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SIDLEY GLOBAL INSURANCE REVIEW

APRIL 2021

TALENT. TEAMWORK. **RESULTS.**

SIDLEY GLOBAL INSURANCE REVIEW

April 2021

The insurance industry is global in nature. Insurers and reinsurers are critically important to the world economy, assuming and transferring risk across each continent and serving as an enormous investor base for the world's capital markets. Risk generated in one part of the world is distributed immediately across multiple markets to traditional and new market entrants alike — insurers, reinsurers, private equity sponsors, capital market investors, and others. Regulatory issues arising in one market may influence the way in which similar regulatory concerns are addressed in other markets; the insurance industry constantly evolves, requiring regulatory regimes and market participants to adapt to changing circumstances.

For a full understanding of the insurance industry, it is essential to have a grasp of the global trends and developments that bear upon that industry. Each year, we prepare the *Sidley Global Insurance Review* as a tool to assist readers in obtaining such an understanding. This publication provides an overview of major legal and market developments in the global insurance industry over the past year, with a focus on the United States, United Kingdom, European Union, Asia, and other markets with significant insurance industry activity, such as Bermuda.

The *Sidley Global Insurance Review* has been produced by Sidley's Insurance and Financial Services group. Sidley is one of the world's premier law firms, with over 2,000 lawyers across 20 offices in North America, Europe and Asia Pacific. Our firm is one of only a few internationally recognized law firms to have a substantial, multidisciplinary practice devoted to the insurance industry. We have more than 85 lawyers devoted to providing transactional, regulatory, and dispute resolution services to the insurance industry throughout the world. Our Insurance and Financial Services group has a deep knowledge of, and appreciation for, the insurance industry and its unique issues and challenges. Regular clients include many of the largest insurance and reinsurance companies, their investors and capital providers, brokers, banks, investment banking firms, and regulatory agencies for which we provide corporate, capital markets, securities, mergers and acquisitions, private equity, insurance-linked securities, derivatives, tax, reinsurance dispute, class action defense, insolvency, and other transactional, regulatory, and litigation services.

We hope you find the 2021 edition of the *Sidley Global Insurance Review* to be a valuable tool in navigating the insurance market.

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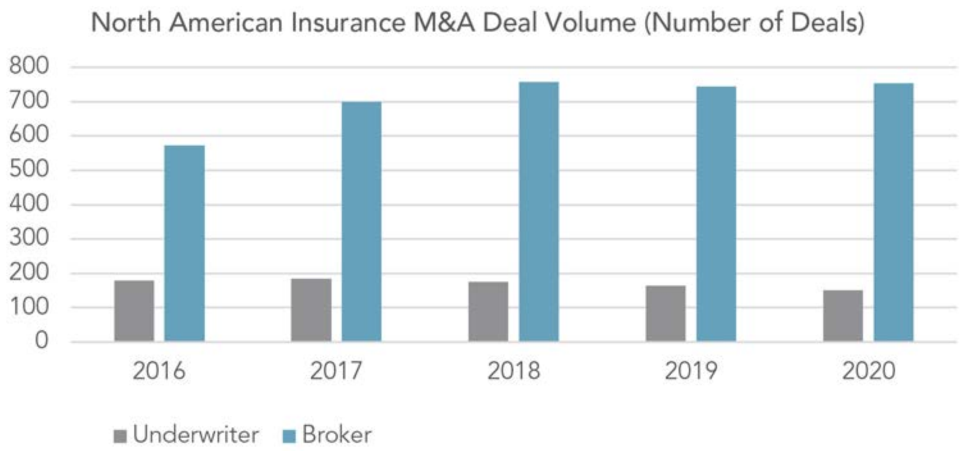
I. The Global Mergers and Acquisitions Market

A. NORTH AMERICAN MARKET

1. Introduction

The insurance industry, like many other industries, faced unprecedented challenges in 2020 as a result of the global COVID-19 pandemic. As the U.S. and the rest of the world ground to a near-standstill at the end of the first quarter and beginning of the second quarter, so too did mergers and acquisitions ("**M&A**") activity in the insurance industry. Amidst stay-at-home orders and other restrictions imposed in response to COVID-19, transaction activity slowed in the face of the economic uncertainty introduced by the pandemic. To paraphrase Mark Twain, however, reports of the demise of the insurance M&A market were greatly exaggerated, and by the second half of the year, deal activity had returned to pre-pandemic levels. Buyers and sellers adapted to the depredations and uncertainties of the pandemic and — encouraged by a recovering economy, a growing pipeline of deals, and ample dry powder — reentered the fray. By the end of 2020, overall deal volume saw only a moderate decline relative to 2019, with 151 insurance M&A transactions announced in 2020, down from 165 in 2019.[1]



Source: *Insurance Broker M&A Activity Ticks Up YOY in FY'20; Underwriter Deals Slow*, S&P Global Market Intelligence (January 12, 2021).

In light of the uncertain political, economic, and financial consequences of COVID-19, transacting parties fashioned novel contractual arrangements to address the new risks introduced by the pandemic. Purchase agreements now routinely allocate pandemic risk explicitly, from both an economic and a contractual perspective (through, among other things, purchase price adjustments, exceptions to interim operating limitations, and material adverse effect carve-outs).

The willingness to transact even in the face of a global crisis was supported by factors including the prospect that successful vaccines would come to market relatively swiftly, and the recognition — after initial uncertainty — that video conferencing and other telecommuting technology could ensure business almost as usual in the insurance and financial services sectors.

While the pandemic disrupted the insurance M&A market in the early months of 2020, it did not appear to have a substantial impact on the trends in the market on which we have reported in prior editions of this publication, which were once again very much in evidence in 2020. These trends, on which we elaborate below, include the enthusiastic participation of private equity-backed and other nontraditional buyers in the insurance market, divestment by carriers of non-core assets, the increasing interest of carriers in insurtech transactions, and the use of special purpose acquisition companies ("**SPACs**") to access public investment.

While a comprehensive discussion of the insurance M&A transactions announced in 2020 is beyond the scope of this review, we present below tables of notable insurance M&A and block reinsurance transactions announced since the start of 2020, which indicate the continuing robustness of the market, notwithstanding the pandemic-related headwinds of early 2020.

The insurance industry, like many other industries, faced unprecedented challenges in 2020 as a result of the global COVID-19 pandemic.

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The willingness to transact even in the face of a global crisis was supported by factors including the prospect that successful vaccines would come to market relatively swiftly, and the recognition – after initial uncertainty – that video conferencing and other telecommuting technology could ensure business almost as usual in the insurance and financial services sectors.

1 *Insurance Broker M&A Activity Ticks Up YOY in FY'20; Underwriter Deals Slow,* S&P Global Market Intelligence (January 12, 2021).

Selected Insurance M&A Transactions (Ranked by Deal Value)

Buyer	Target/Industry	Seller	Announcement Date	Approximate Value
Apollo Global Management, Inc.	Athene Holding Ltd.	Shareholders of Athene Holding Ltd.	March 8, 2021	US$11 billion[2]
KKR & Co. Inc.	Global Atlantic Financial Group Ltd. and Global Atlantic Financial Life Limited / Life & Health	Shareholders of Global Atlantic Financial Group Ltd.	July 8, 2020	US$4.7 billion[3]
The Allstate Corporation	National General Holdings Corp. / Multiline	Shareholders of National General Holdings Corp.	July 7, 2020	US$3.72 billion
Clover Health Investments Corp.	Social Capital Hedosophia Holdings Corp. (SPAC) / Life & Health	Public SPAC shareholders	October 6, 2020	US$3.5 billion
Massachusetts Mutual Life Insurance Co.	Great American Life Insurance Co. / Life & Health	American Financial Group, Inc.	January 27, 2021	US$3.5 billion
Third Point Reinsurance Ltd.	Sirius International Insurance Group Ltd. / Reinsurance	Public shareholders of Sirius International Insurance Group Ltd., as well as institutional majority shareholder CM Bermuda Limited	August 6, 2020	US$3.3 billion[4]
Antelope US Holdings Company (an affiliate of an investment fund associated with The Blackstone Group Inc.)	Allstate Life Insurance Company / Life & Health	Allstate Insurance Company	January 26, 2021	US$2.8 billion
Investor Group[5]	36% stake in Rothesay Life PLC / Life & Health	The Blackstone Group Inc.	September 30, 2020	US$2.7 billion
Brookfield Business Partners LP	Genworth MI Canada Inc.[6] / Mortgage Guaranty	Shareholders of Genworth MI Canada Inc.	October 26, 2020	US$1.25 billion
TowerBrook Capital Partners, L.P. and Further Global Capital Management	ProSight Global, Inc. / P&C Surplus Lines	Public shareholders of ProSight Global, Inc. as well as institutional majority shareholders (affiliates of Goldman Sachs and TPG Global, LLC)	January 15, 2021	US$586 million
Cranberry Holdings, Inc. (a subsidiary of Kemper Corporation)	American Access Casualty Company, its related captive insurance agency, Newins Insurance Agency Holdings, LLC, and its subsidiaries / P&C	American Access Group, LLC	November 23, 2020	US$370 million
Sixth Street Partners	Talcott Resolution Life Insurance Company / Life & Health	Investor Group[7]	January 20, 2021	Undisclosed

2 Reflects the stated value of Athene Holding Ltd. under the terms of the deal.

3 The purchase price was equal to Global Atlantic's book value at the time of closing.

4 Reflects the stated value of the entity surviving the merger.

5 Included, among others, GIC Private Ltd. and Massachusetts Mutual Life Insurance Co.

6 Now known as Sagen MI Canada.

7 Includes Cornell Capital LLC, Atlas Merchant Capital LLC, Global Atlantic Financial Group, TRB Advisors LP, Pine Brook, J. Safra Group, and The Hartford.

Selected Block Reinsurance Transactions (Ranked by Ceded Reserves)

Assuming Reinsurer / Parent	Subject Business	Ceding Insurer	Announcement Date	Ceded Reserves
Athene Holding Ltd.	Fixed annuity business	Jackson National Life Insurance Company	June 18, 2020	US$27 billion[8]
Venerable Holdings, Inc.	Corporate Solutions Life Reinsurance Company / Life & Health	Equitable Holdings, Inc.	October 27, 2020	US$12 billion
Global Atlantic Financial Group Ltd.	Individual disability income business	Unum Group	December 17, 2020	US$8.5 billion
Global Atlantic Financial Group Ltd.	Fixed and fixed-indexed annuities	Great American Life Insurance Company	October 27, 2020	US$5.7 billion

2. Trends in Insurance M&A Activity

Not surprisingly, the COVID-19 pandemic was the defining influence on deal activity in 2020. However, despite the challenges and uncertainties that it imposed, putative buyers and sellers adapted relatively swiftly to the new environment.

Dealmaking was stimulated by the converging seller and buyer motivations that we have observed in recent years: sellers continued to pursue divestitures (including through reinsurance) in order to exit non-core business lines, and buyers sought to broaden their geographic reach, diversify their product offerings, and acquire new distribution channels. The participation of private equity-backed and other financial buyers continued unabated, owing in no small measure to the reliable return streams on invested capital derived from insurance business. Additionally, as has increasingly been the case in recent years, insurers actively explored opportunities to acquire technology and data analytics assets in deals with both early stage and mature fintech businesses. We review below some of the more noteworthy transactions in which those trends are apparent.

a. Challenges Resulting from COVID-19

Nearly all players in the insurance M&A space have had to grapple with COVID-19 in some fashion and, for some, the unique challenges presented by the pandemic fundamentally altered the negotiated outcome, or even the viability, of insurance transactions. In the early going, when market uncertainty seemed at its highest, some deals were terminated as parties struggled to assess appropriate valuations and, as the year unfolded, deals increasingly reflected new ways to allocate the risks posed by the pandemic. For example, it has become almost routine to include COVID-19-specific language in acquisition agreements and to include carve-outs for pandemics or similar outbreaks to material adverse effect language, force majeure provisions, and interim operating covenants.

One prominent early casualty of the outbreak of the pandemic was the proposed sale by Italian investment firm Exor NV ("**Exor**") of its subsidiary PartnerRe, a Bermuda-based global reinsurer, to French insurer Covéa Cooperations S.A. ("**Covéa**"). In February 2020, Exor announced that it was in exclusive talks with Covéa concerning the potential sale, and by early March 2020, the parties had signed a US$9.05 billion agreement for the business. On May 14, 2020, with the pandemic raging across the globe, Exor announced that Covéa had elected to terminate the transaction. Covéa's stated reason was that the consummation of the transaction was no longer tenable given the unprecedented impact of COVID-19 on the insurance market.[9] With the parties unable to agree on a purchase price adjustment, Covéa elected not to consummate the transaction. However, in hopes of "normalizing" the relationship between the parties after the deal was scuppered, Covéa agreed to invest approximately US$1.8 billion in entities managed by PartnerRe.[10] [11]

A notable example of a transaction in which the purchase price was calibrated to reflect the potential impact of COVID-19 was the combination, announced on August 6, 2020, of Third Point Reinsurance Ltd. ("**TPRE**") and Sirius International Insurance Group, Ltd. ("**Sirius**") in a merger

8 Included a US$500 million indirect equity investment by Athene Life Re in the corporate parent of Jackson.

9 *7 Major M&A Deals that Broke Down Due to COVID-19*, Law 360 (January 11, 2021).

10 *French Mutual Covéa Scraps $9 Billion Purchase of PartnerRe from Exor*, Insurance Journal (May 12, 2020).

11 *Exor and Covéa agree investments to settle relationship after failed PartnerRE deal*, Reuters (August 3, 2020).

transaction creating a global company valued at US$3.3 billion to be renamed SiriusPoint Ltd. In response to the uncertainties associated with the pandemic, the parties negotiated a purchase price adjustment mechanism through which the number of preferred shares that Sirius shareholders would receive would be adjusted depending on a threshold of COVID-related losses incurred by the applicable party, as measured upon the third anniversary of the closing.[12]

As we have discussed in previous editions of the Sidley Global Insurance Review, the use of RWI has become increasingly common in insurance M&A transactions, and the RWI market did not escape the impact of COVID-19.

The COVID-19 pandemic has also had an impact on ancillary players in the insurance M&A space, including carriers offering representation and warranty insurance ("**RWI**"). As we have discussed in previous editions of the *Sidley Global Insurance Review*, the use of RWI has become increasingly common in insurance M&A transactions, and the RWI market did not escape the impact of COVID-19. RWI policy premiums appear to have increased during the pendency of the pandemic, and insurance mergers and acquisitions have been subject to closer scrutiny by prospective RWI carriers, which have focused on due diligence relating to the pandemic's effect on the target's risk profile. In a similar vein, specific COVID-19 exclusions have become more customary, although the approaches to such exclusions can vary: some insurers propose blanket exclusions in respect of any business interruption or other losses attributable to COVID-19, while others have taken a more tailored approach. In light of the increasing reliance on RWI in insurance M&A deals in recent years, the effect of the pandemic on RWI pricing, exclusions, and availability bears watching.

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b. Private Equity and Other Financial Investors

Private equity-backed and other financial buyers continued to play a large role in insurance transactions in 2020, a few of which we briefly discuss below.

In July 2020, the largest acquisition transaction of the calendar year was announced when KKR & Co. Inc. ("**KKR**") agreed to acquire Global Atlantic Financial Group Limited ("**Global Atlantic**"). The US$4.7 billion acquisition, which closed on February 1, 2021, gives KKR an approximate 60% economic ownership stake in Global Atlantic, and increases KKR's insurance assets under management from US$26 billion to US$97 billion.[13] According to industry commentators, an especially attractive aspect of the transaction from KKR's perspective was the acquisition of "permanent" capital and, relatedly, a reduction in the need to seek funds from outside investors.[14]

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On January 26, 2021, Blackstone announced its agreement to purchase Allstate Life Insurance Company ("**Allstate Life**") from The Allstate Corporation ("**Allstate**") for approximately US$2.8 billion. Following the pattern of many insurance company acquisitions by financial buyers, the deal contemplates that at closing, Blackstone will enter into an asset management agreement with Allstate Life to oversee Allstate Life's US$28 billion investment portfolio.[15]

Other notable recent deals struck by financial buyers include the take-private acquisition of ProSight Global, Inc., a publicly listed property and casualty ("**P&C**") insurance company, by TowerBrook Capital Partners L.P. and Further Global Capital Management, and the acquisition of Talcott Resolution (whose business consists of a block of runoff variable annuity business spun off from The Hartford Financial Services Group, Inc. in 2018) by Sixth Street Partners from a group of investors including Cornell Capital, Atlas Merchant Capital, and Global Atlantic. Both deals were announced in January 2021.

As this edition of the *Sidley Global Insurance Review* was going to press, Apollo Global Management, Inc. ("**Apollo**") and Athene Holding Ltd. ("**Athene**") announced an agreement pursuant to which Apollo and Athene would merge in an all-stock transaction that implies a total equity value of approximately US$11 billion for Athene. The parties expect that the stronger capital base and alignment resulting from the merger will, among other things, allow the combined company to scale asset and liability origination and broaden distribution channels. The merger, announced on March 8, 2021, is expected to close in January 2022.[16]

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12 *Third Point Re and Sirius Group to Combine*, Third Point Reinsurance Ltd. (August 6, 2020).

13 *KKR to Buy Global Atlantic, Adding Almost $90 Billion in Assets*, Bloomberg (July 8, 2020).

14 *KKR is making a big push into the $30 trillion insurance industry - here's why private equity is starting to look more and more like Berkshire Hathaway*, Business Insider (July 13, 2020).

15 *Blackstone to Buy an Allstate Life Insurance Business for $2.8 Billion*, Bloomberg (January 26, 2021).

16 *Apollo Reabsorbs Athene in All-Stock Deal That Values Firm at $11 Billion*, The Wall Street Journal (March 8, 2021).

c. Changes in Strategic Focus

Allstate's disposition of Allstate Life seemingly reflects another continuing trend among sellers in the insurance space — the desire of some sellers to divest non-core assets and business lines in order to focus on core businesses.

Similarly, in an effort to expand its product offerings and distribution capabilities, Massachusetts Mutual Life Insurance Company ("**MassMutual**") announced in January 2021 that it would purchase Great American Life Insurance Company, its subsidiaries, and affiliated entities ("**Great American Life**") for US$3.5 billion. This acquisition would provide MassMutual with access to Great American Life's existing relationships with banks, independent agents, and broker-dealers. By broadening its product offerings and distribution capabilities, MassMutual has said that it hopes to complement its existing annuity business through the addition of new customers seeking lifetime income solutions.[17]

The British insurer Prudential plc and American International Group, Inc. ("**AIG**") also recently announced plans to spin off significant non-core business lines. Geographic considerations seemed to drive Prudential plc's January 2021 announcement that it would demerge its U.S. business in the second quarter of 2021. The proposed demerger follows the 2019 demerger of Prudential plc's business in the UK, and will enable the company to focus its international operations on its high-growth Asia and Africa businesses.[18] In October 2020, AIG announced plans to split off its life and retirement business from the broader AIG platform, indicating that a simplified corporate structure was a primary goal of the restructuring (a date for which had not been announced when this publication went to press).[19] This potential spinoff is reminiscent of other recent insurance spinoffs, such as AXA S.A.'s spinoff of Equitable Holdings ("**Equitable Holdings**") through a public offering of shares in Equitable Holdings.

In furtherance of its overall business strategy, Kemper Corporation ("**Kemper**"), through its acquisition subsidiary, Cranberry Holdings, Inc., agreed to acquire American Access Casualty Company ("**American Access**") and its affiliated insurance agency, Newins Insurance Agency Holdings, LLC, in an all-cash transaction valued at US$370 million. The acquisition, announced on November 23, 2020, is intended to add to Kemper's specialty auto franchise through American Access' specialty private passenger auto insurance, offered in Arizona, Illinois, Indiana, Nevada, and Texas, and will expand Kemper's distribution capabilities and customer and agent relationships.[20]

d. Block Reinsurance Transactions

A number of sales of non-core lines of insurance business in 2020 were effected through block reinsurance transactions, some of which also involved equity investments in the cedent or its affiliates by the assuming reinsurer. Two examples of such reinsurance/equity investment transactions involved Athene and Venerable Holdings, Inc. ("**Venerable**").

In June 2020, Athene agreed to reinsure US$27 billion in ceded reserves from Jackson National Life Insurance Company ("**JNL**"), in tandem with a concurrent US$500 million indirect equity investment by Athene in the corporate parent of JNL. In October 2020, Venerable announced that it had agreed to acquire Corporate Solutions Life Reinsurance Company, a subsidiary of Equitable Financial Life Insurance Company ("**Equitable**"), and, concurrently, to acquire through reinsurance approximately US$12 billion of legacy variable annuity reserves that Equitable will cede to Venerable.

Global Atlantic also announced two major reinsurance transactions in the fourth quarter of 2020. On October 27, 2020, Global Atlantic announced the reinsurance of US$5.7 billion fixed and fixed-indexed annuities business from Great American Life,[21] and on December 17, 2020, it agreed to reinsure a closed block of Unum Group's individual disability business, backed by US$8.5 billion in assets. The transaction

A number of sales of non-core lines of insurance business in 2020 were effected through block reinsurance transactions, some of which also involved equity investments in the cedent or its affiliates by the assuming reinsurer.

17 *MassMutual to Acquire Great American Life Insurance Company*, Businesswire (January 27, 2021).

18 *Prudential Reveals Plans to Demerge its US Business in 2021*, Insurance Business America (January 28, 2021).

19 *AIG Aims to Split Off Life & Retirement Business*, ThinkAdvisor (October 26, 2020).

20 *Kemper to Acquire American Access in $370 Million Transaction*, Businesswire (November 23, 2020).

21 *Global Atlantic Announces Annuity Reinsurance Transaction With Great American Life Insurance Company*, Businesswire (October 26, 2020).

was structured to close in two phases, with approximately US$7 billion in assets closing concurrent with signing, and the remaining US$1.5 billion expected to close in the first quarter of 2021, pending receipt of any required approvals and consents.[22]

e. Growth and Initial Utilization of Statutory Divisions and Insurance Business Transfers

Plans of division generally must include, among other things, a statement of the purpose of the division, evidence of requisite board or shareholder approval, organizational documents for the surviving and new companies, and an allocation of the assets and liabilities of the dividing company.

"Division" transactions are a creature of statute that have emerged in several jurisdictions in recent years, through which an insurance company may divide into two or more resulting companies and allocate its assets and liabilities (including policy liabilities) between those resulting companies. In order to effect a statutory division, plans of division outlining the terms and conditions of the proposed division must be filed for the dividing entity with the applicable state insurance regulator. Plans of division generally must include, among other things, a statement of the purpose of the division, evidence of requisite board or shareholder approval, organizational documents for the surviving and new companies, and an allocation of the assets and liabilities of the dividing company.

The "insurance business transfer" ("**IBT**") transaction is also a creature of statute that has emerged in several jurisdictions in recent years and is modeled on the UK's Part VII transfer. Such transactions provide a statutory mechanism for novating insurance policies from one insurance company to another without the need to obtain individual policyholder approval. An IBT transaction must be approved by both the domestic insurance regulator and a state court in order to become effective.

As a result of more widespread adoption of these statutes, regulatory guidance is becoming clearer, and has provided insurers with a better roadmap for execution of such divisions or IBTs.

As a result of more widespread adoption of these statutes, regulatory guidance is becoming clearer, and has provided insurers with a better roadmap for execution of such divisions or IBTs. Enacted statutes in Connecticut, Georgia, Illinois, Iowa, Oklahoma, Michigan, Nebraska, Pennsylvania, Rhode Island, and Vermont present an increasingly viable option for insurance companies seeking to separate blocks of business or specified policies, bifurcate business lines, and create increased flexibility in the pursuit of future transactions.

A recent high profile division transaction was proposed in January 2021, when Allstate filed plans of division with the Illinois Department of Insurance for eight of its insurance subsidiaries. If the plans are approved, each subsidiary would be split into two companies. Each of the eight current subsidiaries would retain all of the assets, liabilities, and contracts associated with that subsidiary's business except for certain assets, liabilities, and contracts that would be allocated to the new companies. Subject to regulatory approval, immediately following the divisions, Allstate will merge the eight new businesses into three companies in order to consolidate the new companies into each one of the Allstate, Esurance, and Encompass brands. Following the mergers, each of the consolidated companies will continue to be licensed in Illinois and, subject to receipt of regulatory approval, will also be licensed in Michigan.[23]

f. Insurtech

Traditional insurers continued to see in the insurtech market the opportunity to expand markets and access to customers, provide a more compelling user experience, automate processes, and enhance (and monetize) data analytics.

Last year saw continued growth in the insurtech market, with traditional insurers investing in or acquiring insurtech businesses in order to leverage the efficiencies offered by new technologies, and insurtech firms acquiring stakes in carriers with a view to expanding the reach of their platforms. Traditional insurers continued to see in the insurtech market the opportunity to expand markets and access to customers, provide a more compelling user experience, automate processes, and enhance (and monetize) data analytics. The US$300 million acquisition by Aon plc ("**Aon**") of CoverWallet, a leading digital insurance platform for small and medium-sized businesses, is a recent case in point. In announcing the deal, which closed in January 2020, Aon noted that the acquisition of the CoverWallet platform would expand Aon's position in the commercial insurance market for smaller businesses, while leveraging CoverWallet's technology and data and analytics capabilities to develop and scale digital client solutions for Aon clients.

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22 *Global Atlantic Announces $8.5 Billion Reinsurance Transaction with Unum Group*, Global Atlantic (December 17, 2020).

23 *In the Matter of the Plans of Division of: Allstate Insurance Company, Allstate Indemnity Company, Allstate Property and Casualty Insurance Company, Allstate Fire and Casualty Insurance Company, Encompass Indemnity Company, Encompass Property and Casualty Company, Esurance Insurance Company and Esurance Property and Casualty Insurance Company*, Hearing No. 21-HR-0010, Illinois Department of Insurance.

Conversely, insurtech businesses continued to look for growth opportunities in 2020 through the acquisition of traditional carriers. One example was the September 2020 acquisition by Hippo Insurance Services ("**Hippo**"), a home insurance insurtech agency, of Spinnaker Insurance Company ("**Spinnaker**"), a New Jersey-based national P&C insurer licensed in all 50 states. Hippo acquired Spinnaker in order to expand the geographical reach of its home insurance business. Spinnaker will operate independently under the Hippo umbrella while still serving third-party administrators and driving the growth of its program platform. Hippo and Spinnaker maintained a partnership prior to the acquisition, with Spinnaker serving as Hippo's largest carrier platform since 2017.[24]

g. SPACs

As commentators have noted, the use of SPAC structures in M&A transactions exploded in 2020: 230 new SPACs made their initial public offering debut, raising over US$77 billion, with 104 SPAC business combinations signing or closing during the year.[25] The growth in interest in SPACs was apparent in the insurance and, in particular, insurtech M&A market. For example, in December 2020, Porch.com ("**Porch**"), a real estate technology company, went public through its merger with a SPAC. Simultaneously with the closing of the SPAC transaction, Porch entered into an acquisition agreement with Homeowners of America Holding Corporation to purchase its managing general agent and insurance carrier. Porch anticipates that the acquisition will allow it to penetrate the insurance industry and provide actuarial, underwriting, and claims management products that will be marketed on its online real estate platform.[26] Similarly, on January 7, 2021, Clover Health Investments, Corp., a Medicare insurance startup, went public through a SPAC, and on March 4, 2021, Hippo announced that it would become a public issuer through a merger with Reinvent Technology Partners ("**Reinvent**"), a SPAC.

…the use of SPAC structures in M&A transactions exploded in 2020: 230 new SPACs made their initial public offering debut, raising over US$77 billion, with 104 SPAC business combinations signing or closing during the year.

h. Reciprocal Insurance Exchange Transactions

Reciprocal insurance exchanges, through which individuals and businesses exchange insurance contracts and spread the risk of such contracts among themselves, were popular targets in 2020, and several significant acquisitions or joint ventures involving reciprocal insurance exchanges were announced or closed during the year. In February, Tokio Marine Holdings Inc. ("**Tokio Marine**") completed its US$3.1 billion purchase of Privilege Underwriters Inc. and its subsidiaries ("**Pure Group**"), the attorney-in-fact of the U.S. high-net-worth insurer the Privilege Underwriters Reciprocal Exchange ("**Pure Exchange**"). Pure Group earns a fee for serving as the attorney-in-fact for Pure Exchange and also reinsures a portion of the risk of the policies written by Pure Exchange.[27] Similarly, in June 2020, TowerBrook-backed Orchid Underwriters Agency, LLC ("**Orchid**") and Homesite Group entered a joint venture to launch a reciprocal exchange insurer named Trusted Resource Underwriters Exchange ("**TRUE**") that will initially write Florida homeowners business on an admitted basis.[28] Finally, in November 2020, Cornell Capital and Hudson Structured Capital Management entered into an agreement to acquire Vault Holdings, LLC ("**Vault**"), a provider of personal insurance to high-net-worth clients. Vault operates under a unique hybrid business model, acting as a reciprocal insurance exchange, managing general agent, and excess-surplus insurance provider.[29] Reciprocal insurance exchanges have increasingly been viewed as attractive, owing to their ability to help develop a strong affinity with policyholders and generate fee income through ownership of the attorney-in-fact, while participating in underwriting income through a reinsurance arrangement with the reciprocal insurance exchange.

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24 *Hippo Acquires Spinnaker Insurance Company*, Businesswire (June 3, 2020).

25 *2020 – the Year of SPACs*, Sidley Austin LLP (Joshua G. DuClos) (December 2020).

26 *Porch Valuation Soars to $1B After IPO*, TheRealDeal (December 24, 2020).

27 *Tokio Marine Completes Acquisition of High Net Worth Insurance Specialist Pure Group*, Insurance Journal (February 10, 2020).

28 *Orchid and Homesite team up on Florida homeowners reciprocal exchange*, The Insurer (June 29, 2020).

29 *Cornell Capital and Hudson Structured Capital Management Ltd. to Acquire Majority Stake in Vault from Allied World*, PR Newswire (November 12, 2020).

There is reason to expect that the insurance M&A market will continue on its robust trajectory. While COVID-19 remains a wild card, the promising pace of vaccine deployment, and the seeming efficacy of approved vaccines, have given investors and corporations reason for optimism…

…we may see a return to the fray of some prospective dealmakers that had elected to remain on the sidelines until their concerns about the political, social, and economic uncertainties of the recent past could be assuaged.

While there is cause for optimism that 2021 will be another strong year for the insurance M&A market (and the broader economy), much uncertainty remains.

With a global pandemic undoubtedly casting a shadow over transaction volumes, 2020 proved to be a slower year for insurance M&A in Europe and the UK.

Areas that held up relatively well in 2020 broadly mirrored those of recent years, including the UK broker market, often backed by private equity, and continued interest in the insurtech sector.

3. Outlook

There is reason to expect that the insurance M&A market will continue on its robust trajectory. While COVID-19 remains a wild card, the promising pace of vaccine deployment, and the seeming efficacy of approved vaccines, have given investors and corporations reason for optimism that the dislocation and uncertainty caused by the pandemic will soon be on the wane. From an M&A perspective, this optimism is supported by the continued growth of equity markets.[30] The deployment of assets by private equity and other financial buyers continues to be a key driver of transactional activity in the insurance space.[31] In addition, the increased flexibility afforded by division and IBT transactions should afford insurance companies broader opportunities to divest non-core business.[32] And if, as some commentators have predicted, the resolution of the 2020 national election brings or is perceived to bring a more stable political environment, then we may see a return to the fray of some prospective dealmakers that had elected to remain on the sidelines until their concerns about the political, social, and economic uncertainties of the recent past could be assuaged.[33]

To be sure, challenges remain. While optimism abounds that the pandemic will soon run its course, and there is hope that the U.S. economy will be buoyed by a federal relief package, new COVID-19 variants have been identified across the world, including in the U.S., and many U.S. business are still reeling from the stay-at-home orders and other restrictions imposed to contain the pandemic. Another unknown is the potential impact of the regulatory agenda of the Biden administration, including the extent to which M&A transactions will be subject to greater federal antitrust scrutiny, as well as uncertainty surrounding federal taxes and inflation. Additionally, it has been reported that the Biden administration is exploring a more robust role for the Committee on Foreign Investment in the United States ("**CFIUS**"), particularly relating to Chinese investments in U.S. companies. This has implications for the U.S. insurtech market, which has seen significant Chinese investment in recent years.[34] While there is cause for optimism that 2021 will be another strong year for the insurance M&A market (and the broader economy), much uncertainty remains.[35]

B. EUROPEAN MARKETS

1. Introduction

With a global pandemic undoubtedly casting a shadow over transaction volumes, 2020 proved to be a slower year for insurance M&A in Europe and the UK. Concerns around market volatility and financial uncertainty had a significant impact, but the economic downturn has also created opportunities. Areas that held up relatively well in 2020 broadly mirrored those of recent years, including the UK broker market, often backed by private equity, and continued interest in the insurtech sector. More recently, in response to the difficulties faced in the current market, there has been renewed interest in Lloyd's of London ("**Lloyd's**") legacy deals.

2. Lloyd's

Historically, the long lead time and associated costs of establishing a Lloyd's platform organically via a turnkey operation has meant that M&A has, for many, been a preferable route to market entry, and has added some level of "market access" premium to the valuations of Lloyd's entities. However, this type of transaction has not been at the forefront of activity in 2020.

30 *Insurance deals insights: 2021 outlook*, PwC (December 2020).

31 *Id.*

32 It should be noted that division and IBT transactions are relatively novel and have not been thoroughly tested by the courts.

33 *Blank Check Deals, Distressed M&A to Headline 2021 Deals*, Law360 (January 3, 2021).

34 *Biden is Reportedly Beefing up the National Security Panel CFIUS to Scrutinize Chinese Investments in US Tech Startups*, Business Insider (January 31, 2021).

35 *2021 Insurance Outlook*, Deloitte (December 3, 2020).

In response to the upheaval caused by the COVID-19 pandemic, underwriters have increasingly sought to restructure their portfolios in order to sell underperforming units, or to allow solvency capital to be released through the sale of legacy business. A significant area of Lloyd's M&A activity in 2020 has been related to legacy business. For example, Randall & Quilter ("**R&Q**") agreed in December 2020 to acquire Vibe Services Management Limited, Vibe Corporate Member Limited and Vibe Syndicate Management Limited. The Vibe Syndicate 5678 had been placed into runoff in December 2019.

Changes at Lloyd's over the last few years have also resulted in a number of companies looking to exit unprofitable lines of business. Other Lloyd's legacy deals included the sale of Skuld Syndicate 1897 to Riverstone in June 2020 and Riverstone's acquisition of the Neon Lloyd's managing agency from American Financial Group, Inc. in a deal announced in September 2020.

While established runoff consolidators have continued to grow their Lloyd's legacy platforms, there has also been a notable amount of activity from startup legacy reinsurers. Private equity has played a substantial role in backing such startups, and Compre confirmed in February 2021 that it would launch a legacy syndicate (Syndicate 1994) with capital from Cinven and British Columbia Investment Management Corporation (BCI).

Private equity capital has also played an important role in several other Lloyd's deals in 2020. One such example is Golden Gate Capital's role as anchor investor in Mosaic, a Bermuda-based global specialty insurer, which launched a newly formed Lloyd's syndicate (Syndicate 1609) in February 2020. Further, Bain Capital Credit ("**Bain Capital**") partnered with Beat Capital Partners ("**Beat Capital**") to establish a dedicated underwriting vehicle, funded by Bain Capital through Beat Capital's Lloyd's syndicate (Syndicate 4242).

Additionally, there have been a number of Lloyd's underwriting businesses looking to raise capital in order to take advantage of improving rates. Lancashire Holdings Ltd. raised approximately £352 million in an equity capital raise in June 2020, while Hiscox and Beazley raised approximately US$465 million and US$300 million, respectively, through equity placements in May 2020. In addition, Ark Insurance Holdings Ltd raised US$800 million in a deal with White Mountains in September 2020.

The Lloyd's prospectus, since expanded upon in both Blueprint One — the Future at Lloyd's ("**Blueprint One**") and Lloyd's Blueprint Two ("**Blueprint Two**"), envisages simplified methods for enabling third parties to deploy capital in Lloyd's. One such solution was the "syndicate in a box" ("**SIAB**"). The first such syndicate, sponsored by Munich Re, was launched in January 2020, and another has been created by Parsyl, in partnership with Ascot and AXA XL, in order to insure the storage and transport of the COVID-19 vaccine. The proposed launch of another SIAB, Picnic Syndicate 2460, was unable to proceed as scheduled in January 2021, as not enough capital was raised in time for its launch. In contrast, Brit launched Ki, a follow-only syndicate, in May 2020 (see section IV.C.2.a.iv).

3. Broker M&A

Consolidation in the broker market continued to be a significant trend in 2020. Global insurance brokers Aon and Willis Towers Watson captured headlines in March 2020 with the announcement of an agreement to merge. In a deal valued at approximately US$30 billion, the transaction is expected to close in the first half of 2021, subject to regulatory and antitrust approvals.

In the UK context, several of the higher profile broker M&A deals in the last 12 months have involved private equity firms. Goldman Sachs-backed Aston Lark agreed to acquire Lloyd's broker Brunel, which specializes in professional indemnity insurance, directors' and officers' insurance, and cyber insurance. Further, private equity firm Cinven and the Singapore sovereign wealth fund GIC agreed to purchase specialty (re)insurance broker Miller. In June 2020, private equity firm Searchlight Capital Partners completed an acquisition of a majority stake in Global Risk Partners Ltd., a London-based insurance intermediary which operates retail broking, specialist managing general agent ("**MGA**") and Lloyd's businesses. More recently, U.S. private equity firm HGGC announced its intention to acquire Specialist Risk Group, a London market broker and MGA.

In response to the upheaval caused by the COVID-19 pandemic, underwriters have increasingly sought to restructure their portfolios in order to sell underperforming units, or to allow solvency capital to be released through the sale of legacy business.

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In the UK context, several of the higher profile broker M&A deals in the last 12 months have involved private equity firms.

4. Insurtech

Traditional (re)insurance companies have demonstrated a growing interest in investing their capital into insurtech, learning from the ever-increasing influence of fintech in the financial sector, and noting the advantages that come from using digital products that make insurance more accessible and efficient. Taking this in conjunction with the potential increase in market competitors from major technology companies, and startups that seek to disrupt the insurance sector, the major (re)insurers have been looking to increase the size and scope of their investments to ensure that they do not fall behind.

Traditional (re)insurance companies have demonstrated a growing interest in investing their capital into insurtech…

The final months of 2020 saw the announcement of two significant acquisitions of price comparison websites. The price comparison unit within UK home and car insurer Admiral Group Plc was acquired by digital real estate company Zoopla (ZPG Ltd), which itself was bought by Silver Lake in 2018. The second acquisition is still underway, though an offer by British media company Future Plc was accepted in January 2021 by the shareholders of GoCo Group, an online, data-led operator of comparison website, Go Compare.

The Lloyd's Lab, initially launched in 2018, continues to provide selected teams with a co-working space located in Lloyd's, potential funding and the chance to develop products, platforms and processes for the Lloyd's market. In 2020, Lloyd's launched a COVID-19-related Lloyd's Lab program, working with three new insurtech firms to develop COVID-19-related products and innovations to better protect customers against pandemics and other systemic risks. As noted in section I.B.2 above, Parsyl has undertaken a similar initiative in launching the Global Health Risk Facility, which used the public-private Syndicate 1796 — capitalized by the support of 14 insurers and reinsurers and a loan from the U.S. International Development Finance Corporation — to offer cost-effective insurance for vaccine transport and medical resources in developing countries.

5. Runoff and Restructuring Market

In addition to the transactions in the Lloyd's market, as set out in section I.B.2 above, there was a surge in activity in 2020 across the runoff sector in the UK and Europe, with legacy specialist R&Q completing a loss portfolio transfer with Allianz in September and in August 2020 signing an agreement to acquire the runoff interests of European runoff and legacy business, Inceptum Insurance Company. Many deals continue to stem from the capital requirements introduced under Directive 2009/138/EC ("**Solvency II**"). This coupled with the volatility of the market due to the COVID-19 pandemic has resulted in a number of insurers opting to adapt their business models by divesting themselves of legacy books, particularly in the non-life runoff sector. Solvency II capital requirements in respect of longevity risk have also acted as a catalyst for a wide range of longevity swap and single premium life reinsurance transactions (see section II.B.1).

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Solvency II capital requirements in respect of longevity risk have also acted as a catalyst for a wide range of longevity swap and single premium life reinsurance transactions.

6. Insurance Company Transactions

Outside of the runoff market, there were a number of notable UK and European insurance company M&A transactions in 2020, as many insurers attempted to clean up balance sheets and raise capital to take advantage of current market conditions. In November 2020, in an effort to take advantage of hardening market conditions, Bermuda-based Convex Group Limited — a specialty (re)insurer with carriers in Bermuda and the UK, underwriting across a diverse range of business lines including energy, marine, and property — raised additional funds in its second funding round. GIC, Onex Group Corporation and others committed to investing an additional US$1 billion, followed by a US$500 million preferred equity capital injection from affiliates of Sixth Street in January 2021. Further, in February 2020, Athora Holding Limited secured an additional €1.8 billion in equity funding from Athene, Abu Dhabi Investment Authority, Apollo, and other investors, in order to support the expansion of its European life insurance business.

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RSA Group also announced in November 2020 its agreement to a £7.2 billion takeover from Canadian insurer Intact Financial Corporation and Scandinavian insurer Tryg. Other significant recent European insurance M&A transactions include Aviva's sale of an 80% stake in its Italian life insurer joint venture for US$475 million to UBI Banca, and agreement to sell its French operations to Aema. Further, GIC and MassMutual entered into an agreement, which received regulatory approval in November 2020, to acquire Blackstone's 36% shareholding in Rothesay Life.

In October 2020, it was announced that Germany-based Talanx Group purchased all of the shares of Italian insurer Amissima Assicurazioni, indirectly owned by affiliates of Apollo, and in November 2020, AA plc agreed to a £219 million takeover from private equity firms TowerBrook Capital Partners UK

…the European insurance sector continues to be a source of interest for private equity firms with significant investment funds at their disposal, as insurance groups look to divest assets which they no longer consider to be part of their core business.

and Warburg Pincus International. Even more so now, with historically low interest rates, the European insurance sector continues to be a source of interest for private equity firms with significant investment funds at their disposal, as insurance groups look to divest assets which they no longer consider to be part of their core business. Many private equity firms have seen a chance to acquire these assets and reinvigorate them through more efficient management and wider synergies with their own investment management skill set.

II. The Global Alternative Risk Transfer and Capital Markets

A. P&C MARKET

1. Catastrophe Bonds

The catastrophe bond market saw a record year of new issuance in 2020, with estimates generally ranging around US$11-12 billion (excluding mortgage insurance-linked securities ("**ILS**") deals). Early in the year, the market was disrupted by the COVID-19 pandemic, as further described in section II.A.2 below, but the market recovered, culminating in the highest volume of fourth quarter issuance on record. Analysts generally expect this momentum to continue, predicting new issuance in 2021 ranging in the US$10-12 billion range.

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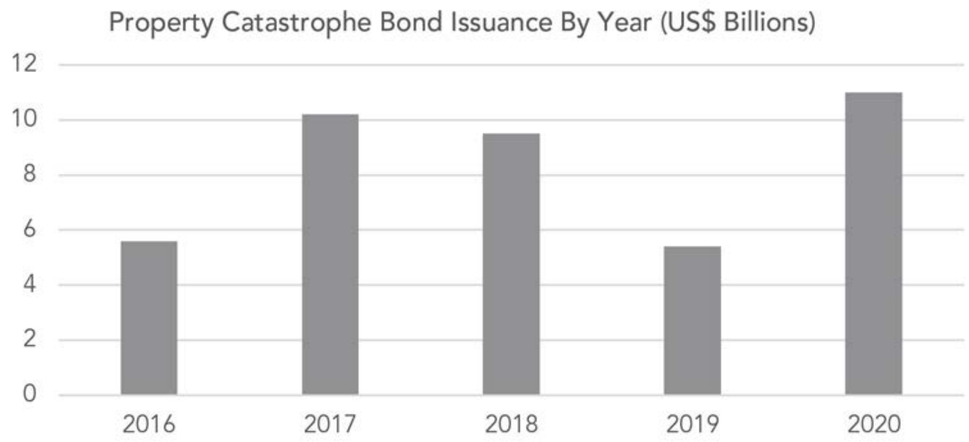

Source: *Insurance-Linked Securities: Aon Securities Q4 2020 Update*, Aon (February 2021).

Last year also saw a further shift away from aggregate triggers towards per-occurrence triggers, although a significant portion of deals still utilized an aggregate trigger. Investor concern about high frequency secondary perils, which have resulted in significant losses over the past few years, has primarily driven this trend. Although aggregate triggers are exposed to the cumulative effects of these secondary perils, losses from these perils generally have not reached the high attachment levels seen in most of the per-occurrence offerings.

Notably, investor appetite for catastrophe bonds has remained high despite the losses seen in recent years and the uncertainty caused by the COVID-19 pandemic, as investors have recognized the advantages of investing in ILS' most liquid and transparent asset class.

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2. Market Response to Recent Catastrophe Losses and COVID-19

Global insured catastrophe losses in 2020 — including losses from severe convective storms in the U.S., Hurricanes Laura, Isaias, and Sally, and the Kyushu floods in Japan — are estimated to be between US$82 billion and US$97 billion, marking the fifth costliest year for both public and private insurance entities on record.[36] Nearly all insured natural disaster losses resulted from weather-related disasters, primarily due to a relatively low number of significant earthquake events and lower insurance take-up in the regions in which such earthquake events occurred. Of the insured losses, 76% stemmed from events that occurred in the U.S. There were 28 separate billion-dollar-loss events in 2020, the highest total ever recorded, with 22 of those occurring in the U.S.[37]

Global insured catastrophe losses in 2020 are estimated to be between US$82 billion and US$97 billion, marking the fifth costliest year for both public and private insurance entities on record. Nearly all insured natural disaster losses resulted from weather-related disasters, primarily due to a relatively low number of significant earthquake events and lower insurance take-up in the regions in which such earthquake events occurred.

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36 *Weather, Climate & Catastrophe Insight – 2020 Annual Report*, Aon Benfield (January 2021); *Swiss Re Institute* (December 2020); *Record Hurricane Season and Major Wildfires – The Natural Disaster Figures for 2020*, Munich Re (January 2021).

37 *Weather, Climate & Catastrophe Insight – 2020 Annual Report*, Aon Benfield (January 2021); *Reinsurance Market Outlook*, Aon Benfield (January 2021).

Some segments of the ILS market experienced a tightening of terms and conditions in response to COVID-19, with protection providers seeking to include communicable disease exclusions to expressly exclude further losses relating to COVID-19 or similar events.

The first half of 2020 started off with new sponsors coming to market, as well as some long-absent sponsors coming to market for the first time in years.

The relative stability of the ILS market throughout this period compared to other assets classes further illustrated the value of the ILS asset class, which was previously evident after the 2008 financial crisis and the 2010-2012 European debt crisis. These characteristics of the ILS market have been well received by investors and are expected to continue to drive capital into this market.

The sidecar market continued to decrease in capacity, similar to previous years, primarily due to loss activity in 2017 and 2018.

The COVID-19 pandemic further contributed to this decrease as investors favored more liquid asset classes, such as catastrophe bonds.

Demand for third-party capital remains strong; however, this demand continues to outweigh capital supply for the time being.

The COVID-19 pandemic also affected the ILS market. Initially, the start of 2020 was marked by tightening spreads as the market filled with capital, which resulted in a record-breaking US$3.96 billion in new catastrophe bond issuances during the first quarter, surpassing 2018 issuances by US$375 million in the same period. The global pandemic changed this dynamic and caused unease and volatility in global financial markets. New issuances were paused in early March 2020 for approximately three weeks, but momentum increased in May and June. Despite global lockdowns and their effects across the broader financial markets, the ILS market remained liquid. New issuance spreads in the ILS market widened by 20-30%, depending on the risk being covered. Investors with access to cash were able to take advantage of the widening spreads.[38] Some segments of the ILS market experienced a tightening of terms and conditions in response to COVID-19, with protection providers seeking to include communicable disease exclusions to expressly exclude further losses relating to COVID-19 or similar events.

The first half of 2020 started off with new sponsors coming to market, as well as some long-absent sponsors coming to market for the first time in years. For the first time since 2013, RenaissanceRe reentered the ILS market with Mona Lisa Re 2020-1 covering U.S. wind and earthquake risks. Other notable sponsors of catastrophe bonds included: the California Earthquake Authority (CEA) with a new vehicle, Sutter Re Ltd., which raised US$700 million in the form of two classes of notes providing earthquake coverage for terms of three and four years, respectively; Hannover Re with 3264 Re 2020-1, covering North American wind/earthquake and European wind; and Markel with Stratosphere Re 2020-1, covering U.S. named storm, earthquake, severe thunderstorm, and winter storm. On the innovation front, Swiss Re's Matterhorn Re 2020-2 Class A transaction was structured as a combination tranche that covers losses from both extreme mortality events and named storm events, marking the first time such a structure has been utilized since Mythen Re 2012-2.

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3. Sidecars and ILS Funds

The sidecar market continued to decrease in capacity, similar to previous years, primarily due to loss activity in 2017 and 2018. Market sources estimate that the sidecar market contracted from about US$8.2 billion in the first quarter of 2019 to about US$6.8 billion in the first quarter of 2020, with only one new sidecar launching in the 12 months ending June 30, 2020, compared to six sidecars in the prior 12 months. In addition, 2020 saw sizeable capital redemptions and fewer ILS funds investing in sidecars as part of their core strategy.[39] The COVID-19 pandemic further contributed to this decrease as investors favored more liquid asset classes, such as catastrophe bonds. Nonetheless, a number of existing sidecar vehicles returned to the market in 2020, including K-Cessions, sponsored by Hannover Re. In January 2020 alone, issuances by 10 sidecars came to the market, including Peak Re's Lion Rock Re II, which upsized to US$77 million. The year ended with a notable transaction sponsored by Premia. Elevation Re, the first legacy market sidecar, raised over US$265 million to support Premia's global legacy and runoff business opportunities.

Sidecars continue to offer strategic value to (re)insurer sponsors by providing a third-party capital platform with increasing benefits over the medium- to long-term. Demand for third-party capital therefore remains strong; however, this demand continues to outweigh capital supply for the time being.

Notable ILS fund activity in 2020 included the launch of Integral ILS Ltd., an alternative fund manager focused on ILS investments, by industry executives Richard Lowther and Lixin Zeng in strategic partnership with TransRe and AmWINS. Integral secured cornerstone commitments from Public Sector Pension Investment Board, one of Canada's largest pension investment managers, and New Holland Capital, an alternative investment manager. As of January 2021, Integral had secured US$600 million in signed commitments.

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38 *Insurance-Linked Securities Market Update, Volume XXXIII, August 2020*, Swiss Re.

39 *ILS Annual Report 2020*, Aon Securities (2021).

4. Global ILS Initiatives

Despite the slow take-up of the Monetary Authority of Singapore (the "**MAS**") ILS grant scheme since its launch in February 2018, there were six catastrophe bond issuances from Singapore in 2020. Of the catastrophe bond transactions taking advantage of the MAS grant scheme, Hamilton Re-sponsored Easton Re Pte. Ltd. was notable in that it was the first Singapore issuance utilizing an industry loss index trigger.

After several years of interest in promoting ILS in China and Hong Kong, some concrete steps towards developing an ILS regime were taken in Hong Kong in 2020. Hong Kong passed legislation in July 2020 enabling the issuance of ILS by special purpose insurers. In September 2020, the Hong Kong Insurance Authority published a consultation paper on the draft Insurance (Special Purpose Business) Rules, which proposes certain draft rules for Hong Kong's ILS scheme, such as the scope of eligible investors, the minimum investment size, and relevant offenses and penalties. While it does not appear that Hong Kong intends to offer a cost subsidy scheme similar to that of the MAS, it may well offer other incentives as Hong Kong aims to revitalize the region's insurance industry and capture a share of the ILS market to support China's significant investment in global infrastructure projects, including China's "belt and road" initiative.

Bermuda's Incorporated Segregated Accounts Companies Act 2019 (the "**ISAC Act**") came into effect in January 2020. The ISAC Act, a standalone piece of legislation and a companion statute to the Segregated Accounts Companies Act 2000 (the "**SAC Act**"), further enhances Bermuda's ILS framework by combining the flexibility of the traditional segregated accounts company with the advantages of separate legal personality enjoyed by an incorporated company. Although the SAC Act already allows for the formation of segregated accounts and ringfencing of assets and liabilities linked to each segregated account, the ISAC Act confers a separate legal personality to each incorporated segregated account (an "**ISA**") of an incorporated segregated accounts company (an "**ISAC**"). An ISA can enter into contracts with other ISAs within the same ISAC, with third parties or with the ISAC itself. Further, ISACs have the option to adopt a separate memorandum of association, bylaws and board of directors for each ISA. While the ISAC Act is not intended to replace the SAC Act, the ISAC Act provides market participants with another way to create a group and operate multiple businesses or funds under one umbrella, with lower formation and management costs than standalone structures.

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While it does not appear that Hong Kong intends to offer a cost subsidy scheme similar to that of the MAS, it may well offer other incentives as Hong Kong aims to revitalize the region's insurance industry and capture a share of the ILS market…

5. M&A Activity

M&A activity in the Bermuda reinsurance market slowed in 2020, with companies instead pursuing organic growth opportunities. Nonetheless, Fitch Ratings believes this could change and warns that weaker firms could become targets if price improvements are not significant enough to offset the added stress of COVID-19 losses. Hedge fund reinsurers have been the subject of recent M&A activity, driven by pressure to produce profitable underwriting results and higher risk-adjusted investment returns. For example, TPRE and Sirius combined operations to form SiriusPoint Ltd., and Arch Capital Group has agreed to acquire Watford Holdings, another total return reinsurer.[40] The COVID-19 pandemic disrupted Covéa's proposed US$9.05 billion acquisition of PartnerRe from Exor. Instead, the parties agreed to Covéa putting US$900 million into special-purpose reinsurance vehicles managed by PartnerRe, as part of a US$1.8 billion co-investment with Exor.[41]

M&A activity in the Bermuda reinsurance market slowed in 2020, with companies instead pursuing organic growth opportunities.

6. Outlook Ahead

Winterstorm Uri swept across the U.S. in mid-February 2021, causing widespread damage, particularly in Texas, where millions were left without power and many without running water. Market sources predict that Winterstorm Uri and related severe winter weather could result in between US$10 billion and US$20 billion in insured losses.[42] Climate change is expected to continue to play an increasing role in the frequency and severity of severe weather events globally.

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40 *Bermuda Re/Insurers "ripe for take over," says Fitch*, Reinsurance News (January 26, 2021).

41 *Id.*

42 *CAT-I Bulletin: February 2021 U.S. Arctic Air Outbreak*, Guy Carpenter (February 2021); *Winter Storm Uri Insured Loss Seen Up to $20bn: Fitch*, Artemis (February 25, 2021); *AIR Says Winter Storm Uri Industry Loss Likely to Exceed $10bn*, Reinsurance News (February 26, 2021).

As environmental, social, and governance considerations become more prevalent in global financial markets (including in the ILS space), governments and regulators have started to respond with regulatory developments.

We expect that the use of alternative risk transfer mechanisms in the P&C market will continue to grow in the year ahead, and the insurance asset class, as a whole, will continue to attract new participants and new capital, despite the losses experienced in recent years and the continuing uncertainty caused by the COVID-19 pandemic.

We expect that traditional insurers and reinsurers will continue to explore new ways to use third-party capital to their benefit, with cyber risk being one potential opportunity for growth, and that the ILS market will continue to look for new and innovative ways to meet the needs of cedents and investors.

The UK's ILS regime has been in force since December 2017…

Since the regime has come into force, the UK regulators have already approved a number of ILS structures.

…the version of SS8/17 and the updates to the PRA Rulebook published alongside PS13/20 became effective on May 26, 2020 and are the current rules and guidance applicable to ILS vehicles established in the UK.

As environmental, social, and governance ("**ESG**") considerations become more prevalent in global financial markets (including in the ILS space), governments and regulators have started to respond with regulatory developments. The most prominent example is the EU's Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088) (the "**SFDR**") which applies from March 2021 for "financial market participants," including insurance undertakings that make available insurance-based investment products to EU investors, and alternative investment fund managers that market their funds to EU investors. The SFDR seeks to address the perceived risk of "greenwashing" when financial products are offered to EU investors, as well as to reorient capital flows towards more sustainable investments. In particular, the SFDR will require all in-scope financial market participants to make certain disclosures in respect of "sustainability risks," including firms that do not otherwise promote their products as having ESG features. Additional detailed disclosures are also required for firms promoting ESG products.

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B. PRUDENTIAL REGULATION AUTHORITY'S UPDATED RULES AND GUIDANCE ON THE UK'S INSURANCE-LINKED SECURITIES REGIME

The UK's ILS regime has been in force since December 2017, with the Risk Transformation Regulations 2017 (the "**Regulations**"), which set out the corporate and regulatory legislative structure for the UK's ILS regime, and the Risk Transformation (Tax) Regulations 2017 (the "**Tax Regulations**"), which set out the tax legislative structure. In addition, the Prudential Regulation Authority ("**PRA**") published the final version of an amended PRA Rulebook, including new rules to incorporate the ILS regime, as well as a Supervisory Statement[43] ("**SS8/17**"), setting out its guidance on the new rules and regulations, and the Financial Conduct Authority ("**FCA**" and together with the PRA, the "**UK regulators**") published its final statement on authorizing and supervising special purpose vehicles for ILS.

Since the regime has come into force, the UK regulators have already approved a number of ILS structures. With the experience gained from this, the PRA committed as part of its 2019/2020 Business Plan to further refine the ILS framework. As part of this commitment, the PRA released, in September 2019, Consultation Paper CP19/19 *'Insurance special purpose vehicles: Updates to authorization and supervision'* ("**CP19/19**") to provide further clarity on the PRA's approach and proposed developments in relation to the authorization and supervision of insurance special purpose vehicles ("**ISPVs**"). The main focus of CP19/19 was to provide updates to SS8/17, as well as certain changes to the ISPV part of the PRA Rulebook, and changes to the Multi-arrangement Insurance Special Purpose Vehicle ("**MISPV**") New Risk Assumption Notification Form. The consultation period ended in December 2019, and the PRA published its Policy Statement PS13/20 *'Insurance special purpose vehicles: Updates to authorization and supervision'* ("**PS13/20**") in May 2020, which sets out the PRA's feedback to the responses it received on CP 19/19, as well as its final policy on the proposed amendments.

The PRA only received one response to CP19/19, which raised a number of questions, including: the documentation requirements for outstanding commercial terms and future arrangements, accounting consolidation assessment, "clawback mechanisms," and basis risk analysis. The PRA addressed each of these queries in PS13/20, but there was little change to the PRA's initial proposals in CP19/19 as a result of these queries. Accordingly, the version of SS8/17 and the updates to the PRA Rulebook published alongside PS13/20 became effective on May 26, 2020 and are the current rules and guidance applicable to ILS vehicles established in the UK. The following highlights the key rule changes that resulted from this process.

43 Supervisory Statement (SS)8/17 *"Authorisation and supervision of insurance special purpose vehicles."*

1. Changes to Funding Arrangements

Solvency II requires that ISPVs remain fully funded at all times,[44] meaning that market participants operating under the UK ILS regime are not able to take advantage of "rollover" techniques used in some other jurisdictions. Such techniques allow ILS vehicles to use or roll over the funding from the current risk year into the following risk year. This can be challenging for ILS participants, as it can be difficult to obtain commitments from investors to effectively provide double the funding to cover both risk periods.

Accordingly, the PRA is aware that ILS market participants have been keen to understand the ways in which the use of techniques such as the roll over of funding might be implemented in the UK in a manner that is compliant with Solvency II. In the updated version of SS8/17, the PRA has added the following as examples of mechanisms that might have the effect of rolling over funding: "deferral of premium payments, funding top-ups, delayed risk period inception, or mechanisms that allow the roll over of funding between two consecutive risk transfer arrangements." While this indicates that the PRA is open to conversations around differing mechanisms to roll over funding, the PRA makes it clear in the new paragraph 3.19A of SS8/17 that, where firms wish to roll over funds, funds being held to meet the Aggregated Maximum Risk Exposure[45] ("**AMRE**") of one risk transfer arrangement should not, simultaneously, be used to meet the AMRE of a new risk transfer arrangement.

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This confirms that, from the PRA's perspective, ILS structures must be fully funded for both risk periods in a renewal situation. The PRA has not elected to implement legislation similar to jurisdictions such as Guernsey, where ILS participants are allowed a 30-day grace period at the beginning of a transaction or at its renewal, where an ILS cell will not be considered to be in breach of the requirement to be fully funded if the collateral is not yet fully in place. However, at the time PS13/20 was published, the UK was still within the transition period and therefore constrained by Solvency II requirements, whereas jurisdictions like Guernsey are not so constrained, making it easier for such jurisdictions to legislate to allow ILS structures to benefit from the use of rollover mechanisms. Now that the UK has withdrawn from the EU, it is possible that the UK may choose not to be so constrained by Solvency II in this regard and, in fact, the PRA notes in PS13/20 that in the context of the UK's withdrawal from the EU it will "keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect." This, therefore, keeps open the possibility of further changes to the rules and guidance regarding UK ILS structures. However, as the UK transposed Solvency II into its own legislation upon withdrawing from the EU, it is still subject to the "funding arrangement" rules in Solvency II. It is still to be determined to what extent the UK will deviate from Solvency II, balancing the need to stimulate growth in the UK market with the desire to remain an equivalent jurisdiction.

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2. Changes to the "Documentation Requirements"

The PRA has revised its expectations in relation to the documentation that is required to be provided as part of the application process. Although the PRA still expects final transaction documents to be submitted where possible, the PRA now recognizes that, in certain circumstances, a complete set of final documentation or drafts of documentation may not be available at the time the applicant wishes to submit its application. Accordingly, the PRA has specified that applicants should aim to engage with the PRA to agree what information is likely to be available and how this may impact the timing of the application. In addition, following concerns raised over the efficacy of this process, the PRA confirmed in PS13/20 that if certain commercial terms in the transaction documents cannot be negotiated until after approval has been received, such outstanding terms should be identified in the documentation submitted to the PRA as part of the application process, and the finalized transaction documents should be provided as soon as they are executed.

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The PRA has also changed its approach regarding the requirement for applicants to submit an independent third-party opinion. The PRA has now confirmed that it will not expect applicants to submit such opinions in every case — for example in the case of a straightforward application — but that it may require a third-party opinion in certain more complex cases that contain novel features. The updated version of SS8/17 now contains some examples of the cases where an independent third-party opinion

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44 Article 319 of the Solvency II Delegated Regulation.

45 As defined in Article 1(44) of the Commission Delegated Regulation (EU) 2015/35.

The PRA is proposing to include a new section in Chapter 3 of SS8/17, which outlines its expectations in relation to risk transfer requirements.

The PRA's proposals set out a summary of the applicable Solvency II requirements, as well as the PRA's expectations in relation to demonstrating compliance with these.

Even with publication of PS13/20 and the additional clarity it provides on the UK's ILS regime, we have not seen the same volume of new UK-based ILS transactions over the course of the last year that we have seen in previous years. Factors such as the COVID-19 pandemic and the UK's withdrawal from the EU ("Brexit") are likely to have impacted this…

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…through London Bridge Risk, Lloyd's is hoping to attract new classes of investors, such as pension funds, since the structure will allow for such investors to participate in a tax-efficient manner, with reduced set-up times and lower transactional costs.

might be required, such as where a transaction includes complex trust or security arrangements, or where the ISPV invests in non-standard assets. In addition, the PRA notes that a foreign legal opinion will be required where the contractual arrangements are subject to foreign law.

3. New Risk Transfer Requirements Section

The PRA is proposing to include a new section in Chapter 3 of SS8/17, which outlines its expectations in relation to risk transfer requirements.

The PRA's proposals set out a summary of the applicable Solvency II requirements, as well as the PRA's expectations in relation to demonstrating compliance with these. Such expectations include providing details of the proposed risk transfer in the application form, and a clear demonstration of how the risk transfer arrangements comply with the Solvency II requirements. In addition, the PRA has made it clear that where a risk transfer case includes non-indemnity triggers, specific details of the structure of those triggers should be included in the application.

The PRA is proposing to include this new section to assist applicants in better understanding how they can show compliance with the Solvency II risk transfer requirements as part of the application process.

4. UK ILS Outlook

Even with publication of PS13/20 and the additional clarity it provides on the UK's ILS regime, we have not seen the same volume of new UK-based ILS transactions over the course of the last year that we have seen in previous years. Factors such as the COVID-19 pandemic and the UK's withdrawal from the EU ("**Brexit**") are likely to have impacted this, particularly since market participants will be interested to see what changes to the regime may arise now that the UK has withdrawn from the EU.

That said, there was one very notable ILS transaction that was approved under the UK's ILS regime. Lloyd's announced that it received regulatory approval on January 14, 2021 for its new MISPV, London Bridge Risk PCC Ltd. ("**London Bridge Risk**"). This is a significant step for the UK's ILS regime, as it is the first PRA-approved ILS structure designed for use for multiple, market-wide transactions for Lloyd's members, and represents the UK regulators' support for using the UK's ILS regime to create innovative products and transactions. It is also a key step forward for Lloyd's in carrying out its Future at Lloyd's strategy, as it is intended that London Bridge Risk will provide an easier and more efficient way for capital at Lloyd's to be deployed and managed.

The structure has been designed to create a streamlined approval process for potential new investors (a simple notification to the PRA for each deal it enters into), provided potential investors utilize the standard documentation and stay within the "Scope of Permissions" approved by the UK regulators. This is appealing to potential investors, as it provides a more efficient, alternative route to participate in the Lloyd's market, to the costly and often lengthy approval process that previously existed. In addition, through London Bridge Risk, Lloyd's is hoping to attract new classes of investors, such as pension funds, since the structure will allow for such investors to participate in a tax-efficient manner, with reduced set-up times and lower transactional costs.

At present, London Bridge Risk is largely perceived as an efficient way for new investors to enter the Lloyd's market to provide capital to members at Lloyd's. Accordingly, it is not viewed by some market participants as a traditional collateralized reinsurance transformer vehicle. However, given that it has been structured as an MISPV, there is scope for its remit to be expanded, and it will be interesting to see how this structure evolves over the years to come. In the meantime, the focus will be on whether the appeal of a more efficient mechanism to enter the Lloyd's market will provide the desired outcome of increased capital flow into the market from a diverse range of new investors, in line with the Future at Lloyd's strategy.

Looking ahead for the London market, now that the UK has withdrawn from the EU, there may be an opportunity for the UK to legislate away from some of the existing positions under Solvency II, such as the requirement to be fully funded. Such changes would likely make the UK a more favorable jurisdiction for the ILS market. This opportunity, coupled with the fact that the UK regulators have recently approved the innovative London Bridge Risk transaction, may increase interest in the UK as an ILS jurisdiction over the medium term.

III. The Global Longevity Market

The two principal sources of longevity risk are defined benefit pension schemes and books of annuity business written by life insurers. The longevity market demonstrated its resilience in the face of the COVID-19 pandemic, with continued high levels of transactional activity.

A. TRANSACTION STRUCTURES

To put into context our review of recent developments and transactions in the longevity market, we first briefly recap below the principal longevity risk transfer methods.

1. Buyouts

A pension buyout involves an insurer taking over the liability to pay all or some of the member benefits from the trustees of the relevant pension scheme. This is achieved by the insurer issuing individual annuity policies to the relevant scheme members in return for a payment of premium by the trustees, usually by way of a transfer of assets from the pension scheme to the insurer. In the case of a buyout, there is a direct insurance contract between the insurer and the individual scheme member; and in the event of a full buyout, where individual policies are issued to all of the members of the pension scheme, the trustees can proceed to wind-up the scheme, with all future administration being performed by the insurer. The buyout option is accordingly the ultimate form of pension scheme de-risking.

2. Buy-Ins

Pension buy-in solutions were developed as a de-risking option for pension schemes that were unable to afford the often prohibitive costs of a full buyout. Under a pension buy-in, there is no direct contractual link between the insurer and the individual scheme members. Instead, the pension scheme trustees hold the buy-in policy in their name as an investment of the scheme, and the scheme continues to deal with the payment and administration of benefits. The trustees pay a premium — usually by transferring an equivalent amount of pension scheme cash, bonds, and other assets under management — and, in return, receive an income stream from the insurer to cover some or all of the scheme's liability to pay member benefits. In the case of some of the larger buy-in transactions, trustees will also require the insurer to post collateral or otherwise secure its obligations to make payments under the policy.

3. Longevity Swaps

In their purest form, longevity swaps are derivatives and not contracts of insurance. However, it is possible to achieve the same economic effect on an insurance basis, and there have been examples of insurers issuing policies to pension schemes structured in the same way as a longevity swap. Although it is important to ensure that the contract is properly structured as a derivative or insurance policy according to whether the protection provider is a bank or insurer, in either case the core economics are very similar. In return for the pension scheme paying a fixed monthly amount to the insurer or bank, the counterparty makes a payment to the pension scheme on a monthly basis (the floating amount) referable to the benefit payable to a defined group of pensioners.

In cases where the front-end arrangement involves a longevity swap with a bank as a counterparty, the longevity risk is in derivative form and is not capable of being directly reinsured. In situations such as this, transformer vehicles, typically based offshore, are used to convert the derivative exposure into insurance risk that can then be reinsured.

Whereas buy-ins and buyouts involve a transfer of inflation, interest rate, investment, and longevity risk, longevity swaps offer a purer hedge against the risk of scheme members living longer than is actuarially predicted; and the fact that there is no upfront payment of a lump sum premium means that the investment, interest rate, and inflation risk remain with the trustees. Accordingly, longevity swaps are typically a less expensive alternative to buy-ins and buyouts, albeit more complex to structure and negotiate. Longevity swaps almost invariably require the two-way posting of collateral to protect against the possibility of early termination by reason of the other party's default or insolvency. The collateral is typically based upon the present value of the covered benefits and will also include a fee element payable to the insurer/bank in the event of termination arising by virtue of trustee default.

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4. Index-Based Trades

A further alternative structure involves the purchase of longevity protection by reference to an index. Given the inherent basis risk that exists within these types of transactions, there have been relatively few index-based trades to date, and these types of transactions are perhaps more likely to remain of greater interest to insurers and ILS investors than to pension schemes.

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B. U.S. MARKET

Beginning with the GM and Verizon deals in 2012, the pension de-risking market in the U.S. experienced significant growth. While in prior years the market consisted primarily of one or two direct writers, in recent years a number of other group annuity writers have become more active in the market. In particular these include, among others, MassMutual, and more recent entrants to the market, Athene and American General Life Insurance Company, a subsidiary of AIG ("**AGL**"). Unfortunately, like most markets, the pension de-risking market in the U.S. saw a decrease in sales in 2020 due to the COVID-19 pandemic. The pension de-risking market in the U.S. saw a quick start to the year in January and February which, according to Aon, was similar to the start of 2019. However, according to LIMRA Secure Retirement Institute ("**LIMRA**"), pension risk transfer sales slowed in the second and third quarter of 2020. Notwithstanding the slowdown due to the COVID-19 pandemic, according to LIMRA, the market bounced back in the fourth quarter of 2020 with buyout pension risk transfer transaction sales soaring to the highest quarterly sales total recorded since the fourth quarter of 2012 and buy-in pension risk transfer transaction sales soaring to the highest quarterly total buy-in pension risk transfer market sales ever reported. Sales in fourth quarter of 2020 for (i) the buyout pension risk transfer market totaled US$13.7 billion, topping the same period in 2020 by 21% and (ii) the buy-in pension risk transfer market totaled US$1.6 billion (representing the sale of two buy-in group annuity contracts).[46]

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Furthermore, sales for the full calendar year of 2020 for (i) the buyout risk transfer market were US$25 billion, down 10% for the same period in 2019 and (ii) the buy-in risk transfer market were US$1.8 billion, down 4% for the same period in 2019. Additionally, over 60% of life insurers reported year-over-year growth for 2019 to 2020. The aforementioned sales for the calendar year 2020 represented the sale of 432 buyout group annuity contracts, which covered 408,277 participants.

In February 2020, Armstrong World Industries, a manufacturing company, transferred to Athene approximately US$1 billion in pension obligations affecting approximately 10,000 retirees. Additionally, in December 2020, General Electric Co. announced it had entered into a deal with Athene pursuant to which it will transfer approximately US$1.7 billion in pension obligations affecting approximately 70,000 retirees.

In December 2020, Weyerhaeuser Co., a timberland company, transferred US$765 million in U.S. pension plan liabilities representing 5,200 retirees and beneficiaries. Weyerhaeuser Co. had previously transferred to Athene approximately US$1.5 billion in U.S. pension plan liabilities affecting approximately 28,500 U.S. retirees and beneficiaries.

Other notable pension de-risking transactions include (i) aerospace and defense company Moog Inc. transferring US$481 million in U.S. pension plan liabilities affecting approximately 3,058 retirees, (ii) Kellogg Co., a food manufacturing company, transferring approximately US$470 million in U.S. pension plan assets and liabilities to an undisclosed insurance company affecting approximately 8,000 retirees, and (iii) the New York Times Company transferring US$235 million in pension obligations to MassMutual affecting approximately 1,850 retirees.

Additionally, Unisys Corp, an information technology company, announced in October 2020 that it plans to transfer approximately US$1 billion in global pension plan liabilities through a series of pension risk transfer transactions over a six-month period thereafter.

Given the recent growth of the longevity market, many insurers in this space have increasingly worked with reinsurers to transfer pension liability risk, either by packaging reinsurance as part of a pension de-risking deal or by obtaining reinsurance for its liabilities after the fact. For smaller insurance companies, working with reinsurers has the potential to strengthen the insurer's balance sheet and increase capacity, allowing it to become a more marketable player in the risk transfer market. Reinsurers,

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46 Statistics and data with respect to the performance of the pension risk transfer market in 2019 and 2020 in this paragraph and the following paragraph are from a market survey conducted by LIMRA.

in turn, are attracted by the diversification opportunities that come with participation in pension de-risking transactions. This trend is likely to grow as new players and current participants seek to establish or solidify their foothold in this space.

The expansion of the pension de-risking market, however, has recently faced regulatory hurdles in the form of investigations by the New York Department of Financial Services (the "**NYDFS**") into the facilitation by life insurers and insurance brokers of the solicitation or negotiation of annuity pension risk transfer business in New York by unauthorized insurers. As a result of these investigations, the NYDFS has begun to enter into consent orders with certain life insurers. The remedies imposed by the NYDFS in these consent orders have thus far included monetary fines, agreements with the life insurers to restructure certain in-force pension risk transfer transactions, and agreements with the insurers to include New York licensed insurers in future pension risk transfer transactions.

C. UK/EUROPEAN MARKETS

In 2020, according to industry commentary on the UK de-risking market, there were over £50 billion of bulk annuity and longevity transactions executed, a total similar to the amount of liabilities transferred in the previous year. Attractive pricing in the bulk annuity and longevity swap markets, resulting from periods of market volatility, contributed to this sustained level of transaction activity. There was a shift in the bulk annuities market in 2020 from the previous year, with a rise in small- to medium-sized transactions in particular, with a 50% increase in the volume of transactions under £1 billion. With respect to longevity swap transactions, total deal volumes exceeded 2019 amounts and were close to the largest year on record, with many multi-billion pound swaps executed. There was also significant progress made with respect to alternative risk settlement strategies such as "superfunds," which are commercial consolidator vehicles for pension schemes that were originally introduced by the UK Department for Work and Pensions ("**DWP**") in early 2018. Overall, market analysis showed that the volume of transactions in the de-risking market hit pre-pandemic predictions despite the effects of the pandemic. This is a testament to the strength of the market and the increasing growth and interest we can expect in future years. More than ever, pension schemes are considering their options for de-risking solutions. Despite market turbulence and uncertainty, we anticipate robust levels of activity in the coming years as pension scheme trustees and sponsors seek to enter into buy-ins, buyouts, longevity swaps, and transfers to commercial consolidators as part of their long-term risk management strategies.

Rather than diminishing activity in the longevity market, the market volatility caused by the COVID-19 pandemic instead created a period of opportunities for pension schemes to effect risk settlement transactions at favorable prices, leading to a flurry of activity for transaction-ready schemes and those in the market for de-risking solutions. Early on in the pandemic, the cost of corporate bonds was lower than typical, and some insurers passed on the benefit to pension schemes through lower buy-in and buyout pricing. The material widening of credit spreads in the market around March and April of 2020 could have, according to market analysis reports, saved pension schemes effecting buy-in and buyout transactions during that period up to 5% compared to transacting in the preceding months. This was particularly beneficial for pension schemes that were able to mobilize quickly and those with existing insurer relationships, as these schemes were able to swiftly execute deals at these prices despite operational challenges posed by the pandemic. Industry commentators have noted that pricing has since stabilized but continues to be attractive and have remarked that 2021 will likely include additional periods of economic uncertainty with the ongoing pandemic and Brexit, which could lead again to favorable opportunities. As with this past year, these commentators indicate that pension schemes interested in capitalizing on these periods would benefit from keeping a close eye on the market and ensuring they are nimble and equipped to access these opportunities when they arise.

The Continuous Mortality Investigation ("**CMI**") annually releases its CMI Mortality Projections Model (the "**Model**"), which is a critical component of the valuation of insurance company and pension scheme liabilities. Last September, the CMI initiated a consultation, noting that "[t]he exceptional mortality experience during the COVID-19 pandemic means that a version of [the Model] that takes account of mortality data for 2020 in the usual way would be likely to show substantial falls in life expectancy, which [the CMI] think[s] would be in excess of what most users of the Model would consider reasonable." As a result, the consultation presented a proposed modification to the calibration process to allow users to place more or less weight on data for individual years, as well as a proposed amendment to the age range of the dataset used to calibrate the model to avoid unrealistically low initial mortality

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With respect to longevity swap transactions, total deal volumes exceeded 2019 amounts and were close to the largest year on record, with many multi-billion pound swaps executed.

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Industry commentators have noted that 2021 will likely include additional periods of economic uncertainty with the ongoing pandemic and Brexit, which could lead again to favorable opportunities.

improvements at high ages. After the consultation period closed in December 2020, the CMI published a working paper noting that in light of the broad support received, it will modify the calibration process to allow users to choose weights for individual years, with the core Model using a weight of 0% for 2020 data. However, the CMI noted it would not be making any changes to the Model from 2019 with respect to the calibration age range, given additional analyses conducted that justify retaining the existing approach. The CMI expects to release its 2020 Model by the end of March 2021.

Reporting by market commentators indicates industry activity aligning with the CMI's messaging, observing that insurers and reinsurers have been conservative when considering the impact of the pandemic on their longevity assumptions, by keeping pricing assumptions constant throughout the year. It is unlikely that there will be significant changes to these assumptions in the next year, as insurers and reinsurers continue to be cautioned not to overweight the data coming out of 2020. While the pandemic and associated lifestyle changes (e.g., increased attention to hygiene practices, social distancing, etc.) may have potential long-term impacts on future mortality expectancy, it is too early to come to conclusions about what those effects may be.

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In the bulk annuity market, industry commentary indicates that total transaction volumes were significant in 2020, with close to £30 billion of buy-ins and buyouts completed, though this was less than the 2019 record of over £40 billion. The year also saw a material reduction in the number of large-scale bulk annuity transactions when compared to the numerous multi-billion dollar deals in 2019. While in 2019 approximately two-thirds of liabilities secured were for deals with a transaction value exceeding £1 billion, in 2020 fewer than half of the bulk annuity transactions exceeded the £1 billion threshold. This shift represents an opening of the market to smaller and mid-sized pension schemes, allowing them to participate in a market with which they previously struggled to gain traction. Market commentators remarked that this change was driven in part by small and mid-sized schemes' ability to more easily and efficiently execute streamlined transactions.

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The largest publicly announced transaction in the bulk annuities market was the February 2020 conversion of a longevity swap to a £1.6 billion buy-in between Merchant Navy Officers Pension Fund and Pension Insurance Corporation, securing the pensions of around 14,000 members. Other notable transactions include the £1.1 billion de-risking transaction in February 2020 between Legal & General Group Plc and AIB Group UK Pension Scheme, covering more than 1,300 members, which was split between an £850 million pensioner buy-in and a £250 million assured payment policy (providing investment risk protection) and which involved the conversion of an existing longevity reinsurance agreement. The Co-operative Pension Scheme completed two significant buy-in deals in 2020. The first was with Aviva in January 2020 insuring £1 billion in defined benefit pension liabilities of around 7,000 members, followed by an additional £350 million insured in respect of 2,300 members in May 2020. The second deal was with PIC in February 2020, priced at £1 billion, which was followed in April 2020 by an additional £400 million buy-in with PIC. In addition, Maersk Retirement Benefit Scheme and Legal & General Assurance Society entered into a £1.1 billion buy-in transaction in December 2020.

With respect to the longevity swap market, industry reporting shows that transaction volumes exceeded 2019 levels and were close to the largest year on record, attributable to the favorable pricing compared to historical rates, due partially to a lack of sustained and consistent improvements in mortality rates. The largest publicly announced deals last year included the longevity swap and reinsurance transaction in January 2020 between Lloyds Banking Group Pensions Trustees Limited, Scottish Widows, and Pacific Life Re in respect of about £10 billion of pensioner liabilities, as well as the May 2020 longevity reinsurance transaction between NN Life and Canada Life, Munich Re, and Swiss Re relating to €13.5 billion of pensioner liabilities from the Netherlands covering over 200,000 pensioners. In June 2020, the Willis Pension Scheme entered into a longevity swap transaction with Munich Re, under which the reinsurer will manage the longevity risk in relation to approximately £1 billion of pensioner liabilities covering roughly 3,500 scheme members. Other notable deals were executed at the close of 2020, such as the November 2020 longevity swap transaction between The Prudential Staff Pension Scheme and Pacific Life Re, covering £3.7 billion pensioner liabilities relating to over 20,000 members. In addition, in December 2020, Barclays Bank UK Retirement Fund executed a £5 billion longevity swap with Reinsurance Group of America, and BBC Pension Scheme effected a £3 billion longevity swap and reinsurance transaction with Zurich and Canada Life Reinsurance, covering about a third of BBC retiree liabilities.

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Market commentators predict that 2021 will be another year of high buy-in, buyout, and longevity swap activity despite periods of market volatility, with some total estimates ranging between £30-40 billion and others exceeding £50 billion. This suggests that the record total in 2019 was not a one-off occurrence and that the market is expected to continue transacting at similar levels in the future. Reinforcing this expectation, other reports forecast an average of £35 billion in risk settlement transactions per year for the next decade, as pension scheme trustees and sponsors continue to demonstrate their sustained interest in de-risking transactions as an integral part of their long-term risk management strategies.

Last year, material progress also occurred with respect to nontraditional risk transfer options and, in particular, with defined benefit superfunds. In June 2020, The Pensions Regulator ("**TPR**"), the regulator of work-based pension schemes in the UK, launched a new interim regulatory regime for the emerging superfund pension market. This interim regime is intended to set expectations on how superfunds should be set up and run, while a permanent authorization and supervisory regime with specific superfunds legislation is developed and finalized by the DWP.

The interim regime presented last summer addresses (i) capital adequacy expectations, including funding triggers, value extraction limitations, and investment principles, with the overarching objective of the capital requirement being to enable 100% of members' benefits to be protected to a high degree of certainty; (ii) key personnel requirements, to ensure that the individuals running a superfund are fit and proper, and can carry out their roles competently; (iii) corporate governance and decision-making authority, including with respect to a superfund's corporate board and trustee board, and appropriate checks and balances pertaining to such decision-making avenues; and (iv) administrative systems and governance processes, including in relation to data, cyber security, administration tasks, and trustee board oversight. In addition to paving the way for a smoother transition to a future legislated framework, the interim guidance also provides the TPR with a firmer basis for enforcement against a superfund, should the TPR deem such action necessary. Following its original publication in the summer of 2020, the TPR subsequently provided additional guidance in October 2020 specifically addressed to trustees and sponsoring employers considering transacting with a superfund. This guidance focused on certain "gateway principles" that should be satisfied by trustees and sponsoring employees seeking to enter into transactions with superfunds, to ensure that these parties are acting in the best interest of the scheme's members. The interim regime will be subject to further guidance by the TPR as the market evolves.

Following initial indications of conflict between the pensions and insurance markets in 2018 when superfunds were introduced, this interim regime was met with criticism by the insurance industry. Commentary published by the Association of British Insurers ("**ABI**") described the interim regime as "light-touch" and "short on detail" which puts the savings of defined benefit pension scheme members at risk. Superfunds and insurance companies would be subject to two different sets of regulations and supervisory bodies (the TPR and PRA, respectively) with superfunds subject to less stringent capital and solvency requirements. Even following the additional guidance provided by the TPR in October, ABI publications view the regulatory regime as not being strong enough to protect defined benefit scheme members, and opined in its publications that a common regulator for pensions and insurance would make more sense.

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While it is most likely that the first superfund transactions in the coming year will be effected by pension schemes with employers already experiencing some level of financial distress, an analysis undertaken by PwC predicts that up to one million pension scheme members and £170 billion of assets (equal to around 10% of the total UK defined benefit pension scheme universe), including those from pension schemes with financially stronger employers, could transfer to a superfund over the next decade. However, because the pension consolidation market is very much in its infancy, it is yet to be determined how successful these superfunds will be and whether these vehicles will be able to scale properly with growing interest.

IV. Global Regulatory and Litigation Developments

Over the last year, regulators and industry members around the world were confronted with new and unexpected challenges brought on by the COVID-19 pandemic and its impact on consumers and insurance markets. Regulators have been engaged in heightened monitoring of the insurance industry to assess the impact of COVID-19 on various types of insurance, individual companies, and the sector as a whole. In addition to addressing the industry sectors most directly impacted by COVID-19, and despite having to meet remotely, regulators continued to make progress on a number of initiatives to address changes in the insurance industry across international group supervision and group capital standards, innovation and technology, risk transfer, data privacy, reinsurance, and many other areas. While responding to the impact of COVID-19 has been and will continue to be a priority in 2021, regulators are also looking ahead to the changing global social and economic landscape with respect to, among other areas, cybersecurity, the use of big data, race and insurance, and Brexit.

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A. U.S. NAIC AND STATE ACTIVITY

1. NAIC and State Insurance Departments Respond to the COVID-19 Pandemic

Beginning early in 2020 and continuing throughout the year, the National Association of Insurance Commissioners ("**NAIC**") and U.S. state insurance regulators took action to respond to the unique insurance-related challenges that the COVID-19 pandemic presents to insurance industry stakeholders. Specifically, the NAIC and state insurance departments have issued guidance in response to COVID-19 covering topics such as health insurance operations and coverage, travel insurance coverage, business interruption ("**BI**") insurance coverage, operational issues for regulators, insurers and other regulated entities, and other insurance topics.

a. Regulatory Guidance Related to Health Insurance Operations and Coverage

As a public health crisis, the COVID-19 pandemic has particularly affected the health insurance industry. The NAIC and nearly all U.S. state insurance departments have issued guidance to health insurance carriers in the areas of telehealth, consumer outreach, special enrollment periods, prescription refills, and cost-shares (co-pays, deductibles and co-insurance). Specifically, in this guidance, many of these states are:

As a public health crisis, the COVID-19 pandemic has particularly affected the health insurance industry.

- Requiring insurers to waive cost-sharing for COVID-19 testing when ordered in accordance with Centers for Disease Control and Prevention (CDC) guidelines and prohibiting insurers from requiring prior authorization for such testing;
- Requiring insurers to waive cost-sharing for COVID-19 vaccinations and administration;
- Requiring insurers to permit early refills, except for drugs in certain drug classes such as opioids, when consistent with doctor/pharmacist approvals;
- Directing insurers to keep their policyholders informed with accurate information about coverage for COVID-19-related testing and treatment;
- Directing insurers to expand the availability of telemedicine for their policyholders and eliminating barriers to its use; and
- Directing insurers to continue to ensure network adequacy, given the anticipated increase in demand due to COVID-19.

Additionally, on March 19, 2020, President Trump signed into law the Families First Coronavirus Response Act, which, among other directives, requires health insurance carriers to provide coverage — at no cost sharing or pre-authorization/medical management requirements — for the testing and administration of Food and Drug Administration (FDA)-approved COVID-19 tests.

b. Regulatory Guidance Related to Travel Insurance Coverage

The COVID-19 pandemic has also caused individuals and businesses to cancel existing travel plans. In response to this disruption to travel, as of February 2, 2021, the NAIC and 19 U.S. state insurance departments have issued guidance to both the insurance industry and consumers regarding travel insurance coverage and COVID-19. The applicable states include: Alabama, Alaska, Arizona, Connecticut, the District of Columbia, Illinois, Iowa, Louisiana, Maine, Maryland, Minnesota, Mississippi, Nebraska, Nevada, New York, Ohio, Oregon, Texas, and Washington.

This guidance generally provides that unless a previously-held travel insurance policy contains an exception applicable to COVID-19 (e.g., an epidemic or pandemic exclusion), a policy of travel insurance that covers the risks of sickness, accident, or death incident to travel presumptively must cover such risks relating to COVID-19. However, this guidance also generally notes that a travel insurance policy that has been purchased more recently likely will not cover cancellations due to COVID-19, as the disease is now considered a known event.

c. Regulatory Guidance Related to Business Interruption Insurance Coverage

Additionally, the global COVID-19 pandemic has caused massive long-term disruptions to both large and small businesses. In response to the economic consequences triggered by COVID-19, as of February 2, 2021, the NAIC and 24 U.S. state insurance departments have issued guidance to the insurance industry and consumers regarding the impact of COVID-19 on BI insurance coverage. The applicable states include: Alabama, Alaska, Arkansas, California, Connecticut, Colorado, the District of Columbia, Georgia, Idaho, Kansas, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, New Hampshire, New York, North Carolina, Oregon, South Carolina, Utah, Virginia, Washington, and West Virginia.

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This guidance addresses, among other topics: how the economic consequences of COVID-19 impact a typical BI insurance policy; how an official declaration of a state of emergency affects BI insurance policies; and how employers' remote work directives affect BI insurance coverage.

In 2020, legislators in several states, including California, Louisiana, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, and South Carolina introduced legislation that would retroactively expand coverage under existing BI insurance policies to cover losses due to the COVID-19 outbreak. However, to date, none of these legislative proposals have been enacted. Additionally, the Illinois state legislature passed legislation that required the Illinois Department of Insurance to establish a task force to study BI insurance needs (the "**Business Interruption Insurance Task Force**"). In its December 2020 report to the Governor and the General Assembly, the Business Interruption Insurance Task Force recommended federal action both to address the immediate need of businesses and to address future pandemic risks to businesses.

In 2020, legislators in several states, introduced legislation that would retroactively expand coverage under existing BI insurance policies to cover losses due to the COVID-19 outbreak. However, to date, none of these legislative proposals have been enacted.

In addition, during the NAIC's Fall 2020 National Meeting (the "**Fall 2020 National Meeting**"), the NAIC Center for Insurance Policy and Research held a special session to discuss pandemic BI insurance coverage and possible federal mechanisms to ensure widespread availability of BI coverage for pandemics. To date, the NAIC has not supported any specific proposal, but it has stated that it views a federal mechanism as necessary to address the BI coverage gap for pandemic risk. The NAIC noted, however, that to the extent insurance is used to facilitate such a program, the program must (i) not undermine critical insurance regulatory protections intended to prevent an insurer from taking on an outsized risk, (ii) reduce the federal government's (and by extension taxpayers') exposure to future pandemics through policyholder payment of premiums, risk mitigation, and possibly more private insurance and reinsurance industry involvement over time, and (iii) incentivize the purchase of coverage by ensuring that the product is available and affordable.

d. Regulatory Guidance Related to Operational Issues for Regulators, Insurers, and Other Regulated Entities

The societal-wide disruptions caused by the COVID-19 pandemic implicate the operations of both the insurance industry and regulators. In connection with these disruptions, nearly all U.S. state insurance departments have issued materials related to, among other topics: regulatory flexibility on filing deadlines, continuing education requirements for producers, and grace periods for premium payments; insurers' plans to deal with financial risk caused by the pandemic; and the fair treatment of insurance consumers during this public health crisis. See also section IV.A.1.f below.

The societal-wide disruptions caused by the COVID-19 pandemic implicate the operations of both the insurance industry and regulators.

e. Regulatory Guidance Related to Other Insurance Topics

The COVID-19 pandemic has affected most areas of daily life. Accordingly, all lines of insurance are potentially implicated by the spread of this disease. U.S. state insurance departments have issued guidance on a wide range of other insurance-related topics, including, but not limited to, life insurance, medical malpractice insurance, workers' compensation insurance, refunds of insurance premiums for automobile insurance and certain other lines of business affected by the COVID-19 pandemic, waiver of vacancy clauses in commercial insurance policies, and extending personal automobile insurance coverage to delivery drivers.

The COVID-19 pandemic has affected most areas of daily life. Accordingly, all lines of insurance are potentially implicated by the spread of this disease.

f. NAIC Adopts Interpretation to Provide Guidance Regarding the Treatment of Premium Refunds, Rate Reductions, and Policyholder Dividends

During the NAIC's Summer 2020 National Meeting (the "**Summer 2020 National Meeting**"), the Financial Condition (E) Committee adopted *INT 20-08 — COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions, and Policyholder Dividends,* which provides guidance regarding the treatment of premium refunds, rate reductions, and policyholder dividends due to decreased commercial and noncommercial activities resulting from COVID-19 ("**Interpretation 20-08**"). Specifically, Interpretation 20-08 included guidance on the following issues related to COVID-19:

- How to account for refunds not required under policy terms;
- How to account for refunds required under policy terms;
- How to account for rate reductions on in-force and renewal business;
- How to account for policyholder dividends; and
- Where to disclose refunds, rate reductions, and policyholder dividends related to COVID-19 decreases in activity.

Notably, rather than accounting for premium refunds as "return of premium," Interpretation 20-08 granted a limited-time exception to existing reporting guidance to permit reporting of certain premium refunds as "other underwriting expenses" if certain criteria were satisfied (the "**Limited Exception**"). The Limited Exception applied to P&C lines of business for which the insurer filed policy endorsements or manual rate filings prior to June 15, 2020, that allowed for discretionary payments to policyholders due to COVID-19-related issues and with respect to which the insurer disclosed to the states or other jurisdictions in which the policies were written its intention to report such payments to policyholders as expenses.

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An insurer using the Limited Exception was required to make additional disclosures in its statutory financial statements as specified in Interpretation 20-08, including disclosure of the underwriting expense reporting as if it were a permitted practice. Although use of the Limited Exception was not subject to a domiciliary regulator's approval as a permitted practice if the requirements of Interpretation 20-08 were met, if a domiciliary regulator disapproved the underwriting expense reporting, the Limited Exception would not apply. The Limited Exception was effective for the second quarter, third quarter, and annual statutory financial statement reporting in 2020, and automatically terminated on January 1, 2021.

2. NAIC Adopts Group Capital Calculation and Related Revisions to Model Holding Company Act

During the Fall 2020 National Meeting, the NAIC adopted the Group Capital Calculation ("**GCC**") template and instructions and corresponding amendments to the Insurance Holding Company System Regulatory Act (#440) (the "**Holding Company Model Act**") developed by the NAIC's Group Capital Calculation (E) Working Group (the "**GCC Working Group**").

The GCC Working Group began developing the GCC template and instructions in 2015 in an effort to provide U.S. regulators with an additional analytical tool for conducting groupwide supervision. The GCC uses a risk-based capital ("**RBC**") aggregation approach intended to act as an additional group supervisory tool for regulators, in conjunction with the Form F Enterprise Risk Report, Own Risk and Solvency Assessment ("**ORSA**") report, and the Corporate Governance Annual Disclosure ("**CGAD**").

In addition to the GCC template and instructions, the NAIC also adopted corresponding amendments to the Holding Company Model Act to require, subject to certain exemptions, that the ultimate controlling person of each insurance group file a GCC on an annual basis with such insurance group's lead state. Insurance groups will be exempt from filing a GCC if:

- The insurance group only has one insurer within its holding company structure, and such insurer writes business only in the domiciliary state and assumes no business from any other insurer;
- The insurance group is required to perform a group capital calculation specified by the U.S. Federal Reserve Board (the "**Federal Reserve Board**") to the extent the lead state commissioner of such group is able to receive the calculation from the Federal Reserve Board;
- The insurance group has a non-U.S. groupwide supervisor located within a "Reciprocal Jurisdiction" as described in the 2019 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) (together, the "**Revised CFR Model Laws**") that recognizes the U.S. state regulatory approach to group supervision and group capital; or
- The insurance group (a) provides information to its lead state that meets the requirements for NAIC accreditation satisfactory to allow the lead state to comply with the NAIC group supervision approach, and (b) the insurance group's non-U.S. groupwide supervisor that is not a Reciprocal Jurisdiction "recognizes and accepts" the GCC as the worldwide group capital assessment for U.S. insurance groups that operate in that jurisdiction.

In addition, the lead-state commissioner will have the discretion to exempt an ultimate controlling person from filing the annual GCC or may accept a limited group capital filing or report as specified by the commissioner in regulation.

The amendments to the Holding Company Model Act also provide that a lead-state commissioner may require a GCC for the U.S. subgroup of any non-U.S.-based insurance holding company system where, after any necessary consultation with other supervisors or officials, it is deemed appropriate by the lead-state commissioner for prudential oversight and solvency monitoring purposes or for ensuring the competitiveness of the insurance marketplace. Up until its adoption by the Executive (EX) Committee and Plenary, regulators continued to express concern with this provision, noting that such a provision may not be consistent with the "Bilateral Agreement Between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance" (the "**U.S.-EU Covered Agreement**") and the "Bilateral Agreement between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance" (the "**U.S.-UK Covered Agreement**") and, together with the U.S.-EU Covered Agreement, the "**Covered Agreements**") and could potentially expose U.S. groups to non-U.S. subgroup reporting by another jurisdiction. Discussion on this issue is expected to continue as state regulators have requested that any elements not specifically set forth in the Covered Agreements be excluded from the accreditation standard with respect to the revisions to the Holding Company Model Act.

3. NAIC Prepares FAQ Document for State Adoption of Revised Suitability in Annuity Transactions Model Regulation

The Annuity Suitability Working Group ("**ASWG**") led the NAIC's multiyear efforts to develop revisions to the Suitability in Annuity Transactions Model Regulation (#275) ("**SAT**") to incorporate a requirement for producers to act in the "best interest" of a retail customer when making a recommendation to purchase an annuity. The NAIC adopted the revised SAT in February 2020, and since that time several states, including Idaho, Iowa, Kentucky, Ohio, and Rhode Island, have begun efforts to adopt the revisions.

However, the work of the ASWG is not complete; throughout 2020, it has been developing a frequently asked questions ("**FAQ**") document to facilitate uniformity in state adoption and implementation of the revisions to the SAT. The current draft of the FAQ document addresses topics such as general background, the intersection of state insurance regulation and federal securities law regulation, how to satisfy the best-interest standard of conduct, and insurer supervision and training requirements. A draft of the FAQ document has been exposed for multiple rounds of public comment. It is expected that the FAQ document will be finalized and adopted in 2021.

4. NAIC Activity Related to Long-Term Care Insurance

The Long-Term Care Insurance (EX) Task Force ("**LTCTF**"), through the work of its three subgroups, is developing guidance intended to facilitate uniformity in long-term care insurance ("**LTCI**") rate reviews and the evaluation of reduced benefit offers for policies that are no longer affordable due to rate increases. In 2020, the LTCTF consolidated the six work streams originally organized to address LTCI issues into the following three subgroups: (a) the LTCI Multistate Rate Review (EX) Subgroup, chaired by Colorado; (b) the LTCI Reduced Benefit Options (EX) Subgroup, chaired by Pennsylvania; and (c) the LTCI Financial Solvency (EX) Subgroup, co-chaired by Texas and Minnesota.

The LTCI Multistate Rate Review (EX) Subgroup is conducting a pilot project to review LTCI rate filings from several insurers. As of the Fall 2020 National Meeting, the subgroup had completed the related work product, which consists of a detailed rate advisory report for two insurers and was nearing completion on a third report. The reports are confidential and intended for use by regulators to develop a more consistent and effective approach to rate filings. The subgroup has also started to develop an outline for a framework for multistate LTCI rate reviews and expects to present a first draft at the NAIC's Spring 2021 National Meeting (the "**Spring 2021 National Meeting**"). The development of the framework will be subject to public review and comment.

The LTCI Reduced Benefit Options (EX) Subgroup adopted two principles documents: one offers guidance to regulators when evaluating the terms of reduced benefit offers by insurers; the other offers guidance to regulators when evaluating the content and presentation of notices to policyholders regarding reduced benefit offers. The two principles documents have been referred to the LTCI Multistate Rate Review (EX) Subgroup to incorporate into the development of the multistate rate review framework.

In connection with the LTCTF's efforts to evaluate cross-state rate subsidization of LTCI policies, in July 2020, the NAIC also solicited proposals from law firms to research and report on existing state laws and regulations that could support a new regulatory framework authorizing insurers to separate policies from insurers' general accounts. The work of the law firm consultant is expected to be evaluated by the LTCI Financial Solvency (EX) Subgroup in 2021.

5. NAIC Continues Development of the Pharmacy Benefit Manager Licensure and Regulation Model Act

The proposed Pharmacy Benefit Manager Licensure and Regulation Model Act (the "**PBM Model Act**") establishes standards and criteria for the licensing and regulation of pharmacy benefit managers ("**PBMs**") providing claims processing services or other prescription drug or device services for health benefit plans. On October 29, 2020, the Pharmacy Benefit Manager Regulatory Issues (B) Subgroup adopted the PBM Model Act, which was then forwarded to the Regulatory Framework (B) Task Force for further consideration and industry comment.

On December 10, 2020, the U.S. Supreme Court issued a unanimous decision in *Rutledge v. Pharmaceutical Care Management Association,* holding that the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"), does not preempt an Arkansas state law that regulates the rates at which PBMs reimburse Arkansas pharmacies and effectively requires PBMs to reimburse such pharmacies at a price equal to or higher than the pharmacy's wholesale cost. That decision and the NAIC's continuing work with respect to the PBM Model Act appear to pave the way for state regulation of PBMs.

6. Health Insurance Regulation — ACA Risk Corridors and Cost-Sharing Reduction Litigation

In April 2020, the U.S. Supreme Court ruled that the government was required to make full risk corridors payments to participating insurers, estimated at over US$12 billion. The 8-1 decision overturned an opinion in favor of the government by the U.S. Court of Appeals for the Federal Circuit (the "**Federal Circuit**").

The Affordable Care Act ("**ACA**") established the risk corridors program to protect insurers from extreme gains or losses during the initial years of the ACA. Under the three-year program in effect from 2014 to 2016, qualified health plans with lower-than-expected claims were required to make payments to the government, while plans with higher-than-expected claims would receive payments from the government. The government initially stated that the risk corridors program was not budget neutral, such that payments out of the program could exceed collections received by the program. After Congress

On December 10, 2020, the U.S. Supreme Court issued a unanimous decision in Rutledge v. Pharmaceutical Care Management Association, *holding that ("ERISA"), does not preempt an Arkansas state law that regulates the rates at which PBMs reimburse Arkansas pharmacies…*

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passed an appropriations rider in December 2014 that limited the source of funding for the program, however, the government concluded that the sole remaining appropriation to fund risk corridors payments were the monies collected under the program. Congress passed similar appropriation riders for the 2015 and 2016 program years. By the program's conclusion, payment obligations under the risk corridors program exceeded collections by over US$12 billion. Lawsuits followed.

…the Federal Circuit held that while the plain language of the ACA entitled insurers to full risk corridors payments, that obligation had been retroactively suspended and/or repealed under the appropriation process.

While insurers largely prevailed at the trial court level, the government prevailed at the Federal Circuit. In a 2-1 decision, the Federal Circuit held that while the plain language of the ACA entitled insurers to full risk corridors payments, that obligation had been retroactively suspended and/or repealed under the appropriation process.

The U.S. Supreme Court disagreed and ruled that the risk corridors program created an obligation to pay, and that obligation was not impliedly repealed under the subsequent appropriations.

The U.S. Supreme Court disagreed and ruled that the risk corridors program created an obligation to pay, and that obligation was not impliedly repealed under the subsequent appropriations. To imply a retroactive repeal of a statutory obligation under the appropriations process required a level of clear intent that was not present in the Congressional riders, which limited the source of funding for the program but did not permanently bar the use of any and all funds for meeting risk corridors obligations, the Court found. "Today's decision," the opinion declared, reflects "a principle as old as the nation itself: the government should honor its obligations." The government has since started to process risk corridors payments, although to our knowledge only for insurers that have perfected a judgment for payment under the Judgment Fund.

Insurers have not fared as well in a second litigation over governmental non-payment under another ACA program, the cost-sharing reduction ("**CSR**") payments program. The CSR program was designed to make healthcare under the ACA more affordable for lower-income citizens by reducing deductibles, co-pays, and other cost-sharing payments normally borne by insureds. Under the program, insurers would pay some or all of the cost-sharing obligations of eligible insureds and then be reimbursed by the government. In October 2017, however, the U.S. Attorney General issued a memorandum finding that the cost-sharing payments were unconstitutional because there was no appropriation from Congress to fund them. The government ceased making the payments.

Lawsuits followed, with insurers prevailing at the district court level. On appeal, the Federal Circuit agreed that Section 1402 of the ACA imposes an "unambiguous obligation" on the government to make CSR payments to insurers. However, the panel departed from the lower courts on damages, finding that damages could be mitigated by monies insurers collected due to so-called "silver-loading." Silver-loading is the name given to actions taken by many insurers to increase premium loads on so-called silver-level plans. Since premium tax credits are set based on the premium for the second-lowest cost marketplace silver plans, the increase in premiums for those plans in turn increased the level of premium tax credits due from the government, thereby blunting the effect of CSR non-payments. The Federal Circuit's ruling held that recovery of unpaid CSRs for 2018 and beyond will be reduced based on the effects of such premium loading. The Federal Circuit remanded to recalculate the damages owed for 2018 in light of these mitigations. An appeal by insurers to the U.S. Supreme Court is expected.

7. Update on U.S. and EU/UK Covered Agreements

The NAIC has adopted as an addition to the accreditation standards (effective September 1, 2022) the 2019 revisions to the Revised CFR Model Laws, which incorporate reinsurance collateral reduction reforms in accordance with the Covered Agreements. The Covered Agreements require states to take action with respect to the reinsurance collateral provisions within 60 months after signing the U.S.-EU Covered Agreement or face potential federal preemption by the Federal Insurance Office ("**FIO**") under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The FIO may begin its federal preemption analysis on April 1, 2021, which is the first day of the 42nd month after the date the U.S.-EU Covered Agreement was signed. Any changes or modifications by states to the language as adopted in the Revised CFR Model Laws could potentially lead to a federal preemption analysis by the FIO.

While states are making progress in their implementation efforts, the disruption in legislative calendars as well as the shift in legislative priorities due to COVID-19 have slowed the adoption process.

As of February 1, 2021, 18 states have adopted the revisions to the Credit for Reinsurance Model Law (#785), and 18 more have legislation under consideration. While states are making progress in their implementation efforts, the disruption in legislative calendars as well as the shift in legislative priorities due to COVID-19 have slowed the adoption process. The Reinsurance (E) Task Force (the "**Reinsurance Task Force**") has noted its willingness to provide support to the states to meet the September 1, 2022 deadline and will communicate with the U.S. Department of the Treasury (the "**Treasury**") and the FIO as necessary regarding state implementation. While questions have been raised regarding a possible extension of the September 2022 deadline, there have not been any specific conversations to date with either the FIO or the EU about extending the upcoming deadline.

8. NAIC Activity Relating to International Insurance Activities

On November 14, 2019, the International Association of Insurance Supervisors (the "**IAIS**") adopted a comprehensive set of reforms designed to enable effective cross-border supervision of internationally active insurance groups ("**IAIGs**") and contribute to global financial stability, specifically (a) the Common Framework for the Supervision of Internationally Active Insurance Groups ("**ComFrame**"), (b) the Insurance Capital Standard (the "**ICS**"), and (c) the holistic framework for the assessment and mitigation of systemic risk in the insurance sector (the "**Holistic Framework**"). Over the last year, the NAIC and its representatives at the IAIS have been actively participating in the implementation process of these reforms, as further described below.

a. The Holistic Framework

In late 2018, the IAIS published a proposed Holistic Framework, which was created to assess and mitigate systemic risk in the insurance sector for implementation beginning in 2020. The Holistic Framework recognizes that systemic risk can arise both from sector-wide trends with regard to specific activities and exposures, as well as from a concentration of these activities and exposures in individual insurers. The Holistic Framework consists of (a) an enhanced set of supervisory policy measures and powers of intervention, (b) an annual IAIS global monitoring exercise ("**GME**"), designed to assess global insurance market trends and developments, and detect the possible build-up of systemic risk in the global insurance sector, and (c) an assessment of the consistent implementation of enhanced supervisory policy measures and powers of intervention.

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The GME includes, at an individual insurer and sector-wide level, a collective discussion at the IAIS on the assessment of potential systemic risks and appropriate supervisory responses and reporting to the Financial Stability Board ("**FSB**") on the outcomes of the GME. The FSB, in consultation with the IAIS and national authorities, began identifying global systemically important insurers ("**G-SIIs**") in 2013. In November 2019, in light of the Holistic Framework, the FSB, in consultation with the IAIS and national authorities, suspended G-SII identification starting in 2020. In November 2022, the FSB plans to review the need to either discontinue or reestablish an annual identification of G-SIIs based on an assessment of the initial years of implementation of the Holistic Framework.

The IAIS is currently conducting a baseline assessment that focuses on relevant Insurance Core Principles ("**ICPs**") and ComFrame standards, which will help the IAIS assess the level and means of implementation by jurisdiction. Once the baseline assessment is finalized, the IAIS is expected to share the outcomes with the broader IAIS membership, the FSB, and the general public in March 2021.

b. ComFrame Implementation

Following the adoption of ComFrame in November 2019, the Group Solvency Issues (E) Working Group ("**GSI Working Group**") performed a gap assessment to identify areas where existing state insurance solvency regulations do not meet the minimum standards under ComFrame. Also, in response to a referral from the GCC Working Group, the GSI Working Group is evaluating the impact of XXX/AXXX reserves on group capital positions.

Although the results of the assessment indicate that many of the minimum requirements of ComFrame are already addressed in the U.S. system, the GSI Working Group has identified certain areas that require further development. The results of the ComFrame gap assessment included the following recommendations:

- Require that a CGAD be filed at the head of the IAIG level to ensure that processes are evaluated at an appropriate level for the full group;
- Update the *Financial Analysis Handbook* to provide additional guidance for use in completing holding company analysis of IAIG groups;

- Update the *Financial Condition Examiners Handbook* to provide additional guidance for use in conducting coordinated exams of IAIG groups;

- Require that ORSAs be conducted and filed at the head of the IAIG level to ensure that risk exposures and control functions are evaluated at an appropriate level for the full group; and

- Update the *ORSA Guidance Manual* to encourage additional discussion of certain elements in IAIG ORSA reporting, including, for example, group business strategy, mapping of risks/processes to legal entities, independence of the risk management function, actuarial function and its role in enterprise risk management ("**ERM**") and the ORSA, independent review/validation of ERM/ORSA processes, macroeconomic stresses and counterparty risk, liquidity risk and stresses, and resolution/recovery planning.

The GSI Working Group decided to form drafting subgroups to develop revisions to the *Financial Analysis Handbook,* the *Financial Condition Examiners Handbook,* and the *ORSA Guidance Manual* to address these recommendations.

The GSI Working Group has also formed a drafting group to address a request from the GCC Working Group to quantify and evaluate the impact of XXX/AXXX reserves held by grandfathered captives on an insurance group's overall capital position. As a result of GCC field testing, the GCC Working Group raised a concern that the GCC, when applied to groups that have XXX/AXXX reserves, may result in a material understatement of group capital. The GCC Working Group requested that the GSI Working Group identify all groups that use XXX/AXXX grandfathered captives (pre-A/XXX Model Regulation (AG 48) business) and request the liability impact and the asset impact from the lead state for each such group. The GCC Working Group has suggested that it may be appropriate for the lead state for any affected group to exercise its discretionary authority to require the group to disclose the ongoing impact of the test to the lead state until it is no longer adverse and material.

c. Evaluation of GCC Equivalency to the ICS

The NAIC is also continuing its work with other interested jurisdictions to develop the Aggregation Method ("AM"), which is intended to be an alternative to the consolidated group insurance capital standard ("ICS") developed by the IAIS to apply to IAIGs.

The NAIC is also continuing its work with other interested jurisdictions to develop the Aggregation Method ("**AM**"), which is intended to be an alternative to the consolidated group insurance capital standard ("**ICS**") developed by the IAIS to apply to IAIGs. The AM will be similar to the GCC described in greater detail in section IV.A.2 above and calculated in a similar but "jurisdictionally agnostic" manner. The IAIS intends to determine by the end of 2024 whether the AM will be considered "outcome equivalent" to the ICS. In November 2019, the IAIS agreed to a definition and approach for this assessment, and in November 2020, the IAIS released a draft document setting out the overarching principles and concepts for the assessment of whether the AM provides comparable outcomes to the ICS. Comments to the draft document were due to the IAIS on January 22, 2021.

If the IAIS determines that the AM does provide comparable outcomes to the ICS, the AM will be considered an outcome-equivalent approach for implementation of the ICS as a prescribed capital requirement ("**PCR**") for IAIGs. Additionally, during the latter half of 2023, the IAIS plans to issue a public consultation on the ICS and initiate an economic impact assessment, with the aim of addressing the results of those undertakings in the final version of the ICS to be implemented as a PCR.

FIO aims to complete its study prior to the IAIS' issuance of a public consultation on the ICS as a PCR and completion of its economic impact assessment in 2023.

Under the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, the Secretary of the Treasury, the Chairman of the Federal Reserve, and the Director of the FIO, in consultation with the NAIC, are required to complete a study and submit a report to Congress on the impact of any final international insurance capital standard on consumers and U.S. markets. In furtherance of this requirement, in October 2020, the FIO issued a notice to solicit input on a future study by FIO to evaluate the potential effects of the ICS on U.S. insurance markets, U.S. consumers, and U.S. insurers. The notice invited input on how FIO should evaluate the potential effects of the ICS on the insurance market in the U.S., including consumers and insurers and requested, among other things, input on how the FIO study should consider the potential effects of implementing the AM in U.S. insurance markets as compared to implementing the ICS. FIO aims to complete its study prior to the IAIS' issuance of a public consultation on the ICS as a PCR and completion of its economic impact assessment in 2023.

9. NAIC Updates Regarding Valuation of Securities

On May 14, 2020, the Valuation of Securities Task Force (the "**VOS Task Force**") adopted amendments (the "**New PPS Amendments**") to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "**P&P Manual**") to address the treatment of principal-protected securities ("**PPS**"). Under the New PPS Amendments, PPS acquired on or after January 1, 2021 must be submitted to the SVO for review within 120 days of acquisition, and PPSs acquired before January 1, 2021 must be submitted to the SVO by July 1, 2021.

The New PPS Amendments include (i) an updated definition of PPS and (ii) three examples of transactions that meet the definition of PPS included for demonstrative purposes only, and do not include all possible PPS transactions. Under the updated definition, PPS are defined therein as "a type of security that repackages one or more underlying invested assets and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an underlying bond(s), but for which the repackaged security generates potential additional returns as described in the detail criteria for PPS."

Under the updated definition, PPS are defined therein as "a type of security that repackages one or more underlying invested assets and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an underlying bond(s), but for which the repackaged security generates potential additional returns as described in the detail criteria for PPS.

The New PPS Amendments also provide that transactions meeting the definition of a PPS must be submitted to the securities valuation office ("**SVO**") for review under the SVO's Subscript S authority. If the SVO determines that there are no "Other Non-Payment Risks" (as defined in the P&P Manual) and the PPS is otherwise eligible for reporting on Schedule D, then it will permit the PPS to benefit from the filing exemption process. If the SVO determines that there are "Other Non-Payments Risks," then it will not permit the PPS to benefit from the filing exemption process.

The New PPS Amendments specifically exclude from the definition of PPSs the following securities: defeased or pre-refunded securities which have separate instructions in the P&P Manual, broadly syndicated securitizations such as collateralized loan obligations ("**CLOs**") and asset-based securities ("**ABS**"), and CLO or ABS issuances held for purposes of risk retention as required by a governing law or regulation.

On October 23, 2020, in a presentation to industry participants, the staff of the SVO provided examples of how a weighted average rating factor ("**WARF**") methodology could be applied to a PPS to assign an NAIC rating to PPS. In presentation materials, the staff stated: "Applying WARF permits the SVO to determine a single NAIC Designation Category for the PPS that is based upon the [relative] risks of the individual components. The single NAIC Designation Category for the PPS should incur approximately the same Risk Based Capital charge as would the underlying investments if [they] were each reported separately." The presentation materials stated that the SVO may notch up or down the implied NAIC designation from the designation implied by the WARF methodology "for things such as: market value fluctuations, ratings changes, principal repayments, or losses."

10. NAIC Considers Revisions to Statements of Statutory Accounting Principles

a. Identification of Related Parties and Affiliates

At the Fall 2020 National Meeting, the Statutory Accounting Principles (E) Working Group (the "**SAP Working Group**") voted to expose for comment further revisions to SSAP No. 25 — *Affiliates and Other Related Parties* to incorporate new disclosures regarding the identification of related parties and affiliates. Revisions to SSAP No. 25 were originally exposed at the NAIC's Fall 2019 National Meeting and are largely aimed at aligning related party and affiliate reporting under statutory accounting principles with U.S. Securities and Exchange Commission ("**SEC**") reporting requirements, the latter of which focus on beneficial ownership and do not include the concept of a disclaimer of control or affiliation (a "**Disclaimer**").

The proposed revisions make the following clarifications:

- Any related party identified under U.S. generally accepted accounting principles or SEC reporting requirements would be considered a related party under statutory accounting principles;
- Noncontrolling ownership over 10% results in a related party classification regardless of any Disclaimer; and

- A Disclaimer may affect holding company group allocation and reporting as a subsidiary, controlled or affiliated entity under SSAP No. 97 — *Investments in Subsidiary, Controlled and Affiliated Entities* but does not eliminate the classification as a "related party" and the disclosure of material transactions as required under SSAP No. 25.

The newly exposed revisions to SSAP No. 25 incorporate recommendations from the GSI Working Group to include a new statutory disclosure to provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers to ensure that state insurance regulators have the full picture of complicated business structures. In response to interested party comments, a supplemental reporting schedule will also be proposed to the Blanks (E) Working Group to capture related party information. The SAP Working Group is expected to continue discussions on these revisions in early 2021.

b. Levelized and Persistency Commission Arrangements

The revisions are intended to clarify existing guidance regarding levelized commissions to require full recognition of liabilities incurred under funding arrangements for commission expenses at the time an insurance policy is written.

The SAP Working Group is continuing discussions on revisions to SSAP No. 71 — *Policy Acquisition Costs and Commissions,* which were proposed to address the practice by certain insurers of using third-party arrangements to fund payments to agents. The revisions are intended to clarify existing guidance regarding levelized commissions to require full recognition of liabilities incurred under funding arrangements for commission expenses at the time an insurance policy is written.

Revisions to SSAP No. 71 were previously exposed by the SAP Working Group on October 15, 2020, to (i) improve the description of funding arrangements, (ii) delete certain previously proposed revisions, including those referencing other types of commissions and the application as a correction of an error, and (iii) propose that the revisions apply to contracts in effect on January 1, 2021. The SAP Working Group noted that the October 2020 revisions attempted to make a distinction between traditional persistency commission and levelized commission funding arrangements in response to industry comments, in order to focus on funding arrangements that attempt to defer acquisition costs while ensuring that traditional persistency commissions did not inadvertently become included in the scope of the proposed revisions.

At the Fall 2020 National Meeting, the SAP Working Group spent a significant amount of time discussing the effective date of revisions to SSAP No. 71, including whether to (i) retain the January 1, 2021, proposed effective date, (ii) push the effective date to December 31, 2021, to allow more time for company discussion with state insurance regulators, or (iii) as the proposed revisions are non-substantive, make such revisions effective upon adoption. The SAP Working Group voted to re-expose the revisions for comment until January 11, 2021, with the minor edits, with such revisions to be effective as of the date of adoption. NAIC staff will also draft an issue paper to document the discussion of conclusions and revisions to SSAP No. 71 for future reference.

c. Issue Paper Regarding Loan-Backed and Structured Securities

During 2020, the SAP Working Group continued conversations with industry on the issue paper initially proposed by NAIC staff regarding SSAP No. 43R — *Loan-backed and Structured Securities* (the "**SSAP 43R Issue Paper**"), which was being developed to document discussions on proposals to determine whether an investment is within the scope of SSAP No. 43R.

Proposed revisions to SSAP No. 43R were initially exposed during the Summer 2019 National Meeting and classified as "non-substantive" changes intended to clarify that collateralized fund obligations (CFOs) and similar structures that reflect underlying equity interests, but that are issued in the form of debt instruments, are not within the scope of SSAP No. 43R and/or are bonds created specifically to lower the associated investment risk-based capital charge without any reduction of risk (i.e., PPS).

After discussing initial comments received to the exposed revisions, the SAP Working Group reclassified the project as substantive and directed NAIC staff to develop the SSAP 43R Issue Paper to document the rationale for all investments covered by the proposed revisions to SSAP No. 43R. The preliminary draft of the SSAP 43R Issue Paper was exposed for comment during the Spring 2020 National Meeting. In response to that exposure, interested parties submitted a 67-page comment letter to NAIC staff outlining numerous concerns regarding the categorization process outlined in the SSAP 43R Issue Paper.

The SAP Working Group held a conference call on October 13, 2020, to discuss the comments to the draft SSAP 43R Issue Paper. During that call, the SAP Working Group discussed a proposal submitted by the Iowa Insurance Division that suggested the project proceed with first identifying principles of investments that should be captured as "bonds" on Schedule D-1 (the "**Iowa Proposal**"). The Iowa Proposal suggested that, thereafter, the project proceed with identifying those characteristics that, while not impairing classification as a bond, may warrant separate identification on Schedule D-1, with secondary phases to include clarification of the classifications under SSAP No. 26R — *Bonds* and SSAP No. 43R. The SAP Working Group exposed the Iowa Proposal for comment until December 4, 2020. The SAP Working Group is engaged in ongoing discussions with industry members regarding the Iowa Proposal. It is expected that the SAP Working Group will continue its discussions regarding the Iowa Proposal in early 2021.

11. NAIC Committee Adopts Real Property Lender-Placed Insurance Model Act

On December 8, 2020, the Property and Casualty Insurance (C) Committee (the "**C Committee**") adopted the Real Property Lender-Placed Insurance Model Act (the "**LPI Model Act**"), which establishes a legal framework within which lender-placed insurance on real property ("**LPI**") may be written in a state. The LPI Model Act includes provisions to (a) maintain the separation between mortgage lenders and servicers, on the one hand, and insurers and insurance producers, on the other hand, and (b) minimize the possibilities of unfair competitive practices in the sale, placement, solicitation, and negotiation of LPI.

The LPI Model Act includes provisions to (a) maintain the separation between mortgage lenders and servicers, on the one hand, and insurers and insurance producers, on the other hand, and (b) minimize the possibilities of unfair competitive practices in the sale, placement, solicitation, and negotiation of LPI.

The LPI Model Act specifically covers, among other matters, (i) the duration of LPI coverage and required evidence of coverage, (ii) the calculation of coverage and premium amounts, (iii) certain prohibited practices, including prohibitions on insurers' and producers' payments of compensation to lenders and servicers in connection with the placement of LPI, and (iv) rate and form filings and other regulatory reporting requirements. The NAIC Executive Committee (EX) and Plenary will consider adoption of the LPI Model Act at the Spring 2021 National Meeting.

12. States Continue Efforts to Address Innovation and Technology in the Insurance Sector

Several NAIC task forces and working groups are evaluating the intersection of technology and insurance, including in the areas of the use of predictive modeling in rate filings by P&C insurers, the application of anti-rebating laws, the use of artificial intelligence ("**AI**") and the potential for technology-based practices to have a disparate impact on minorities and disadvantaged groups.

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a. NAIC Continues Regulatory Review of Predictive Models White Paper

On December 8, 2020, the C Committee adopted the Regulatory Review of Predictive Models white paper (the "**White Paper**"). The White Paper identifies best practices for state insurance regulators in their review of predictive models and analytics filed by insurers to justify rates.

The four best practices for regulatory review described in the White Paper are to:

- Ensure that the selected rating factors, based on the model or other analysis, produce rates that are not excessive, inadequate, or unfairly discriminatory;
- Obtain a clear understanding of the data used to build and validate the model and thoroughly review all aspects of the model, including assumptions, adjustments, variables, and submodels used as input, and resulting output;
- Evaluate how the model interacts with and improves the rating plan; and
- Enable competition and innovation to promote the growth, financial stability, and efficiency of the insurance marketplace.

The White Paper also provides guidance for regulators' review of rate filings based on predictive models by identifying specific "information elements" a regulator may need to consider. The "information elements" are set forth in Appendix B of the White Paper and organized in three categories: (i) selecting model input, (ii) building the model, and (iii) the filed rating plan. Although Appendix B focuses on generalized linear models for personal automobile and home insurance, the White Paper notes that many of the "information elements" may be transferable to other types of models, other lines of business, and other applications beyond rating.

Two noteworthy issues that are not within the scope of the White Paper are (i) guidance for regulators to identify and minimize unfair discrimination and disparate impact, which is expected to be addressed by the Special (EX) Committee on Race and Insurance, and (ii) the importance of causality versus correlation when evaluating a rating variable's relationship to risk. Confidentiality of predictive models is an area of industry concern, and the White Paper merely notes that whether or not rate filings, including any predictive models and supplemental information furnished to a regulator, are accorded confidential treatment is determined by state confidentiality laws. The NAIC Executive (EX) Committee and Plenary will consider adoption of the White Paper at the Spring 2021 National Meeting.

b. NAIC Adopts Amendments to Model Unfair Trade Practices Act

The NAIC adopted amendments to the NAIC's Model Unfair Trade Practices Act to address concerns raised by interested parties that perceive the existing anti-rebating laws to be an obstacle to innovative insurance solutions.

The NAIC adopted amendments to the NAIC's Model Unfair Trade Practices Act (#880) (the "**Unfair Trade Practices Act**") to address concerns raised by interested parties that perceive the existing anti-rebating laws to be an obstacle to innovative insurance solutions.

Under the Unfair Trade Practices Act and existing state rebating laws, insurers are prohibited from offering value-added products, services, or programs in conjunction with the sale of an insurance policy as an inducement to purchase insurance. The amendments focus on Section 4H and clarify that certain value-added products, services, and programs that are intended to protect policyholders or otherwise mitigate the risk of loss to a person or property should not be a prohibited "rebate" or "inducement." The amendments also authorize insurers and producers to offer or give noncash gifts, items, or services and conduct raffles or drawings provided that, among other things, such gifts, items, services, or prizes are not valued in excess of specified amounts, the offer is not made in a manner that is unfairly discriminatory, and the customer is not required to purchase, continue to purchase, or renew a policy in exchange for such gifts, items, services, or prizes. The amendments include a drafting note that recommends that the value cap on such gifts, items, services, and prizes should be the lesser of 5% of the current or projected policyholder premium or US$250. Finally, the amendments also include a prohibition against offering insurance as an inducement to the purchase of another policy or using the words "free" or "no cost" in advertisements.

c. NAIC Adopts Artificial Intelligence Principles

The NAIC unanimously adopted a guidance document titled "Principles on Artificial Intelligence (AI)." The principles were developed by the Artificial Intelligence (EX) Working Group, which was charged with studying the development of AI, its use in the insurance sector and its effect on consumer protection and privacy, marketplace dynamics, and the state-based insurance regulatory framework.

The NAIC unanimously adopted a guidance document titled "Principles on Artificial Intelligence (AI)." The principles were developed by the Artificial Intelligence (EX) Working Group, which was charged with studying the development of AI, its use in the insurance sector and its effect on consumer protection and privacy, marketplace dynamics, and the state-based insurance regulatory framework. The principles set out high-level objectives related to fairness, ethics, accountability, compliance, transparency, security, and risk management that insurance companies and other persons facilitating the business of insurance should follow when playing an active role in the AI system lifecycle. The principles do not carry the weight of law or impose any legal liability on insurers but are intended to assist regulators and NAIC committees addressing insurance-specific AI applications.

d. NAIC Establishes Special Committee on Race and Insurance

The Special (EX) Committee on Race and Insurance (the "**Special Committee**") was established with the following four charges for 2021:

- Conduct research and analyze the level of diversity and inclusion within the insurance sector;
- Engage with a broad group of stakeholders on issues related to race, diversity, and inclusion in, and access to, the insurance sector and insurance products;
- Examine and determine which current practices or barriers exist in the insurance sector that potentially disadvantage people of color and/or historically underrepresented groups; and
- Make recommendations to the Executive (EX) Committee and membership by year-end regarding steps: (i) both state insurance regulators and the insurance industry can take to increase

diversity and inclusion within the sector, (ii) that should be taken to address practices that potentially disadvantage people of color and/or historically underrepresented groups, and (iii) to ensure ongoing engagement of the NAIC on these issues through charges to its committees, task forces, and working groups.

The Special Committee has organized five workstreams in connection with such charges. The first two workstreams are to research and analyze the level of diversity and inclusion within the insurance industry (workstream one) and the NAIC and state insurance regulatory agencies (workstream two), and make recommendations on action steps for each subject. The other three workstreams are to examine and determine which practices or barriers exist in the insurance sector that potentially disadvantage people of color and/or historically underrepresented groups in the following lines of business and make recommendations on action steps for each line: P&C insurance (workstream three), life insurance and annuities (workstream four), and health insurance (workstream five).

Workstreams three through five are expected to coordinate with other NAIC groups, including the Big Data (EX) Working Group, Artificial Intelligence (EX) Working Group, and Innovation and Technology (EX) Task Force. It is anticipated that there will be a focus on big data with respect to insurer practices that potentially disadvantage people of color and/or historically underrepresented groups. Concerns regarding insurers' use of big data include the (i) lack of transparency and disclosure to consumers (i.e., consumers are neither aware of nor able to correct the data used in the underwriting and pricing of insurance), (ii) sources and accuracy of data points used to create algorithms in predictive rating models, (iii) types of data points used in such algorithms, which can have a disparate impact on minorities and disadvantaged groups, such as providing more favorable results to suburban consumers than to urban consumers, (iv) lack of federal and state regulation to "unlock" data points used in algorithms and require insurers to identify all data points used in the underwriting and pricing of insurance, and (v) need for regulation of third-party data vendors and insurers' use of data obtained from such vendors.

13. Privacy

a. NAIC Evaluating Model Law Updates Relating to Privacy Protections

In connection with its charge to review state insurance privacy protections regarding the collection, use, and disclosure of information gathered in connection with insurance transactions, and to make recommended changes, as needed, to certain NAIC models, the Privacy Protections (D) Working Group (the "**PPWG**") determined that the Privacy of Consumer Financial and Health Information Regulation (#672) (the "**Privacy Regulation**") will be used as a baseline model. The initial phase of the PPWG's work involves performing a gap analysis of state and federal privacy laws to determine any recommended revisions to the Privacy Regulation to address any gaps ascertained from the analysis. The PPWG noted that it will focus its work on three main areas: (i) consumer issues, (ii) industry obligations, and (iii) regulatory enforcement.

In connection with its charge to review state insurance privacy protections regarding the collection, use, and disclosure of information gathered in connection with insurance transactions, and to make recommended changes, as needed, to certain NAIC models, the Privacy Protections (D) Working Group determined that the Privacy of Consumer Financial and Health Information Regulation (#672) will be used as a baseline model.

b. California Consumer Privacy Act

The California Privacy Rights Act ("**CPRA**") was approved by California voters on November 3, 2020. The new provisions significantly expand the requirements of the California Consumer Protection Act ("**CCPA**") and will take effect in 2023.

Significantly, the CPRA will create a new subcategory of personal information deemed "sensitive personal information," which includes social security numbers, financial account information in combination with any security code or login credentials, certain types of biometric data, and precise geolocation data. This new subcategory is subject to special limitations. For example, consumers have the right to direct a business to use sensitive information only as is necessary or as specifically prescribed by the CPRA. Any business that uses sensitive personal information for other purposes must provide conspicuous links for consumers to exercise their rights.

…the CPRA will create a new subcategory of personal information deemed "sensitive personal information," which includes social security numbers, financial account information in combination with any security code or login credentials, certain types of biometric data, and precise geolocation data.

Unlike the CCPA's current "sale" opt-out, the CPRA's opt-out gives consumers the additional right to opt-out of the sharing of personal information with a third party even where there is no exchange of consideration between the parties. This includes sharing for the purpose of targeted advertisements. In practice, this means consumers can prevent businesses from using technologies like cookies and pixels to track them across other websites, apps, or services and then share that information (e.g., websites visited or products viewed) with ad networks to deliver targeted advertisements to them.

…the NAIC adopted the Insurance Data Security Model Law (#668) which provides, among other things, that state insurance licensees must develop, implement, and maintain a comprehensive written Information Security Program…

…the NYDFS issued Circular Letter No. 2 announcing a Cyber Insurance Risk Framework that describes industry best practices for New York-regulated P&C insurers. The Cyber Framework is the first official guidance by a U.S. regulator concerning the increasingly critical issue of cyber insurance and sets forth the NYDFS' interpretation of the requirements of existing laws and regulations.

The CPRA's opt-out also gives consumers opt-out rights with respect to businesses' use of "automated decision-making technology," which includes profiling consumers based on their "performance at work, economic situation, health, personal preferences, interests, reliability, behavior, location or movements." In addition, consumers will be able to require a business to disclose "meaningful information about the logic involved in such decision-making processes, as well as a description of the likely outcome of the process with respect to the consumer."

The CPRA incorporates the principle of data minimization, requiring that a business's collection and use of a consumer's data be reasonably necessary and proportionate to the purposes for which it was collected and to refrain from using personal data incompatible with the disclosed purposes for which it was collected. Similarly, businesses will not be permitted to store personal data for longer than is reasonably necessary. Consumers may request information on the length of businesses' retention of their data. The CPRA also incorporates the right of correction, meaning consumers can ask that businesses correct any inaccurate personal information they possess.

These new requirements will be enforced by the California Attorney General and a newly formed data privacy agency, the California Privacy Protection Agency ("**CalPPA**"). CalPPA will have responsibility for overseeing CPRA-authorized audits, educating California consumers about their privacy rights, and acting as a privacy liaison to the California legislature and other agencies. The CPRA also increases the risk of consumer litigation by adding email addresses and passwords or security questions to the list of personal information categories that may give consumers a private right of action in the event of a data breach.

c. NAIC Insurance Data Security Law Annual Certifications

In October 2017, the NAIC adopted the Insurance Data Security Model Law (#668) (the "**Data Security Model Law**"), which provides, among other things, that state insurance licensees must develop, implement, and maintain a comprehensive written Information Security Program (the "**Program**"). To date, the Data Security Model Law has been adopted in at least 11 states, with several others (including New York) having implemented either older or similar laws or administrative guidance.

A Program must be commensurate with the size and complexity of the licensee, the nature and scope of the licensee's activities, including its use of third-party service providers, and the sensitivity of the non-public information used by or possessed by the licensee. A Program must also be based on a risk assessment and contain administrative, technical, and physical safeguards for the protection of non-public information and the licensee's information systems. In addition to maintaining a Program, under the Data Security Model Law, licensees must (i) investigate and timely report data breaches, (ii) exercise due diligence in selecting third-party service providers, (iii) conduct risk assessments, and (iv) annually certify compliance with security provisions to the state insurance commissioner.

The Data Security Model Law also mandates that insurers and other subject to its provisions submit an annual certification of compliance with the law. Of note, the deadline for such certification in five states (Alabama, Delaware, Mississippi, Ohio, and South Carolina) was February 15, 2021. A sixth state (New Hampshire) had a certification deadline of March 1, 2021. Once submitted, parties must maintain the records, schedules, and data supporting their annual certificates for a specified period of time (five years, for example, in the case of Delaware).

Under the Data Security Model Law, licensees with fewer than 10 employees and independent contractors are exempt from the law's information security program requirement; however, exemptions vary by state.

d. New York Department of Financial Services Issues First Guidance by a U.S. Regulator Concerning Cyber Insurance

On February 4, 2021, the NYDFS issued Circular Letter No. 2 announcing a Cyber Insurance Risk Framework (the "**Cyber Framework**") that describes industry best practices for New York-regulated P&C insurers. The Cyber Framework is the first official guidance by a U.S. regulator concerning the increasingly critical issue of cyber insurance and sets forth the NYDFS' interpretation of the requirements of existing laws and regulations.

In 2017, the NYDFS put into effect a first-of-its-kind cybersecurity regulation (23 NYCRR 500) that, among other things, requires all entities and persons regulated by the NYDFS to establish and maintain a cybersecurity program designed to protect the confidentiality, integrity, and availability of their information systems and their customers' non-public personal information and sets minimum standards for compliance related to the assessment of cybersecurity risks, the prevention and detection of security events, and post-breach management. Thereafter, in 2019, the NYDFS created a Cybersecurity Division to focus specifically on protecting industries and consumers from cyber threats.

The NYDFS released the Cyber Framework due to the increase in frequency and cost of ransomware attacks as well as the shift that many individuals and businesses have made online due to COVID-19, two trends that have resulted in a massive increase in cyber risk around the world, with associated increases in instances of cybercrime. In the accompanying press release, NYDFS Superintendent Linda A. Lacewell stated that cybersecurity is the biggest risk for government and private organizations and described how the Cyber Framework was based on "extensive dialogue with industry and experts."

While acknowledging that "[e]ach insurer's cyber insurance risk will vary based [on] many factors," the Cyber Framework nonetheless describes seven practices that authorized P&C insurers should use to manage their cyber insurance risk. According to the NYDFS, the incorporation of these practices should be proportionate to each insurer's size, resources, geographic distribution, and other factors. Insurers should:

- **Establish a Formal Cyber Insurance Risk Strategy.** Senior management and the board of directions should have input and approve of a "formal cyber insurance risk strategy" that "include[s] clear qualitative and quantitative goals for risk, and progress against those goals should be reported" to management regularly;

- **Manage and Eliminate Exposure to Silent Cyber Insurance Risk.** Silent cyber insurance risk, the Cyber Framework explains, is risk that an insurer must cover loss from a traditional insurance policy that does not expressly mention cyber risks. The Cyber Framework instructs insurers to make clear in any policy possibly subject to a cyber claim whether the policy specifically includes or excludes cyber-related losses. It also calls for insurers to "take steps to mitigate existing silent risk, such as by purchasing reinsurance;"

- **Evaluate Systemic Risk.** Systemic risk includes critical third-party vendors and catastrophic cyber events involving third parties, such as NotPetya and SolarWinds. Insurers should regularly conduct "internal cybersecurity stress tests based on unlikely but realistic catastrophic cyber events" and track their impact "across the different kinds of insurance policies they offer as well as across the different industries of their insureds;"

- **Rigorously Measure Insured Risk.** Authorized P&C insurers should use a data-driven and comprehensive plan to assess gaps and vulnerabilities in the cybersecurity of their insureds and potential insureds. Insurers should consider gathering information from firsthand sources, such as interviews and reviewing policies, and third-party sources, such as external cyber risk evaluations so their plan is "detailed enough for the insurer to make a rigorous assessment of potential gaps and vulnerabilities in the insured's cybersecurity;"

- **Educate Insureds and Insurance Producers.** Insurers should offer comprehensive information about cybersecurity measures and incentivize the adoption of these measures through insurance pricing policies based on the effectiveness of each insured's cybersecurity program;

- **Obtain Cybersecurity Expertise.** This includes not only recruitment of those with cybersecurity experience and skills but a commitment by insurers to these employees' training and development so as to "properly understand and evaluate cyber risk;" and

- **Require Notice to Law Enforcement.** Cyber insurance policies should require victims to notify law enforcement in the event of a cyber incident. "[L]aw enforcement," the Cyber Framework explains, "often has valuable information that may not be as available to private sources and can help victims of a cyber-incident;" can help "recover data and funds that were lost;" can "enhance a victim's reputation;" and can "warn others of existing cybersecurity threats, and deter future cybercrime." Moreover, the Cyber Framework observes, the Treasury's Office of Foreign Assets Control (OFAC) will consider an insurer's decision to contact law enforcement as a mitigating factor in the event that sanctions are issued. Based on the NYDFS's survey, 36% of insurers already require their cyber insurance insureds to notify law enforcement of a cyber incident.

As the NYDFS' goal in promulgating the Cyber Framework is "to facilitate the continued growth of a sustainable and sound cyber insurance market," the NYDFS Framework is designed to encourage insurers to address these issues and thereby help mitigate and reduce the risks and costs of cybercrime.

On January 13, 2021, the Competitive Health Insurance Reform Act of 2020 ("CHIRA") was enacted, which partially repealed the McCarran-Ferguson Act's longstanding, federal antitrust exemption for the "business of health insurance."

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B. U.S. FEDERAL ACTIVITY

1. McCarran-Ferguson Act Amended to Repeal Longstanding Federal Antitrust Exemption for the "Business of Health Insurance"

On January 13, 2021, the Competitive Health Insurance Reform Act of 2020 ("**CHIRA**") was enacted, which partially repealed the McCarran-Ferguson Act's ("**McCarran-Ferguson**") longstanding, federal antitrust exemption for the "business of health insurance," including the business of dental insurance. Importantly, CHIRA continues to preserve antitrust immunity for health insurers to (a) collect, compile, or disseminate historical loss data; (b) determine a loss development factor for historical loss data; (c) perform actuarial services if such contract, combination, or conspiracy does not involve a restraint of trade; or (d) develop or disseminate a standard insurance policy form so long as adherence to such form is not required.

CHIRA's amendment to McCarran-Ferguson will affect mainly health insurers and not providers of other forms of insurance such as life and P&C lines. For health insurers, however, the changes significantly increase their antitrust exposure to both government investigations and private litigation:

- Health insurers and other entities in the health insurance industry should prepare for an uptick in antitrust enforcement actions from federal antitrust regulators to prosecute conduct that now qualifies as the business of health insurance under CHIRA and no longer receives immunity under McCarran-Ferguson. The Antitrust Division, in particular, which traditionally has maintained subject-matter jurisdiction over the insurance industry, has become increasingly aggressive in challenging anticompetitive behavior in health insurance markets. On the day of CHIRA's passage into law, the Antitrust Division issued a press release stating that CHIRA "will assist the Antitrust Division in its mission to enforce the antitrust laws by narrowing [McCarran-Ferguson's] defense and clarifying that, except for certain activities that improve health insurance services for consumers, the conduct of health insurers is subject to the federal antitrust laws;" and

- Health insurers and other entities in the health insurance industry also should be braced for an increase in litigation by private plaintiffs such as hospitals and other payors, which likely will view CHIRA's passage as an opportunity to challenge activity that once enjoyed protection under McCarran-Ferguson's exemption for the business of insurance.

In other ways, however, the impact of CHIRA on health insurers may prove to be more limited:

- As noted, CHIRA explicitly carves out certain activities from its partial repeal of McCarran-Ferguson and maintains immunity for entities such as health insurers to (a) collect, compile, or disseminate historical loss data; (b) determine a loss development factor for historical loss data; (c) perform actuarial services; or (d) develop or disseminate a standard insurance policy form if adherence to the form is not required. For example, smaller insurers, which otherwise would have internal data that is too limited to develop fair and accurate actuary rates, may continue to access broader data that will enable them to generate rates that are more competitive with larger insurers who have access to larger pools of internal data. This type of information exchange may fall under CHIRA's carveouts and therefore may continue to be protected under McCarran-Ferguson's exemption;

- Conduct that was never within McCarran-Ferguson's original definition of the business of insurance, such as mergers and acquisitions, will continue to be subject to antitrust scrutiny. Similarly, McCarran-Ferguson never protected conduct such as price fixing, collusion, and monopolization; such conduct will continue to be actively investigated and challenged by regulators and private plaintiffs alike; and

- While entities such as health insurers will no longer be able to argue that McCarran-Ferguson requires dismissal of allegations of federal antitrust violations relating to the business of health insurance, CHIRA does not create new per se violations of antitrust laws for any activities relating to the business of health insurance. Instead, most conduct that qualifies as the business of health insurance under CHIRA is likely to be subject to a rule of reason analysis. As such, entities facing new allegations of antitrust violations under CHIRA can continue to rely on general antitrust principles that require a careful analysis and weighing of the procompetitive benefits and anticompetitive effects of challenged conduct before a violation is established.

It remains difficult to define the full scope of risk that CHIRA will pose for health insurers given how recently the law was enacted. Health insurers should pay close attention to the actions and statements from federal enforcement agencies regarding the new law, as well as court decisions that interpret the new legislation and its carveouts, beginning with the Eleventh Circuit's anticipated decision in the *Oscar Insurance case* (*Blue Cross Blue Shield of Fla v. Oscar Ins., No. 19-14096 (11th Cir. argued Nov. 20, 2020)*), which is likely to be issued later in 2021.

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2. SEC Best Interest Regulation

On June 5, 2019, the SEC adopted four releases intended to enhance the standard of conduct for investment professionals and to reaffirm and clarify the terms of existing relationships between investors and investment professionals. The issue of the standards of conduct governing advisers and broker-dealers has been discussed for more than two decades. The key aspects of the proposal (Form CRS and Regulation Best Interest) became effective on June 30, 2020.

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The four SEC releases are:

- **Form CRS/Relationship Summary.** This new rule requires broker-dealers and registered investment advisers to provide all retail investors (as defined) with a brief relationship summary at the beginning of a relationship and in connection with any material changes. The summary addresses the relationships and services the firm offers, the standard of conduct and the fees and costs of the services, specified conflicts of interest, and whether the firm and its financial professionals have reportable legal or disciplinary events;
- **Regulation Best Interest.** A new rule that requires broker-dealers and associated persons to act in the best interest of a retail customer when recommending a securities transaction or investment strategy involving securities ("**Regulation Best Interest**"). The rule requires broker-dealers to act without placing the financial or other interests of the broker-dealer or associated person ahead of the retail customer when making an investment recommendation;
- **Investment Adviser Interpretation.** An interpretation of the fiduciary standard of conduct for investment advisers, explaining the SEC's interpretation of the duty of care and the duty of loyalty; and
- **Solely Incidental Interpretation.** An interpretation of when a broker-dealer's advice to clients is considered "solely incidental to brokerage" and when that advice crosses over to require registration as an investment adviser.

The obligations under the Regulation Best Interest are satisfied if the broker-dealer does all of the following:

- **Disclosure Obligation.** Reasonably discloses, in writing, to the retail investor the material facts both with regard to the scope and terms of their relationship and with respect to any specific investment recommendation;
- **Care Obligation.** Exercises reasonable diligence, care, skill, and prudence with regard to the broker-dealer's recommendations;
- **Conflict of Interest Obligation.** Establishes and maintains conflict of interest policies that, at a minimum, (i) disclose, or eliminate, all material conflicts of interest associated with the recommendation and (ii) disclose and mitigate, or eliminate, material conflicts arising from financial incentives associated with the recommendation; and
- **Compliance Obligation.** In an enhancement from the original proposal, broker-dealers must establish, maintain, and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

Notably, Regulation Best Interest does not prohibit a firm from selling higher cost or complex products, including insurance products such as variable annuities, nor does it forbid a firm from having a limited product set, so long as the limitations are clearly disclosed. Regulation Best Interest applies at the time a broker-dealer makes a recommendation to a retail client, and does not establish an ongoing monitoring obligation for broker-dealers.

Regulation Best Interest and the accompanying releases were adopted on a 3-2 vote, with the two Democratic Commissioners dissenting. It is possible that the SEC could revisit Regulation Best Interest under new Chairman Gary Gensler. Meanwhile, several states, including Nevada, New York, and New Jersey, have proposed enhanced fiduciary standards for broker-dealers and investment advisers which would go beyond Regulation Best Interest, and in some cases for investment advisers which would impose standards higher than the SEC's fiduciary interpretation. Notably, the NYDFS already has adopted an across-the-board fiduciary standard for both broker-dealers and investment advisers when selling dually regulated insurance and securities products such as variable annuities and variable life insurance policies. Similarly, the Massachusetts Securities Division adopted a fiduciary duty standard for broker-dealers when making recommendations to retail investors, effective September 1, 2020, although Massachusetts (for jurisdictional reasons) exempted all insurance products, including variable annuities, from the coverage of its regulation. Industry groups have opposed most of these state initiatives and have argued that the states should wait to evaluate how the SEC applies Regulation Best Interest before adopting new standards. The industry groups also have argued that the state proposals are inconsistent with (and therefore are preempted by) the National Securities Market Improvements Act of 1996 (NSMIA) and Regulation Best Interest itself.

3. Department of Labor Guidance Relating to the Management of Assets

In 2020, the Department of Labor ("**DOL**") issued three pieces of guidance relating to the management of assets subject to ERISA.

a. Guidance Relating to Investment Advice Fiduciaries

The final rule officially confirms the reinstatement of the five-part test for determining whether a person renders investment advice for purposes of ERISA and sets forth a new prohibited transaction class exemption for investment advice fiduciaries that is based on the "impartial conduct standards," which were generally adopted as a temporary policy after the prior iteration of the fiduciary rule was vacated.

On December 15, 2020, the DOL issued the final version of a re-proposed fiduciary rule to regulate "investment advice fiduciaries" under ERISA. The rule, which became effective on February 16, 2021, replaces the DOL's previous rule on this topic, which was promulgated in 2016 but vacated in 2018 by the U.S. Court of Appeals for the Fifth Circuit. The final rule officially confirms the reinstatement of the five-part test for determining whether a person renders investment advice for purposes of ERISA and sets forth a new prohibited transaction class exemption for investment advice fiduciaries that is based on the "impartial conduct standards," which were generally adopted as a temporary policy after the prior iteration of the fiduciary rule was vacated.

Under the DOL's five-part test, a financial institution or investment professional who is not otherwise a fiduciary under ERISA will be deemed to provide investment advice if such person:

1. Renders advice to a plan as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property;
2. On a regular basis;
3. Pursuant to a mutual agreement, arrangement, or understanding with the plan or plan fiduciary that:
4. The advice serves as a primary basis for investment decisions with respect to such plan assets; and
5. The advice will be individualized based on the particular needs of the plan.

The preamble to the final rule discusses the fiduciary implications of advice to roll over assets from an employee benefit plan subject to Title I of ERISA to an individual retirement account ("**IRA**"). In the preamble, the DOL confirms that advice to roll over assets from an employee benefit plan to an IRA may be covered by the five-part test, depending on the facts and circumstances. As a result, any financial institution or investment professional who makes such a rollover recommendation that satisfies the requirements of the five-part test described above will likely be considered an investment advice fiduciary.

If a financial institution or investment professional meets the five-part test and receives a fee or other compensation (directly or indirectly), it will be deemed an investment advice fiduciary under ERISA. An investment advice fiduciary is subject to the prohibited transaction provisions of ERISA, which restrict fiduciaries from engaging in certain transactions involving plans unless an exemption applies. The final rule includes a new class exemption that is available to registered investment advisers, broker-dealers, insurance companies, banks, and their respective employees or agents who are investment professionals. The class exemption would allow an investment advice fiduciary to receive compensation for providing fiduciary investment advice that otherwise would be restricted under the prohibited transaction rules. There are several conditions that must be satisfied in order for the exemption to be available, including that the investment fiduciary (i) complies with impartial conduct standards described in the exemption, (ii) provides appropriate disclosures to retirement investors, including an acknowledgement of fiduciary status, (iii) maintains adequate policies and procedures to ensure compliance with the impartial conduct standards, and (iv) conducts a retrospective review, at least annually, to detect any violations of the impartial conduct standards or the policies and procedures referenced above.

b. Regulation Clarifying Proxy Voting Rules under ERISA

On December 11, 2020, the DOL issued a final regulation to add new rules for plan fiduciaries to follow when voting proxies or exercising other shareholder rights on behalf of ERISA plans. The new regulation states that the fiduciary duty to vote proxies or otherwise manage shareholder rights does not require the voting of every proxy or the exercise of every shareholder right. Instead, to meet the ERISA fiduciary obligations under ERISA, fiduciaries must (i) act solely in accordance with the economic interest of the plan and its participants; (ii) consider any costs involved; (iii) not subordinate the interests of the participants in their retirement income under the plan to any non-pecuniary objective; (iv) evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights; (v) maintain records on proxy voting activities and other exercises of shareholder rights; and (vi) exercise prudence and diligence in the selection and monitoring of persons, if any, selected to advise or otherwise assist with the exercises of shareholder rights. In addition, if a proxy adviser firm has been retained, the plan fiduciary must monitor the activities of the proxy adviser firm to ensure compliance with these rules.

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The regulation sets forth two safe harbor proxy voting policies that will be deemed to satisfy the fiduciary duties described above:

- A policy that limits voting to proposals that are substantially related to the issuer's business or are expected to materially affect the value of the investment; and
- A policy that the fiduciary will refrain from voting when the plan's ownership of a single issuer of stock is relatively small, relative to the plan's total assets, so that voting on a particular matter is not expected to materially affect the investment performance of the plan's portfolio (or the portion of a plan's portfolio managed by an investment manager).

Even if a plan fiduciary adopts either or both of these policies, the plan fiduciary would not be precluded from voting on a matter that is expected to materially affect the value of the plan's investment after considering any costs involved.

A special rule is included in the regulation relating to proxy voting in the case of pooled investment vehicles. Managers of those vehicles are required to take into account the proxy voting policies of investing plans unless the manager develops its own policies and requires the investing plans to accept those policies when they invest in the vehicle.

Although the regulation generally became effective on January 15, 2021, fiduciaries have until January 31, 2022 to comply with the requirement to review service provider proxy voting guidelines and the requirement applicable to investment managers of pooled investment vehicles.

c. Amendment to Fiduciary Duties Regulation to Require Focus on Pecuniary Factors

On October 30, 2020, the DOL issued a final regulation to set forth strict rules requiring plan fiduciaries to consider only pecuniary factors in making investment decisions. The proposed regulation related to consideration of ESG factors in making investment decisions, but the DOL eliminated that term from the final regulation because it believes that the term ESG "is not a clear or helpful lexicon for a

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regulatory standard." According to the DOL, plan fiduciaries "must never sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals." The regulation defines "pecuniary factor" as "a factor that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(b)(1) of ERISA."

The final regulation indicates that a plan fiduciary may use non-pecuniary factors as a deciding factor in making an investment decision where the plan fiduciary is considering several investment opportunities and is unable to distinguish these alternatives solely on the basis of pecuniary factors. To support the use of the non-pecuniary factors in this situation, the fiduciary must document (i) why pecuniary factors were not sufficient to select the investment; (ii) how the selected investment compares to the alternative investments with regard to certain specified investment consideration factors set forth in the final regulation; and (iii) how the chosen non-pecuniary factor or factors are consistent with the interests of participants and beneficiaries under the plan.

By Executive Order, President Biden directed the DOL to review this regulation. Nevertheless, the final regulation became effective on January 12, 2021.

4. Derivative Transactions

a. Initial Margin Requirement Phase-In Extended Again

During 2020, and in part due to the COVID-19 national emergency, U.S. regulators further extended the phase-in period for initial margin rules…

During 2020, and in part due to the COVID-19 national emergency, U.S. regulators further extended the phase-in period for initial margin rules (the "**IM Rules**"). The initial margin requirements are part of the margin regulatory requirements adopted by the Commodity Futures Trading Commission ("**CFTC**") in the "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants" and collectively by the Treasury, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency in the "Margin and Capital Requirements for Covered Swap Entities" final rules.

The compliance date for phase 5 of the IM Rules was extended from September 1, 2020 to September 1, 2021, and the compliance date for phase 6 of the IM Rules was extended from September 1, 2021 to September 1, 2022. Financial end users who are captured by the IM Rules will need to plan well in advance of their relevant compliance date in order to be able to execute new trades after that date. Compliance with the IM Rules will require that existing trading documentation be amended to incorporate new initial margin ("**IM**") compliant documentation. Further, compliance with the IM Rules will also require the parties to establish custody relationships with a third-party custodian as well as implementation of methods to monitor relevant threshold calculations on an ongoing basis, as required under the IM Rules.

In order to determine whether a financial end user is subject to the September 1, 2021 phase 5 or September 1, 2022 phase 6 compliance date, a series of calculations are required with respect to the derivatives trading activity of the financial end user during a specified three-month period. During 2020, the U.S. regulators adopted changes to the calculation methodology that is used to determine when a financial end user becomes subject to the IM Rules. While the U.S. regulators adopted these changes in order to better align with the similar calculations that are used in Europe, the implementation of the changes has resulted in different standards applying to different dealers depending on whether they are regulated by the CFTC or prudentially regulated by the bank regulators. The International Swaps and Derivatives Association, Inc. ("**ISDA**") has published a summary of the new calculation requirements in order to assist market participants to better understand the new requirements.

b. IM Rules Requirements

The IM Rules require IM to be posted and collected, subject to a permitted threshold of up to US$50 million. IM posted must be in the form of prescribed eligible collateral, which is limited under the IM Rules to cash (limited to major currencies) and limited, highly liquid, securities. Under the IM Rules, all collateral posted as IM must be held by an independent third-party custodian that is not affiliated with either counterparty. Non-cash collateral may alternatively be held via other legally binding arrangements that protect the posting counterparty from the default or insolvency of the collecting counterparty. However, any non-cash collateral held by the posting counterparty must be held in insolvency-remote custody accounts. The IM Rules also require that the amount of IM to be posted be calculated using either a risk-based IM model or by reference to a look-up table of standardized minimum amounts set out in the appropriate IM Rules. ISDA has developed the ISDA Standard Initial Margin Model ("**ISDA SIMM**") to provide a common IM calculation methodology that can be used by market participants globally. Any party using ISDA SIMM to calculate IM, regardless of whether such party, such party's counterparty, or a third-party vendor is the party that actually calculates the IM amount, must execute a license agreement to use ISDA SIMM.

5. U.S. Transition from U.S. Dollar LIBOR

The expected transition from U.S. Dollar ("**USD**") LIBOR to the Secured Overnight Financing Rate ("**SOFR**") in the U.S. saw several material developments during 2020.

The expected transition from U.S. Dollar ("USD") LIBOR to the Secured Overnight Financing Rate ("SOFR") in the U.S. saw several material developments during 2020.

First, the Alternative Reference Rates Committee ("**ARRC**"), which was convened by the Federal Reserve Board and the New York Federal Reserve Bank to facilitate the transition from USD LIBOR, finalized and published sample contractual language for use in a wide range of cash products, from bilateral and syndicated loans to notes offerings, that effectively hard-wired fallback mechanics to automatically transition from USD LIBOR to certain forms of SOFR (or other replacement rates if SOFR isn't available at the relevant time) when USD LIBOR ceases to be available.

Second, in October 2020 ISDA published its IBOR Fallbacks Protocol and Supplement 70 to the ISDA 2006 Definitions ("**IBOR Supplement**"), both of which became effective on January 25, 2021. While the IBOR Supplement has the effect of providing new, more robust fallbacks for all new swap transactions entered into on or after January 25, 2021 that reference the ISDA 2006 Definitions, the IBOR Fallbacks Protocol allows parties to amend existing transactions to incorporate the same fallbacks that are provided for in the IBOR Supplement. As a result of these changes, when a relevant USD LIBOR termination trigger event occurs, the USD LIBOR rates in the relevant swap transactions will automatically adjust to a compounded SOFR in arrears rate, with such other conforming changes as may be necessary to the swaps to allow the new SOFR rate to be calculated in arrears.

Third, the LIBOR administrator, ICE Benchmark Administration ("**IBA**"), published a consultation in December 2020 seeking public feedback on its intention to defer the cessation of its publication of the overnight, one-, three-, six- and 12-month USD LIBOR by 18 months to June 30, 2023, but to continue the planned discontinuation of the one-week and two-month USD LIBOR cessation as of December 31, 2021. As of February 23, 2021, the IBA has yet to formally announce the results of the consultation and its impact on the IBA's intended timing for the planned discontinuation of USD LIBOR.

These material developments during 2020 have helped to solidify certain aspects of the expected transition away from USD LIBOR. However, as a result of the IBA consultation, the exact timing of the transition remains uncertain until the IBA makes further announcements. Additionally, as a result of the ARRC proposed hard-wired fallback provisions and the ISDA IBOR Supplement and IBOR Fallbacks Protocol, it has become clear that there is a disconnect between the approach being taken for cash products under the ARRC proposals and the approach being taken for the derivatives market under the ISDA IBOR Supplement and IBOR Fallbacks Protocol. As a result of the disconnect, cash products will fall back to a different version of the SOFR rate than what the derivatives transactions will fall back to. For instance, the ARRC proposals contemplate a fallback to Term SOFR (if it is published at the time USD LIBOR ceases) or if Term SOFR is not available, to simple SOFR, calculated on a daily basis in arrears, whereas the ISDA fallbacks utilize compounded SOFR, calculated in arrears. Further, there may be differences in the conforming changes made to the different agreements, resulting in further differences between cash and derivatives products. Accordingly, as the industry moves closer to the transition from USD LIBOR to SOFR (or other alternate rates), it will be important for market participants to fully understand the specific fallbacks being used for the cash and derivatives products they hold and the potential economic, financial, and regulatory implications of any differences between those fallbacks.

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C. INTERNATIONAL (NON-U.S.) INSURANCE ISSUES

1. The Impact of the UK's Withdrawal from the EU (Brexit) on the European Insurance Market

a. Trade and Cooperation Agreement

The UK officially exited the EU on January 31, 2020 ("**Exit Day**"), commencing the transition period that ran until December 31, 2020 (the "**Transitional Period**"). During the Transitional Period, the UK was no longer a member of the EU and had no representation on EU bodies. Significantly, however, in the context of the European insurance market, "passporting" rights continued to be available throughout the Transitional Period. As such, (re)insurers and intermediaries could passport from the UK into the EU and vice versa until December 31, 2020, just as they were able to before Exit Day.

On December 24, 2020, the EU and the UK concluded an agreement on their future economic relationship ("**Trade and Cooperation Agreement**"), a free trade agreement that covers economic and security cooperation, including trade in goods and services. This deal was ratified by the UK Parliament on December 30, 2020, when the European Union (Future Relationship) Bill was passed.

Not unexpectedly, the Trade and Cooperation Agreement does not provide for a continuation of passporting as between the UK and EU; in fact, it contains very few specific provisions relating to the insurance and financial services industry.

Not unexpectedly, the Trade and Cooperation Agreement does not provide for a continuation of passporting as between the UK and EU; in fact, it contains very few specific provisions relating to the insurance and financial services industry. The UK and EU published declarations alongside the Trade and Cooperation Agreement agreeing to establish a structured regulatory cooperation on financial services. The UK and EU have committed to establishing a memorandum of understanding by March 2021 setting out the framework for this further cooperation. This is highly unlikely to result in any continuation of passporting between the UK and the EU, and will likely focus more on equivalence (see section IV.C.1.c).

b. Passporting

…most UK insurers have had to determine how best to address the loss of these passports, for example by establishing a presence in one of the remaining EU Member States.

The EU single-market "passport" enabled UK insurers to sell products through branches or "freedom of services" throughout the EU. This is no longer available, and most UK insurers have had to determine how best to address the loss of these passports, for example by establishing a presence in one of the remaining EU Member States. Indeed, since the Brexit announcement, a number of insurers have established an EU presence in order to secure passporting rights. For example, Tokio Marine and Hiscox established a presence in Luxembourg, Aviva in Ireland and Lloyd's and QBE opted for Brussels.

In addition to the creation of new EU platforms, Brexit meant that many UK-based insurers looked to restructure their current operating models by way of portfolio transfers, known as "Part VII transfers" in the UK (a court-sanctioned method to transfer books of insurance policies from one legal entity to another). Such transfers were designed to ensure that in-force EU business was transferred to an EU entity that is able to continue to perform regulated activities in respect of that business, such as paying claims, now the UK has left the single market.

It is not just the loss of passporting from the UK into the rest of the EU that has raised an issue. Now EU (re)insurers are also prevented from passporting into the UK. EU firms that operated through EU passporting provisions now require a Part 4A permission under the UK regime to be able to continue carrying out regulated activities in the UK. The repealing of passporting rights in respect of the UK has been implemented through the EEA Passport Rights (Amendment, etc. and Transitional Provisions) (EU Exit) Regulations 2018 (the "**Passport Rights Regulations**"). This became effective from Exit Day, with passporting rights ceasing at the end of the Transitional Period. However, the legislation also provided for a temporary permissions regime (the "**TPR**"). Insurers were eligible to enter the TPR if: (i) they had applied to the UK regulators for Part 4A authorization on or before April 11, 2019; or (ii) they exercised the right to passport into the UK under a freedom to provide services or a freedom of establishment passport (including firms that currently passport into the UK and have a top-up permission). If such firms had elected to enter the TPR, they would have obtained a "deemed Part 4A permission" to carry on the regulated activities in the UK for a maximum of three years from the end of the Transitional Period, subject to Her Majesty's Treasury ("**HM Treasury**") having the power to extend the duration of the regime by increments of 12 months.

The aim of the TPR is to allow firms that wish to continue carrying out regulated activities in the UK in the longer term to do so while they seek authorization from the UK regulators. The deemed permission covers those activities that the firm was permitted to carry on in the UK via passporting immediately before the end of the Transitional Period.

There is also an additional backstop for EEA firms that have passported into the UK to carry on a regulated activity even where they have not made use of the TPR. The UK government introduced the Financial Services Contracts Regime (the "**FSCR**") through amendments to the Passport Rights Regulations, establishing "Supervised Run-Off" and "Contractual Run-Off" mechanisms. These serve as a "backstop" to the TPR by allowing firms that have not entered the TPR, or leave it without the appropriate permissions, to service preexisting contracts for a limited period. For insurance contracts, firms will be allowed to operate under the FSCR for a maximum of 15 years.

In response to the loss of passporting rights, a number of EEA states have introduced transitional regimes that function in a similar way to the FSCR, enabling UK firms that previously operated in those EEA states using the passporting regime to service and run off existing contracts. Belgium, Spain, and Italy are among the states that have so far introduced such measures with regard to UK insurance firms and/or intermediaries. These measures have been implemented further to the positive response of member states to the European Insurance and Occupational Pensions Authority's ("**EIOPA**") February 19, 2019 recommendations to EU supervisory authorities, encouraging them to allow UK insurance companies to continue servicing their existing cross-border insurance contracts even if they are not properly authorized in that particular EU jurisdiction. This should provide some comfort to those UK insurers who have been concerned about their ability to continue servicing their EU policyholders; however, the divergent practices adopted across the member states on whether existing European business can be run off without breaching licensing requirements continue to cause significant confusion in the market.

c. Equivalence

Under Solvency II, the European Commission (the "**Commission**") is able to grant regulatory equivalence to a "third country" in three areas:

i. Reinsurance (Article 172, Solvency II);

ii. Group Supervision (Article 260, Solvency II); and/or

iii. Group Solvency (Article 227, Solvency II).

The EU and the UK did not meet an initial June 30, 2020 deadline for completing Solvency II equivalence assessments and were unable to reach agreement by the end of the Transitional Period. On November 9, 2020, the UK unilaterally recognized the EU's equivalence and HM Treasury declared that for Solvency II purposes the UK deems the regimes of each EEA state equivalent to that of the UK. Additionally, HM Treasury published guidance on the UK's equivalence framework for financial services and a table of UK equivalence decisions confirming that the EU equivalence decisions will be retained in UK law after the end of the Transitional Period. However, the EU has not yet made an equivalence decision with regard to the UK.

The ramifications of a reciprocal equivalence decision not being made by the EU regarding the UK's regulatory and supervisory frameworks are widespread. A failure to find equivalence in relation to reinsurance creates an uneven playing field between an EU reinsurer and those reinsurers located in non-equivalent jurisdictions. For example, the EU could impose compulsory collateral requirements or require the establishment of a local presence in the EU in order to reinsure EU cedents.

For UK-headquartered insurance groups with EU subsidiaries, if group supervision equivalence is not found, the EU could look to apply Solvency II from the EU perspective (from which the UK may diverge over time) to the top of the UK group, and levy an additional capital charge on the EU subsidiary in respect of group risk. Such UK insurance groups may also come under the purview of the EU for group supervision purposes.

In relation to group solvency, ultimately a finding of equivalence in this area is more beneficial to EU headquartered insurance groups with a subsidiary in an equivalent jurisdiction, as it enables such groups to rely upon the equivalent country's local capital requirements for the applicable subsidiary, even if these are lower than the level of capital that may need to be held under Solvency II requirements.

The aim of the TPR is to allow firms that wish to continue carrying out regulated activities in the UK in the longer term to do so while they seek authorization from the UK regulators. The deemed permission covers those activities that the firm was permitted to carry on in the UK via passporting immediately before the end of the Transitional Period.

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In order to give firms more time to adjust to the significant regulatory changes that came into force at the end of the Transitional Period, the FCA, Bank of England, and PRA were all given temporary powers to delay or phase in regulatory requirements (for a period of up to two years from the end of the Transitional Period) where they changed as a result of Brexit or where they apply for the first time.

d. UK Regulatory Response

In order to give firms more time to adjust to the significant regulatory changes that came into force at the end of the Transitional Period, the FCA, Bank of England, and PRA were all given temporary powers to delay or phase in regulatory requirements (for a period of up to two years from the end of the Transitional Period) where they changed as a result of Brexit or where they apply for the first time. The FCA, Bank of England, and PRA have all issued standstill prudential directions, the final texts of which were published in December 2020, meaning that firms are required to comply with the pre-Brexit version of such requirements until March 31, 2022. It was made clear in the PRA's and FCA's Brexit Policy Statements[47] (published in February 2019) that the regulators intended to use these powers broadly.

In addition to the directions themselves, in December 2020 the FCA published an explanatory note and the Bank of England and PRA have both issued guidance on the standstill directions, together with instruments making relevant changes to the FCA Handbook and PRA Rulebook. Firms making use of the TPR must ensure they can comply with these rules and regulations at the end of the Transitional Period.

e. Legislation and Solvency II Directive

The EU Withdrawal Act, as amended, has transposed all applicable direct EU legislation into domestic UK law, thus ensuring the continuing application of Solvency II under the UK's financial services regulatory regime. In order to address and resolve discrepancies arising from the retained EU law being transposed into UK domestic law, Parliament enacted the Solvency II and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 on October 9, 2018 and the Insurance Distribution (Amendment) (EU Exit) Regulations 2019 on November 21, 2018, which came into force following Exit Day. Together, these measures and statutory instruments have enabled the legislation to continue to operate effectively and seamlessly from Exit Day.

f. U.S.-UK Covered Agreement

In December 2018, in anticipation of the UK's exit from the EU, the U.S. Department of Treasury and the Office of the U.S. Trade Representative announced their intent to enter into the U.S.-UK Covered Agreement with a view to maintaining regulatory certainty and market continuity on insurance matters. The U.S.-UK Covered Agreement addresses three areas of regulation: (i) group supervision, (ii) reinsurance, and (iii) exchange of information between supervisory authorities.

Prior to this, in 2017, the U.S. entered into an agreement with the EU, the U.S.-EU Covered Agreement, containing substantially similar terms to the U.S.-UK Covered Agreement. As the UK had previously benefitted from the U.S.-EU Covered Agreement, the agreement of the U.S.-UK Covered Agreement, based on similar provisions, has meant that little has changed in the regulatory insurance relationship between the two countries in a post-Brexit landscape. At the end of the Brexit Transitional Period both countries exchanged notices, bringing the U.S.-UK Covered Agreement into force as of December 31, 2020.

2. Lloyd's Update

Whereas Blueprint One was initially centered on the wide ranging and very ambitious market reforms set out by the Prospectus (the six "solutions"), in response to the COVID-19 pandemic and in order to prioritize the measures with the largest impact on participants, Blueprint Two has taken a more focused approach and has prioritized the digitization of the open market and delegated authority placement and loss recovery processes.

Lloyd's released Blueprint Two on November 5, 2020, in the third installment in their "Future At Lloyd's" market modernization and transformation program. Blueprint Two follows on from the launch of Blueprint One in September 2019, and from the original announcement of the Future At Lloyd's strategy by Lloyd's CEO John Neal in a prospectus published in May 2019 (the "**Prospectus**").

Blueprint Two is targeting significant cost savings for market participants: Lloyd's estimates that the two-year Blueprint Two program will enable at least £800 million of savings, while the cost of the measures will be funded by the £300 million of senior debt raised in September 2019 in combination with the launch of Blueprint One. Whereas Blueprint One was initially centered on the wide ranging and very ambitious market reforms set out by the Prospectus (the six "solutions"), in response to the COVID-19 pandemic and in order to prioritize the measures with the largest impact on participants, Blueprint Two has taken a more focused approach and has prioritized the digitization of the open market and delegated authority placement and loss recovery processes.

47 PRA Policy Statement: PS 5/19 on the Bank of England's amendments to financial services legislation under the EU Withdrawal Act and the FCA Policy Statement: PS 19/5 on Brexit Policy Statement and Transitional Directions.

a. Key Developments in Blueprint Two

In Blueprint One, Lloyd's set out to establish digital platforms both for the placement of complex risks (the "**Complex Risk Platform**") and for the more efficient transacting in non-complex risk, allowing for greater cost reduction through the use of triaging and automation (the "**Lloyd's Risk Exchange**"). Additionally, Lloyd's intended to digitize the claims process and connect the policy data inputted in the Complex Risk Platform and Lloyd's Risk Exchange (the "**Claims Solution**"). Lloyd's also targeted a simplification of the capital rules to make it easier and faster for new capital to enter the Lloyd's market (the "**Capital Solution**"), and in a similar vein introduced the SIAB solution, which enabled a special syndicate to be set up with less stringent entry criteria.

i. Complex Risk Platform

As a result of the pandemic, Lloyd's has been forced to close its underwriting room for significant periods on several occasions, in accordance with the various lockdown measures. In response, Lloyd's has encouraged a greater uptake of its electronic placement services, with placement being announced as one if its three main priorities for the second half of 2020. Indeed, as reported by the London Market Group (the market body representing specialist commercial brokers and underwriters in the London market), the use of the existing electronic placing platform ("**PPL**") hit an all-time high in July 2020, and this trend is likely to continue given the more widespread use of remote working and online services.

Whereas in Blueprint One Lloyd's intended to develop its own, new placement platform (and indeed announced in February 2020 that it was taking a 40% stake in PPL), Lloyd's announced in Blueprint Two that it will instead work to implement technology and risk placement standards together with an accreditation system, whereby third parties may offer platform services so long as they adopt Lloyd's standards (for example, the e-trading platform Whitespace was granted approved status by Lloyd's in July 2020).

ii. Lloyd's Risk Exchange

In Blueprint Two, the Lloyd's Risk Exchange has been expanded upon and subsumed into Lloyd's wider ambition to develop an end-to-end digital platform for delegated authority business. Lloyd's further announced in Blueprint Two that it will conduct additional consultation and research on how best to support the increasing use of automated, algorithmically driven underwriters. In particular, Lloyd's considers that there is significant opportunity for automated underwriters in developing a platform that allows access to multiple markets, in a so-called "exchange of exchanges."

iii. Claims Solution

The Claims Solution contained in Blueprint One has similarly been rolled into the framework of Blueprint Two, with a greater focus on implementation with regard to open market and delegated authority claims processes.

In order to simplify the process and reduce operational expenses for managing agents in appointing delegated claims administrators, Lloyd's have centralized and standardized the due diligence of such administrators so that each managing agent may rely on the work done by Lloyd's and not have to replicate it for themselves each time. A new delegated claims administration agreement was published in July 2020, and on October 2, 2020, an amendment to the Intermediaries Byelaw came into force that required all delegated claims administrators to be approved by Lloyd's.

iv. Capital Solution and the Attraction of New Capital

There have been a number of significant developments with regard to the provision of new, faster and less prohibitively regulated market opportunities for investors. There is clear demand for such opportunities, as demonstrated by the success of the Beazley Smart Tracker, a special purpose syndicate launched in 2018, which operates on a follow-only model. A follow-only model is where a syndicate does not negotiate terms or price, and commits itself to risk purely by following "lead" syndicates that have committed to that risk. This enables significant cost reduction and quicker decision times, as a significant amount of analysis and due diligence carried out by the lead syndicate is not replicated by the follow syndicate, and as is the case with the Beazley Smart Tracker, a data led approach can be taken to selecting the appropriate follow opportunities to which to commit.

Lloyd's further announced in Blueprint Two that it will conduct additional consultation and research on how best to support the increasing use of automated, algorithmically driven underwriters.

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Another major development occurred with the launch in May 2020 of Lloyd's first fully digital and algorithmically driven syndicate, Ki, by Brit in partnership with Google Cloud, Blackstone, Fairfax, and the computer science department of University College London. Ki is also a follow-only syndicate, using its considerable data and algorithmic expertise to evaluate policies and quote for business through a digital platform directly accessible to brokers, who are able to get automated, real time offers rather than spending time seeking to access follow capacity from the Lloyd's market.

Though not included in either of the Blueprints, in January 2021 Lloyd's received regulatory approval for its new ILS special purpose vehicle, London Bridge Risk. London Bridge Risk is a protected cell company that ILS investors can use to access the market, which will connect via quota share reinsurance to a Lloyd's member. Lloyd's have also developed accompanying standardized documentation, which not only save significant time in accessing the market, but also means that when operating within a set scope of agreed permissions, only minor notifications must be made to the FCA and PRA for new deals as opposed to individual regulatory applications. For further details, please see section II.B.4.

Altogether, Lloyd's have responded to the market demand for market access with lower costs of set-up and resource requirements, and appear committed to continuing to broaden and improve the range of options available.

b. Other Relevant Developments

In preparation for the UK's loss of access to the EU's single market, Lloyd's established a presence in the EU: Lloyd's Insurance Company S.A. ("Lloyd's Brussels") has been exercising its passporting rights to write all new Lloyd's market EEA business since January 1, 2019.

In preparation for the UK's loss of access to the EU's single market, Lloyd's established a presence in the EU: Lloyd's Insurance Company S.A. ("**Lloyd's Brussels**") has been exercising its passporting rights to write all new Lloyd's market EEA business since January 1, 2019. In order to ensure that all existing EEA policies written by Lloyd's in the UK continued to be serviceable after the UK (and therefore Lloyd's members) lost passporting rights at the end of the Brexit transitional period on December 31, 2020, Lloyd's transferred such policies to Lloyd's Brussels in a Part VII transfer, which was sanctioned by the UK's High Court on November 25, 2020.

While these Part VII transfer arrangements have so far not caused regulatory issues, Lloyd's Brussels has committed to revising how managing agents operate by the second half of 2021 after Belgian regulators raised concerns in January 2021 that the operation of underwriting activity could include unauthorized conduct of business distribution. Lloyd's head of market development, Caroline Dunn, noted that Lloyd's Brussels has told supervisors it will amend aspects of its business model to "avoid the possibility that managing agents be construed as performing insurance distribution activities for Lloyd's [Brussels]. It has agreed that any such changes will be implemented as soon as possible." Dunn said that activities suspected of constituting insurance distribution included "analyzing broker submissions, pricing risks, preparing a final quote, deciding whether to put the Lloyd's [Brussels] stamp on Lloyd's [Brussels'] insurance contracts, endorsement handling if not purely of an administrative nature and coverholder appointment agreements which provide for 'prior submit' or 'no discretion' for underwriting." It remains to be seen the precise scope and reach of the required changes to Lloyd's Brexit model that will be required, and how these will impact underwriting by managing agents in practice.

3. Regulatory Trends in the UK Insurance Sector

Generally, there has been an increased focus on the culture and conduct of firms, with non-financial misconduct being a specific area of attention, and a desire from the regulators to further hold firms (and individuals within those firms) accountable for their practices…

Businesses in the UK insurance sector are regulated either by the FCA (if they are insurance intermediaries), or both the PRA and the FCA (if they are insurers or reinsurers). The PRA is responsible for the prudential regulation of these businesses and the FCA is responsible for regulating their conduct. In addition, those businesses that have a Lloyd's underwriting platform are also regulated by Lloyd's, which in turn is regulated by the FCA and the PRA. Over the past year, we have seen certain trends emerging in the behavior of these regulators. Generally, there has been an increased focus on the culture and conduct of firms, with non-financial misconduct being a specific area of attention, and a desire from the regulators to further hold firms (and individuals within those firms) accountable for their practices, while also looking to reduce the risk of harm to market competition and to consumers.

a. FCA Market Study on General Insurance

In 2018, the FCA announced that it was looking into pricing practices in retail general insurance, and subsequently launched a market study into how general insurance firms charge their customers for home and motor insurance, focusing on the following three main issues: (i) consumer outcomes from pricing practices and what drives this; (ii) the fairness of pricing practices; and (iii) the impact of pricing practices on competition.

The final report on the FCA's market study was published in September 2020 and concluded that current pricing practices were harmful to the majority of consumers while also negatively impacting competition. The key finding from the report was that most firms adopt pricing practices that set different prices at new business and renewal. Therefore, consumers who "shopped around" for a new policy with a new insurer at renewal were able to take advantage of lower prices, but those that did not were often subject to "price walking" practices, where their insurer would gradually increase the price paid year over year. This was found predominantly to affect older consumers who are less likely to switch providers than younger consumers, with the FCA finding that there is a higher proportion of older consumers among high margin consumers. Additionally, it was found that shopping around and switching, merely to avoid price walking, can impose unnecessary costs on consumers and firms, which can lead to higher prices overall. The report also concluded that firms know that some customers will be very profitable over the long term and are willing to spend significant amounts to acquire them, and articulated the concern that such costs may then be passed on to customers through higher prices.

Despite there being a slight strengthening in competition, based on the willingness of customers to switch brands to secure a better deal, the FCA found that firms vary price based on consumers' awareness of how the market works and how good their deal is. The report found that firms earn higher margins from consumers who are less aware, and hence the effectiveness of price walking in boosting profit margins. The FCA determined that this type of price discrimination was likely to have a negative effect on competition. Since unaware consumers will not shop around for a better deal, this prevents other firms from competing for these customers.

Given the conclusion that competition may not be working well for all consumers, the FCA has developed a remedies package that seeks to improve outcomes for consumers and change the nature of competition. To remedy the practice of price walking, the FCA has proposed that home and motor insurers be required to offer a renewal price no higher than the equivalent price that would be available to that customer if they were taking out a new policy through the same sales channel. For example, if the customer bought the policy online, they would be charged the same price as a new customer buying online. Firms would still be free to set new business prices, but they would be prevented from gradually increasing the renewal price to consumers over time, other than in line with changes in customers' risk.

In addition, the FCA has proposed enhanced product governance requirements for all general insurance (i.e., not just home and motor insurance) and pure protection products, with the aims of ensuring firms consider the longer term value of their products to customers and comply with FCA rules and guidance. It also proposed the introduction of a reporting requirement for firms to provide data on their pricing for home and motor insurance to the FCA. This would be used to provide a snapshot of firms' pricing practices and changes over time, and highlight where further investigation might be needed.

Finally, for all types of general insurance, the FCA has proposed requirements to ensure that firms explain to customers whether their policy is set to automatically renew and what this means for them, and that make it easier for customers to stop a contract from auto-renewing and to decline auto-renewal of policies.

The FCA has not issued specific details as to when these proposals will be adopted, although it intends to publish a policy statement in Q2 2021, with a view to its final rules coming into effect four months after publication of the policy statement. Alongside the final report, the FCA published a consultation paper providing a further explanation of the proposed remedies and changes to the FCA Handbook, with responses due by January 25, 2021. The FCA stated that it would continue to assess the market during the consultation period and consider the ongoing impact of the COVID-19 pandemic prior to making any final rules and issuing any policy statement. In the meantime, firms should evaluate their pricing and distribution strategies in advance of any regulatory changes, focusing on the key areas raised in the FCA's consultation: guaranteeing value in product governance frameworks, reviewing existing products against the proposed requirements, and improving performance relating to the ongoing publication of value measures data.

It is evident from these remedies that the FCA intends to introduce fair value to all consumers, whether new or longstanding, and strengthen market competition, while also increasing the level of oversight they have over these firms.

It is evident from these remedies that the FCA intends to introduce fair value to all consumers, whether new or longstanding, and strengthen market competition, while also increasing the level of oversight they have over these firms. This approach demonstrates an increasing general shift by the UK regulators to further hold firms accountable for their culture and business conduct, in large part by imposing greater transparency on firms' practices, while reducing the risk of harm to the market and consumers.

The FCA's market study also coincided with work being undertaken by the Competition and Markets Authority ("**CMA**") to examine excessive prices for consumers who stayed with the same provider on policy renewal, with particular reference to certain markets, including home insurance. In December 2020, the CMA published an update on its investigation, welcoming the above-mentioned FCA remedies package.

b. FCA Oversight of the UK Insurance Market

In these letters the FCA identified a number of common drivers of harm across firms, which it intends to focus on rectifying when carrying out its supervisory work.

This approach is also apparent from the FCA's recent "Dear CEO" letters, published in November 2020, to Lloyd's and London market (re)insurers, intermediaries, and managing agents. These two letters set out the FCA's view of the key risks of harm to the market and consumers, outlining the FCA's expectations of firms and how firms should be mitigating these risks of harm. In these letters the FCA identified a number of common drivers of harm across firms, which it intends to focus on rectifying when carrying out its supervisory work.

Aside from an emphasis on financial resilience — unsurprising, given the economic volatility arising from the ongoing COVID-19 pandemic — the FCA's main focus is on firms' culture and non-financial misconduct, stating in both letters that "poor culture in financial services is a root cause of the major conduct failings that have occurred within the financial services industry in recent history, causing harm to both consumers and markets." To combat this, firms are expected to assess and address the drivers of culture in their firm, considering leadership, purpose, governance, and management of employees, including how they are remunerated and trained.

Further, the FCA believes that ineffective governance and oversight of business is another key driver of harm. Firms are expected, among other things, to have implemented and embedded the Senior Managers & Certification Regime ("**SM&CR**"), which was specifically designed to improve standards of governance and hold those within senior positions more accountable for their actions, with the FCA stating that it will consider taking strong action for longstanding issues that remain unresolved. Likewise, inefficient and poorly controlled general insurance distribution channels have been identified as another major driver of harm, with firms expected, among other things, to ensure they have robust controls for sales and renewals arrangements, management of conflicts, and oversight of distribution arrangements.

There are clear consistencies between the approach taken by the FCA in response to its market study on general insurance and its approach to the UK insurance market, with the FCA expecting all firms to work harder to address poor-value products, identifying ineffective governance, poor operational oversight, and unhealthy culture as the main risks to the market and consumers.

c. PRA Interplay

The PRA has expressed a similar interest in ensuring that firms are complying with their obligations under the SM&CR, as illustrated by their evaluation report, published in December 2020. Despite the PRA finding that the SM&CR has helped to ensure that senior individuals in firms take greater responsibility for their actions and has made it easier for both firms and the PRA to hold individuals to account, the report has identified multiple areas that need to be refined in order to ensure that the regime operates more effectively in practice. These areas include conduct and regulatory offenses, remuneration, senior manager expectations, diversity, collective accountability, interim appointments, allocation of responsibilities, time-limited and conditional approvals, and new senior manager expectations.

Similar to the FCA, the PRA believes that firms must do more to prevent misconduct and recognizes the role of the SM&CR in addressing this issue. We are seeing a concerted effort from both regulators to facilitate the effective implementation of the SM&CR and ensure that it is embedded within the UK insurance sector. By stressing the link between seniority and accountability, mechanisms are put in place to prevent senior individuals from avoiding repercussions for any misconduct. Consequently, this greater level of scrutiny and transparency applies the necessary pressure to ensure that these individuals perform their duties to the required standard, which has a subsequent effect on the wider culture and conduct of the firm. By ensuring close adherence to the SM&CR, it allows the UK regulators to further hold firms accountable for their business conduct and should be an ongoing risk management focus for those operating in the insurance sector.

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d. Looking to the Future

Looking into 2021, ESG issues will continue to be high on the agenda, as reflected in the FCA and PRA's priorities for 2021. Although the UK regulators will need to focus much of their efforts on navigating their way through the ongoing COVID-19 pandemic and adapting to life following the end of the Brexit transition period, both regulators will still be focused on ensuring that fair value is delivered to consumers. This is especially the case within the growing digital age, whereby consumers should be benefiting from digital innovation, rather than falling foul of it, as highlighted by the increasing use of data algorithms to automatically discriminate against consumers with protected characteristics. To this end, product intervention by regulators will continue to be a theme moving forward into 2021.

In 2021, we can also expect to see the UK regulators continue to prioritize financial and operational resilience, particularly in light of pressures arising from the pandemic, ensuring that firms' boards can satisfy themselves that their firm is resilient to a wide range of potential adverse credit scenarios in the short and medium term. The FCA has been carrying out periodic COVID-19 impact surveys over the course of 2020 and into 2021, in order to obtain an accurate view of firms' financial resilience and mitigate the risks of harm to consumers. In conjunction with this, the FCA has issued advice on financial resilience for firms, expecting firms to meet their responsibilities by planning ahead and ensuring the sound management of their financial resources. This means taking appropriate steps to conserve capital and to plan how to meet potential demands on liquidity, including the effective use of capital and liquidity buffers, and maintaining an up-to-date wind-down plan that takes into consideration the current market impact of the pandemic.

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Similarly, the PRA wants to see firms continue to improve the stress and scenario testing they undertake to inform boards and risk committees' decision-making, including risk and capital appetite, and strategy setting. The PRA will run another comprehensive insurance stress test in 2022 and, in 2021, will develop its approach to recovery and resolution planning. In addition, the PRA expects to see intensive efforts and early progress in 2021 in transitioning from LIBOR to alternative risk-free rates (RFRs). It will be monitoring firms' progress against the targets of the Working Group on Sterling Risk-Free Reference Rates and targets for non-British pound sterling exposures where relevant.

Both regulators expect firms to consider what is required to meet the standards relating to operational resilience and outsourcing that will be set during 2021, taking into account lessons learned from the pandemic, while also placing greater emphasis on resilience to cyber threats, as the PRA is developing a cyber underwriting scenario for the 2022 insurance stress test. As detailed in the FCA and PRA's suite of consultation papers on operational resilience, and the PRA's supervisory statement on outsourcing and third-party risk management (all published in December 2019), firms should consider the impact of the regulators' proposals on their existing frameworks prior to final policies coming into effect this year. These proposals include, among other things: assessing the relevant risks of sub-outsourcing (paying particular attention to the potential impact of large, complex sub-outsourcing chains on their operational resilience and ability to oversee outsourcing arrangements); placing a greater focus on data security and the conducting of periodic risk assessments of outsourcing arrangements; and developing, testing, and periodically reviewing a business continuity plan and documented exit strategy, which should cover and differentiate between situations where a firm exits an outsourcing agreement in stressed circumstances (e.g., following the failure or insolvency of the service provider) and non-stressed circumstances (e.g., through a planned and managed exit due to commercial, performance, or strategic reasons).

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Finally, spurred on by the growing adoption of sustainable finance strategies — particularly in relation to recovery efforts surrounding the pandemic — the UK regulators will place even greater significance on environmental issues in 2021. With the aim to reach net zero emissions by 2050, the UK regulators are looking to introduce a swathe of new measures in 2021, including measures from the FCA to combat "greenwashing" and implement climate-related financial disclosures for market participants, and the launch of the Bank of England's Climate Biennial Exploratory Scenario, which will involve a selection of the UKs largest general and life insurers, along with representation from the Society of Lloyd's. By the end of 2021, firms should be able to demonstrate that they have implemented and embedded the expectations set out in the PRA's supervisory statement (published in April 2019) on enhancing firms' approaches to managing climate-related financial risks. To demonstrate compliance with this supervisory statement, the PRA expects firms to: (i) have clear roles and responsibilities for the board and its relevant sub-committees in managing the financial risks from climate change, allocating specific responsibility for identifying and managing financial risks from climate change to the most appropriate Senior Management Function; (ii) use stress testing and scenario analysis to inform risk identification and understand the short-term and long-term financial risks that climate change presents to their business models; (iii) review and update risk management frameworks, policies, management information, and board risk reports (including Own Risk and Solvency Assessments (ORSAs)) to include consideration of climate risk; and (iv) develop and maintain an appropriate approach to disclosing climate-related financial risks. In doing this, the PRA expects firms to take a proportionate approach that reflects the firm's exposure to climate-related financial risk and the complexity of its operations, although it expects to see climate change necessitating some action by all firms.

4. PRA Supervisory Statement on the Solvency II Prudent Person Principle

On May 27, 2020, the PRA published a supervisory statement, SS1/20 Solvency II: Prudent Person Principle ("**SS1/20**"), which outlines how the PRA expects firms to comply with the requirements under the Prudent Person Principle ("**PPP**") contained in Solvency II, along with a corresponding policy statement ("**PS14/20**"), which provides feedback to responses to the consultation on the original draft of SS1/20. The expectations set out in SS1/20 apply to all UK Solvency II firms, including in the context of provisions relating to Solvency II groups, mutuals, third-country branches, the Society of Lloyd's, and its managing agents. Although the UK has now left the EU, the Solvency II and Insurance (Amendment, etc.) (EU Exit) Regulations 2019 have since come into force, with the effect of amending retained EU law relating to the implementation of the Solvency II legislation in the UK (under the European Union (Withdrawal) Act 2018) in order to prevent, remedy, or mitigate any failure of EU law to operate effectively post-Brexit. Accordingly, Solvency II operates in the UK just as it did prior to the UK's exit from the EU.

Though the standard of assessment is objective, it takes into account the various business strategies and risk profiles of different firms to judge what would be prudent in those circumstances. Consequently, the PPP allows for greater flexibility and freedom for insurance investments than Solvency I's asset admissibility rules and quantitative limits.

Introduced on January 1, 2016 as part of Solvency II, the PPP replaces the previous insurance investment rules that applied to supervised firms under Solvency I. The PPP sets objective standards that firms must comply with when investing their assets, whereby those investments must meet the standard of a hypothetical prudent person in comparable circumstances. In PS14/20, the PRA draws comparisons between the objective standard of the PPP and the objective standard of the reasonable person test used in criminal and civil law contexts. Though the standard of assessment is objective, it takes into account the various business strategies and risk profiles of different firms to judge what would be prudent in those circumstances. Consequently, the PPP allows for greater flexibility and freedom for insurance investments than Solvency I's asset admissibility rules and quantitative limits.

a. Scope of SS1/20

Despite the greater flexibility afforded by the PPP, the PRA has noted inconsistencies in its understanding and application. SS1/20 sets out areas the PRA expects firms to particularly focus on to ensure compliance with the PPP when investing, and provides further detailed guidance on factors that firms should consider. These expectations do not amend the scope of the requirements and guidance on investments issued by the PRA and covered by EU regulations. Some of these requirements apply at the level of the investment portfolio, while some apply to individual investments or to particular asset classes. Subsequently, the scope of the expectations set out in SS1/20 depends on the scope of the requirements to which the expectation refers and the specific circumstances of each firm.

b. PRA Expectations

The PRA expects firms to develop and document an explicit investment strategy containing, at a minimum, clear investment objectives, asset class allocations, how the strategy aligns with the firm's business model, its risk appetite, risk tolerance limits, investment risk and return objections, and a complete list of assets and how they have been invested in accordance with the PPP. Firms should not only develop an investment strategy broadly at the portfolio level, but should also have investment strategies for different asset classes. The PRA expects firms to review their strategy at least annually, or when there have been material changes to the firm's risk profile, with the board approving any material changes to the investment strategy. The PRA clarifies in PS14/20 that this will not be achieved just through the board engaging with Own Risk and Solvency Assessments (ORSAs): the board must be actively engaged with considering investments.

Moreover, firms should be carrying out risk monitoring as part of their risk management, including monitoring changes in the value and volatility of their investment portfolios and the individual assets they have invested in. Firms must produce an internal risk management policy which also details internal quantitative investment limits for assets and exposures. These investment limits apply at asset class levels rather than at levels for individual assets and should take into account, among other things, the firm's liabilities, diversification of the firm's assets, the nature and quantification of risks associated with each category of asset and individual assets, and the impact of uncertainty on the valuation of assets. SS1/20 notes that firms should ensure their portfolios are appropriately diversified to limit reliance on counterparties and to ensure risk is not excessively concentrated on a particular asset, issuer, or group of undertakings. One way that the PRA expects firms to demonstrate proper diversification is to stress test their portfolios to assess whether their solvency risk appetite or solvency is threatened under stress scenarios of differing intensities.

In SS1/20, the PRA reiterates that firms remain responsible for ensuring all of their obligations are discharged if they outsource any functions. Where a firm's investment activity is fully or partially outsourced, the firm remains subject to the requirements of the PPP and so must ensure that the external investment manager invests in accordance with the PPP. In addition, the PRA makes explicit that the PPP applies to all assets, including reinsurance arrangements.

When investing in assets that are not admitted to trading on a regulated market (i.e., non-traded assets), given that such assets are prone to additional risks, the PRA expects firms to keep investments to prudent levels (assessed in accordance with the PPP) and to ensure that key persons involved in investing in non-traded assets have the requisite expertise to manage the specific risks. Similarly, when investing in non-traded assets or thinly traded assets, given the lack of market pricing for these assets, the PRA expects firms to take into account valuation uncertainty for the purposes of complying with the PPP by implementing systems and controls to limit exposure to valuation uncertainty to align with the risk appetite and investment strategy of the firm. This should involve quantifying or grading the risks associated with valuation uncertainty, so that the firm can define appropriate internal investments.

Finally, the PRA notes that intragroup assets are also subject to all of the requirements of the PPP. As investment in intragroup assets is likely to lead to conflicts of interest, the PRA expects intragroup assets to be subjected to at least the same level of "arm's length" scrutiny and risk management as other assets. Where there is a conflict (e.g., between shareholders and policyholders), such conflicts must be resolved in the best interest of policyholders before investing in any intragroup assets, even if this means ceasing to invest in that asset.

c. Review of Solvency II

As part of the EU's 2020 review of Solvency II, the Commission called upon EIOPA to provide technical advice. In its opinion, EIOPA has advised that the PPP, and supervisors' considerations when assessing whether a firm is compliant with the PPP, is expanded to take into account macroeconomic and macroprudential concerns, such as the risk related to the credit cycle and economic downturn, or other potential sources of systemic risk that may be relevant to firms. Although this is currently a proposal, it is likely that the Commission will be influenced by EIOPA's opinion when it is shaping the legislative proposal it intends adopt in the third quarter of 2021. As such, firms should monitor developments in this area to see if these proposals are ultimately adopted.

d. Breach of PPP

Where firms are judged not to be in compliance with the PPP, this could lead to the PRA choosing to exercise its supervisory powers, which allows the PRA to impose additional requirements on firms. Furthermore, breach of the PPP may be deemed a failure to meet the requirements of the Conditions Governing Business Part of the PRA Rulebook, which may lead to the PRA imposing capital add-ons as a result of such breach. Compliance with the PRA's expectations with respect to PPP — specifically, *In June 2020, the UK government revealed plans to review Solvency II to ensure that it is properly tailored to take account of the structural features of the UK, particularly in the wake of Brexit.*

an explicit investment strategy containing, at a minimum, clear investment objectives, asset class allocations, how the strategy aligns with the firm's business model, its risk appetite, risk tolerance limits, investment risk and return objections, and a complete list of assets and how they have been invested — is a key ongoing requirement for firms and will be at the center of their minds when engaging external investment managers.

5. Solvency II Directive Review

Solvency II provides the framework for the solvency and supervisory regime for insurers and reinsurers in the EU. In June 2020, the UK government revealed plans to review Solvency II to ensure that it is properly tailored to take account of the structural features of the UK, particularly in the wake of Brexit. Likewise, the EU is also undertaking its own review of Solvency II to ensure that the regime is fit for purpose in all economic environments, with the directive requiring that certain areas must be reviewed by the Commission by the end of 2020.

a. UK Review

After the UK government declared its intention to review Solvency II, HM Treasury published a "Call for Evidence" ("**CFE**") in October 2020, outlining the motives behind the review and inviting feedback. The overarching motive behind the review is to ensure that the UK's prudential regulatory regime is better tailored for the insurance sector following the end of the Brexit transition period, which came to a close at the end of 2020. While the UK government and PRA have confirmed support for the fundamental principles and framework underlying the Solvency II regime, they have expressed the view that there are certain areas that could better reflect and facilitate the specific structures, products, and business models of the UK insurance sector. To achieve this, the review will consider how the current prudential regulatory framework can be improved to ensure that it provides for an adequate amount of capital for the insurance sector, a high degree of policyholder protection, and suitable standards of governance, risk management and transparency. Notably, in a February 2021 speech delivered at the Westminster Business Forum, it was made clear that the PRA had no particular goal of either increasing or decreasing the total capital in the insurance sector and, indeed, the PRA had not yet seen clear evidence that current required capital levels are manifestly too high or too low.

The CFE is the first stage of the Solvency II review and requested feedback on various areas, including the standard formula for capital requirements, the risk margin (i.e., the additional resource an insurance firm is required to hold on its balance sheet), the matching adjustment (which recognizes that insurance firms that closely "match" particular assets and liabilities are exposed to less risk), and reporting requirements. Responses were due by February 19, 2021.

The EU has stated that further clarifications are required before their equivalence assessment can be finalized, including with regard to the UK's potential divergence from EU frameworks, such as Solvency II.

Results of the review are not expected to be published until later in 2021. However, the extent to which the UK decides to diverge from Solvency II may well have wider ramifications, particularly within the context of Brexit negotiations and determinations of equivalence. Despite the UK and the EU pledging to conclude equivalence assessments before the end of the transition period, they were unable to reach agreement. Although the UK recognized the EU as an equivalent regime in November 2020, the EU is yet to make a decision with regard to the UK. Consequently, the UK-EU Trade and Cooperation Agreement, signed in December 2020, does not include provisions on equivalence frameworks for the insurance sector. The EU has stated that further clarifications are required before their equivalence assessment can be finalized, including with regard to the UK's potential divergence from EU frameworks, such as Solvency II. For further details please see section IV.C.1.

Given the advantages of the UK being deemed an equivalent jurisdiction for reinsurance, group solvency, and group supervision purposes, it is perhaps unlikely that the CFE will lead to significant divergence from Solvency II. Instead, there are likely to be changes to the way in which UK insurance markets are able to invest in assets. Investment in infrastructure and long-term projects is considered vital to the rebuilding of the UK economy after the COVID-19 pandemic, and there is recognition that this is an area in which change is needed. These points were highlighted in February 2021 in a speech by the Association of British Insurers (the "**ABI**"), the trade body for British insurers, that expressed its members' views that current restrictions on the types of investments that can be held drive insurers to hold large volumes of corporate bonds and sovereign debt, therefore changes to Solvency II in the UK could lead to more balanced portfolios of investments. Specifically, the speech noted that changes to the risk margin and matching adjustment would allow the insurance industry to invest for the long-term and in much more socially useful areas such as green technology, infrastructure, or a wider range of corporate debt, without undermining the security of policyholders. The PRA also in its February speech noted that the risk margin formula is too sensitive to interest rates, which has driven a misallocation of capital.

A further area flagged by the ABI (and, indeed, as expressed by many in the industry) is that current reporting requirements are too burdensome, and the timeframes for getting regulatory clearance are too slow, resulting in new market entrants choosing to establish themselves in other jurisdictions. The ABI, therefore, pushed for improvements in these areas to allow the UK to perform more competitively on the international market. In a similar vein, HM Treasury, in the context of the CFE, noted there may be scope to better balance the relatively prescriptive and rule-based model with a mix of judgment and rules in which the PRA can operate more effectively within the existing principles and framework of Solvency II, and that insurers can apply more efficiently.

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b. EU Review

The UK's review is taking place concurrently with an equivalent review of Solvency II by the EU. The Commission had a legal mandate to review certain areas of Solvency II by the end of 2020.

As part of this review, the Commission called upon the EIOPA to provide technical advice, with EIOPA publishing its opinion on December 17, 2020. Overall, EIOPA's view is that the Solvency II framework is working well from a prudential perspective, but has put forward proposals on how it considers the regime could be improved. EIOPA's key proposals focus on similar areas to the PRA and the ABI in the UK and include proposed adjustments to the treatment of interest rate risk (reflecting the steep fall of interest rates experienced during recent years and the existence of negative interest rates), improvements to the volatility adjustment to better align the design to its objectives, refinements to the calculation of the risk margin of insurance liabilities (recognizing diversification over time, thereby reducing its volatility and size, in particular for long-term liabilities), and revising the criteria for the ability to hold equity long-term, by making a link with long-term illiquid liabilities with the aim to better reflect risks and further encourage long term investments in a sound and prudent way.

EIOPA's key proposals focus on similar areas to the PRA and the ABI in the UK…

However, some industry experts have criticized EIOPA's proposals for being too conservative and failing to offer improvements to protect consumers and strengthen competition. Insurance Europe (the trade body for European insurers) considers that EIOPA's proposals fail to address the treatment of long-term business and reduce excessive operational burdens, which consequently raises barriers to investment, weakens competition and hinders the Commission's ambitions in key projects, such as the Green Deal and the Capital Markets Union. Likewise, the Association of Mutual Insurers and Insurance Cooperatives in Europe ("**AMICE**") believes that EIOPA's Opinion represents an increasingly conservative approach to insurance risk, which ultimately will negatively impact policyholders. AMICE also expressed concern that EIOPA's advice does not reflect several proposed improvements to Solvency II, which have been thoroughly examined and developed to give a better balance to the regime. AMICE explained: "Ultimately, this could mean that insurers will be limited in their offerings to policyholders and their ability to invest, particularly in the long-term which is a key focus for mutual and cooperative insurers."

This sentiment is also expressed in the responses contained within the summary report, published by the Commission on February 1, 2021, which summarizes the feedback received from the consultation it held between July and October 2020. Of the 73 participants that responded, over half represent insurers and insurance trade associations, with insurers ranking the facilitation of long-term guarantee products and sustainable investments as the highest ranked priorities to be addressed by the review. The Commission has stated that it will consider the feedback, in conjunction with EIOPA's work on the review, when it is shaping the legislative proposal that it intends to adopt in the third quarter of 2021.

While the UK and EU's areas of focus coming out of the reviews of Solvency II cover much of the same ground, if the UK's review ultimately results in the UK going further in its reform of the Solvency II regulatory framework than the EU, this divergence may impact whether the EU will consider the UK's regulatory regime equivalent. The potential for too much divergence may therefore have wider ramifications for the insurance industry. This will remain a key area of development, although it is worth noting that AM Best in February stated that its view was that EIOPA's advice to Commission on Solvency II review reduces risk of conflict with the UK's own Solvency II review, saying that concerns that EU changes would make it harder for UK to reform risk margin "appear unfounded." AM Best suggested that if all of EIOPA's advice is implemented, they would expect to see increases to best-estimate liabilities (as measured under Solvency II) though this would be mostly offset by decreases in the risk margin and the effect of a larger volatility adjustment. In light of the Commission's likely decrease of the risk margin, AM Best considered that the UK review of Solvency II is unlikely to be limited by equivalence concerns in its own approach to the risk margin.

6. EU and Member State Competition Law Enforcement Activity

In 2020, insurance-related competition enforcement activity in the EU has been dominated by (mostly state aid-focused) interventions relating to the COVID-19 pandemic.

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a. EU-Level Enforcement by the European Commission and by the EU Courts

i. EU Courts

In March 2020, the Warsaw District Court referred to the Court of Justice of the European Union (the "**CJEU**") a number of questions concerning the interpretation of key aspects of Directive 2002/83 regarding life insurance. The questions concern unit-linked life insurance contracts where the underlying assets of the fund are derivatives (or structured financial instruments with embedded derivatives). The referring court seeks to understand what level of information in relation to the underlying instrument needs to be communicated to purchasers of such contracts, and if failure to provide sufficient information constitutes an unfair commercial practice.

In June 2020, the CJEU issued a judgment upholding the Commission decision according to which Slovak State-owned health insurance bodies do not constitute "undertakings" within the meaning of EU State aid rules because their activities are non-economic in nature. As such, the CJEU confirmed its prior case-law on the application of the EU State aid rules to health insurance bodies operating under State supervision and active in the provision of compulsory social security scheme.

ii. European Commission

In November 2020, the Commission closed, for priority reasons, an antitrust investigation that it had launched in October 2017 into six insurance brokers active in the aviation and aerospace insurance and reinsurance sectors (Case AT. 40501 - *Zeppelin*). The Commission's decision to close its investigation, although framed as being for reasons of prioritization, strongly suggests either that limited or no evidence of wrongdoing was found in the course of its investigation.

In March 2020, the Commission adopted its State aid Temporary Framework ("**TF**") to help EU Member State governments tackle the challenges of the COVID-19 pandemic through public measures. Among others, the TF relaxed State aid rules on short-term export-credit insurance. The TF introduced additional flexibility on how to demonstrate that certain countries are "non-marketable risks," therefore enabling short-term export credit insurance to be provided by EU Member States. That same month, the Commission adopted another amendment allowing State insurers to step in and provide insurance for short-term export-credit risk for all countries, without the need for the Member State in question to demonstrate that the respective country is temporarily "non marketable."

The Commission approved a number of State aid measures to support the trade insurance market.

The Commission approved a number of State aid measures to support the trade insurance market. To ensure that trade credit insurers do not alter their insurance coverage, the Commission authorized guarantee schemes granted by: (i) Germany (April and December); (ii) Denmark (May); (iii) Belgium (May); (iv) Netherlands (May and December); (v) Italy (August); (vi) UK (September and December); (vii) Romania (October); (viii) Lithuania (December); (ix) Spain (December); and (x) France (December). Although not falling within the scope of the TF, those measures were assessed based on the same emergency principles.

b. National Level Enforcement in the UK

i. FCA Publishes Final Report on the General Insurance Pricing Practices Market Study

In September 2020, the FCA published the final report of its General Insurance Pricing Practices market study, finding extensive evidence of gradual increases in home and motor insurance renewal prices (so-called "price walking"). Among other things, the FCA's remedies package proposes: (i) a price-parity obligation for new and renewing customers, (ii) facilitating discontinuation of auto-renewals for customers, and (iii) transparency improvements.

ii. CMA Publishes Update on Loyalty Price Discrimination Investigation

In December 2020, the CMA published an update on its investigation into loyalty penalties, including price walking, costly exit fees and auto-renewals. In 2018, the CMA recommended intervention in the home insurance sector by the FCA. The update also welcomes the above-mentioned FCA remedies package.

iii. CMA Issues Infringement Decision to BGL

In November 2020, the CMA fined BGL (Holdings) Ltd., BGL Group Ltd., BISL Ltd. and Compare The Market Ltd (Collectively "**BGL**") £17.9 million for imposing wide "most-favored-nation" clauses on insurers selling through its price comparison website ComparetheMarket. The "most-favored-nation" clauses imposed by BGL prohibited insurers from offering lower prices on rival price comparison websites.

c. National Level Enforcement in Croatia

In December 2020, the Croatian Competition Agency accepted commitments submitted by the insurance company Croatia Osiguranje d.d. ("**CO**"). The infringement investigation concerned the commercial lease agreement that CO concluded as a lessee, containing a provision that imposed restrictions on the lessor in dealing with CO's competitors.

d. National Level Enforcement in Estonia

In April 2020, the Estonian Competition Authority authorized the concentration between AS LHV Group and Toveko Invest OÜ that aimed to set up a new undertaking named "AS LHV Kindlustus." The new undertaking would mainly operate in the non-life insurance market.

e. National Level Enforcement in France

In February 2020, the French competition authority fined Mutualité de la Réunion ("**MR**") €200,000 for not complying with commitments offered in 2009. The commitments aimed to prevent confusion between the funeral insurance products offered by the likely-dominant MR, and services offered by a cooperative of undertakers set up by MR.

f. National Level Enforcement in Greece

In May 2020, the Hellenic Competition Commission opened a sector inquiry into financial technology services, which also covers insurance services with a focus on comparison platforms and robo-advisors.

g. National Level Enforcement in Ireland

In September 2020, the Competition and Consumer Protection Commission ("**CCPC**") issued its preliminary findings to five insurers, an insurance industry trade association, and an insurance broker alleging that they engaged in anticompetitive cooperation during 2015 and 2016, mainly consisting in public and private announcements of motor insurance premium rises.

In December 2020, the CCPC published its market study on the public liability insurance market. Commissioned by the Irish government in 2019, the study found that: (i) high premium increases are an issue across the whole sector; and (ii) there are availability issues primarily affecting certain sectors, such as community and sports.

In December 2020, the Irish government announced the opening of a new government office, the "Office to Promote Competition in the Insurance Market." The purpose of the new office will be to encourage greater competition in the insurance sector and support the government's reform agenda aimed at reducing the level of insurance premiums.

h. National Level Enforcement in Italy

In November 2020, the Italian competition authority (AGCM) opened an investigation into a fraud-detection project in life and non-life insurance launched by the "Associazione Nazionale fra le Imprese Assicuratrici." The project involves the creation of databases and the development of algorithms to determine fraud risk indicators that insurance companies can use to settle claims.

i. National Level Enforcement in Netherlands

In April 2020, the Dutch Authority for Consumers and Markets ("**ACM**") allowed health insurers to make collective arrangements to provide financial support to healthcare providers during the COVID-19 crisis. These arrangements relate to continuity contributions and advances on payments to healthcare providers not involved in helping COVID-19 patients, and thus experiencing lower levels of work. In October 2020, the ACM allowed health insurers to share the additional costs linked to the COVID-19 crisis.

In June 2020, the ACM published three studies on how insured's wishes affect negotiations between health insurers and hospitals. In particular, the studies focused on: (i) hospital's network status; (ii) level of insurance premiums; (iii) choice of healthcare options; and (iv) the capacity-expansion options of hospitals.

In November 2020, the ACM allowed insurers to set up a scheme to settle car damage claims faster. The Dutch Association of Insurers agreed to implement changes to its system so that insureds can seek redress from their own insurer, and not only from the insurer of the person liable for the damage.

j. National Level Enforcement in Spain

In September 2020, the Spanish Competition Authority ("**CNMC**") launched an investigation into the life insurance and funeral services markets concerning: (i) the execution of notified but non-authorized mergers; and (ii) prior anticompetitive coordination of participants to some of those mergers, including the provision of misleading information to the CNMC.

In September 2020, the Spanish Supreme Court dismissed the appeals of Caser, Scor and Asefa against a decision ordering them to pay around €4 million in damages for having organized a boycott against another insurance company, Musaat, that had refused to join the cartel formed by the three companies in the building liability insurance market.

k. National Level Enforcement in Sweden

In April 2020, the Swedish competition authority, the Konkurrensverket, decided not to continue its investigation against Protector Försäkring Sverige. The investigation started in 2019 and concerns suspected anticompetitive agreements between companies operating in the Swedish insurance procurement sector.

7. Impact of EU and UK Data Privacy Developments on the Insurance and Reinsurance Industry

The EU General Data Protection Regulation ("**GDPR**") entered into force on May 25, 2018, imposing significant obligations on (re)insurers.

The initial intention of the EU GDPR was to create a harmonized approach to data protection compliance across the EU. However, it has become clear this is not the case. In particular, the conditions for processing special category personal data (most notably health data) and personal data relating to criminal convictions, differ across the EEA/UK. This is of particular relevance for the (re)insurance industry in the context of the provision of health, life, and motor insurance. We set out below some of the key issues for the (re)insurance industry in 2020.

It should be noted that following the end of the Brexit transition period on December 31, 2020, EU law (including the EU GDPR) no longer applies to companies in the UK. However, the UK has brought the EU GDPR into UK law as the "**UK GDPR**" which applies as from January 1, 2021. For purposes of this section, IV.C.7, all references to the "GDPR" shall include the UK GDPR, and all references to the EEA shall include the UK — in each case to the extent they relate to the UK.

a. GDPR Enforcement and Fines

Under the GDPR, national data protection authorities ("**DPAs**") have the power to impose administrative fines of up to 4% of a company's annual worldwide turnover (gross revenue) or €20 million, whichever is higher. In addition, DPAs also have significant investigative and corrective powers, including the ability to impose a temporary or definitive ban on processing personal data, or to order the suspension of data flows to a third country (for example, Bermuda or the Cayman Islands).

During 2020, sources indicate there was a 40% increase in GDPR fines imposed on companies by DPAs in the EEA and over 121,000 data breach notifications. By far the largest fine was the decision by the French Conseil d'État in June 2020 to uphold the €50 million penalty imposed against Google LLC in January 2019 by the French DPA (the "**CNIL**"). The CNIL found that Google had insufficiently informed Android users about their data processing activities, given the complexity of Google's privacy policy and terms and conditions, and that the consent obtained from them through the use of pre-ticked boxes was insufficient to serve as a legal basis for processing for targeted advertising. In upholding the fine, the French Conseil d'État referred to the particular gravity of the infringement (involving core principles of the GDPR) and the effect thereof on individuals, and the continuous nature and duration of the infringement. This fine is so far the highest fine issued under the GDPR's regulatory framework to date.

During 2020, sources indicate there was a 40% increase in GDPR fines imposed on companies by DPAs in the EEA and over 121,000 data breach notifications.

The second largest fine in 2020, for €35.3 million, was issued by the Hamburg DPA against a clothing retailer for excessive employee monitoring involving several hundred employees and extensive information of the private lives of these employees. The data was used for, among other things, evaluating individual work performance, and obtaining a detailed profile of employees for decisions regarding their employment. The Hamburg DPA determined that the combination of obtaining information on employees' private lives and recording their activities led to a particularly intensive intrusion on employee's privacy rights.

In relation to the UK, the Information Commissioner's Office ("**ICO**") issued fines to:

- An airline of US$26 million for inadequate security measures following a cyberattack, which resulted in user traffic to the airline's website and mobile application being diverted to a fraudulent website where names, postal addresses, email addresses, and payment card details of customers were compromised; and
- A hotel chain of US$23.8 million for inadequate security measures following a cyberattack affecting approximately 339 million guest records, of which 30 million related to residents in 31 countries in the EEA and seven million related to UK residents. The inadequate security measures originated out of a vulnerability in the information security systems of a company the hotel chain had acquired in 2016, with the compromise to customer personal data remaining undetected until 2018. In its investigation, the ICO highlighted the hotel chain's poor due diligence of the information security systems of the target company prior to the acquisition.

While both fines are significantly lower than what the ICO initially indicated it intended to issue, they remain substantial. In turn, given the large amount of personal data held by the insurance industry, having robust security measures in place is of critical importance in light of DPAs' scrutiny of companies' security measures and likely enforcement action for inadequate security. Moreover, the trends in fines issued by the DPAs in 2020 make clear that security breaches are not their sole focus, and that complying with the other principles under the GDPR are just as important.

…given the large amount of personal data held by the insurance industry, having robust security measures in place is of critical importance in light of DPAs' scrutiny of companies' security measures and likely enforcement action for inadequate security.

DPAs have also continued to take GDPR enforcement actions against companies in the (re)insurance industry. For example, in June 2020, the Baden-Wuerttemberg DPA imposed a €1.24 million fine on a health insurance company for unlawful direct marketing activities and insufficient internal technical and organizational security measures.[48]

b. Profiling and Artificial Intelligence

The GDPR includes a general prohibition on the use of solely automated decision-making processes, including profiling, that have legal or similar effects on individuals. The GDPR does, however, permit such processing where it (a) is necessary to enter into or perform a contract; (b) has been authorized by an EEA state or UK law; or (c) is conducted with the individual's explicit consent, and appropriate safeguards are implemented.

The GDPR includes a general prohibition on the use of solely automated decision-making processes, including profiling, that have legal or similar effects on individuals.

Given the high threshold for valid consent under the GDPR, the most relevant exemption for the (re)insurance industry — when, for example, using underwriting platforms designed to systematically process information about individuals and make certain predictions in order to price risk and allocate

48 *Baden-Wuerttemberg State Commissioner imposes fine on AOK Baden-Wuerttemberg*, European Data Protection Board (July 29, 2020).

premiums — is where this is necessary to enter into or perform a contract with the individual. This will likely also be the most appropriate exemption for reinsurers when, for example, they use big data to assist in market analyses, targeted marketing, and fraud detection.

However, the current concern is that the interpretation given to the concept of "necessity," by guidelines published on solely automated processing, is overly restrictive and may hinder the development and use of innovative products by (re)insurers which in turn, could prejudice consumers.

The Consultative Expert Group will review various areas of the insurance value chain, with specific focus on pricing, underwriting, and the impact of big data analytics on certain groups of vulnerable consumers.

In July 2019, EIOPA set up an expert working party group ("**Consultative Expert Group**") to look at digital ethics in insurance following a review of the use of big data analytics in the motor and health insurance industries. The Consultative Expert Group will review various areas of the insurance value chain, with specific focus on pricing, underwriting, and the impact of big data analytics on certain groups of vulnerable consumers.

On February 19, 2020, the Commission published a white paper on AI calling for a regulatory framework on the use of AI. The Commission is expected to publish the first draft of this legislation on AI in early 2021. The draft legislation will follow a risk-based approach to AI: it will provide a legal framework for all types of AI, and will set out additional mandatory requirements, on such issues as training data, record-keeping, transparency, accuracy, and human oversight, for "high-risk" AI applications. It is not clear yet how "high-risk" applications will be defined, but biometric tools (e.g., facial recognition) are likely to be one of the key focus points. The draft legislation is also expected to provide for "ex-ante" tools, such as market-surveillance and risk-assessment measures, which will allow the EU to verify and test AI systems entering the EU market. The draft legislation will also likely be complemented by detailed guidelines for specific sectors. For example, the head of unit for digital finance at the Commission said that EU financial institutions, including (re)insurers, will be provided additional guidance on using AI.

In addition, the ICO in July 2020 published its AI auditing framework, aimed at compliance officers (e.g., data protection officers and general counsel) and technology specialists, to assess risks that AI can pose to the rights and freedoms of individuals and appropriate measures to adopt to mitigate such risk.

c. Accountability and the GDPR

A growing area of focus by DPAs is the principle of accountability: that is, companies being able to demonstrate how they comply with the many requirements of the GDPR.

A growing area of focus by DPAs is the principle of accountability: that is, companies being able to demonstrate how they comply with the many requirements of the GDPR. These requirements include, for example, the requirement for companies to implement data protection policies, maintain a detailed record of processing activities, conduct data protection impact assessments, and implement data protection by "design" and "default" ("**DPbDD**") when processing personal data.

In October 2020, the European Data Protection Board ("**EDPB**"), the EU-wide data supervisory authority, published guidelines on DPbDD which encourage early adoption of DPbDD when processing personal data, in particular requiring companies to comply with the GDPR data protection principles (e.g., data minimization and storage limitation) at the outset of the processing activities. Importantly, under the guidelines, controllers are expected to be able to demonstrate measures and safeguards to achieve DPbDD, such as a reduction of complaints and response time when data subjects exercise their rights.

(Re)insurers should see the rise in global privacy laws as an opportunity to review their GDPR and broader privacy compliance programs, and leverage work undertaken as part of their initial GDPR project to ensure a smooth and GDPR-consistent implementation for compliance with global privacy laws.

Since the entry into force of the GDPR, many companies are now undertaking a review of the work carried out in the run-up to May 2018 to assess their compliance and accountability under the GDPR and to reevaluate certain decisions which, in many cases, were made in a rush to meet the May 2018 deadline. This is of particular importance, given the rise in global privacy laws with similarities to the GDPR. (Re) insurers should see the rise in global privacy laws as an opportunity to review their GDPR and broader privacy compliance programs, and leverage work undertaken as part of their initial GDPR project to ensure a smooth and GDPR-consistent implementation for compliance with global privacy laws.

d. Brexit

As mentioned above, the UK has left the EU, and the Brexit transition period ended on December 31, 2020, meaning EU law (including the EU GDPR) no longer directly applies in the UK. However, the UK has brought the EU GDPR into UK law as the UK GDPR, the only difference currently being that references to the EEA read the UK. However, since the UK GDPR is UK law, the UK may autonomously decide to amend the UK GDPR and, as such, the UK GDPR may deviate from the EU GDPR in the future.

Under the UK GDPR, businesses, such as (re)insurers established in the UK or (re)insurers established outside of the UK who process personal data of individuals in the UK to provide insurance services, will be subject to the UK GDPR. In turn, the UK GDPR requires that such (re)insurers established outside of the UK appoint a data protection representative ("**DPR**") in the UK.

Further, under the terms of the EU-UK Trade and Cooperation Agreement agreed by the EU and the UK on December 24, 2020, data flows from the EU to the UK will remain unrestricted and can continue on an interim basis without the implementation of additional safeguards. This position will last: (i) for an interim period of up to four months from January 1, 2021 (with an automatic extension for two further months unless either the UK or the EU objects); or (ii) until an adequacy decision is granted (i.e., the Commission finds the UK to provide an "adequate" level of data protection), whichever is earlier and provided the UK makes no substantive changes to its data protection laws. To prepare for a scenario where the Commission does not find the UK to be adequate, the ICO is recommending companies take steps to address international data flows from the EU to the UK now.

…under the terms of the EU-UK Trade and Cooperation Agreement agreed by the EU and the UK on December 24, 2020, data flows from the EU to the UK will remain unrestricted and can continue on an interim basis without the implementation of additional safeguards.

e. Transfers of Personal Data From the EEA

The GDPR imposes a general prohibition on the transfer of personal data to countries outside the EEA that are not considered to have an adequate level of protection. There are certain exemptions under the GDPR from this data transfer prohibition, including:

The GDPR imposes a general prohibition on the transfer of personal data to countries outside the EEA that are not considered to have an adequate level of protection.

- Where certain data protection safeguards have been adopted (such as the data exporter in the EEA and the data importer outside the EEA entering into EU Standard Contractual Clauses ("**SCC**")); or
- Where a derogation in the GDPR from the prohibition applies (such as where the data subject has explicitly consented to the transfer).

On July 16, 2020, the CJEU in the case of *Data Protection Commissioner v. Facebook Ireland, Max Schrems* ("**Schrems II**") invalidated the EU-U.S. Privacy Shield program as a mechanism enabling transfers of personal data to the U.S. and held that SCCs may not, in every circumstance, afford an individual privacy protections that are "essentially equivalent" to those afforded under EU law. Indeed, the CJEU determined that prior to any transfer, data exporters and data importers are obligated to verify, taking into account the circumstances of the transfer, whether the required level of protection is respected in the relevant third country (e.g., the U.S.) and where this is not the case, to implement supplementary protection measures (whether legal, technical, or organizational) to ensure an essentially equivalent level of protection for the personal data.

On November 11, 2020, the European Data Protection Board ("**EDPB**") published two sets of Recommendations to provide further guidance on how companies can meet the requirements set out in the *Schrems II* decision. In particular, the Supplementary Measures Recommendations provide for a six-step process to follow prior to transferring personal data outside the EEA:

- **Step 1 – Transfer Mapping.** Data exporters must create an inventory of their personal data transfers. When doing so, the GDPR's data minimization and purpose limitation principles should also be respected and verified, meaning that data exporters need to ensure they are only transferring adequate, relevant, and the minimum amount of personal data necessary for the purpose in question.
- **Step 2 – Verify Transfer Tools**. For each personal data transfer, data exporters must identify (i) whether the recipient country has been granted an adequacy decision, and if not (ii) which safeguard under Article 46 of the GDPR ("**Article 46 Safeguard**") (e.g., SCCs) or derogation under Article 49 of the GDPR ("**Article 49 Derogation**") (e.g., explicit consent) they will rely on to legitimize the transfer.
- **Step 3 – Assessment of Third-Country Laws.** If the data exporter relies on an Article 46 Safeguard, it must assess to what extent the law or practice of the third country may impinge on the effectiveness of the Article 46 Safeguard in the context of the transfer. The EDPB's second set of Recommendations provides guidance on the form of the assessment and the factors to consider.

Where a company processes personal data of individuals in the EEA to market services by phone, email, text, or fax, it is not only subject to the GDPR but also the EU Directive 2002/58/EC of the European Parliament and of the Council of July 12, 2002…

With respect to the (re) insurance industry, it is likely that (re)insurance companies will be treated as controllers. This is on the basis that, for example, (re) insurance companies, in many circumstances, determine what data of their customers and employees are to be collected, and for what purposes this data are to be used.

- **Step 4 – Implement Supplementary Protection Measures.** Where the assessment under Step 3 reveals that the third country legislation impinges on the effectiveness of the Article 46 Safeguard, exporters should identify and implement supplementary measures to ensure an adequate level of data protection for the personal data transferred. The EDPB has provided a non-exhaustive list of examples of supplementary protection measures.

- **Step 5 – Formalize and Implement Appropriate Safeguards.** Once the data exporter and importer have determined that they can rely on the Article 46 Safeguard for the transfer, with or without the implementation of supplementary protection measures, they must comply with all procedural formalities to put in place the Article 46 Safeguard (e.g., execute SCCs).

- **Step 6 – Reevaluate at Appropriate Intervals.** Data exporters should monitor the legal and regulatory developments applicable to their personal data transfers, as well as the third country's legal regime, to ensure an essentially equivalent level of data protection.

(Re)insurers will need to: (i) carry out a data mapping exercise of their data transfers to get a clear overview of each data transfer from the EEA; (ii) verify whether the recipient jurisdiction has obtained an adequacy decision (e.g., Switzerland or Japan) and if not, determine which GDPR data transfer mechanism, such as SCCs, can be used; (iii) assess the third country's legal order (e.g., the U.S., China, India, etc.) to determine to what extent it impinges on the effectiveness of the Article 46 Safeguard; (iv) implement supplementary protection measures, if needed based on the outcome in (iii); (v) comply with all procedural formalities to implement the Article 46 Safeguard; and, finally, (vi) ensure the reevaluation of the situation at appropriate intervals.

(Re)insurers should also be aware that the Commission has recently issued a new set of draft SCCs that take into account the *Schrems II* decision and provide for a number of additional data transfer scenarios compared to the existing SCCs. Once the SCCs are adopted in 2021, (re)insurers will have 12 months to move from the existing SCCs to the new SCCs.

f. Business Marketing

Where a company processes personal data of individuals in the EEA to market services by phone, email, text, or fax, it is not only subject to the GDPR but also the EU Directive 2002/58/EC of the European Parliament and of the Council of July 12, 2002, concerning the processing of personal data and the protection of privacy in the electronic communications sector (more commonly known as the "e-Privacy Directive"). Where personal data is used to market services to individuals in the UK, companies are also subject to the UK Privacy and Electronic Communications Regulations ("**PECR**").

Under these direct marketing laws, companies cannot send email marketing to individuals unless: (i) they have received the individual's consent; or (ii) the individual is an existing customer who has bought (or negotiated to buy) a product or service. (Re)insurers should maintain a "do not email" list of companies who opt out of direct marketing, and screen any direct marketing lists obtained from third parties against the do not email list.

An additional exemption of relevance to the reinsurance industry given its business model is the business-to-business (B2B) exemption, where companies are able to send email marketing to other companies (including limited liability partnerships) without satisfying the above requirements. However, recipient companies should still be provided with the identity of the sender and a valid email address to unsubscribe from emails. Further, while this exemption is available in the UK, this is not available in all countries in the EEA.

g. Controllers and Processors

The GDPR distinguishes between "controllers" and "processors." With respect to the (re)insurance industry, it is likely that (re)insurance companies will be treated as controllers. This is on the basis that, for example, (re)insurance companies, in many circumstances, determine what data of their customers and employees are to be collected, and for what purposes this data are to be used. As a result of being classified as a controller (relative to being classified as a processor), (re)insurance companies are responsible for complying with the majority of the obligations under the GDPR.

As a controller, (re)insurance companies will need to ensure that where they engage a vendor (acting as a processor) to process personal data on their behalf (for example, to process claims), appropriate contractual provisions are in place as required under the GDPR.

Notably, there has been a rise in recent case law where the CJEU has found two or more parties involved in the processing of personal data to be "joint controllers" rather than a controller or processor or independent controllers. In a recent case, the CJEU held a religious community were joint controllers with a group of individual worshippers who were engaged in door-to-door knocking, ruling the preaching was "organised, coordinated and encouraged" by the wider religious community and noting joint controllership did not necessarily constitute "equal responsibility" between various stakeholders. The EDPB has also recently published draft guidance on the role of controllers and processors under the GDPR which aligns with this broad interpretation of joint controllers.

Given the close relationships within the insurance industry between (re)insurers, insurance brokers and intermediaries, (re)insurers should review agreements with such parties to ensure there is a clear definition of: (i) the roles and responsibilities when processing personal data; (ii) the apportionment of liabilities; and (iii) the mechanisms to resolve disputes. Importantly, under the GDPR, individuals can claim compensation against each of the controllers in a "joint-controllership" for non-compliance with relevant GDPR requirements when processing their personal data. In addition, to the extent vendors are engaged to process personal data on the instructions of the (re)insurers (i.e., as processors) the EDPB's draft guidance on the role of controllers and processors should be considered in particular, as this provides that it is not sufficient for the processing agreement to "merely restate the provisions of the GDPR: rather, it should include more specific, concrete information as to how the requirements will be met and which level of security is required for the personal data processing that is the object of the processing agreement."

h. Privacy Rights and Privacy Litigation

Under the GDPR, individuals in the EEA have significant rights in relation to their personal data, subject to certain exemptions, including the right:

- To request access to their personal data;
- For a copy of their personal data to be provided to a third party;
- To correct errors to their personal data;
- Of erasure of their personal data;
- To restrict the processing of their personal data;
- To object to the use of their personal data where it is based on the controller's legitimate business interests or for direct marketing; and
- Not to be subject to automated decision-making if the decision produces legal or other significant effects that affect them.

Under the right of erasure, where a controller is required to erase personal data which has been made public, the controller must take reasonable steps to inform other controllers (for example, intermediaries and cedent insurers) that are processing such personal data that the individual has requested the erasure by the controller of any links to, or copies or replications of, such personal data. (Re)insurance companies should consider and determine how they will deal with requests to the right of erasure, and when the exemptions to this right can be relied upon. (Re)insurance companies may need to keep personal data to comply with legal or regulatory obligations, or to be able to pay out on a policy at a later stage, and such considerations should be built into guidelines on how to respond to such requests. (Re)insurance companies should ensure that frontline staff are equipped to deal with these requests appropriately.

Further, under the GDPR, individuals are able to claim for "material or non-material damage" as a result of breaches of the GDPR in relation to the processing of their personal data. There has been a sharp increase in data subjects exercising their privacy rights and a significant growth in privacy litigation. Examples of recent privacy litigation include:

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Re)insurers should be aware that breaches of the GDPR could not only result in enforcement action from DPAs in the EEA and the UK's ICO, but potential litigation from affected data subjects.

While the GDPR is not prescriptive as to cybersecurity measures that (re)insurers will need to implement, it sets out (illustratively) measures that could be "appropriate" based on the circumstances…

The GDPR has had a significant impact on the way in which the (re)insurance industry processes personal data, with companies having to make a large number of policy and other administrative changes

…the (re)insurance industry will need to continue its efforts to achieve GDPR compliance, whether in the form of policy, procedural, technological, or other changes, and compliance with privacy and security requirements globally.

As a result of the expanded digital working environment brought on by the COVID-19 pandemic, 2020 saw a rise in the frequency and severity of complex cyberattacks, as cybercriminals exploited opportunities created by new remote working conditions.

- In October 2019, the English High Court granted a group litigation order approving a mass legal action from over 500,000 customers of an airline seeking damages as a result of a compromise to personal data (see section IV.C.7.a above). A deadline for affected data subjects to join the claim has been extended to March 2021, with the total amount of claimants purportedly at 16,000 and likely to rise, and with public reports of estimated payouts reaching £800 million if all data subjects joined the claim.

- In August 2020, the Privacy Collective announced that it was filing a class action lawsuit against two global software companies for their alleged unlawful collection of information through cookies and their subsequent use of this information for targeted advertising.

- In October 2020, the App Drivers & Couriers Union ("**ADCU**"), a UK-based trade union, launched a crowed-funded lawsuit against a ridesharing company headquartered in the Netherlands in relation to its use of an automated algorithm to dismiss drivers with no opportunity for appeal. The ADCU allege that the use of this algorithm is a breach of Article 22 of the GDPR (i.e., the prohibition on the use of solely automated decision-making processes that have legal or similar effects on individuals).

(Re)insurers should be aware that breaches of the GDPR could not only result in enforcement action from DPAs in the EEA and the UK's ICO, but potential litigation from affected data subjects.

i. Information Security

The GDPR requires (re)insurers to implement and maintain "appropriate" technical and organizational security measures, and to notify and remedy certain personal data breaches. These obligations in the GDPR are primarily enforced by administrative fines, levied by supervisory authorities under the GDPR and the UK's ICO, and when damages are awarded in favor of individuals and organizations affected by a personal data breach.

While the GDPR is not prescriptive as to cybersecurity measures that (re)insurers will need to implement, it sets out (illustratively) measures that could be "appropriate" based on the circumstances, namely: (i) pseudo-anonymization and encryption of personal data; (ii) the ability to ensure the ongoing confidentiality, integrity, availability, and resilience of processing systems and services; (iii) the ability to restore the availability and access to personal data in a timely manner in the event of a physical or technical incident; and (iv) a process for regularly testing, assessing, and evaluating the effectiveness of technical and organizational measures for ensuring the security of personal data processing.

More prescriptive guidance in the form of the Guidelines on Information and Communication Technology (ICT) Security and Governance was however, published in October 2020 by EIOPA. These guidelines are, according to EIOPA, intended to promote the increase of the operational resilience of the digital operations of (re)insurers against the risks they face. National supervisory authorities are expected to apply these guidelines from July 1, 2021.

j. Final Thoughts

The GDPR has had a significant impact on the way in which the (re)insurance industry processes personal data, with companies having to make a large number of policy and other administrative changes which, in turn, have been costly. Given recent GDPR enforcement actions and regulatory attention towards areas relevant to the insurance sector — for example, how big data sets are used for pricing and underwriting — the (re)insurance industry will need to continue its efforts to achieve GDPR compliance, whether in the form of policy, procedural, technological, or other changes, and compliance with privacy and security requirements globally. Failure to do so can result in significant sanctions and liabilities. Further, (re)insurers should be prioritizing their Schrems II projects and determining how they will implement the revised SCCs once published, each of which will require an analysis of data flows from the EU/UK to group companies or third-party vendors and others outside of the EEA/UK.

8. UK Cyber Update

As a result of the expanded digital working environment brought on by the COVID-19 pandemic, 2020 saw a rise in the frequency and severity of complex cyberattacks, as cybercriminals exploited opportunities created by new remote working conditions. This led to a corresponding increase in the demand for cyber insurance coverage, but given the continued challenges with cyber underwriting and data gaps, this also led to significant rising losses by insurers in the market. In 2020, market participants and regulators shifted focus from non-affirmative to affirmative cyber coverage and its challenges, including the lack of robust historical claims information, a common approach for underwriting, and accurate risk assessment methodologies. With the backdrop of a vastly heightened dependency on technology and the rapid growth of the digital economy, it is no surprise that cyber resilience, cyber risk, and cyber insurance were brought to the forefront this year as key strategic priorities of regulators and advisory bodies alike.

a. Cyber Insurance Market

The COVID-19 pandemic caused many firms to swiftly transition to partial or full remote working environments, with employees largely reliant on personal devices and residential networks to conduct business on a daily basis. As a result, there was a rise in both the frequency and severity of cyberattacks this past year, as cybercriminals exploited vulnerabilities created by the rapid expansion of virtual workplaces. In particular, ransomware incidents spiked in 2020, with a significant surge in the summer far exceeding the number of similar attacks in previous years. This sudden escalation in ransomware incidents over the last year reinforces the notion that the cyber threat landscape is liable to change rapidly, and underlines insurers' need to be proactive in order to keep up with the evolving needs of the market.

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In 2020, the affirmative cyber market experienced additional growth and demand, with cyber security spending increasing, likely driven by reporting on the greater frequency of cyber incidents as well as changing consumer needs. However, market reports from 2020 also indicate that insurers experienced deteriorated loss ratios leading to some market exits, new policy sub-limits, and an increase in rates of approximately 20%, as well as a general shift towards a harder cyber insurance market, all of which may continue into 2021. The rising losses are attributable to continued challenges with cyber underwriting arising from, among other things, a lack of robust data around cyber exposures, difficulty estimating the aggregate loss potential of cyber books, and the ever-evolving nature of the insured risks. Credit rating agency publications have warned insurers that a growing cyber book coupled with the lack of sufficient claims history to support pricing and reserving decisions, and the potential for high-severity aggregate losses, pose a risk to a reinsurer or insurer's financial strength if not managed appropriately.

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Given the struggle with the profitability of their cyber books, the focus of insurers over the last year turned to improving the quality of their cyber underwriting strategies. We should expect this attention to continue this year, as the market develops in response to the ever-evolving threat landscape. It has become increasingly important for insurers to frequently review their policy language to ensure the language adequately addresses the cyber risks of the present, and to make adjustments as necessary. Market commentary suggests that in 2020, insurers also began to focus on securing access to tools that will, among other things, monitor indicators of cybersecurity compliance and more adequately assess the potential for aggregated losses. The market has also witnessed a growing desire by insurers to better understand the human drivers behind cybercrime in order to successfully insure it.

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The lack of robust information relating to cyber risks contributes to the underwriting challenges insurers face. To address this problem, we have seen an alignment by regulators and market participants alike to undertake efforts to fill these data gaps by, among other things, engaging the industry in stress and disaster testing specific to cyber risks. For example, Lloyd's has recently begun working with CyberCube, a cyber risk analytics firm that provides software to help insurance brokers better understand cyber risk sources and exposures, and to analyze cyber risks in the context of underwriting to aid in determining appropriate levels of cyber coverages and limits. CyberCube's software is currently being used to report to Lloyd's on how syndicates' portfolios would be affected by certain cyber event scenarios developed by CyberCube in conjunction with the Lloyd's underwriting team, Lloyd's Market Association's Cyber Risk Strategy Group, and Guy Carpenter. These scenarios include a cloud outage, power or infrastructure outage, and a major malware attack. In the future, it is expected that these cyber scenarios will form part of Lloyd's formal Realistic Disaster Scenario framework.

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Non-affirmative or "silent" cyber, on the other hand, which was a key issue in prior years, was of somewhat diminishing concern in 2020, likely due to initiatives intended specifically to manage the potential risk exposures stemming from coverages. The Lloyd's 2019 initiative to manage non-affirmative cyber risk exposures by requiring syndicates to clarify their silent cyber coverage positions by either excluding or providing affirmative cyber coverage is still ongoing, with the final two phases taking place in 2021. While market commentators remarked that there were some challenges with this mandate with respect to the first phase in 2020, given the short time frame for implementation, it is expected that these difficulties will largely subside for the final phases due to the additional time the syndicates have had to prepare and adjust policy language accordingly.

…the spotlight this year will continue to shine on the affirmative cyber market, with a particular emphasis on improving cyber insurance underwriting strategies and information gathering efforts.

Looking forward into 2021, we anticipate that the spotlight this year will continue to shine on the affirmative cyber market, with a particular emphasis on improving cyber insurance underwriting strategies and information gathering efforts. Commentators note that the cyber insurance market continues to face unsettled issues and uncertainty, and that it is still in its infancy compared to other lines of business. However, we expect that as cyber insurance becomes a more prominent focus for firms and regulators, material progress will be made this year in developing this market.

b. PRA, FCA, EIOPA, EC Initiatives and Communications

Publications issued by the UK and European regulatory and advisory bodies in 2020 brought cyber resilience, insurance, and risk to the forefront as primary concerns…

Publications issued by the UK and European regulatory and advisory bodies in 2020 brought cyber resilience, insurance, and risk to the forefront as primary concerns, taking greater priority than in years past. These entities demonstrated a renewed focus on emphasizing that cyber resilience is embedded in a firm's operational resilience, a concept that was originally introduced over the past few years, and incremental progress was made in this area through regulations proposed in the UK and in Europe. Additionally, echoing general market sentiment, the UK and European regulatory and advisory bodies remarked in speeches and publications that there are still uncertainties and deficiencies with respect to cyber underwriting and risk management strategies, cyber insurance taxonomy, and cyber-related data.

i. PRA

…the PRA intends to further engage with the general insurance industry to develop a cyber scenario in connection with the 2022 Insurance Stress Test.

In June 2020, the PRA published a Dear CEO letter (the "**Dear CEO Letter**") addressed to chief executives of the regulated general and life insurance firms that participated in the PRA's 2019 Insurance Stress Test ("**2019 IST**"). The Dear CEO Letter provided the results of the 2019 IST, as well as PRA feedback and commentary on such results. The 2019 IST contained an exploratory cyber underwriting loss scenario designed to collect information on firms' management of, and responses to, cyber risk events. As initially anticipated, the results of the 2019 IST confirmed existing concerns that there is a lack of common approach in assessing cyber risk within the industry. In the Dear CEO Letter, the PRA noted that the results of the cyber underwriting scenario reflected "material divergence in expertise, data, models and parametrization in the estimation of both 'affirmative' and 'non-affirmative' cyber claims." The overall lack of consistency in market participants' approach to evaluating cyber risk losses suggests that firms continue to experience difficulty with such loss assessments. This, in turn, demonstrates the limits of available modelling methodologies when applied to cyber risks and, ultimately, reflects the immaturity of the cyber market relative to other lines of business. Looking forward, as mentioned in its Dear CEO Letter, the PRA intends to further engage with the general insurance industry to develop a cyber scenario in connection with the 2022 Insurance Stress Test.

ii. FCA

In 2020, the FCA continued to emphasize operational resilience as a key priority for regulated firms. The FCA focused on the importance of operational resilience as a critical piece of a firm's risk management strategy, and remarked that firms should enhance their cyber and technology resilience to keep up with technological developments and changing working environments.

In 2020, the FCA continued to emphasize operational resilience as a key priority for regulated firms. The FCA focused on the importance of operational resilience as a critical piece of a firm's risk management strategy, and remarked that firms should enhance their cyber and technology resilience to keep up with technological developments and changing working environments. In its messaging over the last year, the FCA highlighted operational resilience in the context of the COVID-19 pandemic. In publications in March and May, the FCA warned of increasing cyber-related criminal acts and operational disruptions threatening firms, cautioning firms about criminals taking advantage of the pandemic to carry out cyber-enabled fraud by exploiting system weaknesses. With these publications, the FCA made clear its expectation that firms continue to prioritize information security despite operational challenges posed by the pandemic and to ensure adequate controls exist to respond to, and proactively, manage cyber threats despite shifts to alternative ways of working. The FCA also repeatedly emphasized its expectation that all firms have tested contingency plans in place to deal with significant cyber events. In a speech in June 2020, Megan Butler, the Executive Director of Supervision at the FCA, placed heavy emphasis on the importance of maintaining and improving operational resilience in the context of a constantly changing pandemic environment. Echoing the messaging of previous publications, Butler also remarked on the expectation of all firms to engage in "mapping" of the resources supporting critical business services and to have tested contingency plans to deal with major events.

It was previously anticipated that in the second half of 2020, the FCA would publish its policy statement and supervisory statement relating to consultation paper CP19/32, a joint consultation with the PRA ("**CP 19/32**") regarding how regulated firms approach their operational resilience framework. However, in March 2020, the FCA announced an extension to the consultation period to October 1, 2020, providing for a later publication date and implementation table in order to lessen the existing burdens experienced by regulated firms amidst the COVID-19 pandemic. In the coming year, the FCA will publish its policy statement and final rules relating to CP 19/32, which will set new requirements mandating that regulated firms take certain actions to take ownership of, and to strengthen, their operational resilience. The FCA webpage notes that its expectation is that regulated firms will not be required to comply with the new rules resulting from the CP 19/32 consultation before the end of 2021.

In the coming year, the FCA will publish its policy statement and final rules relating to CP 19/32, which will set new requirements mandating that regulated firms take certain actions to take ownership of, and to strengthen, their operational resilience.

In addition, as in 2019, the FCA again published insights based on new research on cyber security resulting from quarterly meetings by the FCA's Cyber Coordination Groups, which are comprised of 185 financial services firms from different industry sectors, including insurance. The FCA's highlighted insights for the year focused on the main themes of cyber risks, identity and access management, third parties and supply chains, and malicious emails. While this publication is not intended to be treated as FCA guidance, it does provide regulated firms with a clearer idea of the topics that the FCA considers to be pertinent.

iii. EIOPA

While EIOPA presented cyber risk and the cyber insurance market as secondary topics in its reporting and research in previous years, there was substantial movement with EIOPA bringing these issues to the forefront of its focus in 2020. In its strategic Supervisory Convergence Plan for the year, EIOPA added as a new priority the promotion of appropriate cyber underwriting and cyber risk management practices. EIOPA emphasized its plan to periodically assess such underwriting and risk management practices to address supervisory concerns, and to formulate guidance relating to cyber risk accumulation. EIOPA also noted its intention to more routinely address cyber in its publications and reports, and to introduce cyber risk scenarios into its stress testing frameworks.

While EIOPA presented cyber risk and the cyber insurance market as secondary topics in its reporting and research in previous years, there was substantial movement with EIOPA bringing these issues to the forefront of its focus in 2020.

Consistent with the PRA and FCA, EIOPA emphasized cyber's increasing relevance as a main source of operational risk (particularly as the economy continues to digitalize) and the need to further shrink data gaps relating to cyber risks, underwriting, and management. In a speech in March 2020, Fausto Parente, the Executive Director of EIOPA, remarked that an effective cyber insurance market is a core component of a sound cyber resilience framework. He noted that a main challenge is the lack of information in the cyber insurance market, which makes it difficult for insurers to understand the fundamental aspects of cyber risk, and to adequately price risk and estimate liability of exposures. This, in turn, ultimately presents a significant obstacle to the ability of insurers to provide adequate and appropriate cyber coverages. Among other things, Mr. Parente emphasized the need to have a standardized cyber incident reporting framework to develop a common taxonomy and understanding of cyber terminology, and to promote sharing of aggregated and anonymized data that insurers can use to enhance their risk management and pricing models.

Consistent with the PRA and FCA, EIOPA emphasized cyber's increasing relevance as a main source of operational risk (particularly as the economy continues to digitalize) and the need to further shrink data gaps relating to cyber risks, underwriting, and management.

In October 2020, EIOPA finalized its guidelines on information and communication technology ("**ICT**") security and governance (the "**Guidelines**"), the draft version of which was subject to a consultation period between December 2019 and March 2020. The Guidelines are expected to be applied by national supervisory authorities from July 1, 2021, and seek to provide guidance to national regulators and market participants on issues such as expected "baseline" information and cybersecurity capabilities, regulatory arbitraging and supervisory convergence around expectations applicable to ICT security, and governance.

iv. European Commission

As part of its Digital Finance Strategy Package, in September 2020, the EC adopted a proposal for the Digital Operational Resilience Regulation ("**DORA**") along with a proposed directive. DORA aims to put in place a comprehensive multi-sector digital operational resilience framework. DORA is intended to harmonize and supplement existing rules applicable to financial entities and to promote convergence

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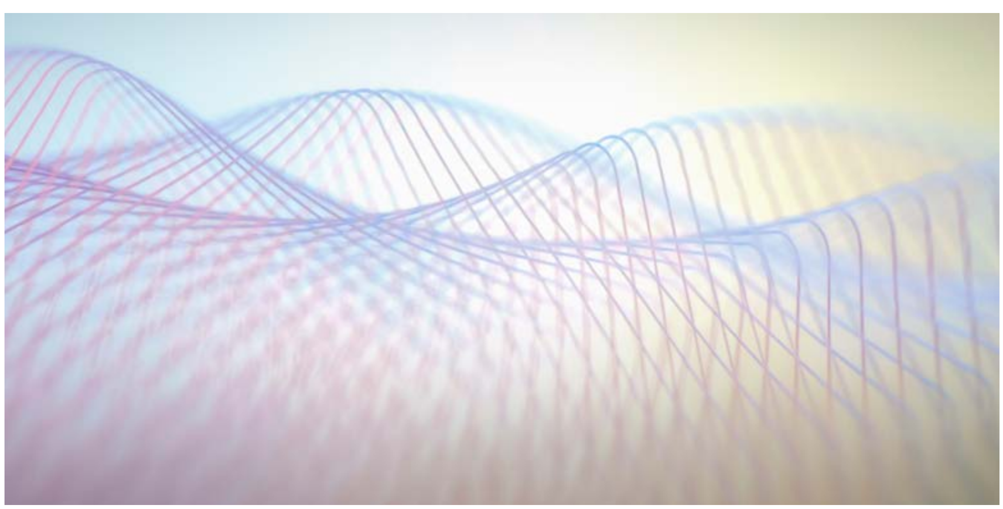
on supervisory approaches with the cooperation of the applicable European supervisory authorities. Among other things, DORA requires financial entities to maintain internal controls and governance structures around the management of ICT threats; classify and adequately document all ICT-related business functions and ICT-related incidents; perform routine ICT risk management framework tests to identify deficiencies; and monitor risks associated with ICT services provided by third parties with oversight assistance from the relevant European lead overseer. DORA also seeks to facilitate cyber threat information sharing among European financial entities.

DORA is similar to the proposals outlined by the PRA and FCA in CP 19/32, though DORA proposes to codify certain mandates, such as reporting requirements, in greater detail than CP 19/32. DORA has a broader scope than CP 19/32, as it addresses issues such as the oversight, monitoring, and risk assessments related to critical ICT third-party service providers. DORA is currently being considered through ordinary EU legislative processes and, if adopted, will apply in the EU a year after coming into force. Given the UK's official exit from the EU in January 2020, DORA will not apply directly to the UK, but we can expect the PRA and FCA to monitor the progress and outcome of the EU legislative process for DORA as it they finalize their own operational resilience requirements for the UK. While the alignment of DORA and the final rules relating to CP 19/32 will be subject to further development through the coming year, financial entities with operations in the UK and the EU would benefit from giving consideration to their compliance with both proposed regimes.



V. Select Tax Issues Affecting Insurance Companies and Products

A. U.S. TAX ISSUES

1. Treatment of Insurance Companies Under the 2020 PFIC Final and Proposed Regulations

…the Tax Cuts and Jobs Act ("TCJA") fundamentally revised the treatment of foreign insurance companies under the passive foreign investment company rules.

As discussed in prior editions of the *Sidley Global Insurance Review*, the Tax Cuts and Jobs Act ("**TCJA**") fundamentally revised the treatment of foreign insurance companies under the passive foreign investment company rules. These changes continue to be of keen interest to U.S. taxable investors, as important issues of timing, character of income, and possible interest and penalties could turn on the treatment of foreign insurance company investments under these rules. Many issues were left over by the legislative changes and proposed regulations. Final regulations on some issues were issued this year, but significant open issues remain in the form of proposed regulations. A brief summary of these issues is below.

Section 1297 of the Internal Revenue Code of 1986, as amended (the "**Code**") defines a "passive foreign investment company" ("**PFIC**") as a foreign corporation, 75% or more of the gross income of which is "passive income" or 50% or more of the assets of which is assets producing, or held for the production of, "passive income" (informally, so-called "passive assets"). After the passage of the TCJA in 2017, the insurance exception to PFIC status provides that "passive income" does not include income derived from the active conduct of an insurance business by a "qualifying insurance corporation" ("**QIC**"). A QIC is generally defined as a foreign corporation that would be subject to tax under Subchapter L if it were a U.S. corporation and whose insurance liabilities constitute more than 25% of its total assets.

On December 4, 2020, the U.S. Internal Revenue Service ("**IRS**") and the Treasury released final and proposed regulations relating to PFICs in general and the insurance exception in particular (the "**2020 Final Regulations**" and "**2020 Proposed Regulations**"). The scope of the latest guidance on PFICs is broad, but the following items are noteworthy from an insurance industry perspective:

a. The latest guidance withdraws, revises, and re-proposes the "active conduct percentage test" under the prior proposed regulations that were released on July 11, 2019 (the "**2019 Proposed Regulations**"). The 2020 Proposed Regulations also introduce a new, alternative "factual requirements test." A QIC that satisfies either test would be considered "engaged in the active conduct of an insurance business" and, therefore, eligible for the insurance exception.

   Under the 2020 Proposed Regulations, a QIC satisfies the factual requirements test if its officers and employees (i) carry out "substantial managerial and operational activities" on a "regular and continuous basis" with respect to the QIC's "core functions," and (ii) perform virtually all of the "active decision-making functions" relevant to underwriting. The 2020 Proposed Regulations define each of these terms in a manner that would require a high level of oversight by the QIC's officers and employees. The "core functions" of a QIC would generally consist of underwriting, investment, contract and claims management, and sales activities.

   The revised active conduct percentage test would generally require a QIC to allocate at least half of its total costs for services (whether performed internally or externally) to the QIC's own officers and employees that carry out certain core functions. The requirement can be expressed as follows:

$$50\% \leq \frac{\text{QIC's total costs incurred with respect to its officers and employees for services attributable to core functions (other than investment activities)}}{\text{QIC's total costs incurred with respect its officers and employees } \textit{and any other person or entities} \text{ for services attributable to core functions (other than investment activities)}}$$

Notably, the 2020 Proposed Regulations would automatically treat two types of companies as PFICs because they are deemed not to be engaged in the active conduct of an insurance business…

As part of the revised active conduct percentage test, the IRS and Treasury specifically excluded investment activities in response to comments that it is increasingly common for insurance companies to rely on third-party investment managers. The 2020 Proposed Regulations, however, would add an oversight requirement that applies to all core functions of the QIC (including investment activities). Under the new oversight requirement, the officers and employees of the QIC with experience and relevant expertise would need to select and supervise the service provider, establish objectives for performance of the outsourced functions, and prescribe rigorous guidelines relating to the outsourced functions that are routinely evaluated and updated.

Notably, the 2020 Proposed Regulations would automatically treat two types of companies as PFICs because they are deemed not to be engaged in the active conduct of an insurance business: (i) companies with no employees or only nominal employees, and (ii) SPVs (e.g., securitization vehicles, catastrophe bond issuers, insurance-linked securities funds that invest in securitization vehicles).

b. Separate from the "active conduct" requirement, the 2020 Final Regulations also provide guidance on the application of the "alternative facts and circumstances" test under the definition of a QIC. In general, a foreign corporation with insurance liabilities equal to less than 25% of its assets can still be treated as a QIC if, among other requirements, the failure to meet the 25% threshold is due solely to "runoff-related" circumstances or "rating-related" circumstances.

   Under the 2020 Final Regulations, the "runoff-related" circumstances exception would generally only be available to insurance companies that are in the process of exiting the insurance business, as opposed to companies experiencing runoff in the ordinary course.

   The "rating-related" circumstances exception would generally only be available to mortgage insurance companies, insurers that can attribute at least half of their net written premiums to coverage against the risk of loss from a catastrophic loss event, or financial guaranty insurance companies.

c. The 2020 Final Regulations provide additional, helpful guidance on certain technical aspects of determining QIC status. Of note, the 2020 Final Regulations include rules for purposes of determining the balance-sheet items that are included in the calculation of an insurance company's liabilities, particularly in the case of balance sheets prepared in accordance with GAAP or IFRS.

d. In the 2020 Final Regulations, the IRS and Treasury built upon guidance from the 2019 Proposed Regulations relevant to the application of certain "look-through" rules for purposes of determining the PFIC status of a QIC. Of note, the assets and liabilities of a subsidiary do not need to be included on the financial statements of a parent QIC in order for the parent QIC to apply the look-through rules to such subsidiary. In last year's *Sidley Global Insurance Review*, we noted that such a requirement under the 2019 Proposed Regulations would have been problematic for foreign insurers and reinsurers that qualify as QICs but do not consolidate with their subsidiaries for financial accounting purposes. The 2020 Final Regulations, however, introduce a new limitation on the amount of income or assets of a subsidiary that is treated as active in the hands of a parent QIC under the look-through rules. The application of this rule depends on the QIC's net equity in such subsidiary.

   The 2020 Proposed Regulations also build upon the concept of a "qualifying domestic insurance corporation" ("**QDIC**"), the income and assets of which are treated as per se active. In particular, the 2020 Proposed Regulations would impose a new limitation on the amount of income or assets of a QDIC that is treated as per se active in the hands of a QIC. The limitation depends on whether the QDIC is a life or non-life insurance company for U.S. federal income tax purposes, and is intended to apply in a circumstance where the QDIC holds substantially more passive assets than necessary to support its insurance and annuity obligations.

The PFIC regulations generally apply (or are proposed to apply) only prospectively. However, taxpayers may choose to apply various provisions to certain prior years, subject to consistency requirements. These regulations provide welcome certainty on some questions, but significant areas of uncertainty remain.

2. Life Product Tax — Assumed Interest Rates for the Tax Definition of "Life Insurance Contract"

Legislation passed at the end of 2020 relaxes the rules applicable to cash value life insurance policies, expanding the pool of possible policies that could provide valuable tax deferral benefits to policyholders. To provide a policyholder with tax deferral on the year to year increase in cash value, a cash value life insurance contract must meet one of two alternative tests under the Code. Traditionally, fixed premium contracts are typically tested under the cash value accumulation test ("**CVAT**") and flexible premium contracts are typically tested under the guideline level premium test ("**GLP**").

Under prior law, the greatest permissible cash value under the CVAT was determined based on an assumed interest rate equal to the greater of 4% or the rate(s) guaranteed in the contract at the time the contract was issued. The maximum permitted premiums under the GLP were determined based on an assumed interest rate equal to the greater of 6% or the rate(s) guaranteed in the contract at the time the contract was issued. In addition, the status of a contract as a modified endowment contract ("**MEC**"), which carries certain adverse tax consequences for distributions or policy loans, was determined by calculating the maximum permissible "7-pay" premiums based on the CVAT assumed interest rate for the contract.

Section 205 of the Consolidated Appropriations Act (P.L. 116-260, Dec. 27, 2020), modifies these rules for contracts issued in 2021 or later. Under the new law, the "applicable accumulation test minimum rate" is substituted for 4%, and the CVAT uses the greater of this new rate or the rate(s) guaranteed in the contract. The new rate is defined, in turn, as the lesser of 4% or a formula rate called the "insurance interest rate." The "insurance interest rate," in turn, is defined as the lesser of a specified "applicable federal rate" or an NAIC valuation interest rate promulgated by the NAIC from time to time. Also under the new law, the GLP rate is the CVAT rate plus two percentage points, and the rate for MEC testing is the CVAT rate.

Under a transition rule of indefinite duration, the "insurance interest rate" will be only 2% from 2021 until such time as the NAIC next promulgates an updated regulatory rate (an "adjustment year" event).

The upshot of the new rules is that companies may, if they wish, design higher cash value life products to be issued in 2021 and later that are more investment oriented, and less oriented toward mortality protection, while still qualifying for tax deferral and non-MEC status. It remains to be seen what the market effects of these new tax qualification rules may be.

3. Final Net Operating Loss Rules

On October 27, 2020, IRS and Treasury published final regulations under sections 1502 and 1503 of the Code (effective December 28, 2020). The final regulations provide guidance implementing amendments to section 172 of the Code under the TCJA relating to the absorption of consolidated net operating loss ("**CNOL**") carryovers and carrybacks. Following the enactment of the TCJA, different carryover and carryback rules apply to non-life insurance companies and all other types of corporations, including life insurance companies.[49] Companies other than non-life insurance companies are allowed a deduction only for an amount equal to the lesser of (i) the aggregate of the net operating loss ("**NOL**") carryovers to the taxable year plus the net operating loss carrybacks to such year or (ii) 80% of current taxable income computed without regard to the deduction allowed under section 172 of the Code. Such companies also cannot carry back NOLs to previous taxable years but can carry NOLs forward indefinitely. Non-life insurance companies, on the other hand, are not subject to the 80% limitation on the use of NOLs or the limitation on carrybacks. Instead, non-life insurance companies can carry NOLs back two years and forward 20 years.

The final regulations describe how to determine the 80% limitation for a mixed group (a consolidated group containing non-life insurance companies and other members). Pre-2018 NOLs will be allocated pro

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The upshot of the new rules is that companies may, if they wish, design higher cash value life products to be issued in 2021 and later that are more investment oriented, and less oriented toward mortality protection, while still qualifying for tax deferral and non-MEC status. It remains to be seen what the market effects of these new tax qualification rules may be.

49 The CARES Act relaxed these restrictions temporarily to allow the carryback of NOLs from 2018 through 2020 for five years, and to eliminate the limitation on using carrybacks and carryforwards to 80% of taxable income.

rata to the "C member" (a member of the consolidated group that is a C corporation other than a non-life insurance company) income pool and the "P&C member" (a member of the consolidated group that is a non-life insurance company) income pool in proportion to their current-year income.

The Treasury and the IRS elected not to implement an alternative approach regarding the allocation of currently generated losses to non-life insurance companies and other members.

The Treasury and the IRS elected not to implement an alternative approach regarding the allocation of currently generated losses to non-life insurance companies and other members. This alternative approach would have required a group to first offset income and loss items within a pool of non-life insurance companies and a pool of other members for all purposes of section 172 of the Code applicable to taxable years beginning after December 31, 2020. This alternative approach also would have contrasted with the historical application of Treasury Regulations section 1.1502-21(b)(2)(iv)(B), under which a CNOL for a taxable year is attributed pro rata to all members of a group that produce net loss, without first netting among entities of the same type.

The final regulations retain the proposed approach to computing a consolidated group's post-2017 CNOL deduction limit. The proposed approach adopts a two-factor computation for consolidated groups comprised of both non-life insurance companies and other members for a consolidated return year beginning after December 31, 2020. The proposed approach divides a consolidated group's non-life insurance companies and its other members into two separate "pools" for purposes of determining the amount of consolidated taxable income that is available to be offset by post-2017 CNOLs after applying the 80% limitation. The post-2017 CNOL deduction limit for a consolidated group equals the sum of two amounts. The first amount (residual income pool) is subject to the 80% limitation and relates to the income of the members that are not non-life insurance companies. The second amount (non-life income pool) is not subject to the 80% limitation and relates to the income of the members that are non-life insurance companies (see Proposed Treas. Reg. § 1.1502-21(a)(2)(iii)(C).).

4. Final Regulations on the Computation of Life Insurance Reserves

On October 13, 2020 the IRS published final regulations that provide guidance on the computation of life insurance reserves and the change in basis of computing certain reserves of insurance companies.

On October 13, 2020 the IRS published final regulations that provide guidance on the computation of life insurance reserves and the change in basis of computing certain reserves of insurance companies. The regulations are effective October 13, 2020.

Section 807(d)(1)(A) of the Code provides that "the amount of life insurance reserves for any contract (other than a [variable contract subject to section 807(d)(1)(B) of the Code]) shall be the greater of (i) the net surrender value of the contract, or (ii) 92.81 percent of the reserve determined under [the tax-reserve method applicable to the contract under section 807(d)(3) of the Code]." Below are some of the notable provisions from the final regulations and where applicable, commentary on the proposed regulations.

The proposed regulations, published April 2, 2020, provided that in determining the amount of the life insurance reserves under section 807(d) of the Code no asset adequacy reserve may be included. The final regulations modified the proposed regulations by providing that "asset adequacy reserves are those reserves established pursuant to an analysis of the adequacy of reserves only if that analysis is pursuant to the requirements of the National Association of Insurance Commissioners' (NAIC) Valuation Manual 30."

The proposed regulations originally included any reserves that were not held regarding a particular contact within the definition of asset adequacy reserve. The final regulations removed that language. However, the final regulations also incorporated in the definition any reserve that is similar to an asset adequacy reserve that is determined under the NAIC's requirements as of the date the reserve is determined. The final regulations also adopt a recommendation to specify what an asset adequacy reserve is rather than solely what the reserve includes. The final regulations define an "asset adequacy reserve" as "(i) [a]ny reserve that is established as an additional reserve based upon an analysis of the adequacy of reserves that would otherwise be established in accordance with the requirements set forth in the NAIC Valuation Manual, such as the CRVM or CARVM as applicable, or (ii) [a]ny similar reserve." (Treas. Reg. § 1.807-1(b)(1).)

The final regulations helpfully provide taxpayers guidance on what may be treated as a non-deductible asset adequacy reserve for these purposes.

The final regulations helpfully provide taxpayers guidance on what may be treated as a non-deductible asset adequacy reserve for these purposes.

5. IRS Guidance on the Sale of Life Insurance Contracts and Determining Adjusted Basis Under Section 1016

Section 1016 of the Code provides general rules for adjusting tax basis in property. Specifically, section 1016(a)(1) of the Code provides that a "[p]roper adjustment in respect of the property shall in all cases be made for expenditures, receipts, losses, or other items, properly chargeable to capital account." The TCJA amended section 1016(a) of the Code by adding the following exclusion where no adjustment will be made: "mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract." The amendment is effective for transactions entered into on or after August 26, 2009.

Rev. Rul. 2009-13 and Rev. Rul. 2009-14 applied section 1016 of the Code (pre-TCJA amendment) in order to determine the adjusted basis of life insurance contracts under sections 1011 and 1012 of the Code in a few factual situations. On February 10, 2020 the IRS issued Rev. Rul. 2020-5 in order to address the impact of the TCJA amendment on Rev. Rul. 2009-13 and Rev. Rul. 2009-14. Below is a summary of one of the situations from the pre-TCJA revenue rulings along with the impact of the TCJA amendment to section 1016(a) of the Code on the situation.

Situation 2 of Rev. Rul. 2009-13 involved an individual ("A") who entered into a life insurance contract with cash value on January 1st of Year 1. A was contractually named as the insured and a member of A's family was the named beneficiary. In the middle of the eighth year, A sold the contract for US$80,000 to an unrelated person who would suffer no economic loss upon A's death. A had paid premiums of US$64,000 prior to the sale of the contract. As of the date of the sale, the cost of insurance charges collected by the issuer was US$10,000. According to Rev. Rul. 2020-9, "Situation 2 of Rev. Rul. 2009-13 provides that if a taxpayer holds a life insurance contract for purposes of insurance protection, it is necessary to reduce the taxpayer's basis in the contract by that portion of the premium paid for the contract that was expended for the provision of insurance before the sale in order to measure the taxpayer's gain upon the sale of the contract. Therefore, Situation 2 of Rev. Rul. 2019-13 provides that *A must reduce A's basis in the contract by the cost of insurance*. As a result, A's adjusted basis as of the date of the sale was $54,000 ($64,000 premiums paid *less $10,000 expended as cost of insurance*). Because A sold the contract for $80,000, Rev. Rul. 2009-13 holds with respect to Situation 2 that A must recognize $26,000 of income on the sale of the contract ($80,000 amount realized less $54,000 adjusted basis of the contract)."

The analysis and resulting holding in Situation 2 of Rev. Rul. 2009-13 no longer applies following the amendments to section 1016 of the Code under the TCJA. The TCJA amendment that added section 1016(a)(1)(B) of the Code provides that the cost basis of a life insurance contract should not be reduced by "mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract." As a result, in Situation 2 of Rev. Rul. 2009-13, the individual must recognize US$16,000 of income as a result of the sale of the contract (US$80,000 amount realized on sale less US$64,000 adjusted basis). The adjusted basis in the contract is equal to the premiums paid.

B. UK/EU TAX DEVELOPMENTS

1. Brexit and Tax

As discussed in section IV.C.1 above, following the triggering of Article 50 of the Treaty on European Union on March 29, 2017, the UK withdrew from the EU on January 31, 2020. The Brexit Withdrawal Agreement, as implemented into domestic legislation via the EU (Withdrawal Agreement) Act 2020, came into force on January 31, 2020.

Brexit has resulted in the exclusion of the UK from the EU directives that previously, in qualifying circumstances, eliminated taxation by EU member states with respect to certain payments made to the UK, such as the elimination of certain withholding taxes pursuant to the Parent-Subsidiary Directive or the Interest and Royalties Directive. UK recipients of dividends, interest, and royalties from certain EU member states will now need to rely on the UK's applicable double taxation agreements in order to mitigate or eliminate these withholding tax costs. These double taxation agreements will not necessarily deliver an equivalent position to the former directives for UK recipients. Accordingly, UK persons who expect to receive dividends, interest, or royalties from payors in EU member states after December 31, 2020, should review their position with respect to underlying withholding taxes. UK recipients of relevant payments may also need to comply with new administrative procedures to secure full benefits pursuant to relevant double taxation agreements.

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The UK has previously stated that it has no intention of restricting the exemptions that these directives previously made available with respect to payments to be made out of the UK to EU member states.

With respect to dividend, interest, and royalty payments to be made by UK persons to recipients in EU member states, the domestic implementation of the directives into UK tax law will be retained without amendment for the time being. The UK has previously stated that it has no intention of restricting the exemptions that these directives previously made available with respect to payments to be made out of the UK to EU member states.

Companies should also monitor the effect of Brexit on their value-added tax ("**VAT**") positions. As a result of the Brexit final terms, the UK is now treated as a "third country" from the perspective of EU member states for VAT purposes. While supplies of services in and out of the UK from and to EU member states should (broadly speaking and for now) be subject to the same overall levels of VAT cost as previously, it is possible that certain cross-border supplies could be treated differently. Imports of goods from, and exports of goods to, the EU will become imports (or exports) from a third country, which may attract import VAT. Her Majesty's Revenue & Customs ("**HMRC**") have indicated in initial guidance that, for insurance companies that have previously recovered input VAT on the basis of insurance-related supplies made to businesses situated outside the EU, such special VAT recovery treatment should extend to all insurance-related services made to persons outside the UK, including persons situated in the EU, following Brexit. Separately, EU nationals working in the UK may not have the same social security rights as previously afforded under EU law, and pre-EU social security treaties may need to be revisited, as the Brexit Withdrawal Agreement does not apply the same scope of social security as previously afforded under EU law.

2. EU Blacklist and New Substance Laws

On December 5, 2017, the EU published its list of 17 non-cooperative tax jurisdictions (the "**EU Blacklist**") directed at counteracting the effects of preferential tax regimes around the world. There have been subsequent modifications to the EU Blacklist, most recently on February 22, 2021, such that the current list includes only American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, the Seychelles, Trinidad and Tobago, the U.S. Virgin Islands, and Vanuatu. Importantly, 47 jurisdictions were originally placed on the so-called "greylist," representing those countries that avoided the EU Blacklist due to commitments to (a) improve transparency, (b) improve fair taxation, (c) improve substance requirements, and/or (d) apply certain OECD BEPS minimum standards. Similarly to the EU Blacklist, the greylist was most recently modified on February 22, 2021, such that it now includes only 10 jurisdictions.

Of note to the insurance industry, Bermuda committed to improve substance requirements and introduced legislation effective as of January 1, 2019, which requires entities carrying on "relevant activities" (which includes insurance business and other financial activities) to demonstrate that they meet certain "substance requirements"…

Of note to the insurance industry, Bermuda committed to improve substance requirements and introduced legislation effective as of January 1, 2019, which requires entities carrying on "relevant activities" (which includes insurance business and other financial activities) to demonstrate that they meet certain "substance requirements," with relevant factors including (i) being managed and directed in Bermuda, (ii) core income-generating activities being undertaken in Bermuda, and (iii) an adequate physical presence, number of employees and operating expenses incurred in Bermuda. Jersey, Guernsey, the Isle of Man, and the Cayman Islands introduced similar legislation. The measures implemented by the Cayman Islands were initially perceived to be deficient, and consequently, the Cayman Islands was added to the EU Blacklist on February 18, 2020. The Cayman Islands was, however, removed from the EU Blacklist as of the update on October 6, 2020, following the adoption of new reforms to its framework on collective investment funds. Similarly, although Bermuda was placed on the EU Blacklist in March 2019, it was subsequently moved to the greylist in May 2019. Since then, as of February 18, 2020, the EU has removed Bermuda from the greylist.

Existing sanctions include restricted access to EU funding and an increased risk of audit by tax authorities. However, a list of more penal sanctions, known as "legislative defensive measures," have been recommended by the EU, and member states were encouraged to implement at least one of these measures by January 1, 2021. These include, for example, the imposition of withholding taxes and the denial of tax deductions on payments made to entities based in blacklisted jurisdictions. A number of member states have proposed such "legislative defensive measures," which are at different stages of implementation.

The EU Blacklist has also been incorporated into other areas of EU legislation. By way of example, there are stricter reporting requirements required under the EU Directive on mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (commonly referred to as "DAC 6") where a deductible cross-border payment made to an associated enterprise resident in a blacklisted jurisdiction is automatically reportable.

The EU has indicated that, from 2020, the EU Blacklist will be updated twice a year.

Recently, the European Parliament has adopted a resolution requesting, among other things, that the Council of the European Union (the "**Council**") and the Commission reform the process by which jurisdictions may be added to the EU Blacklist such that jurisdictions with a 0% corporation tax rate (or no corporation tax) would be automatically included, which would likely include, for example, the Cayman Islands and Bermuda. However, resolutions adopted by the European Parliament are not generally binding on the Council or the Commission, and any further implementation of the European Parliament's resolution therefore remains at the sole discretion of the Council and the Commission. As discussed above, on October 6, 2020 the Cayman Islands was removed from the EU Blacklist; as such, no immediate material impact of this resolution is therefore expected. However, there is a risk that the Cayman Islands, and Bermuda in particular, could be added to the EU Blacklist if these proposals were ever adopted and fully implemented in their current form.

3. The EU Anti-Tax Avoidance Directives

On January 28, 2016, the EU presented its proposal for an Anti-Tax Avoidance Directive ("**ATAD**"). On May 29, 2017, the EU amended ATAD with Directive (EU) 2017/952 ("**ATAD 2**"). ATAD and ATAD 2 contain various measures that could have an effect on insurance companies. Of particular note to insurance companies are (a) the "interest limitation rules" which, broadly, restrict the tax-deductible interest of an entity to 30% of EBITDA, subject to an allowable de minimis of £2 million of net interest expense, and (b) the "hybrid mismatch rules" which, broadly, are designed to counteract arrangements where a payment or quasi-payment gives rise to a double tax deduction or tax deduction for one party without a corresponding inclusion of income for the other party. Other measures prescribed by ATAD and ATAD 2 include exit taxes (e.g., on transfers of permanent establishments or tax residence), rules that attribute the income of a controlled foreign company to its (direct or indirect) controlling company, and a general anti-avoidance rule. EU member states were, subject to derogations for certain states, under an obligation to implement ATAD in their domestic law by January 1, 2019 and ATAD 2 in their domestic law by January 1, 2020, except for certain measures relating to reverse hybrid mismatches, which must be implemented by December 31, 2021. The UK had already implemented a number of tax regimes that rendered the UK tax system compliant with the requirements of ATAD 1 and ATAD 2, and these domestic UK tax regimes are not immediately affected by the final Brexit terms.

The UK had already implemented a number of tax regimes that rendered the UK tax system compliant with the requirements of ATAD 1 and ATAD 2, and these domestic UK tax regimes are not immediately affected by the final Brexit terms.

4. UK Insurance Premium Tax: Administration and Unfair Outcomes Consultation

On November 5, 2020, HMRC published a consultation paper on measures to improve the operation of, and prevent certain types of avoidance and evasion of, UK insurance premium tax ("**IPT**"). The aim of the consultation was to identify measures which may improve the operation of IPT, and make it easier for both the industry and HMRC to administer IPT. The consultation did not, however, consider the rates of IPT or the exemptions to IPT. The consultation period ended on February 5, 2021. Following this, the UK government will publish a response and, should the response indicate that it is appropriate, legislation may be introduced as deemed necessary.

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