Locke Lord LLP

INSURANCE & REINSURANCE NEWSLETTER

DECEMBER 2017

In this Issue

Locke Lord's Insurance Newsletter provides topical snapshots of recent developments in the fast-changing world of insurance. For further information on any of the subjects covered in the newsletter, please contact one of the members of our Insurance team.

OUR EDITOR:

Alan J. Levin
Partner
Hartford | 860-541-7747
New York | 212-912-2777
alan.levin@lockelord.com

OUR AUTHORS:

Theodore P. Augustinos
Partner
Hartford
860-541-7710
ted.augustinos@lockelord.com

Molly McGinnis Stine
Partner
Chicago
312-443-0327
mmstine@lockelord.com

Elizabeth Kilburn
Associate
London
+44 (0) 20 7861 9288
elizabeth.kilburn@lockelord.com

Thomas J. Smedinghoff
Of Counsel
Chicago
312-201-2021
tom.smedinghoff@lockelord.com

Zachary N. Lerner
Associate
New York
212-912-2927
zachary.lerner@lockelord.com

Bilal Zaheer
Partner
Chicago
312-201-2875
bilal.zaheer@lockelord.com

Are We Covered by the EU GDPR? A Warning for U.S.-Only Businesses

By Elizabeth Kilburn and Thomas J. Smedinghoff

All U.S. insurers need to pay attention to the new and comprehensive EU-wide privacy law known as the General Data Protection Regulation[1] (GDPR), which takes effect on May 25, 2018. With its greatly expanded compliance obligations, tough penalty regime (fines can be as much as 4% of a company's worldwide gross revenue), and extra-territorial applicability, even insurers licensed to sell only in the U.S., and with no operations in the EU whatsoever, may nonetheless find that they are subject to the jurisdiction of GDPR.

Continuing to service policies sold in the US to customers who later moved to the EU, for example, may raise issues regarding whether the company's activities bring it within the jurisdiction of the GDPR, which is designed to protect the personal data of individuals in the EU, regardless of nationality.

The GDPR is a comprehensive reform of European data protection laws intended to strengthen online privacy rights and boost Europe's digital economy. It provides for a single set of rules for all organizations processing personal data from the EU, removing many of the inconsistencies across Member States that have been associated with the Data Protection Directive.

The extra-territorial scope of the GDPR is very broad, however, and will likely reach many U.S. insurers and other businesses even though they do not have a presence in the EU. Generally, Article 3 provides that the GDPR will apply to U.S.-based companies in three cases:

(a) If the U.S. Business has an "Establishment" in the EU

The GDPR applies to entities who are engaged in the processing of personal data ***in the context of the activities of an establishment*** in the EU, regardless of whether the processing takes place in the EU or not. However, establishment in the EU does not require the formal presence of a subsidiary or other legal entity.

The GDPR states that an establishment implies the ***effective and real exercise of activity through stable arrangements.*** The legal form of such arrangements, whether through a branch or a subsidiary with a legal personality, is not the determining factor in that respect.

Prior interpretations of the term "establishment" under the Data Protection Directive make clear that that an establishment need not have a legal personality but that a stable establishment requires that "both human and technical resources necessary for the provision of particular services are ***permanently available.***" Thus:

- Where 'effective and real exercise of activity' takes place, for example in an attorney's office through 'stable arrangements,' the office would qualify as an establishment.
- A one-person office would qualify as long as the office does more than simply represent a controller established elsewhere, and is actively involved in the activities in the context of which the processing of personal data takes place.
- In any case, the form of the office is not decisive: even a simple agent may be considered as a relevant establishment if his presence in the EU presents sufficient stability.[2]

In one case, the European Court of Justice held that "the presence of only one representative can, in some circumstances, suffice to constitute a stable arrangement if that representative acts with a sufficient degree of stability through the presence of the necessary equipment for provision of the specific services concerned in the Member State in question."[3]

It is also important to note that processing personal data "in the context of" an establishment in the EU does not require processing ***by*** the EU establishment. The existence of an EU-based establishment may trigger applicability of the GDPR over a non-EU entity, even if that local EU establishment is not actually taking any role in the data processing itself, so long as there is an *"inextricable link"* between the activities of the EU establishment and the processing of data carried out by the non-EU controller.

For example, the European Court of Justice in the "Google Spain" case found that U.S.-based Google Inc. was processing personal data in the context of an EU establishment because its search activities were inextricably linked to the advertising sales generated by Google Spain, a local subsidiary established in the EU. Because the data processing at issue was related to the search business which Google Spain's sale of online advertising helped finance, the court found that the processing by Google in the U.S. was carried out "in the context of the activities" of the Spanish establishment.

Therefore, if this "processing of personal data in the context of the activities of an EU establishment" test is met, the GDPR applies irrespective of whether the actual data processing takes place in the EU or not.

(b) If the U.S. Business Offers Goods or Services in the EU

The GDPR also applies to insurers and other businesses not established in the EU if they process the personal data of individuals who are in the EU when ***offering them goods or services*** (whether or not in return for payment). This applies to the processing of personal data of any "***data subjects who are in the Union***," regardless of their nationality or residence – i.e., it covers the personal data of EU citizens, residents, tourists, and other persons temporarily in the EU (e.g., U.S. businesspersons or military personnel).

The question of what constitutes "offering" goods or services to EU residents is determined on a case-by-case basis. The only guidance on how to interpret this provision indicates that the focus for interpreting this requirement is on the *intention* of the non-EU entity, rather than on the mere availability of its goods or services.

Thus, while the *mere availability* of the website of a U.S.-based entity is not sufficient *per se*, the following website-related factors (among others) have been suggested as strong indications that a non-EU business is *intentionally* offering goods or services to data subjects in the EU and may therefore be subject to the GDPR:

1 Available at http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32016R0679

2 WP 179, Article 29 Working Party, Opinion 8/2010 on applicable law, December 16, 2010, at pp. 11-12.

3 *Weltimmo v NAIH* (Case C-230/14, October 1, 2015), at Para. 30.

- Use of the language of an EU Member State (if the language is different than the language of the business' home state);[4]
- Use of the currency of an EU Member State (if the currency is different than the currency of the business' home state);
- Use of a top-level domain name of an EU Member State;
- Mentions of customers based in an EU Member State; or
- Targeted advertising to consumers in an EU Member State.

A key question for insurers may well be the extent to which they offer goods or services to US-based customers who later move (either temporarily or permanently) to the EU, whether such services are offered through their website or other means.

(c) If the U.S. Business Monitors the Behavior of Individuals in the EU

Insurers and other businesses that are not established in the EU, and that do not offer goods or services in the EU, will nonetheless be subject to the GDPR if they process personal data ***in connection with the "monitoring" of the behavior*** of EU data subjects.[5]

The question of what constitutes "monitoring" is determined on a case-by-case basis, but analysis of the GDPR establishes that monitoring appears to be focused on internet activity that includes both:

- **tracking** an individual on the internet; **and**
- the use of data processing techniques to **profile** such individuals in order to analyze or predict personal preferences, behavior and attitudes.

The GDPR defines profiling to be any form of automated processing of personal data "to evaluate certain personal aspects relating to a natural person, in particular to analyse or predict certain aspects concerning that natural person's performance at work, economic situations, health, personal preferences, interests, reliability, behaviour, location or movement."

Accordingly, it would seem that monitoring requires not only the gathering of personal data involving personal aspects of natural persons, but the automated processing of such data for the purpose of making decisions about the data subjects.

At this point, however, it is unclear exactly how detailed the monitoring of a data subject must be in order to trigger the application of the GDPR.

Any U.S. business which falls in to one of these three categories must start taking measures *now* to ensure it will be fully compliant by 25 May 2018.

4 See, e.g., the CJEU's ruling in Weltimmo (Case C230/14), which emphasized that if a company operates a service in the native language of a country (in that case a Slovakian property advertising service operating in Hungary) it could be held accountable to that country's data protection authority.

5 GDPR Article 3(2)(b) provides that: "This Regulation applies to the processing of personal data of data subjects who are in the Union by a controller or processor not established in the Union, where the processing activities are related to: . . . (b) the monitoring of their behaviour as far as their behaviour takes place within the Union."

Developing Cybersecurity Requirements in Banking, Insurance and Other Financial Services

by Theodore P. Augustinos

The financial services industry has been dealing with requirements for cybersecurity since 1999, but 2017 brought new, significant, and proliferating obligations. The bar for the whole industry was clearly raised by the unilateral action of the New York Department of Financial Services (DFS), which adopted a new regulation, Cybersecurity Requirements for Financial Services Companies (23 NYCRR 500), effective March 1, 2017. The DFS Cybersecurity Regulation imposes significant new responsibilities on DFS licensees (which includes insurers and producers, banks, mortgage lenders and brokers, and others) over a transition period ending in 2019.

Taking up the mantle, the National Association of Insurance Commissioners (NAIC), which had been working on a model information security law for two years, essentially scrapped its prior drafts and, in October 2017, adopted much of the terminology and concepts of the DFS Regulation to promulgate a model law that would not create substantial inconsistencies with the DFS. In fact, a drafter's note to the NAIC Model specifies that compliance with the DFS Regulation would be deemed compliance with the NAIC Model. There are, however, important differences and distinctions between the two regimes, and it is certainly possible that states will adopt the NAIC Model with their own revisions that could create additional inconsistencies, which would complicate compliance, and drive up the cost.

The NAIC Model, if and as adopted into law by the various states, would apply to licensees of state insurance regulators. The DFS Regulation applies to all DFS licensees (as well as those required to obtain DFS permits, registrations, and other authorizations), including licensees in the insurance, banking and other financial services industries, but does not include securities firms, which are not, in New York, licensed by the DFS. It is interesting to note that the Colorado Division of Securities and the Vermont Securities Division have adopted regulations, similar in many respects to New York's, but specific to the securities industry. Between the NAIC Model and other state initiatives, the technical cybersecurity requirements for the financial services industry may certainly be expected to proliferate. Even for financial services participants outside the insurance industry, and for those in jurisdictions that may not take immediate action to adopt the NAIC Model, a review of the new duties would be well-advised, as the themes, if not the actual technical requirements, should be addressed in any serious cybersecurity program.

The following is a description of some of the critical provisions of the DFS Regulation and the NAIC Model, and the differences and nuances between them.

1. **Information Security Program.** Both the DFS Regulation and the NAIC Model require the adoption of an Information Security Program (called a Cybersecurity Program in the DFS Regulation) to govern the protection of data and systems. One of the important developments of the DFS Regulation and the NAIC Model is the recognition that cybersecurity must go further than protection of information, and must protect information and operating systems. Both the

NAIC Model and the DFS Regulation contemplate that the program should take into account the size and sophistication of the licensee, and the nature of its risks, although the NAIC Model is more explicit on this point.

2. **Risk Assessment.** Under both regimes, the Information Security Program itself, and the other, related policies and procedures, are to be based on a risk assessment. The DFS Regulation is far more specific on the technical requirements for a risk assessment, including that it must be conducted in accordance with written policies and procedures.
3. **Qualified and Trained Personnel.** As cybersecurity cannot be addressed with exclusively technical solutions, and as human error plays so prominently as a cause of compromises, both the DFS Regulation and the NAIC Model impose responsibilities related to personnel. The DFS obligations concerning personnel are far more exacting and onerous, but both require the designation of a specific person to be responsible for cybersecurity, and the implementation of awareness training for all personnel.
4. **Access Control.** A key element of any cybersecurity program, controlling access to information systems, is a specific requirement of both the DFS Regulation and the NAIC Model.
5. **Encryption.** While the NAIC specifically requires encryption only of certain data transmitted over a public network, and stored on laptops and other mobile devices, the DFS Regulation also requires encryption of data at rest (e.g., on desktops and servers, or in storage), with some flexibility for compensating controls where encryption is not feasible.
6. **Notification of certain Cybersecurity Events.** Consistent with the new European regime under the General Data Protection Regulation, both the DFS Regulation and the NAIC Model require notification to the regulator of certain compromises of data and systems within 72 hours. Both also leave the obligation to notify affected individuals and other parties to the general breach notification statutes, except that the NAIC Model also requires 72 hour notice by reinsurers to ceding insurers.
7. **Annual Certification of Compliance.** Under both the DFS Regulation and the NAIC Model, annual certificates of compliance must be filed with the regulator. It is important to note, however, that the certification requirement of the NAIC Model applies only to insurance companies, and not to other licensees such as producers and others.
8. **Exemptions.** Both the DFS Regulation and the NAIC Model contain exemptions for certain reinsurers, captives and others, but the DFS Regulation contains several additional, important exemptions. For example, while the NAIC Model would exempt licensees with fewer than 10 employees, the small business exemption of the DFS Regulation also contains an asset and revenue threshold below which a business is exempt. This could reflect the fact that the NAIC Model has expressly provided that its obligations are to be based on the size and sophistication of the licensee; the DFS Regulation has less built-in flexibility. It is important to note that the DFS exemptions for certain covered entities are only partial, and still require compliance with significant elements of the DFS Regulation. Significantly, the NAIC Model exemptions are self-executing, while several of the exemptions under the DFS Regulation require the filing of a notification of exemption.

Equifax Lax About Hacks, Says Shareholder Lawsuit

by Molly McGinnis Stine and Bilal Zaheer

In early September, Equifax disclosed a now well-known data breach that ultimately affected a reported 146 million customers in the United States. The breach allegedly occurred in May 2017, as a result of an online security flaw that was known to the company by March 2017 but that was not properly fixed. In late July, the company noticed suspicious traffic on its system. Ultimately, the breach was discovered, and the software flaw addressed, but not before the names, addresses, social security numbers and other personal information of millions of customers were stolen. The stock market's reaction to the news

of the Equifax data breach was immediate – the company's share price plunged over 15% within days of the announcement.

That led to a group of Equifax shareholders promptly filing a class action against the company, its (now former) CEO and its CFO in a Georgia federal district court, alleging fraud under federal securities laws and seeking to recover damages. The complaint alleges, among other things, that "(1) the Company failed to maintain adequate measures to protect its data system; (2) the Company failed to maintain adequate monitoring systems to detect security breaches; (3) the Company failed to maintain proper security systems, controls and monitoring systems in place; and (4) as a result of the foregoing the Company's financial statements were materially false and misleading at all relevant times."

To date, shareholder lawsuits in the wake of data breaches, especially suits alleging securities fraud claims, have been relatively rare. And as we noted previously, derivative lawsuits filed to date have not fared well in court, with most having been dismissed in the initial stages.

The circumstances of the Equifax breach could make this case different. To begin with, one of the reasons shareholders have generally not filed securities class actions after a data breach is that the affected company did not experience a meaningful drop in share price and so there were insufficient damages to pursue in litigation. Here, Equifax's stock priced dropped 15% the day after the breach was announced and dropped even further in the week after the announcement. The current stock price remains below the price prior to disclosure of the incident.

In addition, media reports indicate that three Equifax executives sold their company stock shortly after the company discovered the security breach but before the breach was disclosed to the public. The amount of stock sold was about $2 million. A special committee comprised of independent board members has investigated the stock sales and recently issued a report stating that the executives were unaware of the breach at the time they sold their stock. Nevertheless, shareholder allegations to the contrary could be enough to take the case into the discovery phase.

Finally, the seriousness of the breach (nearly half of all Americans affected), combined with the fact that Equifax's business is based on securing and protecting customer information, may lay the groundwork for a derivative lawsuit claiming breach of fiduciary duty against Equifax's directors and officers that could survive the initial pleadings hurdles that stymied similar lawsuits brought against directors and officers of Target, Wyndham and Home Depot (no such lawsuit against Equifax directors and officers has been filed yet).

As of the date of this article, derivative lawsuits against directors and officers of Wendy's and Yahoo!, seeking damages in connection with data breaches experienced by those companies, remain pending. Moreover, a derivative lawsuit against Home Depot that was initially dismissed on the pleadings recently settled for $1.125 million after the shareholders sought to appeal dismissal. Thus, it remains worthwhile to keep an eye on the progression of these lawsuits.

Group P&C Insurance: Admitted and Surplus Lines Issues

by Zachary N. Lerner

For decades, group insurance coverage has been an attractive vehicle for the placement of certain property and casualty insurance products. On the carrier side, loss experience may be more favorable when aggregating similar insureds under a master insurance policy, resulting in cheaper premiums for consumers. On the producer side, the use of group P&C coverage helps achieve product distribution efficiencies and may result in fewer regulatory burdens and paperwork, in addition to the added benefit of marketing an aggregated risk platform to an insurer rather than presenting risks on an individual basis.

When the 1980s rolled around, the lack of affordable and available commercial liability insurance coverage become sufficiently apparent that Congress passed the Federal Liability Risk Retention Act of 1986 to increase the availability of such coverage and decrease associated costs. A driving impetus for the passing of the LRRA was to minimize state-law barriers to marketing commercial liability insurance on a group or group-like basis. To achieve these ends, the LRRA provides a degree of federal preemption from state insurance regulation through the establishment of risk purchasing groups (RPGs) and risk retention groups (RRGs). The LRRA does not set forth a regulatory framework under which RPGs and RRGs must operate, but rather allows for the operation of such groups free from certain state insurance laws that would otherwise apply and act as hurdles for achieving the desired effects of the LRRA.

The LRRA does not, however, allow for RPGs to procure on behalf of their members or RRGs to provide to their members property insurance coverage. Furthermore, many of today's commercial insurance liability products are offered through non-LRRA groups operating exclusively under state law without the benefit of the LRRA's state law preemption. As a result, the marketplace is teeming

with a variety of P&C group insurance structures offering a variety of coverages and subject to different, and perhaps in violation of some, state insurance regulatory requirements or prohibitions.

While there are many different forms P&C insurance groups can take, one common theme among all of them is the desire to avoid burdensome state insurance regulation. As a result, there has been an increasing trend in the industry to defer to the "home state" of the master or group insurance policyholder to determine which jurisdictions' laws governing the group (whether it be a RPG or RRG under the LRRA, or an association or similar insured aggregation entity under state insurance law), and to interpret both federal and state law to preempt the jurisdictional reach of other states where members of the group may reside.

Recently, some states have been taking a closer look at some of the group P&C insurance coverage arrangements. This article identifies some of the important issues for insurers and producers to consider, both in the admitted and surplus lines insurance markets, as to the regulation of LRRA and permissible state insurance law groups in connection with commercial insurance programs.

RPGs and RRGs Under LRRA

Scope of RPG Preemption and Applicability of Local State Law

If a group is established as a RPG under the LRRA, it may purchase (although, as it not an insurance carrier, may not itself provide) commercial liability insurance coverage on a group basis for its members and is "exempt from any State law, rule, regulation or order to the extent that [it] would ... otherwise discriminate against a purchasing group or any of its members."[1] The LRRA also preempts states from, among other things, prohibiting insurers from providing insurance coverage and rates exclusive to RPGs based on collective loss experience or from applying seasoning requirements to the minimum tenure of existence of a RPG. However, other than the specifically enumerated preempted actions under the LRRA, states generally have the right to regulate RPGs.

It is important to note, however, that simply determining that a RPG has complied with the laws of its home state that are not preempted by the LRRA is not always sufficient to comply with all applicable laws. For example, on the admitted side, guidance in a number of states indicates that such states impose their insurance rate and policy form filing requirements on coverage issued to RPGs for their members that reside in their states. As a result, because surplus lines insurance carriers need not generally file insurance rates and policy forms, multistate programs underwritten by surplus lines insurers through RPGs will likely reach the market faster as forms and rates will not need to be approved in every state.

While the surplus lines insurance route is sometimes more expeditious and efficient, RPGs do face some regulatory issues unique to the surplus lines insurance market when coverage is procured on a nonadmitted basis. Many RPGs act under the (often incorrect) assumption that surplus lines insurance requirements only apply to the state of the RPG's domicile. In fact, most states have specific laws requiring that the market unavailability affidavit and declination requirements applicable to surplus lines insurance brokers be fulfilled as to each certificate holder residing in such state that purchases coverage through the RPG, as opposed to fulfilling the affidavit and declination requirements only once for the RPG itself in its domiciliary state.[2] Furthermore, state law establishing additional restrictions on surplus lines insurance placements, depending on the jurisdiction, may also apply in the RPG context as well, such as local requirements that certain kinds of coverages be procured from the admitted market.

RPGs also face surplus lines insurance tax implications that will often require taxes to be allocated among states in proportion to where the insured risks reside. For example, the Excess Lines Association of New York notes that "other states may handle [RPG] filings differently and consider the 'insured's home state' to be the state where the [RPG] is headquartered" but nevertheless requires that surplus lines broker taxes be paid "only to New York for New York 'home stated' [RPG] members."[3] By contrast, some other states take the opposite view that surplus lines broker taxes need only be paid to the home state of the RPG, the master policyholder.

Scope of RRG Preemption and Applicability of Local State Law

RRGs, in contrast to RPGs, are captive insurers controlled by their owners and provide coverage to members through the diffusion of liability risks across such members. The LRRA affords RRGs federal preemption protection, and such preemption is in many ways much broader than what the LRRA affords to RPGs. The general rule as to RRGs is that all nondomiciliary state insurance laws are preempted other than express exceptions identified in the LRRA. In particular, all states (other than the domiciliary state of the RRG) are preempted from regulating the operation of a RRG, except for specifically noted purposes, such as mandating compliance with unfair insurance claims practices statutes and registration requirements.

However, LRRA also provides that "[t]he terms of any insurance policy provided by a [RRG] ... shall not provide or be construed to provide insurance policy coverage prohibited generally by State statute ... ."[4] As such, LRRA specifically recognizes the rights of nondomiciliary states to enforce at least some local insurance laws other than as expressly permitted under Section 3902 of LRRA.

The result has been two decades of sparse, but telling, court decisions reflecting the ability of states to enforce state-specific restrictions on RRGs notwithstanding the LRRA's preemption language. For example, under *Wadsworth v. Allied Prof'ls Insurance Co.*, 748 F.3d 100 (2d Cir. 2014), the Second Circuit was asked to determine whether a New York insurance statute giving an injured party the right to sue an insurer for satisfaction of a judgment obtained by the injured party against the insurer's customer, the insured tortfeasor, applies to RRGs. The court found that this statute "specifically governs the content of insurance policies, requiring insurers to place in their New York contracts a provision that is not contemplated by the [LRRA]" and thus is preempted. By contrast, *Zeigler v. Hous. Auth. Of New Orleans*, (La. App. 4 Cir., 2016) addressed a substantially similar fact pattern as seen in *Wadsworth* and found that the LRRA does not preempt a state's right to impose a "direct action" statute on a RRG. Some courts have tried to draw a

1 15 U.S.C.A. § 3903.

2 New York alleviates this requirement somewhat, allowing for the affidavit to be "executed and filed by the licensee on behalf of more than one member of a purchasing group, where liability insurance for such members was procured during the 30 days prior to the filing of the affidavit ...." N.Y. Comp. Codes R. & Regs. tit. 11, § 301.06.

3 ELANY Bulletin No. 2011-29.

4 15 U.S.C.A. § 3905(c).

distinction between laws actually affecting coverage under an insurance policy versus laws affecting procedure or form; under *Speece v. Allied Professionals Insurance Co.*, 853 B,W,2d 169 (Neb., 2014), the court found that the LRRA preempted a state prohibition against the inclusion of mandatory predispute arbitration clauses in insurance policies, concluding that the LRRA's preemptive scope does not extend to laws affecting actual coverage, but that an arbitration clause "does not concern much less prohibit the coverage provided, but instead governs how disputes between the parties are to be resolved."

What do the RRG cases tell us? In short, that courts differ throughout the country on the preemptive scope of the LRRA regarding when states may enforce their insurance laws as to an RRG's members residing within their borders. The existing case law suggests that the LRRA preempts state regulation of insurance policy terms that do not impact the coverage itself (such as anti-arbitration provisions and cancellation/non-renewal provisions), whereas statutes targeting specific scope of coverages (such as prohibitions against insuring punitive damages, which have broad, localized public policy implications) would not be preempted by the LRRA. Congressional reports prepared before passage of the LRRA evidence this intent.[5] However, such distinction is certainly not uniform throughout the country.

Non-LRRA Groups Established under State Law

Many P&C insurance programs continue to operate outside of the scope of LRRA for a variety of reasons, including curtailing costs and expediting entry into the marketplace by avoiding RPG registrations in member states, and the inclusion of types of coverages outside the scope of LRRA, such as property or any other type of nonliability commercial insurance. Furthermore, a handful of states lack robust statutory insurance group frameworks, which may lead to the impression that non-LRRA groups are minimally regulated. This assumption, however, can lead to major pitfalls down the road.

One practical implication of the LRRA's preemption of state prohibitions on selling group commercial liability insurance is that, when coverage is issued through an RPG or by a RRG, grouping of unrelated member insureds without common insurable (jointly owned) interests is permissible. A non-LRRA group, which thus lacks the federal preemption protections of LRRA, must be wary of state "fictitious group" insurance laws that vary across jurisdictions. Some states generally prohibit the use of fictitious grouping for insurance purposes without defining what a "fictitious group" actually is, while other states have more specific definitions. For example, in Georgia, a fictitious group is considered "any grouping by way of membership, nonmembership, license, franchise, employment contract, agreement, or any other method or means resulting in unfair discrimination."[6] Many states go a step further than Georgia and prohibit any P&C insurance grouping unless there is a common insurable interest among the members of the insured group.[7] There are even states that identify only certain kinds of coverages that may be offered on a group insurance basis. For example, in New York, "group" P&C insurance coverage may only be written through a "safety group", a "mass merchandising" or a similar plan where policies are individually underwritten as to each group member; otherwise, P&C insurance group programs in New York may only be written with respect to groups comprised solely of public entities, nonprofit organizations and educational not-for-profit corporations.[8]

When a group intends to procure property insurance coverage on behalf of its members, additional state insurance law restrictions may apply. For example, a number of states expressly prohibit the procurement of property insurance coverage in the group context altogether, irrespective of whether such coverage is issued to a bona fide group, and will often expressly extend such prohibition to the surplus lines insurance market as well.[9] Some jurisdictions, even if their statutes are silent, have internal "desk drawer" rules whereby state insurance departments take the position that group property insurance coverage is impermissible.

Should coverage be lawfully issued to a non-LRRA insurance group, attention must also be given to the laws of each state where an insurance certificate holder resides. For example, in Washington, "[no] master policy or series of policies *or certificates of insurance* of property, inland marine, casualty or surety insurance" may be issued in the state without abiding by applicable group laws (emphasis added). States sometimes enforce their state-specific coverage restrictions on certificate

5 See, e.g., House Report No. 99-865 (September 23, 1986) (indicating that a RRG "may not provide coverage prohibited by State statute or declared unlawful by the highest court of the State whose law applies. Possible examples include coverage for punitive damages, or for intentional, fraudulent, or criminal conduct.")

6 Ga. Code Ann. § 33-6-5(4)(B)

7 See, e.g., Idaho Code Ann. § 41-1317(1) (defining a "fictitious group" as a group "in which members of such group do not have a common insurable interest as to the subject of the insurance and the risk or risks insured or to be insured."

8 N.Y. Insurance Law § 3435(a).

9 See, e.g., Tennessee Interpretive Opinion No. 05-15 ("[t]he issuance of a group property surplus lines policy in itself makes a preference or distinction in favor of that group in so offering.
Accordingly, group property surplus lines insurance policies are generally barred under the Tennessee Unfair Trade Practices Act.")

holders as well, including prohibitions on aggregate limits and deductibles shared between members of the group, restrictions against insuring against punitive damages, and applicability of cancellation and nonrenewal standards.

Insurance producers should also be aware of local state restrictions on non-LRRA insurance groups. For example, even if the master insurance policyholder's home state allows for the charging to an insured of insurance-related broker fees, the practice may be prohibited with respect to a certificate holder residing in a state that disallows such charge. By contrast, a number of jurisdictions will instead defer to the laws of the home state of the master policyholder altogether.

Even if all fictitious group and local state insurance law issues are reconciled, the surplus lines insurance market faces an additional challenge with respect to allocation of surplus lines insurance broker taxes, With respect to individual surplus lines insurance policies, the Nonadmitted and Reinsurance Reform Act of 2010 dictates that all surplus lines insurance broker taxes must be paid to the "home state" of the insured or, if 100 percent of the premium of the insured risk is located outside of the state in which the insured's principal place of business or residence is located, then the state where the greatest percentage of the insured's total premium is located. Some states interpret the NRRA to apply in the group insurance context as well and allow for surplus lines insurance broker tax to be paid solely to the home state of the master policyholder. Other states, like Tennessee, take the position that "group surplus lines certificates of insurance issued to citizens [in the state] ... are considered insurance policies ... and are subject to [the state's] gross premium taxation payment requirements."[10] The surplus lines insurance broker is traditionally the party responsible for payment of such tax and should be aware of the positions of each state as to the taxation of surplus lines insurance premiums; however, in instances where an insured directly procures coverage on a group insurance basis through the process commonly known as "independent procurement", the insured is usually the taxpayer responsible for the payment of an independently procured insurance tax and will need to pay special attention to the laws of each state.

Conclusion and Lessons Learned

Group P&C insurance offers many tangible advantages over traditional individualized coverage, including favorable premiums, efficiencies and economies of scale. Sometimes, group insurance programs offer the added benefit of reduced regulatory scrutiny (particularly with respect to prohibition of discrimination against LRRA-based groups by the states). However, the reality is that P&C insurance group offerings sometimes lead to more regulatory questions across both the admitted and surplus lines insurance markets and require insureds, insurers and producers alike to be acutely aware of local state law. This article is not meant to dissuade insurance carriers or producers from contemplating or offering group P&C insurance coverage, but rather to illuminate just some of the prevalent issues seen today that require a nuanced understanding of how the states view such products and where the market is heading. As group insurance continues to expand within the P&C sphere, we fully expect to see the states issue further clarity on a host of these issues through new statutes, regulations, bulletins and opinions alike in the months and years to come.

10 Id.

ACCOLADES

- Locke Lord has been ranked among the top 40 law firms for client service performance by BTI Consulting Group in its new report, "BTI Client Service A-Team 2018."
- Locke Lord's Insurance Law was recognized by U.S. News/ Best Lawyers in the National Tier 1 ranking and the Metropolitan Tier 1 Ranking for Chicago
- Locke Lord Receives Perfect Score in Human Rights Campaign Foundation's 2018 Corporate Equality Index

ARTICLES & QUOTES

- Alan Levin and Aaron Igdalsky *(both Hartford)* co-authored "At the Intersection," Best's Review, November 2017
- Theodore Augustinos *(Hartford)* quoted in "The SEC Breach and the New Age of Cybersecurity," Mergermarket Cybersecurity Report, November 27, 2017
- Kyle Foltyn-Smith *(Los Angeles)* authored "Grapes of Wrath: Insurance Fallout from the Wine Country Wildfires," Insurance Journal, November 20, 2017
- Theodore Augustinos *(Hartford)* authored "Forward Vision: New York's Cybersecurity Regulation Imposes a Series of Deadlines," Best's Review, November 2017
- Jonathan Bank and Al Bottalico, *(both Los Angeles)* contributed to "Rhode Island legacy transfer market poised for take-off," Insurance Day, October 26, 2017
- Thomas Sherman *(Atlanta)* commented in The Deal Pipeline on NAIC's Adoption of the Cybersecurity Model Act on October 24, 2017
- Jonathan Bank *(Los Angeles)* and Aaron Igdalsky (Hartford) co-authored a Locke Lord Quick Study "A Beacon in the Night Sheds New Light," October 23, 2017
- Zachary Lerner *(New York)* authored "New Insurance Platforms Arguably Require Producer Licenses," Law360, October 17, 2017
- Alan Levin *(Hartford)* quoted in "Lack of Flood Coverage Will Change Market," Intelligent Insurer's PCI Today, October 15, 2017
- John Emmanuel, Robert Romano and Stewart Keir *(all New York)*, co-authored a Locke Lord QuickStudy, "UPDATE: US and EU Negotiate Covered Agreement on Insurance and Reinsurance Regulation," October 4, 2017
- Patrick Byrnes and Matthew Kalas *(both Chicago)* quoted on "Massachusetts: Federal Court Grounds Municipal Drone Law," Drone Life, September 22, 2017
- Theodore Augustinos *(Hartford)*, Andrew Shindler *(London)* and Molly McGinnis Stine *(Chicago)* co-authored "The "C" in Today's C-Suite: Cybersecurity," Reactions Magazine, September 2017

CONFERENCES, PRESENTATIONS AND SPEAKING ENGAGEMENTS

- Locke Lord will sponsor and Alan Levin *(Hartford)* will attend the IBA Insurance – Into the Unknown: Challenges and Opportunities Conference in London on March 23-24, 2018
- Locke Lord will sponsor and Brian Casey *(Atlanta)* will attend GSU – The Riskies: Risk Science and Insurance Leadership Awards in Atlanta on March 8, 2018
- Alan Levin will speak and Aaron Igdalsky *(both Hartford)* will attend ACI's 14th Insurance Regulation Conference in New York, NY on March 7-8, 2018
- Brian Casey *(Atlanta)* will speak at the Warranty Chain Management Conference (WCM) Conference 2018 in San Diego, CA on March 6-8, 2018
- Paige Waters, Rowe Snider and Thomas Jenkins *(all Chicago)* will attend the IAIR Resolution Workshop in Scottsdale, AZ on February 7-9, 2018
- Alan Levin *(Hartford)*, Michael Perlis *(Los Angeles)* and Cary Economou *(Dallas)* will attend St. John's University Insurance Leader of the Year Awards in New York, NY on January 17, 2018
- Locke Lord is a sponsor and Jon Biasetti *(Chicago)* will attend the ABA 44th Annual TIPS Midwinter Symposium on Insurance and Employee Benefits in Coral Gables, FL on January 11-13, 2018
- Julie Mahaney *(Hartford)* and Jill Schaar *(Houston)* attended the Advancement of Professional Insurance Women (APIW) Holiday Luncheon in New York, NY on December 7, 2017
- Paige Waters *(Chicago)* attended the NAIC 2017 Fall National Meeting in Honolulu, HI on December 2-4, 2017
- Julie Mahaney *(Hartford)* attended The Insurance Market Summit: Insurtech is "Changing the Game" in Hartford, CT on November 15, 2017
- Theodore Augustinos *(Hartford)* and Brian Casey *(Atlanta)* hosted a webinar for the Life Insurers Council of LOMA on "The NY DFS Cybersecurity Regulation and its Nationwide Implications through the NAIC Model," on November 15, 2017
- Alan Levin, Donald Frechette *(both Hartford)*, William Primps and John Emmanuel *(both New York)* attended the LatinoJustice PRLDEF Annual Awards Gala in New York, NY on November 8, 2017
- Locke Lord sponsored and Paige Waters *(Chicago)* attended the 21st Annual Insurance Forum in Chicago, IL on November 8, 2017
- Brian Casey *(Atlanta)* spoke at the Gulf State Financial Services Group in Houston, TX on November 8, 2017
- Brian Casey *(Atlanta)* spoke and Christopher Martin *(Houston)* attended the Consumer Credit Industry Association (CCIA) - Delta 2017 Educational Seminar in Houston, TX on November 6-8, 2017.
- Brian Casey and Thomas Sherman *(both Atlanta)* attended the Fasano 14th Annual Longevity Conference in Washington, DC on November 6, 2017
- Brian Casey *(Atlanta)* spoke at the Atlanta RIMS - Risk Management Foundation BOT in Atlanta, GA on November 3, 2017
- Christopher Flanagan *(Boston)* spoke at the 42nd Annual Insurance Tax Conference in Orlando, FL on November 2, 2017
- Brian Casey *(Atlanta)* attended the 23rd Annual Fall LISA - Life Settlement & Compliance Conference in Clearwater, FL on October 15-17, 2017
- Brian Casey *(Atlanta)* spoke at InsureTech Connect 2017 in Las Vegas on October 3, 2017
- Brian Casey *(Atlanta)* was a panelist for Expert Webcast's Market Outlook for Life Insurance Settlements webinar on September 28, 2017
- Brian Casey *(Atlanta)* spoke at LOMA's LIC Laws and Legislation Committee Meeting, hosted by Locke Lord in the Atlanta Office on September 25-26, 2017
- Brian Casey *(Atlanta)* spoke at the GWSCA 3rd Annual Warranty & Service Contracts Conference in Chicago, IL on September 21-23, 2017

EVENTS

- Locke Lord will host a complimentary continuing legal education webinar on *"Dissecting the Amendments to Florida's Viatical Settlement Act,"* on December 20, 2017. For more information, click here.
- Locke Lord will host its popular cocktail reception during the NAIC Spring National Meeting in Milwaukee, WI on March 24-27, 2018. Visit NAIC.lockelord.com, our site dedicated to bringing you the latest NAIC National Meeting information.

Locke Lord LLP

Practical Wisdom, Trusted Advice.

www.lockelord.com

Atlanta | Austin | Boston | Chicago | Cincinnati | Dallas | Hartford | Hong Kong | Houston | London | Los Angeles
Miami | Morristown | New Orleans | New York | Providence | San Francisco | Stamford | Washington DC | West Palm Beach