CIPR Spring Event:

Insurance and Technology

April 5, 2016
3:00 p.m. – 5:00 p.m.
New Orleans, Louisiana

WELCOME MESSAGE

Welcome to the NAIC Center for Insurance Policy and Research (CIPR) Event: *Insurance and Technology*. The mission for the CIPR is to serve federal and state lawmakers, federal and state regulatory agencies, international regulatory agencies, and insurance consumers, by enhancing intergovernmental cooperation and awareness, improving consumer protection and promoting legitimate marketplace competition. To help achieve this mission, the CIPR hosts four annual events that bring together a number of dynamic and informative speakers and panelists. These events offer a forum for opinion and discussion on major insurance regulatory issues.

The nature of the insurance industry creates a unique set of issues and challenges around technology. This event will cover a variety of recent technology trends that could have an impact on the industry, including: peer-to-peer insurance and the regulatory challenges for this market disruptor; the use of BitCoin and BlockChain Technologies in the insurance industry; underwriting and regulatory challenges for electronic currency companies; and the use of “Big Data” and its impact on auto insurance, including price optimization.

While you are here, I encourage you to take some time to explore the French Quarter and downtown New Orleans. I hope you enjoy the event and your stay!

Sincerely,
Eric Nordman
Director of CIPR and Regulatory Services

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MEET THE CIPR TEAM

Eric Nordman, CPCU, CIE, is the director of the NAIC Regulatory Services Division and the CIPR. He directs the Regulatory Services Division staff in a wide range of insurance research, financial and market regulatory activities, supporting NAIC committees, task forces and working groups. He has been with the NAIC since 1991. Prior to his appointment as director of the Regulatory Services Division, Mr. Nordman was director of the Research Division and, before that, the NAIC senior regulatory specialist. Before joining the NAIC, he was with the Michigan Insurance Bureau for 13 years. Mr. Nordman earned a bachelor's degree in mathematics from Michigan State University. He is a member of the CPCU Society and the Insurance Regulatory Examiners Society.

Kris DeFrain is the NAIC Director of the Research and Actuarial Department. She is currently charged as primary NAIC staff for the Principle-Based Reserving and the Casualty Actuarial and Statistical Task Forces. She manages a staff of actuaries, statistical analysts, insurance contract experts, economists, and research analysts working on regulatory solvency and market-related issues, providing regulatory services, and conducting research for the Center for Insurance Policy and Research. She received her bachelor's degree in finance/actuarial science from the University of Nebraska in 1989. Ms. DeFrain received her FCAS designation from the Casualty Actuarial Society (CAS), where she previously served as Vice President—International. She is a member of the American Academy of Actuaries and a Chartered Property and Casualty Underwriter.

Shanique (Nikki) Hall is the manager of the NAIC Center for Insurance Policy and Research. She joined the NAIC in 2000 and currently oversees the research, production and editorial aspects of the CIPR's four primary work streams; the CIPR Newsletter, studies, events and website. Ms. Hall has extensive capital markets and insurance expertise and has authored copious articles on major insurance regulatory and public policy matters. She began her career at J.P. Morgan Securities as a research analyst in the Global Economic Research Division. At J.P. Morgan, Ms. Hall analyzed regional economic conditions and worked closely with the chief economist to publish research on the principal forces shaping the economy and financial markets. Ms. Hall has a bachelor's degree in economics and an MBA in financial services. She also studied abroad at the London School of Economics.

Anne Obersteadt is a researcher with the NAIC Center for Insurance Policy and Research (CIPR). Since 2000, she has been at the NAIC performing financial, statistical and research analysis on all insurance sectors. In her current role, she has authored several articles for the CIPR Newsletter, a CIPR Study on the State of the Life Insurance Industry, organized forums on insurance related issues, and provided support for NAIC working groups. Before joining CIPR, she worked in other NAIC Departments where she published statistical reports, provided insurance guidance and statistical data for external parties, analyzed insurer financial filings for solvency issues, and authored commentaries on the financial performance of the life and property/casualty insurance sectors. Prior to the NAIC, she worked as a commercial loan officer for U.S. Bank. Ms. Obersteadt has a bachelor's degree in business administration and an MBA in finance.

Dimitris Karapiperis joined the NAIC in 2001 and he is a researcher with the NAIC Center for Insurance Policy and Research. He has worked for more than 15 years as an economist and analyst in the financial services industry, focusing on economic, financial market and insurance industry trends and developments. He studied economics and finance at Rutgers University and the New School for Social Research, and he developed an extensive research background while working in the public and private sector.

Learning Objectives

At the completion of this program, attendees will be able to:

- Explain how peer-to-peer (P2P) insurance works
- Identify potential regulatory challenges with peer-to-peer structures
- Explain how Lemonade could function as a market disruptor
- Explain how Bitcoin and Blockchain work
- Explain insurance coverage challenges and potential solutions related to electronic currency
- Identify the current regulatory landscape for electronic currency
- Explain how Big Data is employed in the auto insurance industry
- Identify different types of Big Data
- Identify the potential benefits and concerns of Big Data related to availability or affordability of insurance
- Identify what information regulators should collect to study the availability and affordability of auto insurance

This is a NAIC Insurance Regulator Professional Designated program eligible for two hours of continuing professional development credit. To receive credit, you will need to write down the codes provided periodically throughout the program and provide them in a survey that will be sent to the email address you provided during registration. The survey can be found at the following link: https://www.surveymonkey.com/r/JCJZWKB.

CIPR Event: Insurance and Technology

As of 3/14/16

April 5, 2016
Sheraton—Armstrong Ballroom—8th Floor
New Orleans, LA

2:00 Registration Check-in

3:00 Welcome & Introduction

~ *John M. Huff, Director*
Missouri Department of Insurance

3:10 Session 1: The Impact of Technological Advances on the Insurance Industry

This presentation will discuss peer-to-peer insurance and the regulatory challenges for this market disruptor.

~ *Ty Sagalow, Chief Insurance Officer*
Lemonade

3:40 Session 2: The Use of BitCoin and BlockChain Technologies in the Insurance Industry

This presentation will explore why insurers have been hesitant to underwrite coverage for electronic currency companies and what can be done to make this an insurable risk. Additionally, the session will discuss the current regulatory landscape for these technologies

~ *Dan Robles, Director*
The Ingenesist Project

4:10 Session 3: Big Data Panel

This panel discussion will explore the impact of Big Data on auto insurance, including price optimization, availability and affordability data; and leveraging NAIC data collection and validation expertise to assist regulators in converting Big Data to useful information.

Moderator:

~ *Laura Cali, Commissioner*
Oregon Insurance Division

Panelists:

~ *Jim MacGinnitie, Senior P/C Fellow*
American Academy of Actuaries

~ *David Snyder, Vice President, International Policy*
Property Casualty Insurers Association of America (PCI)

~ *Birny Birnbaum, NAIC Consumer Liaison*
Center for Economic Justice

~ *Ray Farmer, Director*
South Carolina Department of Insurance

5:00 Closing Remarks

~ *John M. Huff, Director*
Missouri Department of Insurance

CIPR Event: Insurance & Technology Presenter Biographies

BIRNY BIRNBAUM
CONSULTING ECONOMIST & EXECUTIVE DIRECTOR
CENTER FOR ECONOMIC JUSTICE

Birny Birnbaum is an economist and former insurance regulator whose work focuses on insurance regulatory issues. He serves as an economic adviser to and Executive Director for the Center for Economic Justice, a Texas non-profit organization, whose mission is to advocate on behalf of low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance.

Mr. Birnbaum has authored reports and testimony for numerous public agencies and consumer organizations, covering a wide variety of topics, including analysis of insurance markets, rating and risk classification, auto, homeowners and flood insurance, consumer credit insurance, title insurance and insurance credit scoring. He has served for many years as a designated Consumer Representative at the National Association of Insurance Commissioners and routinely speaks to the National Conference of Insurance Legislators. He is a member of the Federal Advisory Committee on Insurance, chairing the Subcommittee on Affordability and Availability of Insurance. He has served as an expert witness on a variety of economic and actuarial insurance issues before regulatory agencies and in litigation.

Mr. Birnbaum served as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, he provided technical and policy analysis and advice to the Commissioner of Insurance. He was also responsible for the development of data collection programs for market surveillance and the analysis of insurance market for competition. Prior to coming to the Department, Mr. Birnbaum was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issues. OPIC is a Texas state agency whose mission is to advocate on behalf of insurance consumers.

Mr. Birnbaum was educated at Bowdoin College and the Massachusetts Institute of Technology. He holds two Master's Degrees from MIT in Management and in Urban Planning with concentrations is finance and applied economics.

LAURA CALI
COMMISSIONER
OREGON INSURANCE DIVISION

Laura Cali, an actuary who led the Oregon Insurance Division through the review of 2014 health plan rates amid major reforms, became Oregon insurance commissioner on July 15, 2013.

The division hired Commissioner Cali in mid-2011 as a casualty actuary specializing in workers' compensation and medical malpractice. She previously worked as a consulting actuary for Towers Watson in San Francisco, overseeing projects for self-insured companies, public entities, and insurers. She started her career at Liberty Mutual's home office in Boston, building rating models for workers' compensation and general liability lines of business.

While her area of expertise is in property and casualty insurance, Commissioner Cali became heavily involved in health insurance issues in 2012-2013 as chief actuary and manager of the division's product regulation section. In that position, she helped lead the division's efforts to ensure that health insurers comply with the Affordable Care Act by Jan. 1, 2014.

Commissioner Cali grew up in Sonoma, California, and received her Bachelor of Arts degree in mathematics and economics from Boston University. She is a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries. In her free time, she enjoys cooking, swimming and watching baseball.

RAY FARMER
DIRECTOR
SOUTH CAROLINA DEPARTMENT OF INSURANCE

Ray Farmer was appointed by Governor Nikki Haley to serve as Director for the South Carolina Department of Insurance November 13, 2012. With more than forty years experience, Director Farmer received his degree in insurance from the University of Southern Mississippi and earned his law degree from Atlanta's John Marshall Law School.

Director Farmer served as the Deputy Insurance Commissioner of the Enforcement Division for the Georgia Department of Insurance and, more recently, Vice President for the American Insurance Association. As a part of his service, Director Farmer has served for over thirty years on the Board of Directors of the Georgia Arson Control Program, an organization aiding fire fighters and prosecutors combating arson. He is a member of the State Bar of Georgia and a member of the Tort and Insurance Practice section, as well as, the Workers' Compensation section.

In 2012, Director Farmer was awarded the Herman Hass Award by the Independent Insurance Agents of Georgia for service to the insurance industry and in 2012 he received a Presidential Citation for Outstanding Service to the insurance industry from the Professional Insurance Agents of Georgia. Most recently, he was named Industry Person of the Year for 2014 by the Independent Agents and Brokers of South Carolina.

Director Farmer is a native of Atlanta and he and his wife, Gayle, have two children and five grandchildren.

JOHN M. HUFF
DIRECTOR
MISSOURI DEPARTMENT OF INSURANCE

PRESIDENT
NATIONAL ASSOCIATION OF COMMISSIONERS

John M. Huff, a native of Potosi, MO, was appointed director of the Missouri Department of Insurance (DOI), Financial Institutions and Professional Registration by Gov. Jay Nixon on Feb. 6, 2009. An attorney, he leads the department that protects consumers through the regulation of professionals and businesses that affect Missourians' lives daily.

Director Huff was elected by his peers to serve as the 2016 president of the NAIC, the national insurance standard-setting organization for the U.S.

In September 2010, he was appointed to the U.S. Financial Stability Oversight Council (FSOC) by the NAIC. Director Huff served two terms on the council and was the initial state insurance regulator appointed. The council was created by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Before entering public service, he spent 11 years as an executive with leading insurers and reinsurers, including Swiss Re and GE Insurance Solutions. Director Huff earned his bachelor's degree in business administration from Southeast Missouri State University. He earned an MBA at Saint Louis University, and his Juris Doctor degree from the Washington University School of Law in St. Louis.

W. JAMES (JIM) MACGINNITIE, MAAA, FCAS, FSA
ACTUARY & SENIOR PROPERTY/CASUALTY FELLOW
AMERICAN ACADEMY OF ACTUARIES

W. James (Jim) MacGinnitie is an actuary and the senior property/casualty fellow at the American Academy of Actuaries. He serves as the actuarial profession's chief public policy liaison on property and casualty insurance issues. In this role, he communicates the Academy's work on casualty actuarial issues relating to cybersecurity, catastrophic event risks, workers' compensation, medical professional liability, reinsurance, auto insurance, and other areas to the public and lawmakers.

Mr. MacGinnitie has over 50 years of experience in casualty actuarial and financial issues. Prior to joining the Academy as a fellow, he served on the boards of directors of several insurers and as an independent arbitrator and consultant. Previously, he served as senior vice president and chief financial officer of CNA Financial (Chicago), and partner and director of actuarial services at Ernst & Young (New York). Mr. MacGinnitie founded the casualty actuarial practice of Tillinghast and served as its managing principal both before and after its merger with Towers Perrin, now Towers Watson. He was also professor of actuarial science at the University of Michigan.

Mr. MacGinnitie is a member of the American Academy of Actuaries, a fellow of the Casualty Actuarial Society, and a fellow of the Society of Actuaries. He is a past president of the Academy (1988-89), the Casualty Actuarial Society (1979), the Society of Actuaries (2002), and the International Actuarial Association (2003). He received a bachelor's degree in mathematics from Northwestern University.

DANIEL R. ROBLES, PE, MBA
FOUNDER
THE INGENESIST PROJECT (TIP)

Daniel R. Robles PE, MBA is the founder of The Ingenesist Project (TIP) whose objective is to research, develop, and publish applications of blockchain technology related to the technical and financial services industries.

Mr. Robles currently serves as the Chairman of the FinTech Task Force for the National Society of Professional Engineers, as well as, a research fellow at the International P2P Foundation related to blockchain implementations. He is a serial panelist, moderator, and organizer at the Future of Money and Technology Summit in San Francisco. Earlier in his career, Mr. Robles participated in negotiations for the NAFTA Mutual Recognition Document, which sought to liberalize trade in professional and financial services between the US, Canada, and Mexico. This early experience was formative to his current activities.

As the owner of Coengineers, PLLC, Mr. Robles puts theory to practice in applying modern business methods to real problems in the construction industry. With half his career in construction and the other half in aerospace, his background also includes test engineering on the US Space Shuttle, Satellite ejection systems for Hughes Aircraft, and the commissioning of 777 aircraft for The Boeing Company.

Mr. Robles is known worldwide as blogger for http://www.Ingenesist.com, www.Insurancethoughtleadership.com, www.Coengineers.com, and several others. Mr. Robles resides in Edmonds, Washington with his family, and serves on the City of Edmonds Planning Board. He holds professional engineering licenses in Washington and California and a Master's Degree in International Business from Seattle University.

TY W. SAGALOW
CHIEF INSURANCE OFFICER
LEMONADE

Ty W. Sagalow is Chief Insurance Officer at Lemonade, and CEO of Lemonade Insurance Company, set to be the world's first peer to peer insurance carrier. For over 30 years, Mr. Sagalow served in senior capacities in the insurance industry, including 25 years at AIG as AIG's Chief Underwriting Officer and General Counsel (National Union), AIG's President of Product Development (AIG General Insurance) and Chief Operating Officer of AIG eBusiness Risk Solutions. Following AIG, Mr. Sagalow was Executive Vice President and Chief Innovation Officer at Zurich, North America and Chief Innovation Officer at Tower Group.

Mr. Sagalow is credited with creating many novel insurance products resulting in billions of premium dollars for the insurance industry, including Y2K Insurance, Cyber Insurance, Corporate Reputation Insurance, and Intellectual Property Collateral Insurance, among others. He was the host of the two innovation series produced by World Risk and Insurance News, *Innovations in Insurance With Ty Sagalow* and *What's New in Insurance Hosted by Ty Sagalow.* Mr. Sagalow is a frequent author and speaker on the subject of innovation in the insurance industry .

Mr. Sagalow is both an attorney and a licensed insurance broker. He is a cum laude graduate of Georgetown University Law Center and holds a LLM (Master of Laws) from New York University Law School.

DAVID F. SNYDER
VICE PRESIDENT, INTERNATIONAL POLICY
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI)

David F. Snyder is Vice President, International Policy, for the Property Casualty Insurers Association of America (PCI) in which capacity he covers international and domestic insurance regulatory and trade issues. He represents PCI members before numerous international, federal and state legislative and regulatory bodies, having made presentations in Amman, Basel, Beijing, Buenos Aires and Paris, among others. He is a member of the U.S. delegation to the OECD's Insurance and Private Pensions Committee and chairs the governance working group of the Global Federation of Insurance Associations.

Mr. Snyder graduated Magna Cum Laude from Dickinson College and earned his law degree from the George Washington University Law School. He is admitted to law practice in three jurisdictions and received the Chartered Property and Casualty Underwriter designation. His state and federal government experience includes appellate and civil litigation as well as administrative law. He worked for the Commonwealth of Pennsylvania in the Insurance Department as legislative liaison and hearing officer, later as a Deputy Attorney General in Torts Litigation and finally as General Counsel of the Commerce Department.

Mr. Snyder is serving his sixth term as a Falls Church, Va. City Council Member, having served as mayor and vice mayor. He chairs the National Capital Region Emergency Preparedness Council, an umbrella group that helps set and assess regional emergency preparedness priorities, and has chaired Washington, DC metropolitan regional transportation and environmental boards. When he was most recently chairman of the Metropolitan Washington Air Quality Committee, it was announced that the region has made significant progress in improving air quality and achieved compliance with a key EPA standard. He received the Metropolitan Washington Council of Governments regional leadership award in 2010. He is also Vice President of the Virginia Transit Association.

CIPR Spring Event: Attendee List (as of 3/21/16)

First Name	Last Name	Title	Company	Email	City	State
Francis	Abreo	Insurance Examination Supervisor	Alabama Dept of Ins	blase.abreo@insurance.alabama.gov	Montgomery	AL
Ian	Adams	Associate	Orrick, Herrington & Sutcliffe LLP	iadams@orrick.com	Sacramento	CA
Jean	Adams-Harris	Partner	Johnson Lambert LLP	jadams@johnsonlambert.com	Atlanta	GA
Maureen	Adolf	Senior Policy Adviser/Insurance	Sutherland Law	Maureen.adolf@sutherland.com	New York	NY
Nicole	Allen	SVP	Swiss Re	Nicole_Allen@swissre.com	Washington	DC
Charles	Angell	Deputy Commissioner & Actuary	Alabama Dept of Ins	charles.angell@insurance.alabama.gov	Montgomery	AL
Zata	Ard	Attorney, Office of Legal Services	Louisiana Dept of Ins	zard@ldi.la.gov	Baton Rouge	LA
Mark	Backe	Vice President & Insurance & Operations Counsel	Northwestern Mutual	markbacke@northwesternmutual.com	Milwaukee	WI
Sarah	Bailey	Insurance Specialist III	Alaska Div of Ins	sarah.bailey@alaska.gov	Juneau	AK
J. Kevin	Baldwin	General Counsel	Illinois Ofc of the Special Deputy	kbaldwin@osdchi.com	Chicago	IL
Brett	Barratt	Deputy Commissioner	Utah Ins Dept	bbarratt@utah.gov	Salt Lake City	UT
John	Bauer	Chief Counsel, Regulatory Affairs	NAIC	jbauer@naic.org	Kansas City	MO
Louis	Belo	Chief Deputy Commissioner	North Carolina Dept of Ins	Louis.belo@ncdoi.gov	Raleigh	NC
Christine	Benefield	Associate General Counsel & Vice President	AIG	christine.benefield@aig.com	Houston	TX
Susan	Bernard	Deputy Commissioner	California Dept of Ins	bernards@insurance.ca.gov	San Francisco	CA
Birny	Birnbaum	Director	Center for Economic Justice	birny@cej-online.org	Austin	TX
Kathleen	Birrane	OF COUNSEL	DLA Piper LLP (US)	kathleen.birrane@dlapiper.com	Baltimore	MD
Wes	Bissett	President	The Bellemore Group	wes@bellemoregroup.com	Baltimore	MD
Ralph	Blanchard	Vice President & Actuary	The Travelers Companies, Inc.	RBLANCHA@travelers.com	Hartford	CT
Richard	Bradley	Director of Market Conduct	Massachusetts Div of Ins	richard.bradley@state.ma.us	Boston	MA
Aaron	Brandenburg	Economist & Statistical Information Manager	NAIC	abrandenburg@naic.org	Kansas City	MO
Charles	Breitstadt	Sr. Gov. Rel. Director	Nationwide Mutual Ins	breitsc@nationwide.com	Columbus	OH
Sandy	Brower	Course Administration Supervisor	NAIC	sbrower@naic.org	Kansas City	MO
Lisa	Brown	Sr. Counsel & Director of Compliance Resources	American Ins Assoc	lbrown@aiadc.org	Washington	DC
Peg	Brown	Chief Deputy Commissioner	Colorado Div of Ins	peg.brown@state.co.us	Denver	CO
J'ne	Byckovski	Chief Actuary	Texas Dept of Ins	jne.byckovski@tdi.texas.gov	Austin	TX
Warren	Byrd	Deputy Commissioner	Louisiana Dept of Ins	wbyrd@ldi.la.gov	Baton Rouge	LA
Laura	Cali	Commissioner	Oregon Ins Div	laura.n.cali@oregon.gov	Salem	OR
Dean	Cameron	Director	Idaho Dept of Ins	dean.cameron@doi.idaho.gov	Boise	ID
Adam	Cancryn	Senior Reporter	S&P Global Market Intelligence	acancryn@snl.com	Charlottesville	VA
Gregory	Chew	Chief Insurance Market Examiner	Virginia State Corporation Commission	greg.chew@scc.virginia.gov	Richmond	VA
Virginia	Christy	Chief Assistant General Counsel	Florida Office of Ins Reg	Virginia.Christy@floir.com	Tallahassee	FL
Carolyn	Cobb	Vice President & Chief Counsel, Reinsurance & Int'l Policy	American Council of Life Insurers	carolyncobb@acli.com	Washington	DC
Megan	Collins	Manager, Corporate & Legislative Affairs	CUNA Mutual Group	megan.collins@cunamutual.com	Madison	WI
Michael	Consedine	SVP, Executive Director Government Affairs	Transamerica	michael.consedine@transamerica.com	Washington	DC
Todd	Coslow	Assistant Vice President	Federal Reserve Bank of Chicago	todd.coslow@chi.frb.org	Chicago	IL
Carrie	Couch	Director, Division of Consumer Affairs	Missouri Dept of Ins	carrie.couch@insurance.mo.gov	Jefferson City	MO
Nancy	Crespo	Manager of National Affairs	Insurance Services Office (ISO)	NCrespo@iso.com	Jersey City	NJ
Brenda	Cude	Professor	University of Georgia	bcude@uga.edu	Athens	GA
Richard	Daillak	Vice President	Swiss Re	Richard_Daillak@swissre.com	Armonk	NY
Deborah	Darcy	Director of Government Relations	American Kidney Fund	ddarcy@kidneyfund.org	Rockville	MD
Kris	DeFrain	Director, Research & Actuarial	NAIC	kdefrain@naic.org	Kansas City	MO
Angela	Dingus	Chief, Market Conduct Division	Ohio Dept of Ins	Angela.Dingus@Insurance.ohio.gov	Columbus	OH
Michael	Dinius	President	Noble Consulting Services, Inc.	mdinius@noblecon.net	Indianapolis	IN
Robert	Doucette	Deputy Superintendent of Insuarnce	New Mexico Ofc of the Superintendent	robert.doucette@state.nm.us	Santa Fe	NM
Anne Melissa	Dowling	Acting Director	Illinois Dept of Ins	AnneMelissa.Dowling@illinois.gov	Springfield	IL
Hardy	Drane	Deputy Commissioner	Delaware Dept. of Insurance	hardy.drane@state.de.us	Dover	DE
Elizabeth	Dwyer	Superintendent of Insurance	Rhode Island Div of Ins	elizabeth.dwyer@dbr.ri.gov	Cranston	RI
Jay	Eads	Special Assistant Attorney General	Mississippi Ins Dept	Jay.Eads@mid.ms.gov	Jackson	MS
Raymond	Farmer	Director	South Carolina Dept of Ins	rfarmer@doi.sc.gov	Columbia	SC
Rich	Fidei	Shareholder	Greenberg Traurig	fideir@gtlaw.com	Fort Lauderdale	FL
John	Fielding	Counsel	Steptoe & Johnson	jfielding@steptoe.com	Washington	DC
John	Finston	Deputy Commissioner & General Counsel	California Dept of Ins	john.finston@insurance.ca.gov	San Francisco	CA
Angela	Ford	Senior Deputy Commissioner	North Carolina Dept of Ins	angela.ford@ncdoi.gov	Raleigh	NC
Tiffany	Fosgate	Administrative Assistant	NAIC	tfosgate@naic.org	Kansas City	MO
John	Franchini	Superintendent	New Mexico Ofc of the Superintendent	john.franchini@state.nm.us	Santa Fe	NM
Diane	Fraser	Senior Policy Advisor	Financial Stability Oversight Council	Diane.Fraser@FSOC.gov	Washington	DC
Ann	Frohman	Attorney	Frohman Law Office	Ann@frohmanlaw.com	Lincoln	NE
Bryan	Fuller	Director	Examination Resources, LLC	bryanfuller@examresources.net	Kansas City	MO
Matthew	Gabin	Attorney	Mayer Brown LLP	mgabin@mayerbrown.com	New York	NY
Roman	Gabriel	Vice President	Prudential	roman.gabriel@prudential.com	Newark	NJ
Julie	Gackenbach	Principal	Confrere Strategies	julie.gackenbach@confrerestrategies.com	Washington	DC
Kevin	Gaffney	Director of Rates & Forms	Vermont Dept of Financial Reg	Kevin.Gaffney@vermont.gov	Montpelier	VT
Jennifer	Gardner	Manager I	NAIC	jgardner@naic.org	Kansas City	MO

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First Name	Last Name	Title	Company	Email	City	State
Francis	Abreo	Insurance Examination Supervisor	Alabama Dept of Ins	blase.abreo@insurance.alabama.gov	Montgomery	AL
Matthew	Gendron	General Counsel	Rhode Island Div of Ins	Matthew.Gendron@dbr.ri.gov	Cranston	RI
Candace	Gergen	Health Policy Anaylst	Minnesota Dept of Commerce	candace.gergen@state.mn.us	Saint Paul	MN
Nick	Gerhart	Commissioner	Iowa Ins Div	Nick.Gerhart@iid.iowa.gov	Des Moines	IA
Angela	Gleason	Associate Counsel	American Ins Assoc	agleason@aiadc.org	Washington	DC
David	Glenn	Manager	A.M. Best	david.glenn@ambest.com	Oldwick	NJ
Bill	Goddard	Attorney	Day Pitney LLP	wgoddard@daypitney.com	Hartford	CT
Michael	Gould	Manager, Consumer Services & Investigations	Delaware Dept of Ins	michael.gould@state.de.us	Dover	DE
Ralf	Gütersloh	Head of Foreign Affairs	German Ins Assoc	r.guetersloh@gdv.de	Berlin	
Dale	Hall	Managing Director of Research	Society of Actuaries	dhall@soa.org	Schaumburg	IL
Nikki	Hall	CIPR Manager	NAIC	shall@naic.org	New York	NY
Thomas	Harman	DC Bureau Manager	A.M. Best	tom.harman@ambest.com	Washington	DC
Scott	Harrison	Managing Director	Alvarez & Marsal	srharrison@alvarezandmarsal.com	Washington	DC
Doug	Hartz	Deputy Insurance Commissioner	Washington Ofc of the Ins Cmsr	dough@oic.wa.gov	Olympia	WA
Jim	Hattaway	Managing Director	Noble Consulting Services	jhattaway@noblecon.net	Irondale	AL
Carder	Hawkins	Deputy Commissioner, Information Services	Arkansas Ins Dept	Carder.hawkins@arkansas.gov	Little Rock	AR
Colin	Hayashida	Insurance Rate & Policy Analysis Manager	Hawaii Ins Div	chayashida@dcca.hawaii.gov	Honolulu	HI
Steven	Hazelbaker	Vice President	Noble Consulting Services, Inc	shazelbaker@noblecon.net	Indianapolis	IN
Gary	Henning	Vice President, State Affairs	Zurich Ins Group	gary.henning@zurichna.com	New York	NY
Ann	Henstrand	Senior Director, International	Society of Actuaries	hjameson@soa.org	Schaumburg	IL
Emma	Hirschhorn	Division Chief	California Dept of Ins	emma.hirschhorn@insurance.ca.gov	Los Angeles	CA
Karen	Hornig	Executive Director	NIPR	khornig@nipr.com	Kansas City	MO
Tom	Houston	Financial Examiner Adv	Wisconsin Ofc of the Ins Cmsr	thomas.houston@wisconsin.gov	Madison	WI
Rajat	Jain	Chief Insurance Examiner, Property & Casualty	Nevada Div of Ins	rjain@doi.nv.gov	Carson City	NV
Jenny	Jeffers	Managing Member	Jennan Enterprises, LLC	jenny@jennan.com	Tallahassee	FL
Kori	Johanson	Chief Compliance Officer & Corporate Secretary	ACORD	kjohanson@acord.org	Pearl River	NY
Jeff	Johnston	Sr. Director, Financial Regulatory Affairs-Domesti	NAIC	jjohnston@naic.org	Kansas City	MO
Mary	Jones	Attorney	Louisiana Dept of Ins	mljones@ldi.la.gov	Baton Rouge	LA
Alice	Kane	Partner	Duane Morris LLP	atkane@duanemorris.com	New York	NY
Dimitris	Karapiperis	Research Analyst	NAIC	dkarapiperis@naic.org	New York	NY
Fred	Karlinsky	Shareholder; Co-Chair, Insurance Regulatory & Tran	Greenberg Traurig, LLP	karlinskyf@gtlaw.com	Fort Lauderdale	FL
Len	Karpowich	Director	UnitedHealth Group	leonard_karpowich@uhc.com	Chicago	IL
Rolf	Kaumann	Deputy Chief Examiner - (Property Bureau)	New York Dept of Financial Services	rolf.kaumann@dfs.ny.gov	New York	NY
TK	Keen	Deputy Administrator	Oregon Div of Financial Reg	tk.keen@oregon.gov	Salem	OR
David	Keleher	Senior P&C Specialist	NAIC	dkeleher@naic.org	Kansas City	MO
Alison	Kelly	Director, State Government Relations	MetLife	alison.kelly@metlife.com	New York	NY
Steve	Kerner	Assistant Commissioner	New Jersey Dept of Banking & Ins	steve.kerner@dobi.nj.gov	Trenton	NJ
Tracy	Klausmeier	Property & Casualty Insurance Division Director	Utah Ins Dept	tklausmeier@utah.gov	Salt Lake City	UT
Yaryna	Klimchak	Public Information Administrator	Missouri Dept of Ins	Yaryna.klimchak@difp.mo.gov	Jefferson City	MO
Arlene	Knighten	Executive Counsel	Louisiana Dept of Ins	aknighten@ldi.la.gov	Baton Rouge	LA
Peter	Kochenburger	Associate Clinical Professor of Law	University of Connecticut School of Law	peter.kochenburger@uconn.edu	Hartford	CT
David	Kodama	Assistant Vice President	PCI	david.kodama@pciaa.net	Chicago	IL
Toshiaki	Koga	Manager	Aioi Nissay Dowa Ins Co., Ltd.	toshiaki-koga@aioinissaydowa.co.jp	Shibuya-ku	JP-13
Tamara	Kopp	Receivership Counsel	Missouri Dept of Ins	tamara.kopp@insurance.mo.gov	Jefferson City	MO
David	Korsh	Director, State Affairs	Blue Cross Blue Shield Assoc	david.korsh@bcbsa.com	Washington	DC
Tina	Korty	General Counsel	Indiana Dept of Ins	tkorty@idoi.IN.gov	Indianapolis	IN
Elliott	Kroll	Partner	Arent Fox LLP	elliott.kroll@arentfox.com	New York	NY
Bill	Lacy	Compliance Director	Arkansas Ins Dept	bill.lacy@arkansas.gov	Little Rock	AR
Laurie	LaPalme	Partner	Cassels Brock & Blackwell LLP	llapalme@casselsbrock.com	Toronto	ON
Sonja	Larkin-Thorne	NAIC Funded Consumer Rep	Consumer Advocate	slarkin-thorne@sbcglobal.net	Avon	CT
Greg	Lathrop	Chief Examiner	Oregon Div of Financial Reg	greg.a.lathrop@Oregon.gov	Salem	OR
Joel	Laucher	Deputy Commissioner	California Dept of Ins	laucherj@insurance.ca.gov	San Francisco	CA
Tyler	Laughlin	Chief of Operations	Oklahoma Ins Dept	tyler.laughlin@oid.ok.gov	Oklahoma City	OK
Vincent	Laurenzano	Consultant	Stroock & Stroock & Lavan	vlaurenzano@stroock.com	New York	NY
Jacob	Lauten	Insurance Specialist II	Alaska Div of Ins	jacob.lauten@alaska.gov	Juneau	AK
Ileana	Ledet	Deputy Commissioner, Public Affairs	Louisiana Dept of Ins	iledet@ldi.la.gov	Baton Rouge	LA
David	Lee	Chief Financial Examiner	Arizona Dept of Ins	dlee@azinsurance.gov	Phoenix	AZ
Ramona	Lee	Actuarial Administrator	Iowa Ins Div	ramona.lee@iid.iowa.gov	Des Moines	IA
Darlene	Lenhart-Schaeffer	Chief Examiner	Florida Office of Ins Reg	Darlene.Lenhart-Schaeffer@floir.com	Tallahassee	FL
Tammy	Lohmann	Director, Insurance Product Filing	Minnesota Dept of Commerce	tammy.lohmann@state.mn.us	St. Paul	MN
W. James	MacGinnitie	Senior P/C Fellow	American Academy of Actuaries	macginnitie@actuary.org		
Andrew	Mais	Subject Matter Expert	Deloitte	amais@deloitte.com	Wilton	CT
Pete	Maloney	Partner	Hinshaw & Culbertson LLP	pmaloney@hinshawlaw.com	New York	NY
Diana	Marchesi	Director of State Government Affairs, VP & Assoc	Transamerica Life Ins Co	diana.marchesi@transamerica.com	Washington	DC

CIPR Spring Event: Attendee List (as of 3/21/16)

First Name	Last Name	Title	Company	Email	City	State
Francis	Abreo	Insurance Examination Supervisor	Alabama Dept of Ins	blase.abreo@insurance.alabama.gov	Montgomery	AL
Nicole	Marshall	Resident	EY	nicole.marshall@ey.com	Washington	DC
Fred	Mason	Senior Director	ISO	fmason@iso.com	Jersey City	NJ
Daniel	Mathis	Assistant Chief Examiner	Iowa Ins Div	daniel.mathis@iid.iowa.gov	Des Moines	IA
Denise	Matthews	Director	NAIC	dmatthews@naic.org	Kansas City	MO
Victoria	McCarthy	Vice President, Head of Regulatory Strategy & An	Farmers Ins Group	victoria_mccarthy@farmersinsurance.com	Woodland Hills	CA
Michael	McKenney	Property & Casualty Actuarial Supervisor	Pennsylvania Ins Dept	mmckenney@pa.gov	Harrisburg	PA
Tyler	McKinney	Attorney	California Dept of Ins	mckinneyt@insruance.ca.gov	Sacramento	CA
Patrick	McNaughton	Chief Examiner	Washington Ofc of the Ins Cmsr	patm@oic.wa.gov	Seattle	WA
Patrick	McPharlin	Director	Michigan Dept of Ins & Financial Svcs	mcpharlinp@michigan.gov	Lansing	MI
James	Mills	Chief of Staff	Oklahoma Ins Dept	james.mills@oid.ok.gov	Tulsa	OK
Greg	Mitchell	Attorney	Frost Brown Todd LLC	gmitchell@fbtlaw.com	Lexington	KY
Debapriya	Mitra	Senior Vice President Business Strategy	Genworth U.S. Life Division	debapriya.mitra@genworth.com	Richmond	VA
Jan	Moenck	Partner	Risk & Regulatory Consulting, LLC	jan.moenck@riskreg.com	Minneapolis	MN
Scott	Morris	Chief Technology Officer	NAIC	samorris@naic.org	Kansas City	MO
Chris	Murray	Program Coordinator II	Alaska Div of Ins	chris.murray@alaska.gov	Juneau	AK
Brad	Nail	Sr. Manager, Insurance & Public Policy	UBER	brad.nail@uber.com	Washington	DC
Leslie	Nehring	Chief Financial Examiner	Missouri Dept of Ins	leslie.nehring@insurance.mo.gov	Jefferson City	MO
Angela	Nelson	Director, Division of Market Regulation	Missouri Dept of Ins	angela.nelson@insurance.mo.gov	Jefferson City	MO
Collin	Newberry	AVP - Corporate Accounting	Protective Life Corporation	collin.newberry@protective.com	Birmingham	AL
Rebecca	Nichols	Deputy Commissioner	Virginia Bureau of Ins	rebecca.nichols@scc.virginia.gov	Richmond	VA
Molly	Nollette	Deputy Commissioner, Rates & Forms Division	Washington Ofc of the Ins Cmsr	mollyn@oic.wa.gov	Olympia	WA
Eric	Nordman	Director, Regulatory Services Div & the CIPR	NAIC	enordman@naic.org	Kansas City	MO
David	Noronha	CIO	California Dept of Ins	David.Noronha@insurance.ca.gov	Sacramento	CA
Todd	Oberholtzer	Regulatory Compliance Director	Ohio Dept of Ins	Todd.Oberholtzer@insurance.ohio.gov	Columbus	OH
Anne	Obersteadt	Senior Researcher	NAIC	aobersteadt@naic.org	Kansas City	MO
Bill	O'Connell	Managing Director	Noble Consulting Services, Inc.	boconnell@noblecon.net	Indianapolis	IN
James	Odiorne	Chief Deputy Insurance Commissioner	Washington Ofc of the Ins Cmsr	jimo@oic.wa.gov	Tumwater	WA
Mark	Ossi	Director	Georgia Ofc of Ins & Fire Safety	mossi@oci.ga.gov	Atlanta	GA
Lauren	Pachman	Counsel & Director of Regulatory Affairs	National Assoc of Professional Ins Agents	laurenpa@pianet.org	Alexandria	VA
Paula	Pallozzi	Associate Director	Rhode Island Div of Ins	paula.pallozzi@dbr.ri.gov	Cranston	RI
Laura	Panesso	Director, State Relations	ISO	LPanesso@iso.com	Jersey City	NJ
Andrew	Pauley	General Counsel	West Virginia Ofc of the Ins Cmsr	andrew.pauley@wvinsurance.gov	Charleston	WV
Matti	Peltonen	Supervisory Insurance Analyst	Federal Reserve Board	matti.m.peltonen@frb.gov	Washington	DC
Richard	Piazza	Chief Actuary	Louisiana Dept of Ins	rpiazza@ldi.la.gov	Baton Rouge	LA
Shawn	Pollock	Director, Compliance & Market Conduct	Mutual of Omaha	shawn.pollock@mutualofomaha.com	Omaha	NE
Priya	Pooran	Ms	NA	priya_pooran@yahoo.com	Washington	DC
Sherri	Powell	Director, Government & Regulatory Affairs	AIG	sherri.powell@aig.com	New York	NY
Donna	Powers	Assistant Director	NAIC	dpowers@naic.org	Kansas City	MO
Alan	Prochoroff	Editor	Ins Compliance Insight	aprochoroff@ins-compliance.com	Alexandria	VA
Edwin	Pugsley	Chief Market Conduct Examiner	New Hampshire Ins Dept	Edwin.Pugsley@ins.nh.gov	Concord	NH
Kurt	Regner	Assistant Director	Arizona Dept of Ins	kregner@azinsurance.gov	Phoenix	AZ
Jill	Reuter	Assistant Vice President	A.M. Best	jill.reuter@ambest.com	Oldwick	NJ
Barbara	Richardson	Commissioner	Nevada Div of Ins	icommish@doi.nv.gov	Carson City	NV
Michael	Ricker	Property & Casualty Actuary	Alaska Div of Ins	michael.ricker@alaska.gov	Juneau	AK
Sara	Robben	Statistical Advisor	NAIC	srobben@naic.org	Kansas City	MO
Lynette	Roberson	Attorney	Louisiana Dept of Ins	lroberson@ldi.la.gov	Baton Rouge	LA
Daniel	Robles	Director	The Ingenesist Project	dan@coengineers.com	Edmonds	WA
Rich	Robleto	Deputy Comm - Life & Health	Florida Office of Ins Reg	rich.robleto@floir.com	Tallahassee	FL
Christina	Rouleau	Director of Market Regulation	Vermont Dept of Financial Reg	Christina.Rouleau@vermont.gov	Montpelier	VT
Marisol	Saenz	Attorney	Gardere Wynne Sewell LLP	msaenz@gardere.com	Austin	TX
Ty	Sagalow	Chief Insurance Officer	Lemonade, Inc.	ty.sagalow@lemonade.com	New York	NY
Rebecca	Sanchez	Government Affairs Counsel	American Family Ins	rsanche1@amfam.com	Phoenix	AZ
Joel	Sander	Deputy Commissioner of Finance	Oklahoma Ins Dept	joel.sander@oid.ok.gov	Oklahoma City	OK
Richard	Schlesinger	Chief Insurance Examiner	New Jersey Dept of Banking & Ins	Richard.Schlesinger@dobi.nj.gov	Trenton	NJ
Mary	Schwantes	Director of External Affairs/Deputy Receiver	Florida Dept of Financial Services	mary.schwantes@myfloridacfo.com	Tallahassee	FL
Ken	Selzer	Kansas Commissioner of Insurance	Kansas Dept of Ins	kselzer@ksinsurance.org	Topeka	KS
Carla	Small	Associate	DLA Piper LLP (US)	carla.small@dlapiper.com	New York	NY
Andrene	Smith	Director, Policy Development	Prudential Financial	andrene.smith@prudential.com	Newark	NJ
Joanne	Smith	Manager	Johnson Lambert LLP	jsmith@johnsonlambert.com	Atlanta	GA
David	Snyder	Vice President	PCIAA	david.snyder@pciaa.net	Washington	DC
Margaret	Spencer	Partner	Risk & Regulatory Consulting LLC	margaret.spencer@riskreg.com	Ponte Vedra Beach	FL
James	Stephens	Chief Deputy Director	Illinois Dept of Ins	james.stephens@illinois.gov	Chicago	IL
Karen	Stewart	Commissioner State of Delaware	Delaware Dept of Ins	karen.stewart@state.de.us	Dover	DE

CIPR Spring Event: Attendee List (as of 3/21/16)

First Name	Last Name	Title	Company	Email	City	State
Francis	Abreo	Insurance Examination Supervisor	Alabama Dept of Ins	blase.abreo@insurance.alabama.gov	Montgomery	AL
Mike	Stinziano, PhD	Senior Vice President, Government & Corporate Re	Demotech	mikestinziano@gmail.com	Canal Winchester	OH
Douglas	Stolte	Deputy Commissioner	Virginia Bureau of Ins	doug.stolte@scc.virginia.gov	Richmond	VA
Satoshi	Takemoto	Chief Representative of DC Office	DLI North America (Dai-ichi Life Group)	takemoto@dlusa.com	Washington	DC
Lisa	Tate	Vice President & Associate General Counsel	American Council of Life Insurers	lisatate@acli.com	Washington	DC
Beth	Terrell	VP & Associate General Counsel	Transatlantic ReInsurance Co	bterrell@transre.com	New York	NY
Paul	Tetrault	State & Policy Affairs Counsel	NAMIC	ptetrault@namic.org	Beverly	MA
Brandon	Thomas	Partner	The Thomas Consulting Group, Inc.	bthomas@ttcgi.net	Indianapolis	IN
Cheryl	Tobin	VP Counsel	Pacific Life	cheryl.tobin@pacificlife.com	Newport Beach	CA
Alexander	Traum	Associate	Kramer Levin Naftalis & Frankel LLP	atraum@kramerlevin.com	New York	NY
Tim	Tucker	Washington Affairs Executive	NCCI	tim_tucker@ncci.com	Boca Raton	FL
John	Turchi	Deputy Commissioner	Massachusetts Div of Ins	john.turchi@state.ma.us	Boston	MA
Phil	Vigliaturo	Property & Casualty Actuary	Minnesota Dept of Commerce	phil.vigliaturo@state.mn.us	St. Paul	MN
Bob	Wake	General Counsel	Maine Bureau of Ins	robert.a.wake@maine.gov	Augusta	ME
Lisa	Warrum	Vice President	Noble Consulting Services, Inc.	lwarrum@noblecon.net	Indianapolis	IN
Donna	Watz	Deputy General Counsel	Minnesota Dept of Commerce	donna.watz@state.mn.us	Saint Paul	MN
Barry	Weissman	Shareholder	Carlton Fields	bweissman@carltonfields.com	Los Angeles	CA
Thomas J.	Welsh	Attorney	Orrick Herrington Sutcliffe, LLP	tomwelsh@orrick.com	Sacramento	CA
Robin	Westcott	Vice President, General Counsel	AAIS	robinw@aaisonline.com	Lisle	IL
Melissa	Wheeler	Regional Government Relations Manager	Westfield Group	melissawheeler@westfieldgrp.com	Westfield Center	OH
Donna	Wilson	Estate Manager	Oklahoma Receivership Office	dwilson@okaro.org	Oklahoma City	OK
Jim	Woody	CFO	NAIC	jwoody@naic.org	Kansas City	MO
Mark	Worman	Associate Commissioner, Regulatory Policy Division	Texas Dept of Ins	mark.worman@tdi.texas.gov	Austin	TX
Matthew	Wulf	Vice President, State Relations & Assistant Gene	Reinsurance Assoc of America	WULF@REINSURANCE.ORG	Washington	DC
Glenn	Yamashita	Insurance Examiner	Hawaii Ins Div	gyamashi@dcca.hawaii.gov	Honolulu	HI
Yuka	Yamashita	Senior Research Analyst	Meiji Yasuda America	yuka@meijiyasudany.com	New York	NY
Mike	Yanacheak	Actuarial Administrator	Iowa Ins Div	mike.yanacheak@iid.iowa.gov	Des Moines	IA
Noel	Young	Regional Counsel	Allstate Ins Co	noel.young@allstate.com	Tempe	AZ

The CIPR serves: federal and state lawmakers; federal and state regulatory agencies; international regulatory agencies; and insurance consumers. It enhances intergovernmental cooperation and awareness, improving consumer protection while promoting legitimate marketplace competition. The site provides information on current insurance regulatory developments, ongoing CIPR projects, and coverage of a wide-range of insurance industry topics.

The CIPR's organization and navigation shares many of the same elements the NAIC home page as described on Page 1.

Here are the highlights unique to CIPR pages:

1. The NAIC's Central Office/CIPR staff can provide a great deal of information to regulators and lawmakers. Contact information providing direct access to them is vital to the CIPR site's function.

2. Click to see the most current as well as archived issues of the CIPR Newsletter.

3. The A-Z Index of Insurance topics and issues. Click to see detailed analysis and documentation on a wide range of insurance topics and issues.

4. The Key Issues section includes a topical listing of key insurance regulatory issues.

5. The Special Reports/White Papers section provides assess to NAIC special reports, white papers and articles on a wide range of insurance regulatory topics and concerns.

6. Statistics Map: this page provides access to state score cards which detail statistics about each jurisdiction's insurance market along with that of the entire US. In addition, links to samples of NAIC research reports and data are provided.

NAIC Web Site Support
Contact Information:

1. NAIC Help Desk:
Phone 816.783.8500
E-mail help@naic.org
fax 816.460.7456
2. NAIC Web Team: webpost@naic.org
3. NAIC Communications: news@naic.org

CIPR EVENTS

The CIPR holds four events each year—three events during each of the NAIC National Meetings and one off-site event. For more information on our past events, including presentations and audio, please visit our website at: www.naic.org/cipr_events.htm.

2015 Events

- Regulation of Captives (Nov. 18)
- All About Earthquakes (Aug. 14)
- Boom or Bust? A Look into Retirement Issues Facing Baby Boomers Symposium (June 15-16)
- Risk of Pandemics to the Insurance Industry (Mar. 27)

2014 Events

- Navigating Interest Rate Risk in the Life Insurance Industry (Nov. 19)
- Implications for Increasing Catastrophe Volatility on Insurers and Consumers Symposium (Oct. 7-8)
- Commercial Ride-Sharing and Car-Sharing Issues (Aug. 16)
- Insuring Cyber Liability Risk (Mar. 28)

2013 Events

- The Future of Automobile Insurance: Telematics in the U.S. (Dec. 16)
- Exploring Insurers' Liabilities Summit (Aug. 27)
- Health Care Reform - Tools for Oversight and Assistance in the Marketplace Symposium (Apr. 30-May 1)
- Insurance for Acts of Terrorism (Apr. 9)

2012 Events

- Financing Home Ownership Luncheon (Nov. 30)
- State of the Life Insurance Industry: Implications of Industry Trends Symposium (Oct. 25-26)
- Flood Insurance Summit (Aug. 14)

2011 Events

- Conference on Transatlantic Insurance Group Supervision (Sep. 7-8)

Big Data and Insurance

By Eric Nordman, Director of Regulatory Services and CIPR

The traditional insurance company is viewed as slow to change its ways. However, in this evolving technological world, those who operate at a snail's pace will likely be left behind.

The Age of Big Data is upon us—and regulators, insurers, businesses and individuals need to be mindful of the potentially disruptive effect big data can have on our lives. These disruptive effects can be beneficial and detrimental at the same time.

◆ The Good News About Big Data

As more and more functions become automated, the data collected electronically and stored can lead to some amazing insights—provided it is stored in ways that are useful for analysis. Having a lot of data does not automatically mean an enterprise is able to effectively use the massive amount of data to convert it to useful information. However, big data, properly managed, can improve how an insurer does business. This can be beneficial for the insurer and its customers. It does have the potential to be disruptive and may not be beneficial for each of its current policyholders.

In essence, what big data provides an insurer is analytical information that may allow the insurer to distinguish itself from its competitors. What big data does is add precision to the information an insurer maintains about its customers. In theory, the insurer can use this information to more accurately determine a price to charge its customers. This creates an opportunity for insurers to implement risk-based pricing based on the most accurate information obtainable. It also presents an opportunity for an insurer to engage with its customers in ways not possible before. The question remains whether insurers will take advantage of the customer engagement and educational opportunities big data presents.

Telematics is one area with tremendous potential. The ability to use customer information for pricing based on actual driving abilities should allow insurers to abandon some of the risk proxies used in the past. Customer relations should improve, as consumers will understand that an objective evaluation of their risk is fairer than some of the less intuitive measures of risk used in the past. Further, if insurers take advantage of the opportunity presented, they can share information with drivers so consumers can actually improve their driving abilities and potentially reduce the future cost of insurance. This would provide a tremendous public relations boost to the insurance industry, if properly employed.

Telematics can also be used to reduce insurance fraud. The event data recorder (EDR) is a device, similar to a black box found on an aircraft, which records information about the movements of a car. It is triggered by a sudden change in wheel speed. The sudden change directs the EDR to retain the geocoded information immediately before the sudden change occurs. The information might include whether brakes were applied, the position of the vehicle, the speed the vehicle was traveling, whether air bags were activated and whether seat belts were buckled. Claims adjusters with access to EDR information from both cars involved in an accident can determine who was at fault in an accident. The determination will be based on the computer-generated information instead of having to rely on observations by drivers, passengers and other eye witnesses. The result could be a more accurate assessment of responsibility and less fraud, which could result in lower insurance prices.

Benefits of telematics to drivers generally include the potential for a reduction in accident frequency and severity from driver improvements after receiving feedback from telematics devices. Costs are also constrained by providing rapid emergency response time following an accident. Accident victims can be located and transported to medical facilities quickly, saving lives and reducing recovery time, which reduces costs. Vehicle theft costs can be reduced by using telematics devices to track and recover stolen vehicles. There are also benefits to society in general from reductions in driving as consumers choose to limit miles driven to reduce gas consumption and lower insurance costs. This helps create less traffic congestion and results in less pollution from reduced energy consumption.

Telematics offers opportunities for businesses, too. Perhaps the greatest opportunity exists in the commercial trucking arena. A commercial fleet insurer may be able to offer enhanced risk-management services to fleet operators. They can use actual data derived from telematic devices in vehicles to provide driver tracking and current location, as well as monitor where the truck has been. It may also prove helpful to schedule and expedite loads so there is less down time, allowing the business to use the fleet of trucks more efficiently. Of course, it is also helpful in underwriting and pricing the policy. Merging traffic flow information with the current location of a truck should allow efficient rerouting to avoid bottlenecks. The risk-management and efficiency opportunities are endless.

The volume of data and its complexity has helped create a cottage industry of vendors willing to help insurers turn data into insight. The largest insurers seem to be able to handle

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the conversion of data to useful information on their own. However, many midsize and smaller insurers lack the capacity to do this by themselves. This provides an opportunity for businesses willing to supply the expertise to assemble big data, much of it unstructured, into useful information to benefit businesses, individuals and insurers.

Some of these entities are the usual suspects, such as IBM and the large insurance consulting firms. However, advisory organizations have also been interested in providing these services. Insurance Services Office (ISO) and the America Association of Insurance Services (AAIS) offer assistance to their members. In addition, there is a new entrant into the advisory organization space: Towers Watson.

Towers Watson has become a licensed advisory organization in several states. Towers Watson collects loss data from participating insurers, aggregates it and files a predictive score in states where it is licensed as an advisory organization. Insurers use the filed predictive score by simply informing the regulator as part of a normal rate filing. This provides a way for midsize and smaller insurers to offer a usage-based insurance product without all the costs of collecting, analyzing and maintaining the big data set behind the predictive score.

The AAIS has produced an article called, *Changing Paradigms in Personal Lines Ratemaking*.[1] It suggests insurers are shifting from a "policy view" of risk to a "household view" of risk. This paradigm shift uses big data to look at risks in ways not possible in the past. In the article, the AAIS states: "consumers can now affect their rate classification by decisions they make at the time of application…there is a growing trend to balance consideration of short-term profitability with consideration of an account's lifetime value based on projections of an insured's likelihood to remain with a carrier."

Big data also offers opportunities to capture information to inform enterprise risk management (ERM) processes. With the Own Risk and Solvency Assessment (ORSA) on the horizon for major insurers, big data can be helpful in completing the ORSA Summary Report. Big data can be used to optimize the evaluation of risks in an ERM capacity. Better identification and quantification of risks allow optimal deployment of capital and superior matching of risks and assets.

Big data can be helpful in new product design. If an insurer is better able to understand what consumers want, it can be more successful in developing insurance products to meet the consumer's needs. The more an insurer knows about its customers, the more likely it will be successful over the long term. For example, a computer-savvy consumer might want to have direct access to enter change of vehicle or driver information, saving administrative staff time and expense for the insurer.

Big data can be helpful in managing various distribution channels for insurers. With data coming from insurance producers, call centers and online services, making sure the data coming from various sources ends up in one place and in a consistent format, can be a challenge for insurers. Proper management of big data is a must for continued success.

◆ Some Cautions About Big Data

Consumers have some reservations about the use of big data. Consumer and environmental organizations generally support pay-by-the-mile and usage-priced insurance, because these programs allow consumers to reduce the cost of insurance by driving fewer miles. However, some consumers believe the telematics-based auto insurance programs are not transparent, so the consumer has no idea how the programs quantify risk or what the consumer can do to lower the price for auto insurance. Consumers would benefit from greater transparency and proactive feedback to empower the consumer to modify driving behavior to reduce premium costs. Some consumer advocates maintain the telematics programs fail to achieve the critical loss-mitigation role of insurance pricing because of the opaque nature of the scoring models.

There are also consumer concerns about the type of information being collected and, with recent data breaches, how collected data is safeguarded. Maintenance of consumer privacy is a primary concern.

Consumers recognize the possibilities offered by EDRs, but realize the information flow needs to go in both directions. Some consumers distrust insurers and fear EDRs will be used unfairly. They fear the insurer will use the information from EDRs when it is beneficial to the insurer, but not when it benefits the claimant.

Some consumer advocates maintain that insurers' use of big data results in unfair discrimination against consumers in low-income communities. They encourage the use of a disparate impact standard to measure the potentially discriminatory effects. They maintain that insurers' use of big data penalizes low-income consumers because of where they live and when they need to drive. Low-income consumers with older vehicles may not own a vehicle capable of deploying a

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[1] www.aaisonline.com/Portals/0/AAISDocuments/Viewpoint/Online%20Articles/Fall%202014/7_Changing%20Paradigms.pdf. Accessed July 13, 2015.

dongle or other telematics device. Thus, these consumers cannot take advantage of telematics offerings from insurers. Further common occupations among lower-income consumers may require them to travel at night because of their jobs, rather than for entertainment.

Some consumer advocates believe insurer claims that usage-based insurance products provide a "discount only" are misleading. They point out that insurers must raise base rates to make up for the premium shortfall when discounts are offered to some, but not all, consumers. The consumer advocates see this as hiding the true effect of usage-based auto insurance. They note that insurers are missing an opportunity to connect with customers and help them become better drivers. Consumer advocates tend to favor rating plans that use risk-based factors that encourage loss mitigation.

◆ Complexity and its Impact on Regulation

With the increased use of big data by insurers, the job of reviewing rate filings and monitoring competition has become more complex for insurance regulators. Rate filings by insurers today are much more complicated than they used to be. Regulatory actuaries and rate reviewers are challenged by the vast number of risk-classification factors being used and the interconnectivity of the rate factors to each other. In the past, a review of statistical information supporting a filing and the rating algorithms used by insurers would be easy to understand. The insurer would establish a base rate, a set of increased limit factors and various rate relativity factors applied in a multiplicative manner to arrive at a premium to charge an individual consumer. In contrast, today's rate filings require the actuary or reviewer to work with the insurer to understand how each risk classification factor interacts with other risk classification factors in a complex matrix of data cells. This approach is only possible because of big data.

The concept of price optimization has been a controversial topic at recent NAIC national meetings. The Casualty Actuarial and Statistical (C) Task Force has been drafting a paper on price optimization. The first issue is to agree upon a precise definition of "price optimization," as there seem to be a variety of opinions about it (see article on page five for more on price optimization). In the past, the concept of judgment has been used by insurer actuaries to adjust rates for a number of factors, such as smoothing increased limits factors, when use of actual data would suggest anomalies in pricing. For example, actual data might suggest the premium for a policy with a $100,000 limit might be more than one with a $125,000 limit. Judgment would be used to smooth the overall increased limit factor table. It would not be prudent to have a factor encouraging consumers to buy the policy with $125,000 limit because it was cheaper this year, only to have the premium double next year. Judgement is also used to reflect the prices charged by competitors.

Today, insurers are beginning to use big data to develop quantitative information using sophisticated data-mining tools and modeling techniques. They want to use this new information to replace the judgmental aspects of the rate-making process.

Others believe price optimization is simply the use of a factor to measure a consumer's propensity to shop for coverage. It is this one component of price optimization that is responsible for much of the controversy on the topic. The regulatory actuaries are working to build consensus on a definition and provide some guidance to regulators on how price optimization should be treated in rate filings. Several states have issued opinions on the use of price optimization in rate filings.

◆ Summary

Big data is here to stay. It offers some amazing possibilities for consumers. There are also some drawbacks needing attention. Big data can make life better for some and worse for others. It is incumbent upon regulators to develop techniques to look inside of complex rating systems and understand how insurers are using big data to impact consumers. Pushing for more transparency and encouraging insurers to offer consumer benefits to improve driving and better protect homes and business should be part of the plan. It would be a shame to lose the loss-mitigation opportunities big data can offer.

About the Director

Eric Nordman, CPCU, CIE, is the director of the NAIC Regulatory Services Division and the CIPR. He directs the Regulatory Services Division staff in a wide range of insurance research, financial and market regulatory activities, supporting NAIC committees, task forces and working groups. He has been with the NAIC since 1991. Prior to his appointment as director of the Regulatory Services Division, Nordman was director of the Research Division and, before that, the NAIC senior regulatory specialist. Before joining the NAIC, he was with the Michigan Insurance Bureau for 13 years. Nordman earned a bachelor's degree in mathematics from Michigan State University. He is a member of the CPCU Society and the Insurance Regulatory Examiners Society.

The Use of Price Optimization in Insurance Ratemaking

By Shanique (Nikki) Hall, CIPR Manger

The recent use of "price optimization" tools in determining the premium to be charged to policyholders is an emerging and evolving issue that has recently drawn increased attention and discussion among state insurance regulators, the industry and consumer advocacy groups. Some argue the use of price optimization to determine premiums may result in rates that are unfairly discriminatory. State insurance regulators around the country are actively monitoring the issue. Seven states—California, Florida, Indiana, Maryland, Ohio, Vermont and Washington—have recently issued bulletins prohibiting or restricting the use of price optimization (i.e., the concept of rating based on price elasticity) in personal lines ratemaking, while others states have issued requests for information.

The NAIC Casualty Actuarial and Statistical (C) Task Force is carefully examining the issue. Earlier this year, the Task Force began drafting a *Price Optimization White Paper* (White Paper)[1] analyzing price optimization and its use in insurance ratemaking, with the primary focus on personal lines. The Task Force hopes to finish the White Paper later this fall, which will provide guidance and regulatory recommendations to the states on price optimization. This article will address price optimization and consumer advocacy concerns, as well as provide an overview of recent state regulatory responses.

◆ Insurance Ratemaking

The premium, or rate, a consumer pays for insurance is determined by his or her insurance company during the ratemaking process. This process may involve a number of considerations, including estimates of future claims costs and expenses, profit and contingencies, marketing goals, competition, and legal restrictions.[2] The premium has essentially two functions: 1) it should produce total funds sufficient to cover the insurer's obligation; and 2) it should distribute the cost of insurance fairly among insured persons.[3]

Actuaries have a key role in the ratemaking process and are generally responsible for determining the estimated costs of risk transfer. Traditionally, actuaries relied on historical premium, loss and expense information—along with judgement and anecdotal evidence—to determine rates. However, the advent of more sophisticated data mining tools and modeling techniques have allowed the use of more objective and detailed quantitative information about the judgmental aspects of the rate-setting process instead of reliance primarily on anecdotal evidence. According to the draft White Paper, this process of using sophisticated tools and models to quantify other business considerations such as marketing goals, profitability or policyholder retention is referred to as "price optimization."

◆ Price Optimization

Price optimization is a practice that has been used in many industries for years, most commonly in the retail and travel industries. Many companies have embraced price optimization models to help determine what price they will charge for their products or services. Vendors such as Towers Watson and Earnix have developed commercially available software that allows companies to perform price optimization.

According to Earnix, the use of price optimization strategies for personal lines insurance started more than a decade ago in Europe and is currently making rapid headway in North America.[5] However, the number of insurers using price optimization is unclear. Many reference Earnix's 2013 North America Auto Insurance Pricing Benchmark Survey, which found 45% of large insurance companies and 26% of all insurance companies in North America currently optimize prices. Survey responses were collected online from 73 executives and pricing professionals representing insurance companies that sell auto coverage in Canada and the United States.[6]

While price optimization is not a new concept, there is no widely accepted method or common definition, particularly with respect to how it is being employed in the insurance industry. There are a wide variety of existing definitions used by different stakeholders to describe a range of practices. Some stakeholders refer to price optimization as relying on predictive modeling and "big data,"[7] while others refer to the term to mean using information about customers' price sensitivity as a rating factor.[8]

(Continued on page 6)

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[1] References to the White Paper in this article refer to the May 19, 2015 draft version.

[2] Statement of Principles Regarding Property and Casualty Insurance Ratemaking. Retrieved from: *https://www.casact.org/professionalism/standards/princip/sppcrate.pdf*.

[3] Kulp, C.A. The Rate-Making Process in Property and Casualty Insurance—Goals, Technics, and Limits. Retrieved from: *http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2460&context=lcp*.

[4] Retrieved from: *www.naic.org/documents/committees_c_catf_exposure_price_optimization_wh_paper_draft.pdf*.

[5] Retrieved from: *http://earnix.com/wp-content/uploads/2012/09/Earnix-NA-PO-myths-WEB1.pdf*.

[6] Retrieved from: *http://earnix.com/wp-content/uploads/2013/08/2013-NA-Auto-Pricing-Survey-Summary-v3.1.pdf*.

[7] For more on Big Data, see the article on page two in this edition of the *CIPR Newsletter*.

[8] Price Optimization: Regulators Struggling with Big Data. *Law360*. Jun. 8, 2015.

In the draft White Paper, price optimization is described as "a complex process based on predictive modeling intended to assist insurance companies in setting prices. It is an additional component of the pricing process in which the insurer transitions from actuarial rates to final prices. According to Earnix, price optimization uses a variety of applied mathematical techniques (linear, nonlinear, integer programming) in the ratemaking process to analyze more granular data."

Several state insurance departments have included a description or definition of price optimizations in their bulletins. Each state insurance department has characterized price optimization somewhat differently. For example:

- The Maryland Insurance Administration describes price optimization as "the practice of varying rates based on factors other than the risk of loss, such as the likelihood that policyholders will renew their policies and the willingness of certain policyholders to pay higher premiums than other policyholders."[9]
- The Florida Office of Insurance Regulation describes price optimization as "a process for modifying the insurance premium that would otherwise be charged to an insured or class of insureds in order to maximize insurer retention, profitability, written premium, market share, or any combination of these while remaining within real world constraints."[10]
- The New York Department of Financial Services refers to price optimization as "the practice of varying rates based on factors other than those directly related to risk of loss, for example, setting rates or factors based on an insured's likelihood to renew a policy or on an individual's or class of individuals' perceived willingness to pay a higher premium relative to other individuals or classes."[11]
- The Indiana Department of Insurance describes price optimization as "using data collection and analysis to predict which consumers will accept higher rates without changing insurers and/or varying premiums based upon factors that are unrelated to risk of loss so that each insured is charged the highest price that the market will bear."[12]

◆ ISSUES SURROUNDING PRICE OPTIMIZATION

Most states have consumer protection laws regulating the pricing of insurance contracts. State law requires rates for insurance not be "unfairly discriminatory." In other words, the same rates should be charged for all members of an underwriting class with a similar risk profile. Charging different rates for risks with the same expected loss is considered by many to be unfairly discriminatory.

Consumer advocacy groups, like the Consumer Federation of America (CFA) and the Center for Economic Justice (CEJ), have expressed concern about insurers' use of price optimization, contending it is a practice where premiums are "set based on the maximum amount a consumer is willing to pay, rather than the traditionally accepted methods of calculating premiums based on projected costs, such as claims, overhead and profit."[13] They argue price optimization is being used by insurance companies to increase profits by raising premiums on individuals who are unlikely to shop around to find a better price.[14] They also assert the practice discriminates against low-income consumers who tend to shop around less frequently than wealthier consumers.

Both the CFA and the CEJ have urged state insurance regulators to stop insurance companies from using price optimization when setting rates and premiums. They say the use of price optimization by insurers violates statutory and actuarial standards barring unfairly discriminatory rates, and leads to higher rates for consumers for reasons unrelated to risk of loss.[15]

Proponents of price optimization argue, however, that price optimization is used widely in many or most markets, and, in fact, represents innovation in pricing models that ultimately benefits consumers, regulators and insurers.[16] Trade groups representing the property and casualty industry maintain prices charged to consumers using the technique are legal and meet regulatory standards, as optimization stems from ranges of price estimates that are actuarially sound.[17]

Robert Hartwig, president of the Insurance Information Institute (III), notes the assertion low-income consumers are particularly vulnerable because they do not shop around is unsubstantiated, based on polling done by III last year. A 2014 III poll found 68% of people with an annual income of less than $35,000 compared prices when shopping for auto

(Continued on page 7)

[9] www.mdinsurance.state.md.us/sa/docs/documents/insurer/bulletins/bulletin-14-23-unfair-discrimination-in-rating.pdf.
[10] www.floir.com/siteDocuments/OIR-15-04M.pdf.
[11] www.sutherland.com/portalresource/NY-308-Letter.pdf.
[12] www.in.gov/idoi/files/Bulletin_219.pdf.
[13] www.consumerfed.org/pdfs/price-optimization-letter-state-auto-insurance-commissioners.pdf.
[14] Jergler, Don. Price Optimization Allegations Challenged, NAIC Investigating Practice. Insurance Journal.
[15] Retried from: www.consumerfed.org/news/1079.
[16] Hartwig, Robert. Price Optimization in Auto Insurance Markets: Actuarial, Economic and Regulatory Considerations. Insurance Information Institute. July 17, 2015.
[17] Scism, Leslie. Loyalty to Your Car Insurance May Cost You. *The Wall Street Journal*. Feb. 20, 2015.

insurance, compared with 61% of those with annual incomes of more than $100,000.[18] While these figures indicate between 32% and 39% of Americans do not shop around, one could conclude people with incomes less than $35,000 are more likely to shop for insurance than their wealthier counterparts.

◆ State Regulatory Responses

State insurance regulators are concerned price optimization may be a departure from traditional "cost-based ratemaking and toward ratemaking based in part on consumers' price sensitivity."[19] Consequently, a growing number of states have taken preemptive action to ban the practice. Several states have issued bulletins stating price optimization results in rates that are unfairly discriminatory. Some of these states are also requiring insurers to remove price optimization factors from rate filings.

According to the draft White Paper, "some states believe existing state laws are sufficient to deal with price optimization and that no bulletin or other public statement is necessary. Many states have not received a filing that stated price optimization was incorporated into the rating process. Many states are looking more closely at the issue or are waiting for the issue to be more thoroughly discussed and reported upon by the NAIC."

Various state regulatory responses regarding price optimization include:

- **Maryland:** On Oct. 31, 2014, the Maryland Insurance Administration issued Bulletin 14-23 to all property and casualty companies in Maryland. Bulletin 14-23 notes Maryland has determined the use of price optimization results in rates that are unfairly discriminatory, and as a result, "insurers may not use price optimization to rate policies in Maryland." Insurers using price optimization to rate insurance policies in Maryland are required to file a corrective action plan no later than Jan. 1, 2015.[20]
- **Ohio:** On Jan. 29, 2015, the Ohio Department of Insurance issued Bulletin 2015-01 noting the use of price optimization represents a departure from traditional cost-based rating and can result in two insureds with similar risk profiles being charged different premiums. "Consequently, the use of price optimization results in rates that are unfairly discriminatory." Insurers currently using price optimization in ratemaking were instructed to submit a SERFF filing that eliminates the factors based on price optimization no later than March 31, 2015 for renewal business.[21]
- **California:** On Feb. 18, 2015, the California Department of Insurance issued a notice to more than 750 property and casualty insurers doing business in California advising them that price optimization in ratemaking is unfairly discriminatory and violates the law. Insurers were instructed to cease using price optimization and adjust their rates in California. Any insurer that has incorporated price optimization factors into their ratings plans was given six months to adjust its rates and submit new filings to the department.[22]
- **New York:** On March 18, 2015, the New York Department of Financial Services (NYDFS) issued a Section 308 inquiry letter to all property and casualty insurers operating in New York, seeking information concerning price optimization in order to help determine whether insurers use price optimization in New York along all property and casualty lines, and whether corrective actions are needed with regard to insurers' rating practices. The letter states the NYDFS is concerned insurers are "charging higher premiums based on whether a consumer is less likely to notice, shop around, or object." Insurers were directed to provide the information by no later than April 15, 2015.[23]
- **Florida:** On May 14, 2015, the Florida Office of Insurance Regulation (FLOIR) released Information Memorandum (OIR-15-04M) to all property and casualty insurers authorized to do business in Florida. The memorandum notes price optimization involves analysis and incorporation of data not related to expected cost for risk characteristics. It concludes "the use of price optimization results in rates that are unfairly discriminatory." The FLOIR directs property and casualty insurers that have used price optimization in determining rates filed and currently in effect to "submit a filing to eliminate that use" and further directs future filings "do not utilize price optimization in any manner."[24]
- **Vermont:** On June 24, 2015, the Vermont Department of Financial Regulation issued Bulletin No. 186 stating some property and casualty insurers have been relying upon price optimization to help determine the premiums they will charge policyholders. The bulletin notes "while insurers may employ judgment in setting their

(Continued on page 8)

[20] *www.mdinsurance.state.md.us/sa/docs/documents/insurer/bulletins/bulletin-14-23-unfair-discrimination-in-rating.pdf*.
[21] *www.insurance.ohio.gov/Legal/Bulletins/Documents/2015-01.pdf*.
[22] *www.insurance.ca.gov/0400-news/0100-press-releases/2015/release022-15.cfm*
[23] *www.aaisonline.com/Portals/0/259393019-N-Y-Department-of-Financial-Services-Letter-on-Price-Optimization.pdf*.
[24] *www.floir.com/siteDocuments/OIR-15-04M.pdf*.

rates, judgmental adjustments to a rate may not be based on non-risk-related factors such as "price elasticity of demand" which seek to predict how much of a price increase a policyholder will tolerate before switching to a different insurer. The bulletin also notes the use of such factors unfairly discriminates between policyholders of the same risk profile. Insurers were directed to disclose all personal lines rate filings on the SERFF General Information page whether the company uses non-risk-related factors to help determine the insured's final premium.[25]

- **Washington:** On July 9, 2015, the Washington State Office of the Insurance Commissioner issued a Technical Assistance Advisory to property and casualty insurers doing business in Washington state warning that any use of price optimization resulting in premiums, rates, or rating factors "unrelated to cost and risk" will be considered unfairly discriminatory and in violation of Washington state law. It concludes by stating that the Washington State Office of the Insurance Commissioner will not approve rates it considers to be unfairly discriminatory.[26]
- **Indiana:** On July 20, 2015, the Indiana Department of Insurance issued Bulletin 219 directed at all personal lines insurers doing business in Indiana. The purpose of the bulletin was to alert insurers "that the use of price optimization in establishing rates is not permitted." The Bulletin instructs all companies currently using price optimization to submit a new rate filing within 90 days.[27]

◆ NAIC White Paper

The NAIC Casualty Actuarial and Statistical (C) Task Force (Task Force) began drafting the White Paper earlier this year after the issue of price optimization was referred to it from the NAIC Auto Insurance (C/D) Study Group in November 2014. The Task Force released a first draft for public comment March 24, 2015. The Task Force received numerous comments from regulators, the industry and consumer groups. A second draft was subsequently released for public comment May 19 and comments received were discussed by conference call. The most recent draft was released for public comment Aug. 10 and discussed at a Task Force meeting held Aug. 15 at the NAIC Summer National Meeting. The latest draft is exposed for a public comment period ending Sept. 14, 2015.

The current version of the draft White Paper provides background information on state rating law, actuarial principles and price optimization, including an overview of various definitions of "price optimization" used by stakeholders. Potential benefits and drawbacks of price optimization are also identified, which includes the concerns raised by consumer advocacy groups. A section discussing regulatory responses to price optimization rating schemes is also included, which discusses the concerns raised by state insurance regulators. The draft White Paper also includes recommended wording in Appendix A for the states to consider when issuing a letter or bulletin to personal lines insurance companies.

The final section of the draft White Paper outlines regulatory recommendations and next steps. A first draft of the final section was released prior to the Aug. 15 Task Force meeting. The most current draft of the White Paper can be found on the Task Force's Web page.[28]

◆ Summary

The concept of price optimization has gained increased attention recently. The concerns are centered on its use to price premiums in the personal lines market. State insurance regulators are actively monitoring the issue. The final version of the *Price Optimization White Paper* will provide state insurance regulators with regulatory guidance. A final version is expected to be finished this fall before the NAIC Fall National Meeting in November.

About the Author

Shanique (Nikki) Hall is the manager of the NAIC Center for Insurance Policy and Research. She joined the NAIC in 2000 and currently oversees the research, production and editorial aspects of the CIPR's four primary work streams; the CIPR Newsletter, studies, events and website. Ms. Hall has extensive capital markets and insurance expertise and has authored copious articles on major insurance regulatory and public policy matters. She began her career at J.P. Morgan Securities as a research analyst in the Global Economic Research Division. At J.P. Morgan, Ms. Hall analyzed regional economic conditions and worked closely with the chief economist to publish research on the principal forces shaping the economy and financial markets. Ms. Hall has a bachelor's degree in economics and an MBA in financial services. She also studied abroad at the London School of Economics.

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[25] www.dfr.vermont.gov/reg-bul-ord/price-optimization-personal-lines-ratemaking.
[26] www.insurance.wa.gov/about-oic/newsroom/news/2015/documents/TAA-PO-July2015.pdf.
[27] www.in.gov/idoi/files/Bulletin_219.pdf.
[28] www.naic.org/committees_c_catf.htm.

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