not disclaim liability beyond what is allowed under ERISA, not try to waive the investor's right to be in a class action in a dispute with them, and not try to require unreasonable arbitration or mediation of individual investor claims against them. *§II(g)(5)*



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# The Layers of the BICE - The Conditions (cont.)

To use the relief promised by the BICE for *level fee fiduciaries* -

- Before or at the time of the transaction, the financial institution and advisor must affirmatively acknowledge fiduciary status with respect to investment advice about the recommended transactions. *§ II(h)(1), § II(b)*
- The financial institution and advisor must comply with the "Impartial Conduct Standards." *§ II(h)(2), § II(c)*
- In the case of a recommendation to rollover to an IRA (or switch to a level fee arrangement), the financial institution must document why the recommendation was in the investor's best interest. *§ II(h)(3), § VIII(d)*

A level fee fiduciary (i) can receive only compensation that is a fixed percentage of asset value or a set dollar amount that does not vary based on an investment recommendation and (ii) must disclose that fee in advance. *§ VIII(h) For further commentary, consult the Department of Labor's Conflict of Interest (Part I-Exemptions) FAQs issued on October 27, 2016, Q&As-13 through -19.*

# The BICE - The Conditions

To use the relief promised by the BICE for a *new BICE contract* for an IRA (or a plan not covered by ERISA) -

- There must be a contract, signed before or at the time of the transaction.  No longer is it required before any recommendation is made, but a later contract must cover prior related advice.
- The contract must acknowledge the protected person's fiduciary status.
- The contract must contain an agreement to adhere to the "Impartial Conduct Standards."
- The contract must warrant the protected person has adopted policies and procedures designed to mitigate the unsavory effects of conflicted advice.
- The protected person must disclose mandated information early and often.
- The protected person must generate and keep specific data about the investment recommendations it wants protected.
- The signed BICE contract must be accessible to the investor on the protected person's website. *§ I(b), § II(a)*

# The BICE - The Contract

*Exception:* Existing investment-related contracts or agreements executed before January 1, 2018 and in effect on that date can be amended to include BICE requirements, instead of requiring a new BICE contract. *§ II(a)(1)(ii)*

- Amendment would be accomplished by delivering the proposed amendment, plus a full set of BICE-required disclosures to the investor before January 1, 2018. *§ II(a)(1)(ii), § II(e)*
- A failure to terminate the existing contract within thirty days after delivery can be treated as negative consent. *§ II(a)(1)(ii)*

# The BICE - The Contract (cont.)

*Exception:* If a financial institution does **not** get a BICE contract with an IRA (or plan not covered by ERISA), the BICE can still provide relief, if -

- The advisor giving a recommendation does not get paid compensation from the recommendation.
- There are policies and procedures designed to stop paying that compensation to the advisor.
- The protected persons comply with the "Impartial Conduct Standards," implement certain required policies and procedures, and implement the BICE-required website.
- The failure to get the BICE contract was not an effort or arrangement designed to avoid compliance. *§ II(a)(1)(iii)*



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# The BICE - Contract Terms

The following are general details about the required BICE contract:

- The protected persons and the retirement investor are required parties who must sign. *§ II(a)(1)(i)*
- The required signatures are needed before the conflicted recommended transaction is complete. *§ II(a)(1)(i)*
- The advisor (and his financial institution) must both admit to investment advice fiduciary status. *§ II(b)*
- The advisor (and his financial institution) must warrant to four specified protections. *§ II(d)*
- The contract must include required disclosures. *§ II(e)*
- The contract must ***not*** contain (i) exculpatory clauses disclaiming or limiting a protected person's liability for breaching the contract, or (ii) a waiver or qualifier of the investor's right to bring or join an action in court against a protected person. *§ II(f)*



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# The BICE - Impartial Conduct Standards

These are at the core of the new exemption. In the BICE contract, the advisor (and his related financial institution) must commit to the following "***Impartial Conduct Standards***":

- The investment advice given must be in the "Best Interest" of the investor.
- An investment will **not** be recommended if the total compensation expected from that investment to the advisor, financial institution and their affiliates will be more than reasonable compensation.
- **No** statements by the advisor (or his financial institution) to the retirement investor (about the investment, fees, conflicts or other relevant details) will be misleading at the time they are made. *§ II(c)*

# The BICE - Best Interest Conduct

- "***Best Interest***" conduct says the investment advice fiduciary will

  "act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor without regard to the financial or other interests of… [any] other party." *§II(c)(1), §VIII(d)*

- The BICE's best interest standard sounds very familiar to those knowledgeable about ERISA's fiduciary standard in ERISA section 404(a)(1)(B). But, ERISA section 404(a)(1)(B) does not apply to the usual IRA, and the standard has been tweaked for the BICE.



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# The BICE - Required Contract Warranties

The BICE contract must include the following -

- The financial institution warrants it has written policies and procedures reasonably and prudently designed to make its advisors follow the Impartial Conduct Standards.
- The financial institution warrants it has found its material conflicts of interest, imposed measures to limit their effects, and picked a monitor to oversee this.
- Subject to an exception, the policies and procedures forbid using quotas, performance appraisals, bonuses, differentiated compensation or other such incentives that might result in recommendations that are not best interest advice. *§ II(d)*



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# The BICE - Unwelcome Contract Terms

There will be no BICE relief if the BICE contract has any of these terms -

- Exculpatory language disclaiming or limiting liability in the event of a breach.
- Conditions, waivers or limits on (i) being a part of a class action, (ii) being part of a class settlement, or (iii) being part of an individual settlement, although limits on punitive damages and rescission can be okay.
- Arbitration or mediation of individual claims in difficult places or limited in other unreasonable ways. *§ II(f)*

# The BICE - Required Contract Disclosures

The BICE contract must include these disclosures clearly and prominently (in its terms or with the contract) -

(1) State the best interest standard of care owed

(2) Tell the investor what services are offered and how they will be paid

(3) Describe material conflicts of interest

(4) Disclose fees to be paid by the investor and by third parties

(5) Describe policies, procedures and disclosures available upon request

(6) Provide a link to the BICE-required website.

# The BICE - Required Contract Disclosures (cont.)

The BICE contract must include these disclosures clearly and prominently (in its terms or with the contract) (con't.) -

(7) Describe the model contract and policies available on the website.

(8) Disclose whether the proprietary products are being offered and any limits those products put on the recommendations.

(9) Discuss whether offered products generate third party payments and whether the chance of getting those payments limited offered products.

(10) Provide contact information for complaints.

(11) Discuss whether the investor's investments will be monitored and how often, and whether alerts will be sent. *§ II(e)(1)-(7)*



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# The BICE - Required Separate Disclosures

- Independently of the BICE contract, the retirement investor must get two more kinds of disclosure to get BICE relief.

  (1) *Transaction Disclosure.* Before executing a purchase, the financial institution must provide a single document that (i) recites the best interest standard of care owed, (ii) describes material conflicts of interest, (iii) tells the investor about policies, procedures and disclosures it can get, (iv) includes a link to the institution's website, and (v) tells the investor about content on the website.

  (2) *Website.* The financial institution must create and maintain a public, freely accessible website that shows (i) the institution's business model and associated material conflicts of interest, (ii) typical fees and charges, (iii) a model BICE contract or its BICE-related terms, (iv) a summary of its BICE-required policies and procedures, (v) products offered in the recommendation that can result in third party payments to the institution, and (vi) summaries of payout and compensation grids for advisors from recommended products. *§ III(a)-(b)*



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# The BICE - Proprietary Products

A financial institution can restrict advisors' investment recommendations, partially or completely, made to ERISA plans and to IRAs <u>and</u> use the BICE.

*Allowed Restrictions*

***Proprietary products***

- can use this exception.
- are products managed, issued or sponsored by the institution. *§IV(a), §VIII(l)*

Products that generate ***third party payments*** to the financial institution or advisor (or affiliates)

- can use this exception.
- are charges not directly paid by the plan or IRA, which include revenue sharing payments, 12b-1 fees, distribution, solicitation or referral fees (and other examples) *§IV(a), §VIII(q)*

# The BICE - Proprietary Products (cont.)

*Additional Requirements* (which apply equally to both exceptions)

Transactions under these circumstances will be deemed to satisfy only the best interest standard, if the following are completed by the time of the transaction.

- Inform the investor “clearly and prominently” about which of the two restrictions is involved and the limits the involved restrictions put on the universe of possible recommendations. Using “may” is not allowed.
- Inform the investor “fully and fairly” about material conflicts of interest.
- Satisfy the BICE's separate disclosures requirements.
- Document the financial institution's imposed limits on restrictions, material conflicts of interest and services to be provided in exchange for third party payments.

# The BICE - Proprietary Products (cont.)

*Additional Requirements* (which apply equally to both exceptions) (con't.)

- The institution must reasonably conclude the limits and conflicts will not result in excessive compensation or recommending imprudent investments and document the reasons why.
- Adopt and monitor policies, procedures and incentive compensation practices that meet the BICE's standards.
- Ensure the compensation received from these conflicted transactions is no more than reasonable compensation.
- Ensure the recommendations are in the investor's best interest. *§ IV(b)*

# 84-24

Prohibited Transaction Exemption 84-24 ("84-24") was amended and restated in the guidance released with the BICE.

- 84-24 can protect insurance agents, brokers, insurance companies, pension consultants, investment companies, certain principal underwriters and investment advisors. *84-24, § I(b)(1)-(6)*
- It provides relief from all of the Internal Revenue Code's and ERISA's prohibited transactions. *84-24, § I(b)* In this respect alone, it is better than the BICE.
- It allows payments of insurance commissions, mutual fund commissions and other consideration that would be, or would arise from, otherwise prohibited transactions, and it allows certain purchases and one kind of sale that would otherwise be prohibited transactions. *84-24, § I(b)(1)-(6)*

# 84-24 (cont.)

After it is fully effective, it will no longer apply to -

- A purchase of "investment company securities" by an IRA.
- A purchase of a "variable annuity contract, indexed annuity contract or similar contract" by an IRA or by an ERISA plan. It does not define these terms. *84-24, § I(c)*

# 84-24 Conditions

When acting as an investment advice fiduciary,

(1) the fiduciary must act in the best interests of the ERISA plan or IRA; and

(2) the fiduciary's statements must not be materially misleading when made. *84-24, § II*

When generally using 84-24,

(1) the transaction must be effected in the ordinary course of business;

(2) the transaction must be on terms at least as favorable as an unrelated, arm's length transaction; and

(3) the total of all fees and compensation received cannot exceed reasonable compensation. *84-24, § III(a)-(c)*

When using 84-24 to protect against the first 4 of the transactions it allows, additional conditions must be satisfied. *84-24, § IV* Those using 84-24 also have recordkeeping requirements to meet. *84-24, § V*

# 84-24 Covered Transactions

Only these transactions can be protected under 84-24:

**#1:** Receiving an insurance commission when an IRA or ERISA plan buys an insurance contract or fixed rate annuity contract.

- An insurance commission is a sales commission paid by the insurer for services related to causing the purchase and includes renewal fees and trailers, but excludes revenue sharing payments, administrative fees and marketing payments. *84-24, §§I(b)(1), VI(f)*
- Only insurance agents, brokers and pension consultants can use.

**#2:** Receiving a mutual fund commission when an ERISA plan buys investment company securities.

- A mutual fund commission is a "commission or sales load" paid for services related to causing or executing the purchase, but excludes 12b-1 fees, revenue sharing payments, administrative fees and marketing fees. *84-24, §§I(b)(2), VI(i)*
- Only a principal underwriter can use. *84-24, §§I(b)(2), VI(m)*
- An investment company must be registered under the Investment Company Act of 1940.

# 84-24 Covered Transactions (cont.)

Only these transactions can be protected under 84-24 (con't.):

#**3:** Causing the purchase of an insurance contract or fixed rate annuity contract with assets of an IRA or an ERISA plan or the purchase of investment company securities with assets of an ERISA plan. *84-24, § I(b)(3)*

- Only an insurance agent, broker or pension consultant can use this relief as part of buying insurance or an annuity.
- Only a principal underwriter can use this relief as part of buying investment company securities.

#**4:** Buying an insurance contract or fixed rate annuity contract from an insurance company with assets of an IRA or an ERISA plan. *84-24, § I(b)(4)*

- Includes consideration paid to the insurance company.

# 84-24 Covered Transactions (cont.)

Only these transactions can be protected under 84-24 (con't.):

#**5:** Buying an insurance contract or a fixed rate annuity contract from an insurance company using ERISA plan assets. *84-24, § I(b)(5)*

- The insurance company must be a fiduciary or service provider for the plan only because it sponsors a master or prototype plan. *84-24, § § I(b)(5), VI(g)*

#**6A:** Buying investment securities from an investment company or principal underwriter using ERISA plan assets. *84-24, § § I(b)(6), VI(j)*

- The investment company, principal underwriter or an investment advisor must be a fiduciary or service provider for the plan only because it sponsors a master or prototype plan or is a nondiscretionary trustee.





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# 84-24 Covered Transactions (cont.)

Only these transactions can be protected under 84-24 (con't.):

#**6B:** Selling investment securities owned by an ERISA plan to an investment company or principal underwriter. *84-24, § I(b)(6)*

- The investment company, principal underwriter or an investment advisor must be a fiduciary or service provider for the plan only because it sponsors a master or prototype plan or is a nondiscretionary trustee.

# 84-24 Controversy

Unexpectedly, amended and restated 84-24 limited the annuity products that can be within the exemption's relief.

- 84-24 has been the standard exemption for 21 years for sales and purchases of annuity contracts and related commission payments that would be prohibited by the ERISA or the Internal Revenue Code.
- New 84-24 provides relief only for annuity contract transactions involving a "Fixed Rate Annuity Contract." *84-24, § I(b)(1)*
- "***Fixed Rate Annuity Contract***" is a fixed annuity contract (immediate or deferred) issued by an insurance company (i) that "satisfies applicable state standard nonforfeiture laws" at issue date, or in the case of only group fixed annuities, "guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in [the] state," and (ii) the benefits of which do not vary based on investment experience of the insurer's separate account or accounts or investment experience of an index or investment model. *84-24, § § I(b)(1), VI(k)*

# 84-24 Controversy (cont.)

- A variable annuity, an indexed annuity and a “similar annuity” is not a fixed rate annuity. These terms are not defined in 84-24.
- “[T]raditional annuities, declared rate annuities, [and] fixed rate annuities (including deferred income annuities)” are fixed rate annuities eligible for 84-24, according to the preamble to 84-24.  The Department believes each provides payments that are predictable.

# Trump's First 100 Days and What Happens Next

Randy Evans, Dentons (Atlanta)

# Trump's First 100 Days and What Happens Next

**Randy Evans**
Partner, Dentons

J. Randolph ("Randy") Evans is a partner at Dentons, the largest law firm in the world. He is a litigator, author and columnist, and is proficient in handling complex matters involving high-profile, high-exposure challenges for clients around the world. Currently, he serves as co-chairman of the Georgia Judicial Nominating Commission, the chairman of the Republican National Lawyers Association and the Georgia committeeman for the Republican National Committee. Randy has also been appointed to serve as a member of the ABA's Standing Committee on Governmental Affairs.

# Lunch break

# US and International Perspectives on Own Risk and Solvency Assessment (ORSA)

## Panelists:

Bruce Baty, Dentons (Kansas City)
Hartley Lefton, Dentons (Toronto)
Martin Mankabady, Dentons (London)

# Quick Recap: What is an ORSA

- It is an own risk and solvency assessment
- Undertaken to assess the adequacy of risk management and current and prospective solvency positions under normal and severe stress scenarios
- Key management tool/arguably the cornerstone of a risk-based prudential regime
- It will require insurers to analyze all reasonably foreseeable and relevant material risks (i.e., underwriting, credit, market, operational, liquidity risks etc.) that could have an impact on an insurer's ability to meet its policyholder obligations
- Insurers and/or insurance groups are required to articulate their own judgment about risk management and the adequacy of their capital position
- It is intended to be a continuous evolving process
- It has been adopted in number of countries/regions e.g.
  - US
  - Canada
  - Europe

# The Genesis of ORSA in the US

- In 2008, the AIG Financial Products unit based in London, a non-insurance component of the AIG holding company system, took on huge losses from risky investments
- The near collapse of AIG's holding company system prompts US insurance regulators to reevaluate their group supervisory framework and pay closer attention to the risks created by activities going on outside of those entities as well as the reputational and contagion issues that could exist - NAIC launches the Solvency Modernization Initiative (SMI)
- In November 2011, as part the NAIC's SMI, the NAIC voted to adopt a significant new addition to U.S. insurance regulation: the US Own Risk and Solvency Assessment (ORSA)
- The NAIC Risk Management and Own Risk and Solvency Assessment Model Act (#505) went into effect on Jan. 1, 2015. Under Model (#505), large and medium size US insurers and insurance groups are required to regularly perform an ORSA and file a confidential ORSA Summary Report of the assessment with the regulator of each insurance company upon request, and with the lead state regulator for each insurance group whether or not any request is made
- ORSA applies to any individual U.S. insurer that writes more than $500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than $1 billion of annual direct written and assumed premium

# The Genesis of ORSA in the UK

- IAIS a key proponent of ORSA
- Europe a driving force behind it
- UK's ICAS regime involved risk evaluation and reporting on capital requirements
- ORSAs feature across the globe
  - Some differences
  - Key requirements/challenges similar
- Solvency II ORSA
  - Emphasis on governance
  - Key plank of ERM
  - Covers every legal entity/group as a whole
- Key issue
  - What will happen in the event of a "hard" Brexit?

# The Genesis of ORSA in Canada

- OSFI focus on “principles-based”/”risk-based” approach to regulation
- Solvency II ORSA
  - Emphasis on governance of federally-regulated financial institutions (including branches in Canada of foreign companies)
  - Key plank of ERM
  - Covers every legal entity/group as a whole
- Generally consistent with the ORSA process around the world, including US and UK
  - Insurers in Canada are entering their fourth ORSA cycle
- Key issue in 2017
  - Integration of IFRS 9 and capital risk
- Key broader issues
  - What will a regulator do with ORSAs?  What is a “good” ORSA, since the guideline is so general?

# ORSA in the US

- An insurer or insurance group subject to ORSA is expected to:
  - Regularly, no less than annually, conduct an ORSA to assess the adequacy of its risk management framework, and current and estimated projected future solvency position
  - Internally document the process and results of the assessment
  - Provide a confidential high-level ORSA Summary Report annually to the lead state commissioner if the insurer is a member of an insurance group and, upon request, to the domiciliary state regulator

# ORSA in the US (cont.)

- First ORSA reports filed in 2015
- 2016 - first year insurance regulators will review ORSA Summary Reports
- State insurance regulators, going forward, will assess the regulatory value of these reports and to what extent the information provided enhances their risk-focused surveillance of insurance groups
- The majority of states have adopted Model #505; required by the end of 2017 for accreditation purposes
- The NAIC estimates about 300 reports will be filed every year, once all states have adopted Model #505, of which approximately 200 will be at group level and 100 at single-entity level

# ORSA in the US: Financial Exams

- Financial examiners will review the overall risk-management function of an insurer and the ORSA report-development process and work papers
- The exam will cover the insurer's processes for identification of risks throughout the company that could threaten solvency, risk-mitigation strategies, internal controls, and control implementation
- Regulators want to understand the frequency at which information on each critical risk area is reported to and reviewed by senior management and the Board:
  - the review and approval of the ORSA summary report
  - the actuarial function on the adequacy of reserve provisions
  - the prospective solvency position of the insurer
  - investment decision-making processes
  - reinsurance decision-making processes
  - business strategy/finance decision-making processes
  - the compliance function
  - financial reporting/internal audit processes
  - major marketing initiatives
  - information on reasonably foreseeable prospective risks
  - market conduct decision-making processes

# ORSA in the UK/EU

# ORSA in the UK/EU

- Some pilots/interims 2014-2015 - requirement as from 1 January 2016
- EIPOA guidelines
  - Non-prescriptive/customised assessment
- Key documents
  - ORSA policy (including framework)
  - ORSA report (summary, key issues, forward looking assessment)
  - Supporting evidence of board sign-off
  - MI (eg ORSA dashboard)
- Potential risks
  - Include emerging/group-wide
  - How link to risk appetite/risk tolerances
  - Mitigating actions/impact on strategy
- Capital/solvency
  - Future position
  - Position of group/key subsidiaries
  - Availability/transferability of own funds

# ORSA in Canada

- First ORSA reports filed in 2014
- Board/Committees
  - Risk – What are our business risks?  What risks are we comfortable taking on?
  - Capital – What do we need?  Do we have enough?  What is our buffer?
  - Check on Management
- Regulator's Supervisory Review
  - Reviews the ORSA/ORSA Report to Board against its own understanding of the insurer's risk appetite and profile
  - Will review ORSA's in varying depths and frequencies
  - But also hands-off
    - "The supervisory review of the ORSA is not intended to prescribe how an insurer should perform, use or report on its ORSA."

# ORSA in Canada

- Quantitative and Qualitative
- Used as a reference point of all applicable risks
- Check on capital
- Check on stress-tests

# Issues for Panel Discussion

1. How is the ORSA regime generally bedding in?
2. Is the forward-looking nature of the ORSA its most challenging aspect?
3. What does stress-testing look like in practice?
4. What are some of the key risks being identified? what impact (if any) is this having on capital/strategy etc.?
5. Is the ORSA part of an increasing trend of regulatory convergence?

# A Conversation With Former NYDFS Executive Deputy Superintendent Maria Filipakis

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# A Conversation With Former NYDFS Executive Deputy Superintendent Maria Filipakis

**Matthew Gaul**
Partner, Dentons

**Maria Filipakis**
Former NYDFS Executive Deputy Superintendent

Matt Gaul is a former insurance regulator and securities enforcement attorney for the state of New York, who represents insurance companies and other financial institutions in government investigations and complex regulatory matters.

Prior to re-entering private practice, Matt spent almost seven years in New York state government serving in various capacities. Most recently, he was deputy superintendent for Life Insurance in the New York State Insurance Department (now the Department of Financial Services), where he oversaw regulation of the financial solvency and sales practices of life insurers in the state. Matt also served in the New York State Attorney General's Office as chief of the Investor Protection Bureau, leading the enforcement of the state's securities law (commonly known as the Martin Act) under Attorney General Andrew Cuomo. Before that he spearheaded a number of major fraud and antitrust cases touching the insurance industry under Attorney General Eliot Spitzer.

Maria Filipakis is a Managing Director at Global Atlantic Financial Company heading the company's regulatory and government affairs and strategies. Prior to joining Global Atlantic, Ms. Filipakis was the Executive Deputy Superintendent of the Capital Markets Division at the New York State Department of Financial Services. In that role, she led the department's cybersecurity, fintech and virtual currency initiatives. Ms. Filipakis supervised a staff providing expertise in capital markets, risk management, and financial analysis to the department, as well as monitoring and regulating the latest developments, trends, and products in the financial services marketplace. Before joining the department, she held senior positions at the New York State Insurance Department and Attorney General's Office, including running the Investor Protection Bureau.

# Break

# Insurance Technology and Technology Insurance: Drones and Highly Autonomous Vehicles

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Panelists:

Anthony R. Moschetta, Global Aerospace
Mark McKinnon, Dentons (Tysons)
Eric Tanenblatt, Dentons (Wash., DC)

Moderator:

Matthew Gaul, Dentons (New York)

# Overview

- **Drones/UAV**
  - History
  - Regulation
  - New Risks & Liability Issues
  - Insurance Implications
- **Driverless Cars/HAV**
  - History
  - Regulation
  - Decreasing Risks & Shifting Liability
  - Insurance Implications
- **Compare and Contrast**


# DRONES

21st Century Technology Meets the Insurance Industry

# A Very Brief History of Drones

- 1898 – Nikola Tesla demonstrated a radio-controlled, small unmanned boat
- WW II – Various radio-controlled unmanned aircraft are developed for target practice
- 1995 – The MQ-1 Predator UAV enters service
- 2010 – The Parrot AR Drone, a smartphone-controlled quadcopter is introduced to the public
- 2012 – Congress requires the FAA to integrate small drones into the national airspace
- 2013 - Amazon unveils the concept of a drone delivery service
- September 2014 – FAA issues the first Section 333 exemption

# A Very Brief History of Drones (cont.)

- March 2015 – A drone flight is demonstrate at the NAIC conference in Phoenix, Arizona
- August 2015 – FAA releases B4UFLY smartphone app
- December 2015 – Anticipating Santa will leave tens of thousands of drones under Christmas trees, the FAA requires drone registration
- August 29, 2016 – 14 CFR Part 107 goes into affect: “The rule establishes a framework for the routine operation of small UAS for commercial purposes and provides the UAS industry with the clarity it needs to grow and thrive.” But does not mandate that commercial operators obtain insurance.
- March 2017 – US Air Force states that it now has a greater need for Drone pilots than traditional manned aircraft

# FAA Aerospace Forecast for 2017 – 2037

- Predicts tremendous growth in “nearly every aspect of air transportation” over the next five years, including UAS
- The small UAS commercial fleet will grown tenfold to 420,000 by 2021 (but notes that the scope of permissible operations is inextricably linked to the regulatory regime)
- There are over 600,000 registered hobbyists which corresponds to an estimated 1.1 million small UAS
- As of December 31, 2016 – over 29,000 Remote Pilot Licenses have been issued

# What Does the Future Hold for Civilian Aviation – Autonomous Flight Operation?

- Will the need for “Drone Programmers” replace the need for “Drone Pilots”?

- As with land vehicles, will we soon be traveling in autonomous aircraft?

# Regulation: Are “Unmanned Aircraft” Really Aircraft?

- Huerta v. Haughwout
  - UAS are aircraft
  - FAA has broad investigative authority
  - 14 C.F.R. 91.13 can be used in UAS enforcement matters
  - Limits of the Commerce Clause raised but left for another day

# Regulation: BVLOS - What is the Risk the Regulators are Mitigating?

# Regulation: BVLOS - What is the Risk the Regulators are Mitigating?

# Risk & Liability: Micro UAS - What is the Risk?

- 2.5 pound object falling from 30 feet – 50%

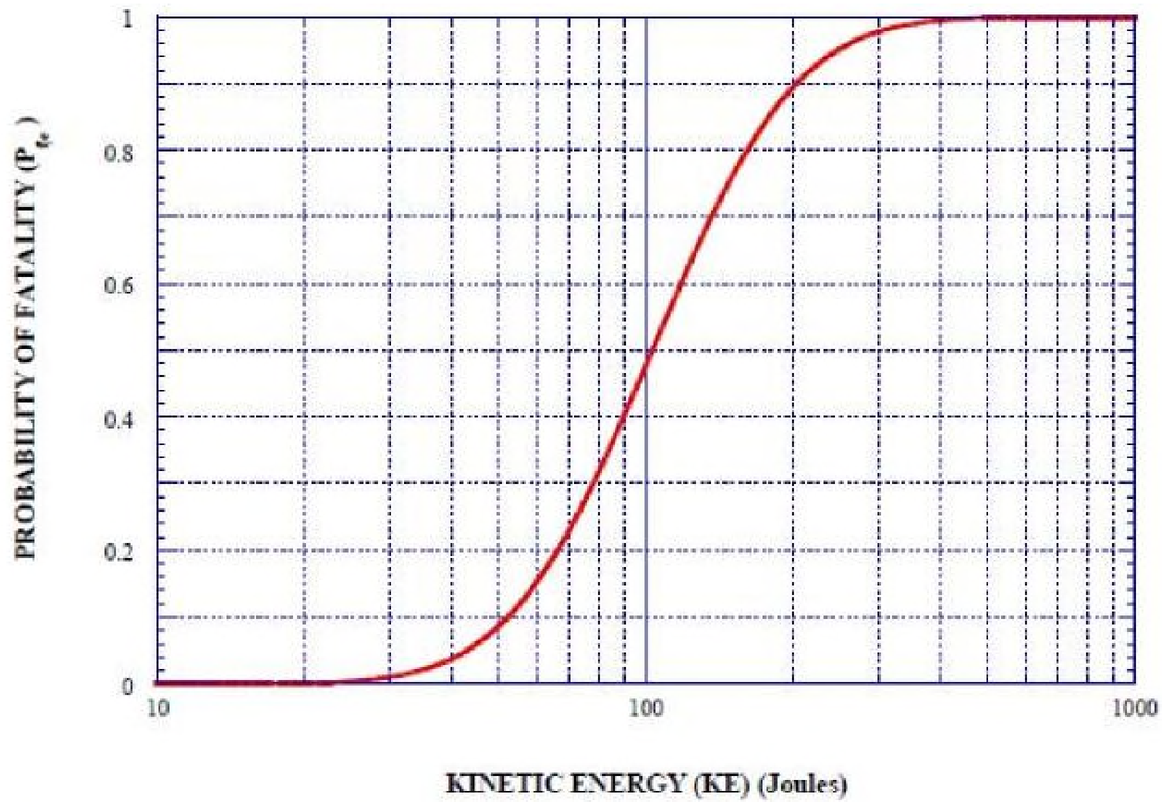



FIGURE 11. KINETIC ENERGY VERSUS PROBABILITY OF FATALITY

# Risk & Liability:
# What Does a UAS Lawsuit Look Like?

- Plaintiff was a corporate CFO
- Full thickness corneal laceration
- Emergency surgery
  - Medical Expenses, Lost Income for "Extended Period of Time," Lost Opportunities and Growth for the Company, Hedonic Damages
- Strict Liability
- Negligence
- Breach of Warranty
- Colorado Consumer Protection Act
  - Treble Damages, Attorney Fees, Costs
- Loss of Consortium
  - Wife has Suffered Loss of Time, Income, Consortium, Affection, Love, Support, Care, Society, Comfort, Companionship, Services

# What Does a UAS Lawsuit Look Like? (cont.)

- Parrot Rolling Spider Minidrone

# What Does a UAS Lawsuit Look Like?
# The Search for the Deep Pocket

- Parrot S.A.
- Parrot Drones S.A.S.
- Parrot Inc.
- Parrot Asia Pacific (Shenzhen) LTD
- Sensefly
- PIX4D, S.A.
- Pix4D Inc.
- MICASENSE, S.A.
- Airinov S.A.S.
- Iconem
- EOS Innovation
- Biocarbon Engineering Ltd.
- John Does 1-40

# Drone Insurance

- Who are the customers for Drone Insurance?
- Which industry sector(s) will write Drone Insurance?
- What coverages are available?
- What are insurance regulators thinking?
- What rates will be charged?
- How will technology impact Drone Insurance?

# Who are the Customers for Drone Insurance?

- Agriculture – crop management
- Film, Journalism, TV (Sports)…remember Lady Gaga's Super Bowl performance
- Real Estate
- Construction
- Police, Fire and Rescue
- Educational Institutions
- Power, Oil and Gas
- Telecommunications
- Insurance – Underwriting and Claims
- Hobbyists

# But Don’t Forget …

- Drone service providers and consulting companies: e.g., MEASURE-AERO.COM and HIREUAVPRO.COM
- Manufacturers – Hardware and Software
- Companies that hire third-party drone services
- Drone Racing

# Which Industry Sector(s) Will Write Drone Insurance?

- Will it be the aviation specialty market or will it find a home with the traditional property/casualty market … or both?
- Industries utilizing Drones are going to the markets they know first (Is a Drone just another machine the construction industry or photographers insure through their standard business policies?)
- Most homeowners' policies exclude "aircraft" with the exception of model or hobby aircraft not used or designed to carry people or cargo.

# What Coverages Are Available?

- Hull and Payload Coverage (Hobbyist & Commercial)
- Third-party personal injury and property damage
- Product Liability & Grounding Coverages for Manufacturers

  But what about …

- Invasion of Privacy?
- Regulatory liability?
- Cyber risk?

# What Are the Insurance Regulators Thinking?

- Insurance Companies were among the early commercial operators who sought special waivers from the FAA
- Early efforts to seek approval of a UAS Hull and Liability policy modeled on the form used for traditional aircraft – concerns centered on whether flight operations would comply with FAA regulations
- Use of GPS mapping and short duration policies to provide coverage
- Rating UAS risks … that’s the next question.

# What Rates Will Be Charged?

"Insurance rates are built on rigorous actuarial standards and subject to strict regulation."

- Who is collecting Done premium and loss data?
- Do we have sufficient data for evaluating drone risks?
- If categorized as "aircraft" – rate regulation may be exempt in many states.

# How Will Technology Impact Drone Insurance?

- Skyward (recently acquired by Verizon) provides a drone management platform
- Verifly provides on-demand drone insurance through your smartphone
- Flock (based in the UK) provides real-time analytic platform flight planning
- Airware provides drone operating system

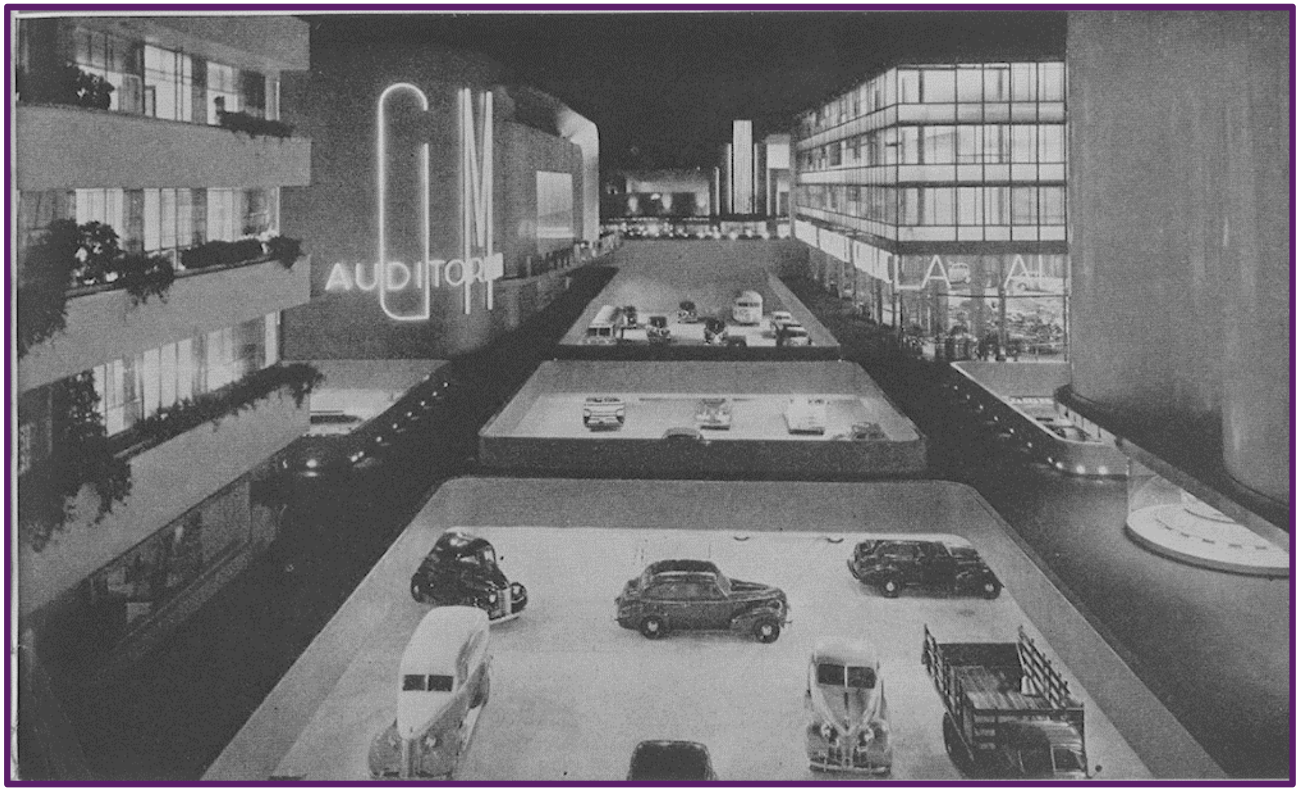
# Driverless Cars

# History of Autonomous Vehicles: Long Imagined

- More than 500 years after Leonardo Da Vinci built his famed robotic cart, which was self-propelled and capable of pre-programmed maneuvering, the world will finally enter the era of the true *auto*mobile: driverless cars.

# History of Autonomous Vehicles: Long Imagined (cont.)

- Driverless cars first entered the collective imagination at the close of the Great Depression, when a presenter at GM's Futurama Exhibit at the 1939 World Fair envisioned a future in which cars would drive themselves.



# History of Autonomous Vehicles: Long Imagined (cont.)

- In 2010, Google launched a fleet of seven autonomous Toyota Prius hybrids. The cars required the presence of a human safety fallback, but safely negotiated the pitfalls of San Francisco traffic and the winding roads of Lake Tahoe in early tests. The cars used radars, lasers, cameras, and GPS to map the surrounding area.

# History of Autonomous Vehicles: Long Imagined (cont.)

- Google didn't commercialize the cars immediately, leaving open the door for traditional car makers like Mercedes, Audi, and Volvo to begin piloting HAV programs.
- Now, nearly every major car manufacturer is working to unveil autonomous offerings by 2020. Technology firms have also jumped into the void, in particular those with interests in autonomous taxis, like Uber, Lyft, NuTology, and Waymo.

# Autonomy Around the Globe

- In 2016, Volvo launched an autonomous pilot program in Sweden designed to put HAV technology in the hands of ordinary motorists (rather than engineers).
- Also in 2016, the Queen's Speech included a modern transport plank to support the introduction and regulation of HAV technology in the United Kingdom. Last month, British lawmakers made good on that by introducing legislation allowing for self-driving cars and stipulating rules for insurance. Under the bill, HAV cars must be insured while in manual operation and autonomous operation. (Those injured in crashes will pursue liability claims against manufacturers.)
- Japanese government and business began collaborating last year to lay the regulatory and technological foundation to make Tokyo a self-driving city by 2020, in time for Summer Olympic Games.

# The Levels of Autonomy

- The National Highway Traffic Safety Administration rates autonomy—that is, the level of human or alternatively computer operation of a vehicle—at five graduated tiers.
- Generally speaking, only Level Three Autonomy vehicles are available today for ordinary motorists.
- Levels Zero and One: Human driver monitors the driving environment
  - Zero, no automation: Full-time performance by a human driver of all aspects of all driving tasks (cars circa 20 years ago)
  - One, driver assistance: A driver assist system of either steering or acceleration and deceleration coupled with requirements that a human driver perform remaining dynamic tasks

# The Levels of Autonomy (cont.)

- Levels Two and Three: Driver remains in broad control, ceding certain controls at certain times to the vehicle
  - Two, partial automation: Driver-assist systems control both steering and acceleration and deceleration by intelligently processing environmental information, while the human driver performs remaining dynamic tasks.
  - Three, conditional automation: Automated driving systems perform all aspects of the driving task, with expectation that a human driver will respond and intervene when and where necessary.

# The Levels of Autonomy (cont.)

- Levels Four and Five: the Moon Shot

  - Four, high automation: Performance by an automated driving system of all aspects of the driving task within defined geographic cordons (i.e., college campuses, business districts)
  - Five, full automation: The full performance of driving by an automated driving system under all roadway and environmental conditions. Human intervention is not required, so conventional aspects of the car--steering wheels, acceleration/deceleration pedals--are removed.

# Five Major HAV Benefits to Society

- **Safety**: More intelligent cars will dramatically reduce the staggering loss of life each year in automobile accidents.

- **Savings** of time, fuel: Autonomous vehicles will empower drivers to reclaim commutes while expending less fuel.

- **Land optimization**: With proliferation of HAV taxi fleets, parking structures will prove obsolete, allowing for their redevelopment into possible green spaces.

- **Fleet automation**: Big rig trucking is dramatically understaffed, but HAV technology will help fill the widening manpower gulf.

- **Mobility**: Self-driving cars will liberate those who cannot operate a vehicle (elderly)

# Regulatory Landscape: It's Complicated

- Finally, technology is catching pace with imagination. The same, however, cannot be said of law and regulation.
- Last year, the National Highway Traffic Safety Administration (NHTSA) issued federal guidelines for the testing and deployment of highly autonomous vehicles (HAV).
  - They were merely guidelines, not sophisticated rules. Traditional rule-making takes years, some times as many as eight.
- Rather than creating a formal regulatory regime, NHTSA asked HAV pioneers to satisfy a 15-point safety checklist to pre-certify their vehicles, including data-recording, privacy, and safety thresholds. The document was broadly in favor of HAV technology, citing its potential to reduce the more than 35,000 vehicle-related deaths each year.

# States in Regulatory Arms Race

- In its long-awaited federal automated vehicles policy guidance, NHTSA urged the states to allow the federal government to regulate autonomous vehicles.
- NHTSA hoped to avoid a patchwork framework in which driverless cars could operate in one state, but veer into illegal territory when it crossed a state's border into another.
- Because the federal guidance was not binding for the states, state legislators and regulatory agencies have vaulted into action.

# Barreling Towards a 50-State Regulatory Patchwork

- The number of state legislation concerning the testing or commercial application of HAV tech has risen each year for the last four years.
  - So far, HAV bills were introduced in 27 state legislatures this year. That's up from the 20 that were introduced last year and the 15 the year prior.

- Since 2011, when Nevada became the first state to authorize the operation of driverless cars, at least 34 states and Washington D.C. have considered legislation related to autonomous vehicles.
  - Of them, 13 states--Alabama, Arkansas, California, Florida, Georgia, Louisiana, Michigan, Nevada, North Dakota, Pennsylvania, Tennessee, Utah, and Virginia--have adopted driverless tech laws.
  - Separately, governors in Arizona and Massachusetts issued autonomous vehicles executive orders.

# Big Questions for Policy Makers, Regulators

- The primary areas of policy makers and regulators hope to address include:
  - The allowance of platooning--cars tracking closely together, often at high speeds--that is considered unsafe when humans are behind the wheel;
  - Cyber security of the car's systems; and
  - Ethical moral quandaries: how will the car's programs determine the most ethical action if all outcomes lead to injury or death?
  - The collection of vehicle data;
  - Licensing, registration, and inspection requirements;

# Consequences for Insurance, Safety

- In 2015, more than 35,000 people died on U.S. roadways.
  - 94 percent of crashes are the result of human error, choice, or behavior.
- Federal regulators believe that highly autonomous vehicles will catalyze unprecedented levels of safety.
  - Technologists and regulators believe that sensor and mapping technologies will reduce the number and severity of collisions.
- Safer cars make for safer roads. Safer roads make for reduced premiums.
- Safety and low insurance premiums will push widespread adoption of technology
  - Tesla experiment in offering insurance coverage with sale of car with autonomous features
- Provocative question: will children born today ever learn to drive? Will their parents let them?

# Consequences for Insurance, Safety (cont.)

- After completing a six-month investigation into a fatal accident involving a Tesla, the National Highway Traffic Safety Administration found that Tesla **vehicle crashes dropped by 40 percent after the release of the car maker's "autopilot" system**.

  - The autopilot program is an advanced driver assistance program, still short of full automation, that includes features like traffic-aware cruise control (TACC) and "Autosteer," which marries information from forward-looking cameras, radars and ultrasonic sensors to detect lane markers and the presence of other vehicles and objects.

# Consequences for Insurance, Safety (cont.)

- VIDEO - Tesla Autopilot predicts crash on Autobahn

# Consequences for Insurance, Safety (cont.)

- Autonomous--that is, safer--vehicles will radically alter the balance equation between risk (drivers) and capital (insurance companies).

- Premiums for U.S. auto insurers may plummet as much as 40 percent by 2050 with full adoption of autonomous vehicles, according to a report issued late last year by reinsurance broker Aon Plc.
  - By 2035, U.S. premiums could fall by 20 percent from 2015's rates if the technology is adopted by even moderate levels
  - Personal auto insurance accounts for 47 percent of global insurance premium

- The prediction makes several important assumptions:
  - A dramatic claims reduction balanced by expectation in higher claims severity. The practice of affixing sensors to bumpers leaves them vulnerable to damage in the event of an accident, according to Aon.

# Liability in the Age of Truly Automated Cars

- Hacker attacks or faulty software could shift the burden of legal and regulatory liability away from drivers and towards manufacturers or, in the case of ride-sharing autonomous vehicles, the owner(s) of the autonomous fleet.

- Entirely new models to assign liability will be required.
  - Is a car maker at fault if a distracted driver, relying on an autopilot system, causes an accident?
  - Is a car market at fault if a car's systems were hacked, causing an accident?

# Regulatory Landscape in Canada

The Right Honourable Stephen Harper,
former Prime Minister of Canada

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# Closing Remarks

Matthew Gaul, Dentons (New York)