SIDLEY

SIDLEY GLOBAL INSURANCE REVIEW

MARCH 2023

TALENT. TEAMWORK. **RESULTS.**

SIDLEY GLOBAL INSURANCE REVIEW

March 2023

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 consider 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 Pacific, 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 2,300 lawyers across 21 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 70 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 2023 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. THE NORTH AMERICAN MARKET

1. Introduction

The resilience of the insurance industry and its investors was tested in 2022, as the insurance mergers and acquisitions ("**M&A**") market experienced significant declines in both deal volume and transaction value, especially when compared against the upsurge in deal activity that characterized 2021. These stiff declines coincided with, and to a great extent seemed driven by, the broader geopolitical and macroeconomic factors that have recently plagued other industries and the financial markets generally — among them lingering economic uncertainty, rising interest rates, inflation, recessionary forces, severe weather events in the U.S., and the Russia-Ukraine conflict. The ability of the market in recent years to adapt and respond to economic challenges such as the depredations of the COVID-19 pandemic was less in evidence in 2022, as M&A transactions involving both insurance carriers and insurance brokerages plummeted in 2022 in the face of these challenges.

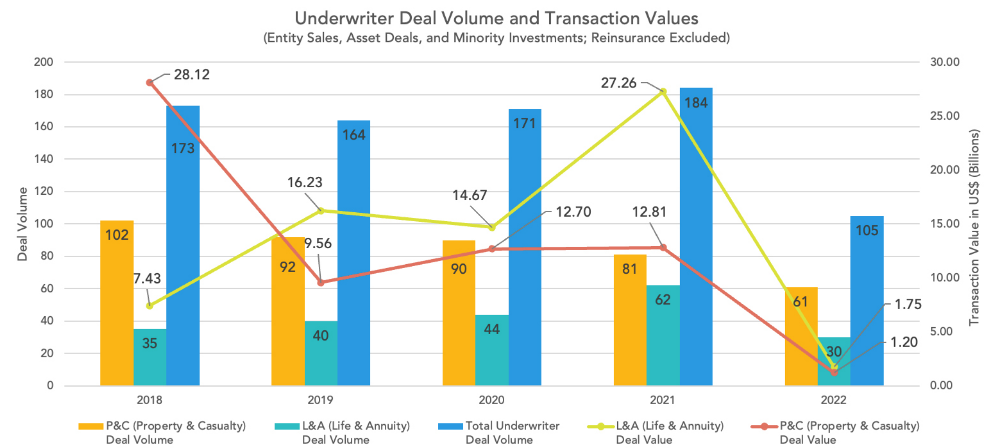
The resilience of the insurance industry and its investors was tested in 2022, as the insurance mergers and acquisitions ("M&A") market experienced significant declines in both deal volume and transaction value …

M&A transactions in both the life and annuity and the property and casualty ("**P&C**") spaces declined substantially in 2022. Annual deal value in the P&C market was down from US$12.81 billion in 2021 to US$1.2 billion in the first 11 months of 2022. Acquisitions in the life and annuity space in 2022 were limited to only 30 transactions through November, and measured an aggregate value of US$1.75 billion, less than half as many as compared to 2021— a significant decline from 2021, during which aggregate deal value for stock acquisitions amounted to US$27.26 billion.

The market downturn arrived in earnest in the second quarter of 2022, after a first quarter that seemed to enjoy residual (if short-lived) momentum from the end of 2021. The downward trend continued throughout the balance of 2022, with the decline in aggregate transaction value accelerating as the year progressed.

While a decline from the relative high-water mark of 2021 was to be expected, 2022 did not simply represent a reversion to the mean — deal volume and transaction value in 2022 were meaningfully lower relative to the past several years. While challenging economic circumstances certainly played a major part in this decline, the reduced activity in the life M&A market may also be attributable to the maturation of the legacy life M&A market. As many life insurers have disposed of non-core legacy blocks of business (in particular, fixed annuity blocks) in recent years (accounting for record deal volume in the legacy life M&A market), buyers and sellers have been forced to broaden the scope of the lines of business in which they propose to transact, including more complex products and blocks of business.

As many life insurers have disposed of non-core legacy blocks of business (in particular, fixed annuity blocks) in recent years (accounting for record deal volume in the legacy life M&A market), buyers and sellers have been forced to broaden the scope of the lines of business in which they propose to transact, including more complex products and blocks of business.



[1]

As predicted in the 2022 edition of this publication, the Russia-Ukraine conflict and the attendant geopolitical tensions and dislocation have, in tandem with rising interest rates and growing inflation,

1 Data used to compile this graph was derived from *Insurance M&A 2022 review: Deal activity slows from prior-year highs*, S&P Global (December 28, 2022). The data for 2022 reflects transactions as of November 30, 2022. Our review of industry transactions in December 2022 did not demonstrate a material deviation of the larger trends described in this publication.

produced much greater uncertainty in global financial markets, sparking fears of a global economic recession. The rising interest rate environment and its effect on debt availability have strained financing options for potential acquirors and resulted in increased cost of capital, with concomitant declines in return-on-equity thresholds. It appears that these factors have inhibited insurance M&A activity across the board, with acquisitions of insurance producers (which tend to be more highly leveraged) being particularly hard hit.

As of this writing, continuing economic headwinds suggest that the insurance M&A market will remain sluggish in the near term, although recent sanguine predictions about the trajectory of inflation, a continued waning of the effects of the COVID-19 pandemic, and the abundance of undeployed capital at private equity ("**PE**") firms all suggest that better days may lie ahead for the insurance M&A market.

While a comprehensive discussion of the insurance M&A and reinsurance transactions announced in 2022 is beyond the scope of this review, we present below tables listing some of the more noteworthy insurance M&A and block reinsurance transactions announced during 2022.

NOTABLE M&A TRANSACTIONS

Buyer	Target / Industry	Seller	Announcement Date	Equity Value
Berkshire Hathaway Inc.; O&M Acquisition Corporation	Alleghany Corporation, Inc. / P&C	Alleghany Corporation	March 21, 2022	US$11.6 billion
Brown & Brown, Inc.	Global Risk Partners Limited / Broker	Investor Group	March 7, 2022	US$1.9 billion
Riser Merger Sub, Inc. (subsidiary of The Carlyle Group Inc.)	NSM Insurance HoldCo, LLC / Broker	White Mountains Catskill Holdings, Inc.	May 9, 2022	US$1.8 billion
JAB Holding Company S.à.R.L.	Crum & Forster Pet Insurance Group and Pethealth Inc.	Fairfax Financial Holdings Limited	June 20, 2022	US$$1.4 billion
BRP Insurance Intermediary Holdings, LLC	Westwood Insurance Agency / Broker	QBE Holdings, Inc.	March 3, 2022	US$385 million
Ohio Farmers Insurance Company	Lloyd's of London Syndicate 1200 / Multiline	Argo Group International Holdings, Ltd.	September 9, 2022	US$125 million

NOTABLE REINSURANCE TRANSACTIONS

Assuming Reinsurer / Parent	Subject Business	Ceding Insurer	Announcement Date	Ceded Reserves
Talcott Financial Group	Fixed annuities and universal life insurance with secondary guarantees	Principal Financial Group Inc.	January 1, 2022	US$25 billion
Global Atlantic Financial Group Limited	Group retirement annuities	Equitable Financial Life Insurance Company	August 16, 2022	US$10 billion
Fortitude International Reinsurance Company Limited	Individual annuities	Taiyo Life Insurance Company	April 8, 2022	US$4 billion
Venerable Holdings, Inc.	Variable annuities	John Hancock Life Insurance Company of New York (U.S. subsidiary of Manulife Financial Corporation)	October 3, 2022	US$1.6 billion
Resolution Re (Bermudan subsidiary of Resolution Life Group Holdings LP)	Whole life	The Dai-Ichi Life Insurance Company, Limited	June 22, 2022	US$1.5 billion
Talcott Financial Group; Resolution Re	Fixed indexed annuities	Allianz Life Insurance Company of North America	December 3, 2021 (closed January 7, 2022)	US$35 billion
Fortitude Group Holdings, LLC	Variable annuities	Prudential Annuities Life Assurance Corporation	September 15, 2021 (closed April 1, 2022)	US$31 billion

2. Life and Annuity

Though there was a notable dearth of major stock transactions of life insurance companies in 2022, PE firms continued to pursue reinsurance transactions in the life and annuity space, and seemed to focus their efforts on the acquisition of variable annuity blocks in particular. This continues a trend by life insurers to offload legacy variable annuity blocks to PE buyers, in order to reduce their exposure to the market volatility inherent with riders associated with such products.

Though there was a notable dearth of major stock transactions of life insurance companies in 2022, PE firms continued to pursue reinsurance transactions in the life and annuity space, and seemed to focus their efforts on the acquisition of variable annuity blocks in particular.

For example, in April, Prudential Financial, Inc. ("**Prudential**") completed its sale of approximately US$31 billion of in-force variable annuity liabilities to Fortitude Group Holdings, LLC ("**Fortitude**"). In the press release announcing the transaction, Prudential noted that the transaction would allow Prudential to be more "nimble" and "less market-sensitive." Similarly, in August, Global Atlantic Financial Group ("**Global Atlantic**") announced that it would reinsure a US$10 billion block of group retirement annuities from Equitable Financial Life Insurance Company. The announcement of this transaction came on the heels of Global Atlantic's March announcement of its reinsurance of a US$4 billion block of annuity business. In a similar vein, in November 2022, Talcott Financial Group, sponsored by private equity firm Sixth Street, reinsured a US$7.4 billion block of variable annuities from The Guardian Life Insurance Company of America.

Some U.S. PE-backed reinsurers have shown a continued interest in broadening the geographic regions in which they look for deals, and particularly in Asia, as highlighted by the recent interest in Japanese life and annuity transactions. One notable example is the announcement by Fortitude of the reinsurance of a US$4 billion individual annuity block from Taiyo Life Insurance Company, a subsidiary of the T&D Insurance Group headquartered in Tokyo, in which Fortitude highlighted its drive to "broaden the markets" in which it operates. Similarly, Resolution Life Group Holdings LP's ("**Resolution**") Bermudan reinsurance platform, Resolution Re, announced its reinsurance of US$1.5 billion of liabilities from The Dai-Ichi Life Insurance Company, a Japanese insurer, shortly after announcing the formation of a representative office in Singapore. In the press release announcing the transaction, Resolution emphasized the "potential for significant growth" in the Japanese and broader Asian markets, and the importance of regional strategic relationships.

Some U.S. PE-backed reinsurers have shown a continued interest in broadening the geographic regions in which they look for deals, and particularly in Asia, as highlighted by the recent interest in Japanese life and annuity transactions.

Though "flow" and traditional reinsurance arrangements are beyond the scope of this section of the *Sidley Global Insurance Review*, we note that U.S. PE-backed participants have expressed interest in such reinsurance investments in Asian insurance markets in recent years, an interest that remained in evidence in 2022. For example, Athene Holding Ltd. ("**Athene**") entered into the Japanese annuity reinsurance market in 2020 when it established a flow reinsurance partnership with a large Japanese financial institution and followed that with a second flow reinsurance partnership with a large Japanese counterparty in 2021. Athene further expanded into the Asia Pacific annuity market at the end of 2022. Similarly, Global Atlantic entered into a flow reinsurance transaction with a Singapore-based insurer last year, following a block reinsurance transaction entered into by Global Atlantic and AXA Hong Kong in July of 2021. Finally, Aspida Life Re Ltd. entered the Asian market last year with its announcement on November 9, 2022 of a flow reinsurance transaction with a prominent Japanese life insurance company.

3. P&C

Though the macroeconomic factors that limited life and annuity transactions in 2022 were felt just as keenly in the P&C sector — in which deal activity has, in the recent past, not been anywhere as robust as in the life sector to begin with — their consequences manifested differently. Inflation drove higher claims costs, particularly for personal lines business, due in large part to increases in the cost of replacement goods and materials. In order to mitigate the effects of these cost increases, some P&C insurance companies have been seeking increased premium rates, and we expect that, if inflation remains at or near its current level, these efforts will continue. However, regulatory requirements applicable to rate increases and the consequent delays in right-sizing premiums may hamper such efforts in the near term.

… some P&C insurance companies have been seeking increased premium rates, and we expect that, if inflation remains at or near its current level, these efforts will continue.

The effects of climate change have also continued to eat into the profit margins of certain P&C insurers, particularly catastrophe insurers and reinsurers, as claims costs continued to climb, especially in regions of the U.S. ravaged by hurricanes, floods, and other natural disasters. These external economic and natural forces appear to have contributed to lower valuations of some P&C insurers and reinsurers, particularly those with significant exposure to catastrophe and property risk.

Despite these obstacles, seasoned industry players nevertheless found ways to transact in the P&C space. In March 2022, Berkshire Hathaway announced its acquisition of Alleghany Corporation in an all-cash stock purchase transaction for a deal value of approximately US$11.6 billion. And in September 2022, Ohio Farmers Insurance Company announced that it would acquire Lloyd's of London Syndicate 1200, with a balance sheet of over US$650 million, from Argo Group International Holdings, Limited ("**Argo**"). Shortly before this publication went to press, Argo and Brookfield Insurance announced a definitive merger agreement under which Brookfield Reinsurance agreed to acquire Argo in an all-cash transaction valued at approximately US$1.1 billion. The transaction is expected to close in the second half of 2023.

The deal activity in the P&C space in 2022, while relatively light, nevertheless demonstrated the continued consolidation of the insurance producer/managing general agency ("**MGA**") market. For example, in March, Brown & Brown, Inc. announced that it had entered into an agreement to acquire the operations of Global Risk Partners Limited, an insurance intermediary that specializes in retail broking, specialist MGA, and Lloyd's businesses. Similarly, White Mountains Insurance Group, Limited announced in May that it had agreed to sell NSM Insurance Group, a specialty insurance distribution platform, to investment funds affiliated with The Carlyle Group Inc. In further evidence of this trend towards consolidation, BRP Insurance Group ("**BRP**") in April 2022 acquired Westwood Insurance Agency ("**Westwood**") for US$385 million and separately entered into a program administrator agreement with an affiliate of Westwood, Millennial Specialty Insurance, LLC, to assume all MGA functions associated with a builder-sourced homeowners block of business. This deal was BRP's largest to date.

4. Rising Interest Rates and Treatment of "Negative IMR"

Given recent interest rate hikes, some insurers have been realizing losses on the sale of fixed income assets, driving down IMR balances and, in some cases, even causing such balances to become floored at zero (or otherwise to be negative).

As described in more detail in section V.A.11.c. of this publication, rising interest rates spurred the National Association of Insurance Commissioners ("**NAIC**") to announce at its Fall 2022 National Meeting that it would consider permitting negative interest maintenance reserve ("**IMR**") to qualify as an admitted asset on the books of insurance carriers. Negative IMR results when net realized losses on sales of interest rate-based investments are greater than net realized gains on sales of interest rate-based investments, both of which are amortized in an IMR calculation. Given recent interest rate hikes, some insurers have been realizing losses on the sale of fixed income assets, driving down IMR balances and, in some cases, even causing such balances to become floored at zero (or otherwise to be negative).

The NAIC's Statutory Accounting Principles Working Group acknowledged that revisions to SSAP 7 (Asset Valuation Reserve and Interest Maintenance Reserve) are needed to address the likelihood that some life and annuity insurers will carry negative IMR. Regardless of whether the NAIC recommends (and states ultimately enact) reforms to recognize negative IMR such that it is effectively an asset, it seems likely that the treatment of negative IMR will be a source of additional negotiation in reinsurance treaties, including the negotiation of covenants that require cedants in funds withheld and modified coinsurance transactions to seek permitted practices in order to unlock the value of negative IMR. Practitioners should consider how the value of any negative IMR will be shared if negative IMR is recognized as an asset, including potential post-closing adjustments if applicable permitted practices are granted. For a more comprehensive discussion of the NAIC's potential action with respect to the treatment of negative IMR, see section V.A.11.c. of this publication.

5. Insurtech

The insurtech subsector, which has long sought to disrupt the broader insurance industry, has, like other players in the insurance space, been deeply affected by the larger macroeconomic challenges discussed herein. Rising interest rates led to increased capital costs and declining investment in insurtech companies, which decreased significantly year-over-year. Large investments dropped off the most steeply — as of November 30, 2022, insurtech companies attracted 66.7% fewer investments of US$100 million or more as compared to 2021.[2] Insurtech company valuations have likewise declined, and venture capitalists seem to have shifted their focus to profitability, deemphasizing the narrative around "disruption" and focusing instead on returns on their investments.

No insurtech company undertook an initial public offering ("**IPO**") in the first half of 2022, down from 10 in 2021.[3] This noticeable drop in IPOs is consistent with the state of the broader capital markets, which

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2 *Gallagher Re: Global Insurtech Report*, Gallagher Re (February 2023).

3 *The Funding Streak in Insurtech Continues*, Boston Consulting Group (June 8, 2022).

have experienced significant decreases in IPOs, including those utilizing special purpose acquisition companies ("**SPACs**"), across all industries. In the first three quarters of 2022, 78 SPAC IPOs were completed, as compared to 444 in the same period during the prior year.[4]

With the muted IPO market for insurtech companies in 2022, and the decline in valuations across certain insurtech players, some insurtech companies have been acquired by larger players in the industry. For example, P&C platform Trōv, which was one of the earliest self-identified insurtech companies, announced in February 2022 that it would sell its platform to Travelers. In March 2022, Hub International Limited, a global insurance brokerage and financial services firm, announced that it would acquire Insureon Digital Insurance Agency, formerly one of the largest independent agencies in the U.S. for digital delivery and fulfillment of commercial insurance to small businesses. If current economic conditions persist, established insurance companies and insurance brokerages may continue to look to acquire distressed insurtech companies at attractively low valuations.

With the muted IPO market for insurtech companies in 2022, and the decline in valuations across certain insurtech players, some insurtech companies have been acquired by larger players in the industry.

Other insurtech companies have attempted to weather the difficult market by building out their underwriting capabilities. To that end, in recent years, some insurtech companies have acquired insurance company "shells" (dormant insurance companies with licenses but without liabilities). This continued in 2022, with Munich Re Digital Partners' sales of Digital Affect Insurance Company to Coalition and Digital Edge Insurance Company to ManyPets, and Tesla Insurance's acquisition of Balboa Insurance Co. from Bank of America Corp. The targets in each of these deals were licensed shell companies.

Other insurtech companies have attempted to weather the difficult market by building out their underwriting capabilities.

The trend of consolidation within the insurtech industry also continued in 2022, with Ethos Technologies, Inc. ("**Ethos**"), an exclusively digital provider of term life insurance, acquiring Tomorrow Ideas, Inc. ("**Tomorrow**"), which produces wills and trusts in a streamlined and digitized manner. The transaction will allow Ethos to begin offering policies through Tomorrow's digital application in a manner that the parties hope will streamline and digitize the traditional process of will execution. Similarly, Super Home Inc. ("**Super Home**"), an insurtech company that provides subscription care for the home, announced the acquisition of Platinum Home Protection in February of 2022, which offers similar products and services that are complementary to Super Home's existing product suite.

The trend of consolidation within the insurtech industry also continued in 2022 …

6. Representations and Warranties Insurance

After years of increasing representations and warranties insurance ("**RWI**") premiums, in 2022 rates finally moderated, and in some instances declined. A combination of decreased deal flow, new market entrants, increased capacity, and the easing of staffing shortages to underwrite RWI policies have all contributed to a return to pricing comparable to early 2021.[5] In addition, as capacity has grown, the utilization of M&A insurance products other than traditional RWI, such as bespoke tax and contingent risk policies, is on the rise.

After years of increasing representations and warranties insurance ("RWI") premiums, in 2022 rates finally moderated, and in some instances declined.

However, as premium rates have moderated, claims activity has steadily been on the rise, largely due to the steady increase in RWI policies written, a trend which we can expect will continue, given the torrent of deal activity (and the corresponding uptick in the issuance of RWI policies) that characterized 2021. Though the most common claims categories continue to be those applicable to financial statements, tax, legal compliance, and material contracts, there has been increased claim activity in other claims categories, such as intellectual property, asset condition, and customers and supply chain issues. Whether increased claim volume (or severity) in the latter types of claims categories will result in a growing list of policy exclusions remains to be seen, but given the growing entrenchment of RWI policies in the M&A space generally (and in the insurance industry as well), we expect that RWI will remain vital to insurance M&A in 2023.

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7. Strategic Partnerships and Sidecars

Even as insurance M&A deals dramatically declined, the past year nevertheless demonstrated the willingness of PE firms to enter into strategic partnerships with insurance companies, particularly those that provide an investment management mandate in exchange for capital commitments to grow the business of insurance carriers and to facilitate future acquisitions. Such partnerships reflect a drive by

Even as insurance M&A deals dramatically declined, the past year nevertheless demonstrated the willingness of PE firms to enter into strategic partnerships with insurance companies …

4 *SPAC offerings, deals fall to pre-surge levels*, S&P Global (November 14, 2022).

5 *Looking Ahead to 2023: Trends in Private Equity and M&A Insurance*, Woodruff Sawyer (October 11, 2022); *No Uncertain Terms: Shifts in Key Deal Terms Ahead,* Middle Market Growth (January 10, 2023).

insurance companies to access capital in alternative ways to support their own growth, and demonstrate the continued emphasis of PE firms to pursue asset management opportunities and to invest in the future growth of the insurance companies with which they have partnered.

This trend is exemplified by the November 2022 announcement by American Equity Investment Life Holding Company ("**AEL**") of a US$250 million reinsurance partnership with 26North Partners LP ("**26North**"), a PE firm founded by Josh Harris. The chief executive officer and president of AEL remarked that this "strategy is aligned with policyholders through [AEL's] unique go-to-market and investment management approaches and capital-light structure," and that the strategy is part of the company's efforts to "refine a capital-efficient business model to deliver superior, sustained returns for [its] shareholders and further strengthen [its] robust balance sheet." Similarly, Blackstone Incorporated ("**Blackstone**") and Resolution signed a deal pursuant to which Resolution will become Blackstone's strategic partner for new closed book transactions, including reinsurance, in the life and annuity sector globally. The terms of the deal include an investment management mandate to Blackstone for certain of Resolution's investment portfolios, and the parties intend to raise new capital to Resolution's total equity capital base, including a US$500 million strategic investment from Blackstone. In the press release announcing the transaction, Resolution stated that "the enhanced capital base will allow Resolution to rapidly scale its growth path in a highly active acquisition market—continuing its mission of being a global custodian to life insurance and annuity policyholders." Blackstone has entered into similar arrangements in prior years with American International Group Inc. ("**AIG**") and F&G, a unit of Fidelity National Financial Inc. Similarly, in January of this year, SILAC Insurance Company ("**SILAC**") and Hildene Capital Management, LLC ("**Hildene**") announced a long-term strategic alliance pursuant to which Hildene will acquire a strategic minority ownership in SILAC and SILAC will enter into a US$2.5 billion reinsurance arrangement with an affiliate of Hildene. Similar to the Blackstone-Resolution arrangement, Hildene will provide investment management services to SILAC.

Such strategic partnerships were not limited only to investments in insurance carriers, however. At the time of this writing, AIG announced that it had entered into a binding memorandum of understanding with Stone Point Capital LLC, a private equity firm focused on investment in businesses within the global financial services industry, to form an independent MGA to serve the high-net-worth market. The transaction is subject to the negotiation of definitive agreements, and the terms of the transaction have not been disclosed.

… strategic life insurers and PE firms, and other financial buyers, are also increasingly utilizing sidecars, a type of special purpose investment vehicle, as an alternative source of capital to support life insurance business, as well as to facilitate block acquisitions and pension risk transfers.

Similarly, strategic life insurers and PE firms, and other financial buyers, are also increasingly utilizing sidecars, a type of special purpose investment vehicle, as an alternative source of capital to support life insurance business, as well as to facilitate block acquisitions and pension risk transfers. Though sidecars have been utilized in the P&C space for years, this technology has also been adopted in the life sector, as a means to provide standby capacity to life insurers and an opportunity for investors to co-invest in reinsurance underwriting through the sidecar structure.

In February 2023, Athene announced a first closing for Apollo / Athene Dedicated Investment Program II, with approximately US$2 billion in capital commitments to be invested in the Athene Co-Invest Reinsurance Affiliate Holding 2 Ltd. ("**ACRA 2**") sidecar program. The ACRA 2 sidecar is the follow-up to the successful ACRA 1 sidecar, which was established in 2019 and scaled to become a reinsurance platform with over US$60 billion of assets.

Another notable example of the utilization of these sidecar structures in the life space is the launch of Martello Re Limited ("**Martello Re**"), a sidecar organized by Massachusetts Mutual Life Insurance Company ("**MassMutual**"), Centerbridge Partners ("**Centerbridge**"), and Brown Brothers Harriman. With initial equity reported at US$1.65 billion, MassMutual and its affiliates reinsured approximately US$14 billion of general account liabilities to Martello Re and entered into a flow arrangement to reinsure new business. Future plans include the offering of services to other insurance carriers in the life and annuity space. Barings and Centerbridge will manage Martello Re's investment portfolio under the terms of the deal. In a similar example, in January 2023, Kuvare Holdings LP ("**Kuvare**") disclosed that it and investment manager Davidson Kempner Capital Management LP ("**Davidson Kempner**") had partnered to form Kindley Re Limited ("**Kindley**"), a sidecar vehicle. Kindley will co-invest at least US$400 million with Kuvare in qualifying life insurance and annuity transactions, including flow and block reinsurance deals, generated by Kuvare's insurance operating companies, backed by an initial capital commitment from Davidson Kempner. We expect that the use of sidecars in the life space as a means to support both current underwriting and the funding of future acquisition and retrocession transactions will increase in the coming years.

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8. Outlook

The insurance industry and its investors continue to face significant uncertainty going into 2023 as a result of persistent macroeconomic and political challenges, and high interest rates that show few signs of abating. That said, the buildup of undeployed capital at PE firms, and increased interest in strategic partnerships and sidecars, may help to offset these challenges in the coming months. Whether and to what extent these potential mitigants will be enough to overcome the unfavorable economic climate remains to be seen.

B. UK AND EUROPEAN MARKETS

1. Introduction

Throughout 2022, insurance M&A activity in the UK and Europe was relatively subdued, with a notable slowdown in activity in the second half of the year. The trends across 2022 broadly mirrored those of recent years, including consolidation in the broker market and continued interest in Lloyd's of London ("**Lloyd's**") legacy deals.

2. Lloyd's and the Legacy Market

Historically, the long lead time and associated costs of establishing a Lloyd's platform organically via a turnkey operation have meant that M&A has, for many, been a preferable route to market entry. In a significant transaction, Ohio Farmers Insurance Company in September 2022 announced its acquisition of Lloyd's of London Syndicate 1200, with a balance sheet of over US$650 million, from Argo, which was completed in February 2023.

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However, with the emergence of alternative methods for making new investments at Lloyd's (see further below), the principal Lloyd's M&A focus in 2022 continued to be on the legacy market. The focus on legacy has, in part, been driven by the continued focus of Lloyd's on improving underwriting performance. The legacy market has been supported by a hardening market, as organizations have looked to optimize portfolios and how they deal with or carve out legacy reserves, with (re)insurers increasingly seeking to restructure their portfolios, either to release solvency capital via back-year transactions, or to put underperforming units into run-off. Another trend at Lloyd's has been that the size of some portfolios being marketed to the legacy market are larger than in the past.

However, with the emergence of alternative methods for making new investments at Lloyd's, the principal Lloyd's M&A focus in 2022 continued to be on the legacy market.

Among the more significant Lloyd's legacy deals in 2022, Enstar Group Limited ("**Enstar**") announced the completion of a ground-up loss portfolio transfer with Aspen Insurance Holdings Limited and its subsidiaries for their 2019 and prior business. Enstar assumed net loss reserves of US$3.12 billion, subject to a limit of US$3.57 billion. In February 2022, RiverStone International ("**Riverstone**") completed an agreement with MS Amlin Underwriting Limited to undertake a split reinsurance-to-close transaction ("**RITC**") of the UK P&C portfolio of the 2019 and prior years of account of MS Amlin's Syndicate 2001 ("**Syndicate 2001**"), with net technical provisions of US$266 million. This was followed in early 2023 by a US$1.2 billion split RITC and the portfolio transfer of certain discontinued classes in the 2019 to 2021 years of account of Syndicate 2001.

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 is the "syndicate in a box" ("**SIAB**"). SIAB offers market entrants a Lloyd's syndicate platform, access to Lloyd's systems, and supported guidance on Lloyd's standards. Similar to 2021, Lloyd's approved a number of new SIABs during 2022, including European insurer Wakam's Syndicate 1347, which received Lloyd's approval to start underwriting B2B2C insurance for the 2023 year of account. 2022 also saw the launch of new SIABs such as Greenlight Re's Syndicate 3456 (which provides insurance capacity to insurtechs) and MIC Global's Syndicate 5183 (providing end-to-end digital microinsurance products) as part of the broader Future at Lloyd's program.

In 2022, Carbon Underwriting Limited, a SIAB since July 2020, received approval from Lloyd's to become a full Lloyd's syndicate from January 2023.

A further way in which Lloyd's is pursuing its Blueprint One and Blueprint Two development strategies is through the implementation of the new multi-arrangement insurance special purpose vehicle ("**MISPV**"), London Bridge Risk PCC Ltd. ("**London Bridge Risk**"), which was approved by regulators in January 2021. In August 2022, Lloyd's received regulatory approval from the Prudential Regulation Authority ("**PRA**") and the Financial Conduct Authority ("**FCA**") to set up a second London Bridge PCC ("**LB2**"), building on the success of London Bridge Risk. LB2 has been granted three additional capabilities, those being that: (i) corporate members will be able to write excess of loss coverages; (ii) syndicates will be permitted to provide collateralized reinsurance on both an excess of loss and quota share basis; and (iii) all structures are able to fund reinsurance obligations through the offer of either preference share or debt securities. Both Lloyd's members and managing agents will be able to use LB2 to manage their capital and risk management requirements by attracting new sources of capital and reinsurance protection.

3. Broker M&A

Consolidation in the broker market continued in 2022. This included Howden Group's ("**Howden**") US$1.5 billion takeover of TigerRisk announced in June 2022, consolidating Howden's position as a global insurance intermediary.

Since securing new investment from its private equity backers in December 2021, the Ardonagh Group ("**Ardonagh**") has continued to be active in the broker M&A market. During 2022, Ardonagh purchased Léons Group (an insurance brokerage in the Netherlands), the Australian firm Envest, and MDS Group, an insurance broker and risk management adviser. In the UK, Ardonagh has completed the acquisition of recovery insurance MGA and assistance specialist Lorega Holdings Limited, and has agreed to acquire Lloyd's broker Oxford Insurance Group.

In December 2022, BMS Group, the London-based independent specialty insurance and reinsurance broker, announced that it had signed an agreement with private equity firm Eurazeo to receive an investment of up to £355 million.

Given that many UK brokerage firms are now backed by private equity, this is likely to continue to drive further broker M&A (and possibly IPOs) over the course of 2023, as private equity owners look to maximize and realize returns from their investment.

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4. Insurance Company Transactions

While UK and European insurance groups undertook very little transformational M&A throughout 2022, cross-border transactions have remained a feature of European insurance M&A over the past year.

While UK and European insurance groups undertook very little transformational M&A throughout 2022, cross-border transactions have remained a feature of European insurance M&A over the past year.

In February 2022, Allianz announced that it would be acquiring 72% of Greek insurer European Reliance General Insurance Company. Once completed, the deal will create the number one Greek P&C insurer and the fifth-largest insurance company in Greece, in terms of market share.

In addition, insurance groups such as Generali and AXA continued to use M&A activity to strengthen their core market/business lines. For example, Generali completed the acquisition of La Médicale from Crédit Agricole Assurances, and agreed to acquire the former MetLife pension business in Poland. AXA acquired the renewal rights to Ageas UK's commercial business, supporting AXA's growth strategy in the UK.

In August 2022, Phoenix Group Holdings plc announced the acquisition of Sun Life UK, a closed book UK life insurance company, from Sun Life Financial Inc. in a deal worth £248 million.

5. Insurtech

Insurers are increasingly seeking partners whose global reach and expertise extends beyond capital. Technology, in the form of insurtech, has also been a key driver, as purchasers have sought potential efficiencies, including digital distribution platforms, data analytics, and process automation. Traditional (re)insurance companies have demonstrated a growing interest in investing their capital into insurtech, given the advantages of using digital products that make insurance more accessible and efficient, and the threat of increasing competition from major technology companies and startups that seek to disrupt the insurance sector.

Despite uncertainty in the face of inflation, rising interest rates, and market volatility, insurtech deal activity in 2022 continued, but at a slower pace than in 2021. At least one of the drivers in the current insurtech market is that some insurtechs are now at the stage where they are capable of seeking acquisitions themselves. In October 2022, UK insurtech ManyPets acquired Digital Edge Insurance Company from Munich Re Digital Partners.

In addition, there continues to be a demand for digitized and streamlined insurance services, as traditional insurers look to modernize by acquiring insurtechs and bringing these capabilities in-house. One such transaction in 2022 was Munich Re's acquisition of Apinity, a startup that provides the potential to integrate other sectors into the insurance industry's API systems to allow for greater data sharing within the industry.

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II. The Global Alternative Risk Transfer Market

A. P&C MARKET

1. Catastrophe Bonds

After a record-breaking 2020 and 2021, and expectations for a strong 2022, the 2022 catastrophe bond market faced several unexpected challenges, resulting in a lack of available investment capital and a resultant dip in new issuance to approximately US$8.6 billion[6] (excluding private transactions). The year started relatively strong, but the pace of new issuance significantly declined in the second half of 2022, and in particular in the fourth quarter of 2022.

After a record-breaking 2020 and 2021, and expectations for a strong 2022, the 2022 catastrophe bond market faced several unexpected challenges …

Despite heading into 2022 with investor wariness over several years of lower than expected returns — due to, among other things, relatively low catastrophe bond spreads, concerns about inflation, social inflation in Florida (i.e., the impact of litigation and other practices that increase losses), and the rise of higher-frequency secondary perils, such as severe thunderstorm and wildfire, contributing to some catastrophe bond losses and trapping capital — industry experts felt bullish about another strong year, forecasting at least US$10 billion of new issuance for 2022.

However, 2022 was met with a whole new set of challenges. The lingering effects of the COVID-19 pandemic and the outbreak of the Russia-Ukraine conflict resulted in some of the highest inflation in decades, which could translate into increased insured losses, as replacing damaged property following a natural disaster is now more expensive. Additionally, the drop in value of the Euro against the U.S. Dollar resulted in Euro-denominated funds having less capacity to cover what are generally U.S. Dollar coverages in catastrophe bonds. Market volatility, exacerbated by the Russia-Ukraine conflict, resulted in some investors taking their money out of the insurance-linked securities ("**ILS**") space to take advantage of more opportunistic investments. On top of all of this, Hurricane Ian hit in late September 2022, further trapping existing capital and potentially resulting in payouts under many bonds.

The cumulative effect was to significantly reduce the amount of capital available to invest in ILS transactions, all while insurance companies continued to pursue insurance protection via catastrophe bonds and other ILS. This supply/demand imbalance resulted in hard market conditions, and we enter 2023 with catastrophe bonds potentially being a more attractive investment product than it has been in years, as rates and the corresponding spread-to-expected-loss multiples are significantly higher than they have been over the past few years. Because of this, industry experts expect some opportunistic investors to come to the catastrophe bond market in 2023 and for existing investors to raise additional capital to take advantage of the hard market environment, and are therefore predicting a strong 2023 for the catastrophe bond market.

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Inflation still remains a major concern for investors, but there are some positive signs on the social inflation front, as Florida recently passed laws aimed at confronting the issues leading to social inflation (although it remains to be seen how effective these measures will be). Additionally, market participants are looking to expand the catastrophe bond market to cover additional risks, such as cyber and casualty risks, and perhaps 2023 will prove to be the year that the catastrophe bond market expands into these areas.

6 *Bullish Broker-dealers Forecast up to $11.5bn of New Cat Bond Issuance in 2023*, Trading Risk (January 2023).

This is the third consecutive year that insurable losses have surpassed US$100 billion.

2. Market Response to Recent Catastrophe Losses

Global insured catastrophe losses in 2022 are estimated to be approximately US$140 billion.[7] The estimated total is well above the 21st century annual average (US$84 billion) and median (US$75 billion).[8] This is the third consecutive year that insurable losses have surpassed US$100 billion. Private sector insurers paid approximately US$125 billion in losses, while public insurance entities covered the remaining US$15 billion.[9] There were 19 individual billion-dollar insured loss natural disasters globally in 2022, tied with the fifth highest on record. Tropical cyclone once again was the costliest peril for the insurance industry, with US$56 billion in insured losses.[10] Hurricane Ian, which resulted in more than US$50 billion of insured losses and more than US$95 billion of economic losses, became the second costliest natural disaster ever recorded (measured by insured loss on a price-inflated basis), only surpassed by Hurricane Katrina in 2005.[11] The second costliest peril in 2022 was drought in the U.S., with US$8 billion in insured losses.[12] Approximately 75% of such insured losses stemmed from events that occurred in the U.S. Depending on the final losses arising from Hurricane Ian, 2022 is anticipated to be the fifth costliest year on record.[13]

Approximately 42% of direct aggregated economic losses were insured by public and private entities, resulting in a 58% protection gap, one of the lowest protection gaps ever recorded.

Approximately 42% of direct aggregated economic losses were insured by public and private entities, resulting in a 58% protection gap, one of the lowest protection gaps ever recorded. This record low protection gap is primarily due to a large share of the losses in 2022 stemming from events occurring in the U.S., a region with a relatively mature insurance market, while other regions experienced below average losses. The protection gap provides the insurance industry and the financial markets with an indication of where there is opportunity for growth and assistance. The Asia Pacific region has one of the largest protection gaps, with less than 20% of losses covered by insurance.[14]

In response to these catastrophe losses, the ILS market remained stable, with 73 transactions coming to market, totaling US$10.5 billion of issuances.[15] Although 2022 was not a record year, the amount was still above the decade average of US$9.7 billion. While catastrophe bonds were the dominant type of ILS issuance in 2022, there were other non-catastrophe bond ILS issuances, such as those based on mortality rates, longevity, and medical claim costs. The majority of the issuances came to market in the first half of the year. In the first six months of 2022, 51 separate transactions were issued, amounting to approximately US$8.7 billion. In total, the outstanding catastrophe bond market reached a new year-end high at US$37.9 billion, reflecting US$2 billion of growth in the market over the course of 2022. Investors pushed for and achieved very strong pricing on transactions in 2022, and the spread above expected loss was at its highest point since 2012.[16]

A number of notable transactions occurred in 2022. Black Kite Re Limited, a Hong Kong registered entity sponsored by Peak Reinsurance Company, issued US$150 million of catastrophe bonds. This is only the second catastrophe bond issuance out of Hong Kong since the special administrative region of China enacted its special purpose reinsurance vehicle and ILS regulations. Tomoni Re Pte Ltd., a newly registered Singapore-based special purpose reinsurance vehicle, issued two classes of notes benefiting two Japanese insurance carriers, Mitsui Sumitomo Insurance Co. Ltd. and Aioi Nissay Dowa Insurance Co., Ltd., totaling US$100 million and US$120 million of notes, respectively. Chinese insurer PICC

7 *Nat Cat Insured Losses Totaled $140bn in 2022: Gallagher Re*, Trading Risk (January 2023).

8 *2022 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2023).

9 *Gallagher Re Report Reveals US$100 billion Nat Cat Loss Price Tag*, Insurance Business Magazine (January 2023).

10 *2022 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2023).

11 *Hurricane Ian Drives Natural Catastrophe Year-to-Date Insured Losses to USD 115 billion, Swiss Re Institute Estimates*, Swiss Re (December 2022).

12 *2022 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2023).

13 *Global Insured Losses From Natural Disasters Topped $130B in 2022 in 5th Costliest Year*, Insurance Journal (January 2023).

14 *2022 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2023).

15 *Artemis' Q4 2022 Cat Bond & ILS Market Report*, Artemis.bm (January 2023).

16 *Cat Bond Spread Levels Double Since the Start of 2022: Tenax*, Artemis.bm (November 2022).

Property and Casualty Company Limited sponsored its first catastrophe bond, covering US$32.5 million of Chinese earthquake risk, issued by Great Wall Re Limited, a special purpose insurer domiciled in Hong Kong. The U.S. Federal Emergency Management Agency ("**FEMA**") returned to the catastrophe bond market for its fifth FloodSmart Re issuance. FEMA has obtained US$450 million of reinsurance coverage, totaling US$2.225 billion of collateralized reinsurance from the capital markets across five catastrophe bonds issued under its FloodSmart Re Ltd. program since 2018. In early 2023, Beazley, a London-headquartered insurance and reinsurance company, sponsored a US$45 million Section 4(a)(2) private catastrophe bond providing the company with cyber reinsurance protection, representing the first cyber catastrophe bond issuance. Core Specialty Insurance Holdings, Inc. sponsored its first catastrophe bond, a US$65 million bond issued by Yosemite Re 2022-1, a rare excess and surplus lines-focused transaction. Bowline Re Ltd., sponsored by Transatlantic Reinsurance Co., issued three tranches of notes totaling US$165 million and, for the first time, incorporated a U.S. and international peril into one tranche. Additionally, Swiss Re closed an innovative hybrid transaction, a first of its kind to combine ILS and bank financing. Swiss Re partnered with J.P. Morgan and other institutional investors to secure US$1.15 billion in protection for severe underwriting-related losses.

3. Sidecars and ILS Funds

As in recent years, the P&C reinsurance sidecar market has continued to experience certain challenges after consecutive years of losses and poor performance. Some reinsurers have closed their sidecar vehicles, while other sidecars have shrunk considerably. Some investors have been reluctant to invest in ILS structures, as a result of trapped capital from recent catastrophe events. Nevertheless, the sidecar market saw a number of transactions in 2022, with some opportunistic investors seeking to take advantage of improved market pricing. MS Amlin returned to the market and sponsored Phoenix 3 Re in a US$45 million deal using a Singapore-domiciled special purpose vehicle (an increase in issuance size from its predecessors, Phoenix 1 Re and Phoenix 2 Re). MS Amlin cited an "increased underwriting risk appetite," saying that it now benefits from US$83 million of collateralized reinsurance capacity through its Phoenix sidecar vehicles, which support local Asian cedants.[17] Ark Insurance Holdings Limited, a P&C insurance and reinsurance subsidiary of the White Mountains Insurance Group, Ltd., sponsored a US$250 million collateralized reinsurance sidecar (Outrigger Re Ltd.). The quota share arrangement provides reinsurance protection on a portion of Ark Bermuda's global property catastrophe reinsurance portfolio. Oxbridge Re Ltd., a Cayman Islands-based reinsurance firm, launched an initiative through which it aims to sponsor the issuance of digital or tokenized reinsurance securities, which will be used to raise capital and support collateralized contracts underwritten via its sidecar, Oxbridge Re NS. Swedish pension fund Alecta invested US$200 million in SCOR's new sidecar structure, Atlas Gotland Worldwide Catastrophe Sidecar, part of SPI Atlas Re Limited. RenaissanceRe Holdings Ltd. created its first third-party reinsurance capital-backed joint venture focused on casualty and specialty risk, Fontana Holdings L.P., which launched with US$475 million of capital, most of which came from institutional investors. Accelerant launched a US$175 million third-party capital-backed reinsurance sidecar transaction, the first ever launched by an insurtech company. Additionally, Vantage Group Holdings Ltd. established a substantial reinsurance capacity facility primarily funded by third-party capital.

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Despite the challenges in recent years, sidecars continue to be an effective means by which sponsors can share their underwriting risks and returns with third-party investors, while earning fee income. Sidecars continue to be an efficient and attractive investment for longer-term investors with an appetite for diversifying risks.

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4. Global ILS Initiatives

a. U.S.

The Florida legislature passed, and Governor DeSantis signed, SB 2A into law, which is aimed at improving the property insurance market in Florida by reducing litigation and ultimately attracting capital, including reinsurance, back to the state. The bill eliminates one-way attorney fees and the controversial assignment of benefits agreements, among other reforms.[18] In removing certain legal and fraud-related risks, that have been driving significant loss amplification and loss creep in the reinsurance and ILS

In removing certain legal and fraud-related risks, that have been driving significant loss amplification and loss creep in the reinsurance and ILS market, this law may help to reinvigorate the Florida ILS market.

17 *MS Amlin Upsizes Asian Reinsurance Sidecar*, Artemis.bm (January 2023).

18 *Florida Insurance Bill to bring 'Much-needed Relief': AM Best*, Trading Risk (December 2022).

market, this law may help to reinvigorate the Florida ILS market. Some industry executives believe that litigation costs related to claims settlement could be lowered by at least 50% as a result of the new law. This can provide catastrophe bond investors with greater clarity on expected payouts and could also help alleviate concerns about trapped capital.

In a similar vein, the Louisiana legislature met in a special session to discuss adding US$45 million to the Insure Louisiana Incentive Fund (the "**Louisiana Program**") in the hopes of attracting more insurance capacity. The state is facing capacity constraints in its property insurance market. As part of the Louisiana Program, the legislature is considering matching grants to incentivize new and existing carriers to write residential and commercial policies in coastal areas. The Louisiana Program would award grants between US$2 million and US$10 million to each company that participates. At least 50% of the new policies supported by the Louisiana Program must come from southern Louisiana. Companies must also provide that coverage for at least a five-year period, and they will earn 20% of the grant in each of the five years. Certain carriers have already expressed interest in the Louisiana Program.

b. Singapore

To date, Singapore has supported 22 catastrophe bond issuances by cedants across the U.S. and Asia Pacific.

Speaking at the Singapore International Reinsurance Conference in November 2022, Alvin Tan, a board member of the Monetary Authority of Singapore (the "**MAS**"), expressed Singapore's continued focus on increasing the amount of reinsurance business undertaken in Singapore. To date, Singapore has supported 22 catastrophe bond issuances by cedants across the U.S. and Asia Pacific. The MAS plans to build out the regulatory environment necessary to support a growing range of ILS structures and transactions. The MAS is reportedly contemplating the introduction of sidecars and collateralized reinsurance arrangements, and associated regulatory, tax, and legal infrastructure changes.

c. Bermuda

Bermuda saw another strong year of new company registrations for catastrophe bond-, ILS-, and collateralized reinsurance-related vehicles in 2022, with catastrophe bond issuer formations leading the way.

Bermuda saw another strong year of new company registrations for catastrophe bond-, ILS-, and collateralized reinsurance-related vehicles in 2022, with catastrophe bond issuer formations leading the way. There were 24 new special purpose insurers registered in Bermuda in 2022. 2022 also saw two new Collateralized Insurer class of company structures registered in Bermuda. The first was Kettle Re Ltd., which was registered for Kettle, the reinsurance-focused deep-learning and artificial intelligence ("**AI**") insurtech. The second was insurtech Vesttoo's first underwriting structure in Bermuda, Vesttoo Alpha P&C Ltd. 2022 saw the highest number of new registrations since 2014. The increase in insurance and reinsurance company registrations in 2022 demonstrates the continued importance of Bermuda as a global hub for underwriting and risk capital management, while the ILS-related registrations reflect the island's market-leading role as an ILS domicile.

d. Hong Kong

The HKIA has said that it is working with mainland regulators and other relevant authorities on a number of market development initiatives to expand its insurance and reinsurance market.

In 2021, the Hong Kong Insurance Authority (the "**HKIA**") finalized its ILS regulatory regime, alongside the legislation necessary to establish special purpose insurance or reinsurance vehicles for securitizations and issuance of catastrophe bonds. The HKIA also approved a two-year pilot ILS grant scheme in 2022. With three catastrophe bond issuances so far, the HKIA is set to increase its effort in promoting its ILS framework and attracting more catastrophe bond or ILS issuances to Hong Kong. The HKIA has said that it is working with mainland regulators and other relevant authorities on a number of market development initiatives to expand its insurance and reinsurance market.

5. M&A Activity

M&A activity decreased in 2022 in the face of rising inflation and interest rates, and the threat of a recession. Credit Suisse Insurance Linked Strategies-supported reinsurance company Kelvin Re Limited ("**Kelvin Re**") was acquired by New York-headquartered financial services group Cowen. Kelvin Re suffered relatively significant losses through consecutive years of natural catastrophe events, and its investor at the time placed the company into run-off in 2020. Cowen already undertakes some insurance and reinsurance-related activities and has a reinsurance entity in Luxembourg, Cowen Reinsurance SA. International insurance group Howden Group Holdings announced the acquisition of reinsurance and risk capital adviser TigerRisk Partners. Howden now has a far more significant capital markets arm, with TigerRisk Capital Markets and Advisory, a leading player in ILS and increasingly active structurer and bookrunner for catastrophe bond deals. Howden noted that "the combination also enhances the credibility, relevance, scale and capability of Howden's full service offering across insurance, reinsurance, MGA and capital markets … [and] consolidates the Group's position as a global insurance intermediary creating a US$30 billion GWP business with an enterprise value of over US$13 billion, employing 12,000 people across 45 countries."[19] In October 2022, Berkshire Hathaway announced the completion of its acquisition of Alleghany Corporation in a US$11.6 billion transaction.

6. Outlook

The cyber ILS market is expected to gain traction in 2023, as demand for capacity continues to outstrip supply, while data and models become more sophisticated, according to CyberCube, a cyber modeling specialist. Many companies struggle to find the coverage they need for cyber risk at affordable rates. In early 2023, Beazley sponsored an issuance of approximately US$45 million of private cyber catastrophe bonds issued by the Artex SAC Limited vehicle using its Cairney segregated account, one of the first transactions of its kind. This transaction provides Beazley with one year of per occurrence indemnity reinsurance protection against all perils in excess of a US$300 million cyber catastrophe event. Coalition, a technology-focused cyber insurance company, announced the launch of a Class 3B Bermuda reinsurance company called Ferian Re Ltd., which will act as a sidecar-like source of capacity to support its cyber insurance programs. Hannover Re also has agreed to a proportional cyber reinsurance deal with Stone Ridge Asset Management, which will provide US$100 million in capital to cover the transfer of cyber risks to the capital markets. The convergence of cyber risk and the ILS market will continue to be an important topic in 2023 and years to come.

The cyber ILS market is expected to gain traction in 2023, as demand for capacity continues to outstrip supply, while data and models become more sophisticated …

Investor interest in institutional asset classes that are environmental, social, and governance ("**ESG**")-appropriate is set to increase rapidly, which is expected to help ESG assets under management around the world expand 84% to US$33.9 trillion by 2026, according to a new report from PwC. PwC highlights that 30% of investors are struggling to find attractive and adequate ESG investment opportunities. At the same time, ESG assets are on pace to account for roughly 21.5% of total global investment assets under management in less than five years. Another signal of accelerated future growth is that demand is currently outstripping supply, and investors cannot find enough ESG assets in which to invest. PwC Bermuda Asset and Wealth Management explained, "Our survey highlights a surge in demand for ESG funds that exceeds almost all previous expectations. Over the next two years, eight in 10 institutional investors plan to increase their allocations to ESG products. What's more, nearly nine in 10 have either already rejected or stopped investing with a specific asset manager (39%) or would consider doing so (50%) due to shortcomings in the manager's ESG investment strategies." We expect ESG to continue to become a more significant consideration for ILS sponsors and investors.

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We also expect that the use of alternative risk transfer mechanisms in the P&C market, including in the casualty, specialty, and legacy sectors, will continue to grow in the year ahead, and the insurance risk asset class as a whole will continue to attract new participants and new capital, despite the losses experienced in recent years. 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.

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B. PRA'S UPDATED RULES AND GUIDANCE ON THE UK'S ILS 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 PRA published the final version of an amended PRA Rulebook, including new rules to incorporate the ILS regime, as well as a Supervisory Statement[20] ("**SS8/17**") setting out its guidance on the new rules and regulations, and the FCA published its final statement on authorizing and supervising special purpose vehicles for ILS.

Since the regime has come into force, the UK regulators have approved a number of ILS structures. With the experience gained from this and informal feedback from the industry, the PRA has continued to review this framework, with a view to refining it further. The first of these refinements took place in 2020,

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19 *Howden acquires TigerRisk, expanding Reinsurance, Capital & Advisory Capabilities*, Artemis.bm (June 2022).

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

when the PRA released updated rules and guidance[21] [22] on the authorization and supervision of UK ILS vehicles and the rules around funding arrangements. In July 2022, the PRA released a new consultation paper ("**CP10/22**"),[23] which aimed to review the PRA's approach to authorizing and supervising the activities of insurance special purpose vehicles ("**ISPVs**") operating short-tail, wholesale, and general insurance structures. This follows the PRA's announcement in May 2022 that it would be operating a new "green channel" for these ISPVs, with a more streamlined approach to authorization. On December 16, 2022, the PRA published a Policy Statement ("**PS12/22**"),[24] which includes the updates it has made to SS8/17 following feedback it received on CP10/22.

1. Change to Legal Opinion for Non-English Law Governed Contracts

Under the previous version of SS8/17, ISPV applicants were expected to submit a legal opinion on the effectiveness and enforceability of any non-English law governed contracts. However, under the updated rules and guidance, the PRA has confirmed that this is no longer an expectation, but it still reserves the right to request a legal opinion on a case-by-case basis.

2. Clarification on Senior Management Function Holders Needed for an ISPV

ISPV applicants are required to seek approval for fit and proper individuals to carry out the following senior management functions ("**SMFs**"): (i) Chief Executive Officer (SMF1); (ii) Chief Finance Officer (SMF2); and (iii) Chair of the Board (SMF9). While it was possible under the previous version of SS8/17 for a single individual with the relevant skills and experience to be appointed to more than one of these roles, the PRA has since clarified under the updated version of SS8/17 the circumstances in which this is the case. For "standard" applications, the PRA has confirmed that a single individual may hold more than one SMF role and can in fact hold all three. However, for "complex" applications, the PRA considers that the three SMF roles may need to be held by different individuals, although this would always be assessed on a case-by-case basis. In addition, the PRA has set out some parameters relating to the appointment of a single individual to more than one SMF role, such that firms should have contingency plans in place in the event that this individual can no longer perform these roles.

3. Clarification on Approach to Multiple Cedants Ceding Risk to a Single Cell Via a Single Contract

Under SS8/17, a standalone ISPV may only take on a single contract for risk transfer from a single cedant. Therefore, it cannot take on a contract for risk transfer from multiple cedants; nor can it take on more than one contract for risk transfer from a single cedant. However, the PRA has recognized that by only allowing one insurance entity to cede to a single cell under a single contract, it may be preventing insurance groups from entering into certain transactions (such as group aggregate covers). Accordingly, the PRA has updated the guidance in SS8/17 to permit multiple cedants in limited circumstances to cede risk through a single cell under a single contract. In order for the PRA to consider approving such an arrangement, all of the following criteria must be met:

- The cedants must be part of the same insurance group or be Lloyd's syndicates managed by the same managing agent and with shared economic interests (syndicates managed on a "turnkey basis" by a managing agent would not be considered to have a shared economic interest with the other syndicates managed by that same managing agent);
- The cedants transfer risk via the same contract to an ISPV (or cell of an MISPV). They should have aligned economic interests such that no cedant has preferential terms over another (in particular with respect to receipt of claims), and the contractual arrangements should make clear

21 See PS13/20 *Insurance Special Purpose Vehicles: Updates to authorsation and supervision* and the May 2020 version of SS8/17.

22 Please see our 2021 *Sidley Global Insurance Review* article on *The Prudential Regulation Authority's Updated Rules and Guidance on the UK's Insurance-Linked Securities Regime* for more detail on the updates to the rules and guidance.

23 Consultation Paper CP 10/22 *Insurance Special Purpose Vehicles: Further updates to authorization and supervision.*

24 PS 12/22 *Insurance special purpose vehicles: Further updates to authorization and supervision.*

how claims would be apportioned between different cedants, including if there are sub-limits per cedant in a contract. The contractual arrangements must not allow for the claims of any one cedant to be subordinated to that of another;

- The risks being transferred are short-tail, wholesale, and general insurance in nature;
- Applicants must show that the inclusion of multiple cedants within the proposed structure does not undermine effective risk transfer, subordination of investor rights to all ceding parties, or the fully-funded requirements; and
- The ISPV (or cell of an MISPV) must ensure that all the cedants remain part of the same insurance group. If there are any group composition changes over the duration of the transaction which result in the removal or addition of a cedant, the PRA expects to be informed ahead of this change being made.

4. Clarification on the Interpretation of "Quantifiable Risk"

When assessing the solvency of an ISPV, the PRA is required to take into consideration the quantifiable risks of that special purpose vehicle. With respect to "standard" applications, the PRA has clarified that, at a minimum, it expects applicants to consider at least insurance risks, market risks, operational risks, and asset risks that may exist in the ISPV.

5. Clarification on the Requirement for Written Policies for "Standard" Applications

ISPVs are required to have policies in place relating to their systems of governance.[25] However, the PRA has confirmed that it does not expect firms to submit, as a matter of course, the full suite of written policies that are in place. It will instead expect firms to provide a list of such policies. However, the PRA does maintain its discretion to request to see the full suite of written policies (or a summary of those) on a case-by-case basis.

6. UK ILS Outlook

Although the UK government is committed to making the UK ILS regime a more attractive market, this has not as yet led to a significant increase in the volume of new UK-based ILS transactions.

That being said, there were some notable ILS transactions in 2022. Following the success of its initial February 2019 terrorism risk catastrophe bond, Pool Reinsurance Company completed placement in March 2022 of its second ILS catastrophe bond through its UK-domiciled special purpose vehicle Baltic PCC Ltd. In addition, Lloyd's announced in August 2022 that it has received regulatory approval for its second MISPV, London Bridge Risk 2 PCC Ltd. ("**London Bridge Risk 2**"). Following feedback from market participants and investors on the usefulness of the original platform for deploying capital into the Lloyd's market, London Bridge Risk 2 has been structured to allow for a broader range of investment models and reinsurance structures.

It remains to be seen whether the steps taken by the UK government and regulators to increase the competitiveness of the UK ILS market will increase interest in the UK as an ILS jurisdiction over the medium term. It was noted by the PRA in PS12/22 that, although not within the scope of CP10/22, respondents to the consultation specifically made suggestions on further areas of potential reform that might be required to increase UK ILS transaction volumes. These included the requirement to be fully funded, authorization timelines, application form changes, and taxation. The PRA indicated that it may consider these suggestions as part of any future policy-making process. As the UK has withdrawn from the EU, there is now scope for the UK government to increase the ILS regime's competitiveness by legislating away from some of the requirements under Solvency II for ISPVs, in particular that such vehicles should remain fully funded at all times. Changes in this respect would bring the UK more into line with other key ILS markets.

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25 Article 324 (2) (a) of the Delegated Regulation.

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. There have continued to be high levels of transactional activity in both areas, driven by the favorable position of many pension schemes, the development of alternative de-risking options, and many Europe-based life insurance groups looking to hedge longevity exposure in light of the additional regulatory capital required under Solvency II in respect of annuity business. This, coupled with the continuing demand from defined benefit pension schemes, has led to the development of an active secondary market for longevity risk in which reinsurers have been the principal participants, often through intermediated deals where established insurers front with pension schemes or via special purposes segregated or protected cell companies.

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. Buy-Outs

A pension buy-out 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 buy-out, there is a direct insurance contract between the insurer and the individual scheme member; and in the event of a full buy-out, 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 buy-out option is accordingly the ultimate form of pension scheme de-risking.

2. Buy-Ins

Pension buy-in solutions were develop ed as a de-risking option for pension schemes that were unable to afford the often prohibitive costs of a full buy-out. 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 buy-outs 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 buy-outs, albeit more complex to structure and negotiate. Longevity swaps almost invariably require the two-way posting of collateral to protect against

There have continued to be high levels of transactional activity driven by the favorable position of many pension schemes, the development of alternative de-risking options, and many Europe-based life insurance groups looking to hedge longevity exposure in light of the additional regulatory capital required under Solvency II in respect of annuity business.

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Industry commentary on the UK de-risking market indicates that in 2022 there were over £40 billion of bulk annuity and longevity transactions executed.

… deal activity with respect to longevity swap transactions remained strong throughout 2022, with total publicly announced UK deal volumes reaching approximately £17 billion.

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.

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.

B. U.S. MARKET

Consistent with recent years, the pension de-risking market in the U.S. continued to experience significant growth in 2022. While there were a number of large transactions, there was a record breaking number of single premium buy-out sales, suggesting interest from a wide variety of plan sponsors. In 2022, there was a total of 562 buy-out contracts, toppling a record previously set in 2019. According to LIMRA Secure Retirement Institute ("**LIMRA**"), single premium buy-out sales totaled US$48.3 billion in 2022, up 42% from 2021, led by remarkably strong third-quarter sales. However, during the same time, single premium buy-in sales fell to US$3.6 billion, which is nearly a 9% decrease compared to sales made in 2021.

Sales for the full calendar year of 2022 were approximately US$51.9 billion, up significantly for the same period in 2021, and include the following transactions:[26]

- In February 2022, Pactiv LLC entered into a deal pursuant to which it transferred approximately US$1.3 billion in pension obligations affecting approximately 13,000 retirees.
- In June 2022, Lockheed Martin Corp., a defense company, transferred approximately US$4.3 billion in pension obligations affecting approximately 13,600 retirees.
- In September 2022, International Business Machines Corp. announced it had entered into a deal to transfer approximately US$16 billion in pension obligations affecting 100,000 retirees.

Given the continued growth of the market, many new participants continue to enter the market or are seeking entry into the market as direct insurers or as reinsurers of direct writers. Several factors contributed to the increased activity in 2022. There were a number of large transactions driving the record numbers. In addition to those mentioned above, eight other transactions near or over US$1 billion took place throughout the year. Further, such transactions have been seen as an opportune way to transfer asset risk, given recent market volatility. Higher interest rates improved plan funding status, allowing employers to mitigate their risk. According to LIMRA, in 2023 strong performance in this space is expected to continue, as a number of transactions close to or over US$1 billion are already set to take place.

C. UK/EUROPEAN MARKETS

1. Market Overview

Industry commentary on the UK de-risking market indicates that in 2022 there were over £40 billion of bulk annuity and longevity transactions executed. In the bulk annuity market, the first half of 2022 was largely dominated by small- and medium-sized transactions. However, following the significant increase in gilt yields in September 2022, which resulted in the value of transferred liabilities being significantly lower than previously anticipated, there was a trend towards full scheme buy-ins/buy-outs towards the end of the year.

Meanwhile, deal activity with respect to longevity swap transactions remained strong throughout 2022, with total publicly announced UK deal volumes reaching approximately £17 billion. This has been driven in part by the reduction in cost of reinsuring longevity risk. Factors that have contributed to this

26 *Special edition - US and UK PRT market overview*, Legal & General Retirement America, Pension Risk Transfer Monitor (February 2023), https://www.lgra.com/knowledge-center/prt-monitors. Statistics and data with respect to the performance of the pension risk transfer market in 2022 in this paragraph are from market data collected, and projections made, by Legal & General Retirement America.

include increased allocations to illiquid assets in insurers' investment strategies, reinsurers increasing their capacity for deferred longevity reinsurance, new entrants into the market resulting in a downward pressure on prices, and the rise in gilt yields during the latter part of 2022.

It is anticipated that the trend towards full scheme buy-ins/buy-outs will continue and be the dominant type of bulk annuity transaction over the course of 2023, given the improvement in buy-in/buy-out funding levels over the course of 2022. However, it is also thought that some of the larger pension plans will look to use longevity swaps in 2023, rather than a buy-in, as such plans are now having to hold higher collateral levels to protect against future gilt yield rises following the volatility in 2022.

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One of the larger publicly announced transactions in the bulk annuities market in 2022 was the £2.3 billion partial buy-in between British Steel Pension Scheme and Legal & General ("**L&G**"). This covered 25% of the total scheme liabilities and follows a previous buy-in with L&G in 2021, covering 5% of the total scheme liabilities. Since then, British Steel Pension Scheme and L&G have entered into a further £2 billion buy-in in January 2023, bringing the total liabilities insured to 60%. Another significant bulk annuity deal in 2022 involved the Trustee of Electronic Data Systems 1994 Pension Scheme entering into a £1.1 billion buy-in with Pension Insurance Corporation to fully insure the scheme's pension liabilities, which includes 3,000 pensioners and 2,300 deferred pensioners. The full scheme buy-in has been entered into on the premise of a full buy-out of the scheme in due course.

There were a number of significant intermediated longevity transactions in 2022, including the longevity swap and reinsurance arrangement entered into between Scottish Widows and SCOR in respect of approximately £5.5 billion of longevity risk for one of Lloyds Banking Group's pension schemes. Under the transaction, SCOR assumed the full £5.5 billion longevity exposure, with Scottish Widows acting as fronting insurer. SCOR also entered into a £1.7 billion longevity swap and reinsurance arrangement with Zurich with respect to 15,000 members of the Defined Benefit section of the Balfour Beatty Pension Fund. Zurich also acted as the fronting insurer on a further £500 million in-force longevity swap arrangement with Canada Life Re, covering longevity risks associated with the UBS (UK) Pension and Life Assurance Scheme. This expands the protection to £1.9 billion (from £1.4 billion under the original transaction in 2020), and includes some liabilities related to deferred members, which were not covered under the original transaction.

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2. The PRA's View on the UK Longevity Market

In September 2022, Charlotte Gerken, Executive Director of Insurance Supervision at the PRA, spoke at the Bank of America 27th Annual Financial CEO Conference about trends in the UK longevity market, and both the benefits and regulatory risks that these trends pose. In short, the PRA has identified two key trends in the UK life insurance sector: (i) relating to reinsurance (split into: (a) the continued high level of longevity reinsurance, and (b) the emergence of so-called "funded reinsurance"); and (ii) the continued growth of untraded or illiquid assets in life insurers' investment portfolios. The PRA stated that while both of these trends can lead to improved pricing for customers, which increases competitiveness and the overall growth of the UK market, they can also pose increasing concentration risks at both an individual firm and market level.

The PRA's main concern with the continued high use of longevity reinsurance and the emergence of "funded reinsurance" is the risks posed by a recapture event, which would require the insurer to reassume the transferred risk. In order to do this, the insurer would need to take back control of collateral assets and have sufficient capital to reassume the risk. This may be particularly challenging for an insurer in the "funded reinsurance" context, given that these structures usually require the insurer to pay a large (usually one-off) premium payment at the outset, meaning the amount of capital required to reassume the risks could be significant. While insurers might argue that they can simply reinsure with another reinsurer, should a recapture event occur, the PRA notes that the longevity reinsurance market is dominated by a small pool of counterparties, meaning that the ability to do this may be unrealistic. In addition, many of these reinsurers are based outside the UK and therefore held to differing regulatory standards, making it more challenging for the PRA to effectively monitor these structures to ensure policyholder protection.

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With respect to the trend towards investment in private credit or illiquid assets, the PRA notes that although there are positives to this strategy (as they often provide attractive returns and the long-term nature of many of these assets is a good duration match for annuity insurers), they do pose model concentration risks. First, given the novel nature of these types of assets, it is hard to identify all risks

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associated with them, meaning that there is sometimes a tendency to over-value such assets on the balance sheet. This valuation uncertainty could pose a potentially material source of model concentration risk for firms. Second, private assets are not publicly rated, meaning that such assets are often internally rated by firms, leading to rating uncertainty. This is relevant to annuity insurers as it has an impact on their matching adjustment portfolio, which is an important regulatory benefit for them that allows future investment profits to be booked upfront, thereby increasing a firm's capital resources. As, under the current rules, an asset's rating is the only measure of risk used to determine the matching adjustment, the reliance on rating to capture all risks associated with a specific asset poses another form of model concentration risk for firms.

In terms of supervisory expectations in relation to these risks, it is clear that the PRA expects senior management at firms to be using the Prudent Person Principle ("**PPP**") to assess and understand the risks that they face and their resilience to them. The PRA considers the PPP to be a powerful tool that firms and regulators can use to help mitigate concentration risks, as it can accommodate a range of investment strategies, risk management practices, business models, and types of risk concentration. As the market continues to evolve and new types of concentration risk emerge, the PRA will be looking for evidence that firms are adequately implementing the PPP, and that in doing so they are utilizing more than just quantitative techniques to evaluate strengths and weaknesses in their strategies; qualitative considerations should also be taken into account. The PRA will also be reviewing insurers' assessment of counterparty exposures as part of its Life Insurance Stress Test exercise.

Separately, the PRA acknowledges that in order to enhance its own understanding of the risks posed by these trends and the best way to address them, it will need to engage with insurers and other stakeholders, such as international regulators (particularly as many of the reinsurance counterparties in this space are based outside of the UK). The PRA will consider whether there is a need to tighten controls on recognition of reinsurance structures and volumes to mitigate any risks to policyholders. That being said, with the correct controls in place to manage counterparty concentration and recapture risk, the PRA believes that reinsurance can continue to play an important role in providing diversification to the UK life insurance market.

IV. Select Tax Issues Affecting Insurance Companies and Products

A. U.S. TAX ISSUES

1. Guidance Needed on Issues Specific to Insurance Industry Under New Corporate Alternative Minimum Tax

The passage of the Inflation Reduction Act of 2022 (Public Law No: 117-169) (the "**IRA**") on August 16, 2022 was arguably the most significant U.S. federal income tax development over the past year. Among other notable aspects, the IRA includes a new 1% excise tax on repurchases of corporate stock, provisions governing tax credits for clean energy investments, and a new 15% alternative minimum tax on the "adjusted financial statement income" ("**AFSI**") of certain large corporations (commonly referred to as the "book minimum tax" or "corporate alternative minimum tax") ("**CAMT**").

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On September 27, 2022, the American Council of Life Insurers ("**ACLI**") sent a comment letter to the U.S. Internal Revenue Service ("**IRS**") and the U.S. Department of the Treasury ("**Treasury Department**") that identified several areas where guidance on the CAMT is particularly needed for insurance companies (the "**ACLI Letter**"). On December 27, 2022, the IRS and Treasury Department issued interim guidance as part of Notice 2023-7 addressing various topics of general applicability under the CAMT, but that was generally reserved on issues affecting the insurance industry. CAMT guidance specific to the insurance industry was then issued by the IRS and Treasury Department on February 17, 2023 as part of Notice 2023-7 (the "**Notice**"). The Notice addresses some, but not all, of the topics identified in the ACLI Letter.

The CAMT is briefly described below, followed by a summary of certain issues addressed in the Notice and an overview of several industry-specific issues that remain open.

a. Overview of the New CAMT

For taxable years beginning after December 31, 2022, the CAMT imposes a 15% alternative minimum tax on "applicable corporations" based on their AFSI. In general, an "applicable corporation" is a corporation with average AFSI that exceeds US$1 billion over a three-year testing period. A corporation's AFSI is aggregated with the AFSI of all persons treated as a single employer under certain provisions of the Internal Revenue Code of 1986, as amended (the "**Code**"), for purposes of determining whether such corporation is an applicable corporation. A corporation that is a member of a foreign-parented multinational group is generally considered to be an applicable corporation if (i) the three-year average AFSI of the group exceeds US$1 billion and (ii) the three-year average AFSI of the U.S. members exceeds US$100 million.

For taxable years beginning after December 31, 2022, the CAMT imposes a 15% alternative minimum tax on "applicable corporations" based on their AFSI.

Notably, AFSI is determined by reference to the net income or loss of the corporation as reported for financial accounting purposes and after making certain adjustments required under the Code. The net income or loss reported on the corporation's "applicable financial statement" ("**AFS**") is the starting point for this inquiry. The AFS for many insurance companies will be their financial statements prepared in accordance with Generally Accepted Accounting Principles ("**GAAP**"). If an insurance company does not prepare its financial statements in accordance with GAAP, then it may be required to refer to its financial statements prepared in accordance with International Financial Reporting Standards ("**IFRS**") or its financial statements prepared in accordance with statutory accounting principles ("**SAP**") prescribed by the NAIC.

b. Industry Issues Addressed in the Notice

The IRS and Treasury Department directly responded to requests for guidance on certain points regarding (i) the determination of AFSI in the case of reinsurance structured on a coinsurance funds withheld basis ("**FWH**") or a modified coinsurance basis ("**Modco**"), and (ii) the impact of separate account investments on the determination of AFSI.

"Embedded Derivatives" in FWH and Modco Reinsurance Transactions

The ACLI Letter noted that guidance is needed to avoid distortions in the calculation of AFSI attributable to GAAP insurance accounting for reinsurance transactions structured on a FWH or Modco basis. As explained by the ACLI, the need for guidance stems from the capital geography specific to reinsurance, pursuant to which items that offset or are not typically included in reported earnings for GAAP purposes happen to run through different lines for accounting purposes, raising the risk that items that economically offset nonetheless produce material differences in AFSI.

First, under GAAP, net income is generally a company's operating income as reported on the income statement and used for purposes of reporting earnings per share. Net income is distinct from "other comprehensive income" ("**OCI**") which includes, among other items, unrealized gains or losses, and is reported as a component of change in owners' equity. The legislative history of the IRA indicates that OCI was not intended to be a component of AFSI.

Second, GAAP accounting rules differ depending on whether the reinsurance is structured on a pure coinsurance basis, on the one hand, or a FWH or Modco basis, on the other hand. In a pure coinsurance transaction, the ceding company transfers a quota share of reserves and assets supporting the reserves to the reinsurer. GAAP generally permits the reinsurer to account for subsequent fluctuations in asset values as part of the reinsurer's OCI.

In FWH and Modco transactions, however, the ceding company retains the assets supporting the reserves. Under GAAP, the ceding company accounts for the unrealized gains or losses attributable to the assets as part of its OCI. The ceding company also establishes a liability (a FWH- or Modco-payable due to the reinsurer) that is marked to market but accounted for as part of the ceding company's net income. The reinsurer then recognizes corresponding items of gain or loss as net income, as the receivable due from the ceding company fluctuates. On an overall basis under GAAP, these two will tend to offset within each party's financial statements: although one adjustment goes through OCI and another goes through net income, they offset.[27] But for purposes of the CAMT, the difference in geography produces a distortion: the asset and liability changes do not offset because the gains flow through OCI, which is excluded from AFSI.

In the Notice, the IRS and Treasury Department issued interim guidance which (i) generally confirms that changes in net income attributable to unrealized gains or losses included in the ceding company's OCI should not be included for purposes of determining AFSI and (ii) provides that changes in net income on the AFS attributable to the change in the amount payable to the reinsurer are not included in AFSI, to the extent that the corresponding change in asset value is also not included in AFSI (i.e., the treatment of the two match). A corresponding rule is provided for reinsurers. The Notice provides exceptions, however, if the reinsurer retrocedes the reinsured risk (thereby reducing the FWH- or Modco-receivable on its AFS), or if the ceding company or the reinsurer makes a fair value election for the FWH or Modco treaty (thereby causing the offsetting items both to run through either AFSI or OCI). In these circumstances, AFSI would not exclude changes in net income attributable to unrealized gains or losses, at least in part.

Separate Account Products and the Determination of AFSI

The ACLI Letter identified a potentially significant distortion between the GAAP accounting for separate account products and the determination of AFSI for CAMT purposes.

The ACLI Letter identified a potentially significant distortion between the GAAP accounting for separate account products and the determination of AFSI for CAMT purposes. As the ACLI observed, GAAP requires unrealized gains and losses attributable to separate account products (e.g., variable annuities or variable life insurance contracts) to be marked to market, with a corresponding adjustment to reserves that ensures no net effect on GAAP net income. Similar adjustments are made for U.S. federal income tax purposes to ensure no life insurance company taxable income is realized due to asset valuation and related reserve changes. See Code § 817(a).

The determination of AFSI, however, does not incorporate such principles with respect to entities that do not consolidate for U.S. federal income tax purposes. For example, AFSI only takes into account dividends and other amounts includible in gross income or deductible as a loss under U.S. federal income tax principles with respect to a corporation that does not join in the filing of a consolidated return with the taxpayer. See Code § 56A(c)(2)(C). AFSI is determined in a similar manner with respect

27 The ACLI Letter notes that the payable on the books of the ceding company and the receivable on the books of the reinsurer are commonly referred to as the "embedded derivative" for FWH and Modco treaties. The ACLI Letter notes that management teams tend to exclude the effects of this embedded derivative in communications to shareholders about adjusted operating income, as the embedded derivative is not typically considered to be an accurate demonstration of the company's true operating income. Thus, for the ceding company, neither the asset nor liability side of the transaction affect overall GAAP results or earnings reflected in net income.

to a partnership interest held by the taxpayer. See Code § 56A(c)(2)(D). Accordingly, if a life insurance company separate account holds a share of corporate stock or an investment in a fund classified as a partnership for U.S. federal income tax purposes, AFSI would exclude the unrealized gains or losses attributable to such investments, possibly without a corresponding adjustment for the offsetting effect on reserves, thereby resulting in a difference between AFSI, on the one hand, and GAAP net income or life insurance company taxable income, on the other hand. Similar issues can arise from closed block arrangements and foreign contracts.

In the Notice, the IRS and Treasury Department attempt to prevent this distortion by requiring that a change in separate account liabilities be disregarded to the extent such change is attributable to items that are excluded from AFSI. For example, if a separate account holds a share of corporate stock that appreciates by $10, thereby resulting in a $10 increase in policyholder liabilities, but this unrealized appreciation is excluded from AFSI because the unrealized appreciation is not a dividend and not includible in gross income, then the $10 increase in policyholder liabilities is also excluded to the same extent. This approach is expected to maintain parity among AFSI, GAAP net income, and life insurance company taxable income with respect to separate account products.

In the Notice, the IRS and Treasury Department attempt to prevent this distortion by requiring that a change in separate account liabilities be disregarded to the extent such change is attributable to items that are excluded from AFSI.

c. Industry Issues Requiring Further Guidance

Several issues identified by the ACLI as requiring further guidance under the new CAMT are not addressed in the Notice. The following is a non-exhaustive list of such issues.

Different Consolidation Regimes for Accounting and Tax Purposes

The ACLI noted that GAAP, IFRS, and SAP diverge from U.S. federal income tax principles governing life-nonlife consolidated groups. Generally, life and nonlife insurance companies must be affiliated for at least five taxable years before they can consolidate for U.S. federal income tax purposes. See Code § 1504(c)(2). The U.S. consolidated return rules also require the application of elaborate subgroup methods for purposes of determining consolidated taxable income of a life-nonlife consolidated group. See Treas. Reg. § 1.1502-47(a)(2). Because GAAP, IFRS, and SAP do not incorporate similar principles, the ACLI anticipates there will be differences between AFSI and consolidated taxable income. The ACLI has identified a need for guidance reconciling the differences between the accounting and tax rules for consolidated groups that include insurance companies.

Loss Carryovers and Carrybacks

The ACLI has identified material differences in the treatment of loss carryovers and carrybacks for CAMT purposes as compared to the treatment of similar items for insurance companies under U.S. federal income tax principles. Generally, AFSI is reduced by the lesser of (i) "financial statement net operating loss carryovers" (i.e., the amount of net loss, if any, set forth on the corporation's AFS for taxable years ending after December 31, 2019) or (ii) 80% of AFSI computed without regard to financial statement net operating loss carryovers. See Code § 56A(d). No carryback of financial statement net operating losses is permitted.

U.S. federal income tax principles, by contrast, generally permit capital losses to be carried back three taxable years. See Code § 1212(a)(1). The ability to carry back capital losses is particularly valuable to life insurance companies because investment activities are core to their business model, and the ACLI has observed that the absence of a similar ability to carry back financial statement net operating losses is expected to affect life insurance companies disproportionately.

Similarly, nonlife companies are permitted to carry back net operating losses two taxable years under U.S. federal income tax principles, but an analogous carry back mechanism is not provided for purposes of determining AFSI. The ACLI has raised concerns that the different loss carryback rules for CAMT and U.S. federal income tax purposes are expected to create distortions that lack an economic justification.

Finally, the ACLI has identified a need for guidance on how losses should be carried back or forward withing a subgroup, or across subgroups, for purposes of determining AFSI in the case of a life-nonlife consolidated group.

M&A activity for insurance companies often takes the form of a reinsurance transaction or a reinsurance transaction that is part of a broader sale or acquisition of a line of business. The ACLI notes that it would be helpful to have guidance on how significant, one-time increases in accounting net income resulting from such transactions should factor into the determination of AFSI during the three-year testing period.

Impact of Reinsurance Activity on the Determination of AFSI

M&A activity for insurance companies often takes the form of a reinsurance transaction or a reinsurance transaction that is part of a broader sale or acquisition of a line of business. The ACLI notes that it would be helpful to have guidance on how significant, one-time increases in accounting net income resulting from such transactions should factor into the determination of AFSI during the three-year testing period.

d. Future Guidance

Although the IRS and Treasury Department addressed several important issues affecting the insurance industry as part of the Notice, a number of significant issues require further guidance. Over the course of 2023, industry members and members of the legal community are expected to continue monitoring the publication of any such guidance, as well as the publication of any proposed regulations on the CAMT.

2. Insurance Industry Reacts to Proposed Regulations on the Determination and Inclusion of RPII

As noted in the 2022 *Sidley Global Insurance Review*, the Treasury Department published proposed regulations ("**Proposed Regulations**") on January 24, 2022 regarding the determination and inclusion of related person insurance income ("**RPII**") under the subpart F regime of the Code. The Proposed Regulations have prompted numerous comments from industry members in the intervening period. Of note, commentators have focused on an aspect of the Proposed Regulations' "related insured" concept that is widely considered to be unsupported by the text of the statute and an expansion of Congress's intent to address captive insurance arrangements.

Subpart F of the Code is an anti-deferral regime that generally applies to income earned by foreign corporations that are considered to be controlled by 10%-or-greater U.S. shareholders ("**CFCs**"). The subpart F rules require such U.S. shareholders to include in gross income (as ordinary income) their pro rata share of the CFC's "subpart F income," which includes "insurance income" that (i) is attributable to issuing or reinsuring insurance or annuity contracts and (ii) would be taxed under subchapter L of the Code if the income were earned by a domestic insurance company.

More stringent rules apply in the case of RPII. RPII is any insurance income attributable to a policy of insurance or reinsurance that directly or indirectly insures a U.S. shareholder of the CFC or a person "related" to such U.S. shareholder. For purposes of taking RPII into account, a U.S. shareholder is a U.S. person that owns any shares of the foreign corporation's stock (a "**RPII U.S. shareholder**"), and RPII inclusions may be required if RPII U.S. shareholders own (directly, indirectly, or constructively) 25% or more of the foreign corporation's stock by vote or value (a foreign corporation meeting such test, a "**RPII CFC**").

The definition of "related person" under the Code provides that a person is related with respect to another person if such person controls or is controlled by the other person, or the two persons are under common control by the same person or persons. For this purpose, "control" means ownership of more than 50% of the vote or value of stock or other ownership interests. Accordingly, for purposes of RPII, the Code considers a person to be related to a RPII U.S. shareholder if that person controls or is controlled by the RPII U.S. shareholder, or if the person and the RPII U.S. shareholder are under common control.

The Proposed Regulations, however, introduce a category of "related insured" that has generated much attention from industry members. Under the Proposed Regulations, a "related insured" with respect to a RPII CFC includes a person (other than a publicly traded corporation or publicly traded partnership) that is more than 50% owned by RPII U.S. shareholders of the RPII CFC. A fact pattern that would be covered by this category of "related insured" includes affiliate reinsurance between non-publicly traded subsidiaries of a publicly traded parent that is more than 50% owned by RPII U.S. shareholders. RPII inclusions may result in this scenario even though no individual RPII U.S. shareholder has control over the publicly traded parent and the U.S. ownership is dispersed.

The preamble to the 2022 Proposed Regulations explains that the new "related insured" concept is intended to prevent the avoidance of RPII when the insured is held by multiple RPII U.S. shareholders (or their affiliates), and is issued pursuant to the authority granted under section 953(c)(8)(A) of the Code. That Code section authorizes the Treasury Department to "prescribe such regulations as may be necessary to carry out the purposes of [the RPII rules], including regulations preventing the avoidance of [the RPII rules] through cross insurance arrangements or otherwise" (emphasis added). Nonetheless, industry members have noted that this category of "related insured" does not have a textual basis under the Code and is a departure from prior proposed regulations on RPII that were promulgated in 1991.

Commentators have also pointed out that the new category of "related insured" is a departure from Congress's original goal of limiting unintended tax advantages enjoyed by U.S. taxpayers that owned foreign captive insurance companies. These captive arrangements typically provided insurance coverage to their owners and related persons. In contrast, the new category of "related insured" would apply to corporate groups that (i) are broadly held by U.S. persons, (ii) provide insurance and reinsurance coverage to third parties, and (iii) enter into routine affiliate reinsurance transactions for risk management and capital efficiency purposes.

Commentators have also pointed out that the new category of "related insured" is a departure from Congress's original goal of limiting unintended tax advantages enjoyed by U.S. taxpayers that owned foreign captive insurance companies.

Finally, because there is no minimum ownership threshold for RPII inclusions, industry members have raised concerns that RPII U.S. shareholders who own a *de minimis* interest in a RPII CFC will be s urprised to learn that they have RPII inclusions and may well be unprepared to satisfy the resulting reporting obligations.

The Proposed Regulations remain in proposed form as of this writing, and will generally become effective for taxable years of foreign corporations beginning on or after the date final regulations are published. In the meantime, industry stakeholders will continue to monitor the Treasury Department's response to the comments submitted on the new "related insured" concept. Public insurance companies are also expected to continue disclosing the risks that the Proposed Regulations pose to their U.S. investors from a RPII perspective.

The Proposed Regulations remain in proposed form as of this writing, and will generally become effective for taxable years of foreign corporations beginning on or after the date final regulations are published.

3. Senator Wyden Launches Investigation into Private Placement Life Insurance

During the second half of 2022, Senate Finance Committee Chair Ron Wyden (Democrat-Oregon) launched an investigation into a product commonly known as "private placement life insurance" ("**PPLI**"). As part of his investigation, Senator Wyden sent letters to three providers of PPLI and the ACLI asking for information about the value of assets administered with respect to PPLI products, how PPLI products are invested, and how PPLI products are marketed, among other topics. Senator Wyden has expressed concern about the perception that PPLI products are only marketed to the wealthiest taxpayers and provide a mechanism for circumventing the income and estate tax. No enforcement actions have been publicly announced since Senator Wyden opened his investigation. Industry members are expected to closely monitor developments in Senator Wyden's investigation.

B. UK/EU TAX DEVELOPMENTS

1. EU Blacklist and Substance Requirements

On December 5, 2017, the EU published its list of non-cooperative tax jurisdictions ("**EU Blacklist**") directed at counteracting the effects of preferential tax regimes around the world. There have been subsequent modifications to the EU Blacklist, which is updated twice a year, most recently on October 4, 2022, such that the current list includes only American Samoa, Anguilla, the Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, 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 (i) improve transparency, (ii) improve fair taxation, (iii) improve substance requirements, and/or (iv) apply certain Organisation for Economic Co-operation and Development ("**OECD**") BEPS minimum standards. Similarly to the EU Blacklist, the greylist was most recently modified on October 4, 2022, such that it now includes 22 jurisdictions.

Of note to the insurance industry, Bermuda committed to improving 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 5, 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. Of course, there is no guarantee that jurisdictions which have been removed from the EU Blacklist or the greylist may not be reinstated in the future as tax laws and practices develop.

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," has 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. Most member states have now implemented at least one defensive tax measure against blacklisted jurisdictions.

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.

2. The EU Anti-Tax Avoidance Directives

EU member states have now largely implemented the measures prescribed by ATAD and ATAD 2.

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 (i) 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 (ii) 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 have now largely implemented the measures prescribed by ATAD and ATAD 2.

In addition, on December 22, 2021, the EU published a proposal for a new Anti-Tax Avoidance Directive ("**ATAD 3**") which, in its current form, is designed to impose new minimum substance rules to prevent the misuse of shell entities for improper tax purposes. ATAD 3 proposes to introduce additional reporting requirements for certain EU tax resident companies that have inadequate economic substance (as prescribed under ATAD 3). EU entities that, among other things, outsource the administration of their day-to-day operations and decision-making on significant functions ("**Outsourcing Condition**") and receive mobile and/or passive income, such as interest, dividends, and royalty income, may be caught by these rules. It is currently planned that implementation will be required by EU member states by June 30, 2023; however, the European Parliament's Committee on Economic and Monetary Affairs ("**ECON**") published a number of proposed draft amendments to ATAD 3 in September 2022, which included extending the implementation date to June 30, 2024. ECON also suggested limiting the application of the Outsourcing Condition to outsourcing arrangements with third parties. It is yet to be seen whether ECON's proposed amendments will be adopted.

The UK had already (prior to Brexit) implemented a number of tax regimes that rendered the UK tax system broadly compliant with the requirements of ATAD 1 and ATAD 2.

The UK had already (prior to Brexit) implemented a number of tax regimes that rendered the UK tax system broadly compliant with the requirements of ATAD 1 and ATAD 2. The UK will not, however, be bound to implement ATAD 3, and no proposals have currently been put forward for a similar regime in the UK. It is, however, possible that the EU will in the future look to introduce additional rules (alongside ATAD 3) to impose certain sanctions (such as withholding or equivalent taxes) on payments to entities based in non-EU member states, such as the UK and Bermuda, where such entities do not maintain minimum substance which is broadly consistent with the requirements of ATAD 3 (in whatever final form ATAD 3 takes).

3. UK's Implementation of the OECD's Pillar Two Proposal

The UK government has confirmed it will also introduce a UTPR; however, it is expected that this will be at a later date, once other jurisdictions have progressed with the implementation of Pillar Two.

In January 2022, the UK government's HM Revenue and Customs ("**HMRC**") published a consultation paper ("**Consultation Paper**") on the UK's implementation of the OECD's "Pillar Two" proposal, which set out global minimum tax rules designed to ensure that large multinational businesses pay a minimum effective rate of tax of 15% in each jurisdiction they operate in. This is intended to be achieved through the introduction of two new taxes, the Income Inclusion Rule ("**IIR**") and the Undertaxed Profits Rule ("**UTPR**"), which impose a "top-up" tax when profits are taxed below the effective tax rate of 15%. In July 2022, HMRC published draft legislation on the IIR under which a parent entity would be liable for a "top-up" tax in the UK if a subsidiary's effective tax rate in any jurisdiction is below 15%. In its current form, the legislation would apply to multinational enterprises with global revenues exceeding €750 million in at least two of the previous four years. The UK government has confirmed it will also introduce a UTPR; however, it is expected that this will be at a later date, once other jurisdictions have progressed with the implementation of Pillar Two.

Respondents (in particular from the insurance sector) have raised a number of technical issues in response to the Consultation Paper, including in relation to the calculation of the effective tax rate and the "top-up" tax.[28] Following the closing of the Consultation Paper, further refinements to the IIR draft legislation are anticipated.

4. The UK's Qualifying Asset Holding Company Regime

The UK's Qualifying Asset Holding Company regime came into effect on April 1, 2022, and offers a range of tax exemptions and simplifications to UK tax resident asset holding companies (an "**AHC**") which meet the criteria to elect into the regime.

Under the regime, a UK tax resident AHC will benefit from the following special tax treatment:

- Exemption from certain rules which would otherwise disallow tax deductions for results-dependent interest payments (on, for example, profit-participating loans).
- Exemption from corporation tax on gains arising on the disposal of a broader class of underlying assets, now expanded to include not only shares (with no requirements as to minimum stake or holding period) but also warrants and non-UK real estate.
- Exemption from withholding tax on interest returns paid to investors in the AHC, including interest-bearing and profit-participating debt, and dividends.
- Capital treatment (rather than income treatment) on share buybacks by the AHC.
- Simplification of existing UK anti-hybrid rules.
- Certain exemptions from UK stamp taxes on share buybacks.

The net effect of this regime (alongside certain existing elements of the UK tax regime, e.g., the UK dividend exemptions) is that a UK tax resident AHC should, broadly, be able to invest in a wide range of UK and foreign assets and realize various forms of income and gains, including gains on distressed debt, and return proceeds to investors without incurring material exposure to UK corporation tax. A UK tax resident AHC will generally be taxed on a transfer priced basis to reflect a "margin" commensurate with its holding company function(s) — this "margin" approach is generally expected to make a UK tax resident AHC competitive, in terms of direct tax leakage, with common holding company jurisdictions such as Luxembourg, Ireland, or the Netherlands.

Among other conditions, in order to qualify for this regime a UK tax resident AHC will need to be held as to at least 70% by "qualifying" investors. While this test is likely to make the AHC regime of most interest to widely held funds (in which, of course, insurance businesses may be significant investors), certain categories of life insurance business will also be treated as "qualifying" investors in their own right, and may wish to use UK tax resident AHCs to make and hold their own investments.

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28 *OECD Pillar 2 Consultation on implementation: Summary of Responses*, HMRC and HM Treasury (July 2022).

The transfer of loan capital is generally exempt from Stamp Duty and Stamp Duty Reserve Tax in the UK …

5. UK Stamp Tax Changes for ILS

The transfer of loan capital is generally exempt from Stamp Duty and Stamp Duty Reserve Tax in the UK (the "**loan capital exemption**"). Common features of many ILS may, however, mean they fall outside the loan capital exemption (e.g., because they may carry a return which is linked to the profits of an underlying business). The Securitisation Companies and Qualifying Transformer Vehicles (Exemption from Stamp Duties) Regulations 2022 was introduced in May 2022, and provides for a more explicit exemption from the requirement to pay UK Stamp Taxes on the transfer of certain standard notes issued as part of an ILS transaction.

At this stage, HMRC will engage stakeholders in the brokerage and insurance industries to explore these possibilities, and no draft legislation has been published at this time.

6. 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 that 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. A summary of the responses to this consultation was published on November 30, 2021. Broadly, HMRC has concluded from the responses that no legislation should be implemented at this time to tackle tax avoidance structures, and that no changes should be made to the content or process of IPT returns. However, HMRC has stated that it will consider taking forward its proposal of a "Code of Conduct" for the UK insurance broker industry. This will likely include a register of insurers who are registered for IPT and provide brokers with the ability to report insurers not so registered (although participation by brokers would be voluntary). At this stage, HMRC will engage stakeholders in the brokerage and insurance industries to explore these possibilities, and no draft legislation has been published at this time.

C. IMPACT OF GLOBAL MINIMUM TAX REGIMES

In addition to the UK, as noted above, a number of other jurisdictions, particularly in the EU, have announced plans to implement the OECD's "Pillar Two" proposal. In its 2023 budget, Bermuda also announced that it is actively looking at how to implement the proposal, and while the Cayman Islands has not indicated that it will introduce the proposal, the Minister is considering an additional level of reporting for companies to ensure the proposal works as intended.

These developments will be of particular interest to large multinational insurance businesses that have operations in low-tax jurisdictions such as Bermuda and the Cayman Islands.

As noted above, "Pillar Two" sets out a system of global minimum tax rules designed to ensure that large multinational businesses pay a minimum effective rate of tax of 15% in each jurisdiction they operate in. The OECD maintains an up-to-date list of relevant jurisdictions at https://www.oecd.org/tax/beps/. These developments will be of particular interest to large multinational insurance businesses that have operations in low-tax jurisdictions such as Bermuda and the Cayman Islands.

V. Global Regulatory and Litigation Developments

In 2022, regulators and industry members around the world continued to navigate ongoing changes in insurance regulation related to private equity ownership of insurers, restructuring mechanisms, international group supervision and group capital standards, innovation and technology, data privacy, reinsurance, and many other areas. Regulators have also been considering regulations in diverse areas of the industry, including with respect to annuities, long-term care insurance and mortgage guaranty insurance. The changing global social and economic landscape with respect to, among other areas, best interest standards, cybersecurity and the use of big data, and climate and resiliency has also continued to prompt consideration by the NAIC.

In 2022, regulators and industry members around the world continued to navigate ongoing changes in insurance regulation related to private equity ownership of insurers, restructuring mechanisms, international group supervision and group capital standards, innovation and technology, data privacy, reinsurance, and many other areas.

A. U.S. NAIC AND STATE ACTIVITY

1. NAIC Continues Review of Private Equity Ownership in the Insurance Industry

Private equity ("**PE**") ownership in the insurance industry has once again gained regulatory attention internationally, as well as at the state and federal levels in the U.S. In response, the NAIC has been reviewing issues related to PE ownership in the insurance industry. In August 2022, the NAIC adopted the Regulatory Considerations for Private Equity Owned Insurers (the "**List of PE Considerations**"). The Macroprudential (E) Working Group developed the List of PE Considerations to address, among other things, perceived regulatory gaps with respect to the increase in PE ownership of insurers, the role of asset managers more generally in insurance, and the increase in private investments in insurers' portfolios. A copy of the List of PE Considerations as adopted by the NAIC is available at https://content.naic.org/sites/default/files/inline-files/Plan for the List of MWG Considerations - PE Related and Other.pdf.

In connection with the adoption of the List of PE Considerations, various NAIC groups received referrals from the Macroprudential (E) Working Group for further assessment. Set forth below is a summary of the status of various working groups' review of the relevant considerations as of the NAIC's Fall 2022 National Meeting (the "**Fall 2022 National Meeting**"):

- The Group Solvency Issues (E) Working Group (the "**GSI Working Group**") received a referral relating to Item 1 (Holding Company Structures) and Item 2 (Ownership and Control) from the List of PE Considerations. At the Fall 2022 National Meeting, the GSI Working Group considered potential action items that might address these concerns, such as (i) developing an advanced regulator training to better prepare regulators to handle review of complex transaction and legal entity structures and (ii) increasing coordination across states in transactions involving multiple Form A filings. The GSI Working Group is forming a drafting group to develop a work plan to address these issues.

- The Risk-Focused Surveillance (E) Working Group received a referral relating to Item 3 (Investment Management Agreements) and Item 4 (Ownership of Insurers with Short-Term Focus and/or Unwilling to Support a Troubled Insurer) and decided to defer its review of such items until the completion of its ongoing project to update general guidance to the NAIC handbooks related to affiliated service agreements (which is expected to be completed in early 2023).

- The Life Actuarial Task Force ("**LATF**") received a referral relating to Item 4 (Ownership of Insurers with Short-Term Focus and/or Unwilling to Support a Troubled Insurer). At the Fall 2022 National Meeting, LATF noted that existing asset adequacy analysis requirements in the NAIC Standard Valuation Law (#820) and VM-30 (Actuarial Opinion and Memorandum Requirements) require that company-appointed actuaries perform testing to ensure that the reserves held for the company's liabilities are adequate in light of the assets supporting the business and that regulators already review associated company Statements of Actuarial Opinion with respect thereto periodically. In addition, with respect to Item 10 (Privately Structured Securities) and Item 12 (Pension Risk Transfer Business Supported by Complex Investments), LATF noted that it recently adopted Actuarial Guideline LIII — Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves ("**AG 53**"), effective for year-end 2022 reporting, which requires disclosure of additional documentation and analysis related to complex assets supporting businesses including annuities, pension risk transfers, and other life insurer business.

- The Examination Oversight (E) Task Force has delegated work on its referral relating to Item 8 (Identifying Underlying Affiliated/Related Party Investments and/or Collateral in Structured Securities) to its Financial Analysis Solvency Tools (E) Working Group and its Financial Examiners Handbook (E) Technical Group. Both groups developed new guidance for inclusion in 2023 NAIC handbooks related to the new related party investment disclosures developed by the Statutory Accounting Principles (E) Working Group ("**SAP Working Group**") and AG 53 standards developed by LATF that will be in place for year-end 2022 reporting. The groups may develop additional guidance for NAIC handbooks, as well as supporting regulatory reports and tools, as work proceeds in this area.

- The SAP Working Group has completed, or is in the process of reviewing, various revisions to the Statements of Statutory Accounting Principles ("**SSAPs**") that would address Item 7 (Identifying Related Party-Originated Investments (Including Structured Securities)), Item 8 (Identifying Underlying Affiliated/Related Party Investments and/or Collateral in Structured Securities), and Item 9 (Asset Manager Affiliates and Disclaimers of Affiliation), including the recently adopted changes to SSAP No. 25 — Affiliates and Other Related Parties ("**SSAP No. 25**") and SSAP No. 43R — Loan-Backed and Structured Securities ("**SSAP No. 43R**") related to the guidance for related party reporting requirements and the development of the principle-based bond definition, which are described below.

- Finally, with respect to Item 14 (Offshore/Complex Reinsurance), members of the Macroprudential (E) Working Group have been focused on this issue and are in the process of completing confidential discussions with industry participants and other jurisdictions regarding the use of offshore reinsurers and complex affiliated reinsurance vehicles. As a next step, the Macroprudential (E) Working Group plans to develop a template for regulators to use in reviewing these transactions in order to better understand their economic impact. The Macroprudential (E) Working Group will consider further work and/or referrals once they have concluded these discussions.

2. NAIC Continues Efforts to Facilitate Uniformity in the Implementation of the Revised Suitability in Annuity Transactions Model Regulation

The Annuity Suitability (A) Working Group is drafting a frequently asked question ("**FAQ**") document to address the comparable standards safe harbor included in the 2020 revisions to the Suitability in Annuity Transactions Model Regulation (#275) ("**SAT**").

The revised SAT, which the NAIC adopted in February 2020, incorporates a requirement for producers to act in the "best interest" of a retail customer when making a recommendation of an annuity. To meet this standard, a producer must not place his or her own financial interest ahead of the consumer's, and the producer must also satisfy four key obligations of care, disclosure, conflict of interest, and documentation. Under the comparable standards safe harbor in the revised SAT, the requirements of the SAT are deemed to be satisfied if the recommendation and sale of an annuity is "made in compliance with comparable standards."

In an attempt to facilitate uniformity in the implementation of the comparable standards safe harbor, the FAQ document addresses topics such as when a producer would be considered to be acting as a financial professional for purposes of the safe harbor provision, which comparable standards meet the criteria for the safe harbor, and obligations of insurers with respect to producers seeking to rely on the safe harbor. The Annuity Suitability (A) Working Group exposed a draft of the FAQ document for comment in May 2022. Iowa and the other states that have adopted the 2020 revisions to the SAT are gathering information related to the enforcement of the safe harbor, which will help to inform the next draft of the FAQ document.

3. NAIC Addresses the Applicability of Nonforfeiture Benefits to Index-Linked Variable Annuities

In December 2022, LATF adopted a new Actuarial Guideline ("**Actuarial Guideline ILVA**") to prescribe conditions under which index-linked variable annuities ("**ILVAs**") can be considered variable annuities exempt from the scope of the Standard Nonforfeiture Law for Individual Deferred Annuities (#805) (the "**Standard Nonforfeiture Law**"). In February 2023, the Life Insurance and Annuities (A) Committee ("**(A) Committee**") adopted Actuarial Guideline ILVA.

Under the existing regulatory framework, "contracts that provide for annuity benefits that vary according to the investment experience of a separate account" are exempt from the Standard Nonforfeiture Law and instead are subject to requirements for nonforfeiture benefits under the Variable Annuity Model Regulation (#250) (the "**VA Model Regulation**"). Thus, traditional variable annuities with unit-linked values are subject to the VA Model Regulation, and the market values of the separate account assets are the basis for contract benefits, including surrender values.

... traditional variable annuities with unit-linked values are subject to the VA Model Regulation, and the market values of the separate account assets are the basis for contract benefits, including surrender values.

The Index-Linked Variable Annuity (A) Subgroup was charged with evaluating how this framework should apply to "hybrid" annuity products, commonly referred to as index-linked variable annuities, which provide periodic credits based on the performance of a specified portfolio of assets (e.g., an index), which typically are not unit-linked and do not invest in the assets whose performance forms the basis for the periodic credits.

In the form adopted by LATF and the (A) Committee, Actuarial Guideline ILVA sets forth principles and requirements for determining interim values (including death benefit, withdrawal amount, annuitization amount, or surrender values) such that an ILVA is considered a variable annuity and thereby exempt from the Standard Nonforfeiture Law. In particular, a basic principle of Actuarial Guideline ILVA is that an ILVA must provide for interim values that are consistent with the market value of a hypothetical portfolio (composed of a fixed income asset proxy and a derivative asset proxy) supporting the ILVA. The market value of the assets may be determined by a fair value methodology or by applying a market value adjustment to the book value. While the current version of Actuarial Guideline ILVA does not codify alternative methods of determining interim values that had been suggested by industry commenters, this version does allow a contract to provide for a different methodology for determining interim values, provided that the insurer demonstrates that the interim values determined using such methodology will be "materially consistent" over the crediting period with the interim values that would be produced using the hypothetical portfolio methodology.

In the form adopted by LATF and the (A) Committee, Actuarial Guideline ILVA also would require an insurer to provide an actuarial memorandum with each ILVA product filing that includes actuarial certifications that:

- The interim values defined in the contract provide equity between the contract holder and the insurance company;
- The assumptions used to determine the market value of the derivative asset proxy are consistent with the observable market prices of derivative assets, whenever possible;
- Contractually defined interim values are "materially consistent" with the interim values that would be produced using the hypothetical portfolio methodology (less a provision for the trading costs at the time the interim value is calculated); and
- Any trading costs represent reasonably expected or actual costs at the time the interim value is calculated.

It is expected that Actuarial Guideline ILVA will be considered for adoption by the NAIC's Executive (EX) Committee and Plenary at the NAIC's Spring 2023 National Meeting. If adopted in its current form, Actuarial Guideline ILVA would apply to all contracts issued on or after July 1, 2024. After such time, if an ILVA does not comply with the principles and requirements of Actuarial Guideline ILVA, such ILVA would not be considered a variable annuity and therefore would be subject to Standard Nonforfeiture Law.

It is expected that Actuarial Guideline ILVA will be considered for adoption by the NAIC's Executive (EX) Committee and Plenary at the NAIC's Spring 2023 National Meeting.

In August 2022, the NAIC approved a model law development request to amend the Property and Casualty Insurance Guaranty Association Model Act ...

Many in the industry consider national uniformity on guaranty association coverage following IBT and CD transactions to be a gating issue to such transactions being used more widely.

4. Changes to Property and Casualty Insurance Guaranty Association Model Act

a. NAIC Considers Revisions to Guaranty Association Model Act to Address Insurance Business Transfers and Corporate Divisions

In August 2022, the NAIC approved a model law development request to amend the Property and Casualty Insurance Guaranty Association Model Act (#540) (the "**Guaranty Association Model Act**") to address the effect of certain restructuring mechanisms on the availability of guaranty association coverage. The amendments were prompted by the Restructuring Mechanisms White Paper, which discusses new statutory processes that certain states have adopted to govern insurance business transfer ("**IBT**") and corporate division ("**CD**") transactions. The white paper includes a recommendation that the Guaranty Association Model Act should be amended to address issues related to guaranty association coverage following IBT and CD transactions. Many in the industry consider national uniformity on guaranty association coverage following IBT and CD transactions to be a gating issue to such transactions being used more widely.

b. NAIC Considers Revisions to Guaranty Association Model Act to Address Cybersecurity Insurance Coverage

In December 2022, the Financial Condition (E) Committee ("**(E) Committee**") adopted a Request for NAIC Model Law Development to amend the Guaranty Association Model Act to address cybersecurity insurance coverage. The request was prompted by the trending of cybersecurity insurance coverage into the admitted market as reported by the National Conference of Insurance Guaranty Funds. The proposed amendments to the Guaranty Association Model Act include: (i) clarification that cybersecurity insurance is included within guaranty association coverage; (ii) an optional definition of "cybersecurity insurance," which is not defined in the current Guaranty Association Model Act; (iii) a coverage limitation of US$500,000 per single cybersecurity incident and an authorization for the guaranty association's engagement of service providers to mitigate losses from a cybersecurity incident; and (iv) optional pay and recovery language for guaranty association coverage that is subject to net worth exclusions. The model law development request remains subject to approval of the Executive (EX) Committee and Plenary at a future meeting.

5. NAIC Adopts Long-Term Care Insurance Multistate Actuarial Framework

During the NAIC's Spring 2022 National Meeting (the "**Spring 2022 National Meeting**"), the Executive (EX) Committee and Plenary adopted the Long-Term Care Insurance Multistate Rate Review Framework ("**MSA Framework**"), which was previously adopted by the Long-Term Care Insurance (EX) Task Force at the NAIC's Fall 2021 National Meeting. The MSA Framework is intended to provide a consistent national approach for reviewing current long-term care insurance rates that results in actuarially appropriate increases being granted by the states in a timely manner and eliminates cross-state rate subsidization. The MSA Framework became fully operational in September 2022.

In 2023, the Long-Term Care Insurance (EX) Task Force expects to monitor and evaluate the progress of the multistate actuarial ("**MSA**") rate review process as outlined in the MSA Framework and make modifications as appropriate. The task force will also monitor state insurance department rate review actions subsequent to the implementation of the MSA Framework and MSA rate review recommendations.

6. NAIC Adopts Macroprudential Risk Assessment Process

The Macroprudential Risk Assessment will be used to proactively identify and assess industrywide insurance risks to allow insurance regulators to consider and incorporate, as needed, various macroprudential surveillance measures across the insurance sector.

In April 2022, the Macroprudential (E) Working Group and Financial Stability (E) Task Force adopted the Macroprudential Risk Assessment process document, which was developed by the Macroprudential (E) Working Group to set forth the process for conducting the NAIC's Macroprudential Risk Assessment as a component of the NAIC's overall efforts to enhance regulators' ability to monitor industry trends.

The Macroprudential Risk Assessment will be used to proactively identify and assess industrywide insurance risks to allow insurance regulators to consider and incorporate, as needed, various macroprudential surveillance measures across the insurance sector. NAIC staff and state insurance regulators will identify, aggregate, and track the performance of targeted insurance industry and macroeconomic risk indicators on a biannual basis. The Macroprudential Risk Assessment incorporates both quantitative and qualitative assessment factors to facilitate regulator identification of key risk exposures. Each of the quantitative and qualitative risk indicators will be sourced from aggregated NAIC Annual Statement data as well as public data sources, which will be reviewed and updated as needed to quantify emerging material risk exposures.

Quantitative factors will be used to track and measure risk exposures by establishing key risk indicators for ongoing monitoring and assessment. The quantitative assessment categories include (i) macroeconomic factors affecting the broader economy and most likely to impact the insurance industry, (ii) interconnectedness with other financial sectors and the overall financial stability of the insurance industry, (iii) the overall capitalization of the insurance industry and perceptions of financial strength (i.e., ratings and outlooks), (iv) exposure to risks associated with insurance underwriting performance, reserve development, and overall profitability, (v) credit exposure, (vi) changes in interest rates and/or prices adversely affecting the value of investments and liabilities, and (vii) liquidity exposure, as well as other risks.

Quantitative factors will be used to track and measure risk exposures by establishing key risk indicators for ongoing monitoring and assessment.

In addition, qualitative factors may be used to supplement the risk indicators by incorporating information from a broader range of sources into the risk assessment process to identify emerging issues and industry trends for consideration. Such tools and resources may include results of company surveillance efforts (such as the NAIC Own Risk and Solvency Assessment reviews), industry news, and internal/external research studies (including those performed by the NAIC's Capital Markets Bureau, Center for Insurance Policy and Research, and rating agencies), as well as insights from federal resources (such as Financial Stability Oversight Council, Federal Reserve, Federal Insurance Office, and Office of Financial Research), as well as international resources, including the International Association of Insurance Supervisors' ("**IAIS**") Global Monitoring Exercise ("**GME**").

… qualitative factors may be used to supplement the risk indicators by incorporating information from a broader range of sources into the risk assessment process to identify emerging issues and industry trends for consideration.

Insights from both the quantitative and qualitative reviews will be aggregated to reach a baseline assessment of industry exposure to various macroprudential risks, which will then be evaluated, adjusted as needed, and approved by the Macroprudential (E) Working Group going forward.

Macroprudential risks will be presented to the Financial Stability (E) Task Force for general policy consideration, which could include the development of additional tasks, policies, practices, or disclosures to address sector-wide risk exposures. In addition, assessments may be shared with federal and international regulators for broader financial sector and macroprudential surveillance purposes.

State insurance regulators may use the results of the macroprudential risk assessment process for identification of sector-wide risks and potential systemic risks, and may also focus their supervisory resources toward identifying individual insurers that contribute to such higher-assessed sector-wide risks and potential systemic risk or activities. It has been noted that further analysis may warrant additional supervision and oversight of select insurers.

State insurance regulators may use the results of the macroprudential risk assessment process for identification of sector-wide risks and potential systemic risks …

7. NAIC Proposes Amendments to Mortgage Guaranty Insurance Model Act

In 2022, the Mortgage Guaranty Insurance (E) Working Group (the "**MGI Working Group**") resumed in earnest activities related to drafting amendments to the Mortgage Guaranty Insurance Model Act (#630) (the "**MGI Model Act**"). In October 2022, the MGI Working Group exposed for comment draft revisions to the MGI Model Act. The exposure draft included (among other changes) updated capital and surplus requirements and new sections on risk concentration, reinsurance, sound underwriting practices, quality assurance, rescission, and records retention. Industry comments focused on the effect of reinsurance on contingency reserves, overly restrictive investment limitations, rescission rights, requirements to file underwriting guidelines, and a desire to codify the Commissioner's authority to waive a breach of the risk-to-capital ratio. In response to industry comments, the MGI Working Group has been preparing a revised draft of the amendments to the MGI Model Act, with the goal of adopting the amendments at or before the Spring 2023 National Meeting.

The exposure draft included (among other changes) updated capital and surplus requirements and new sections on risk concentration, reinsurance, sound underwriting practices, quality assurance, rescission, and records retention.

While amendments to the MGI Model Act have been part of the MGI Working Group's charges for the past few years, the MGI Working Group had been focused on other charges related to the development and implementation of the Mortgage Guaranty Insurance Supplement (the "**MGI Supplement**") to the statutory financial statement and work on the mortgage guaranty capital model. Data is now being collected in the new MGI Supplement, which data will inform the future development and implementation of the capital model. The MGI Working Group has also tabled work on the Mortgage Guaranty Insurance Standards Manual (which was referenced in previous versions of amendments to the MGI Model Act).

8. States Continue Implementation of Revisions to Model Credit for Reinsurance Law and Regulation

All states, the District of Columbia, and Puerto Rico have adopted 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**"), thus avoiding the prospect of federal preemption of state credit for reinsurance laws under the Federal Insurance Office's preemption analysis (which was required to be completed by September 1, 2022).

The Revised CFR Model Laws eliminate reinsurance collateral requirements for certain reinsurers and limit the worldwide application of prudential group insurance measures on insurance groups that are domiciled in a "reciprocal jurisdiction."

The Revised CFR Model Laws eliminate reinsurance collateral requirements for certain reinsurers and limit the worldwide application of prudential group insurance measures on insurance groups that are domiciled in a "reciprocal jurisdiction." See https://isiteplus.naic.org/crin-report/crinReportPublic.xhtml for a list of reciprocal jurisdiction reinsurers and where they have reciprocal jurisdiction status. Reciprocal jurisdictions include (i) accredited U.S. jurisdictions, (ii) non-U.S. jurisdictions that have entered into a covered agreement with the U.S. (such as the EU and the UK), and (iii) "qualified jurisdictions" that meet certain additional requirements consistent with the terms and conditions of the covered agreements, including that the jurisdiction "recognizes the U.S. state regulatory approach to group supervision and group capital." Bermuda, Japan, and Switzerland are approved as "qualified jurisdiction reciprocal jurisdictions."

9. NAIC Activities Relating to International Insurance Activities

a. IAIS Makes Progress With the Insurance Capital Standards and Comparability Assessment of the Aggregation Method

In November 2019, the IAIS adopted the Common Framework for the Supervision of Internationally Active Insurance Groups ("**ComFrame**") and the insurance capital standard ("**ICS**"), which is the group-capital component of ComFrame, as part of a set of reforms designed to enable effective cross-border supervision of internationally active insurance groups and contribute to global financial stability. The ICS is being implemented in two phases, the first of which is a five-year monitoring period (which commenced in January 2020) that will be followed by full implementation of the ICS as a groupwide prescribed capital requirement ("**PCR**").

The U.S. and other jurisdictions have developed the aggregation method ("**AM**") as an alternative to the ICS to avoid the application of multiple capital standards to groups domiciled in the U.S. and such other jurisdictions. The AM will be used as a PCR under ComFrame only if the AM is determined to provide "comparable outcomes" to the ICS. If the IAIS determines by the end of the monitoring period that the AM provides comparable (i.e., substantially the same) outcomes to the ICS, then the AM will be considered an outcome-equivalent approach for implementation as a PCR in lieu of the ICS.

In November 2019, the IAIS agreed on a process and timeline for developing criteria to assess whether the AM provides comparable outcomes to the ICS. The IAIS developed draft high-level principles ("**HLPs**") from which detailed criteria were developed for each HLP. The comparability assessment team will be selected by the ICS and Comparability Task Force ("**ICSTF**") and consist of employees of the Secretariat. The assessment team will be responsible for delivering the necessary technical analysis of the AM and ICS to support the ICSTF in making an informed recommendation to the IAIS Executive Committee ("**IAIS ExCo**") on the outcome of the comparability assessment. The ICSTF will oversee the assessment team's work and review the interim and final results of its analysis. Based on the ICSTF's recommendations, the IAIS ExCo will make the final decision on whether the AM provides comparable outcomes to the ICS.

On July 21, 2022, the International Insurance Relations (G) Committee heard comments from interested parties on the IAIS' public consultation on the draft criteria that will be used to assess whether the AM provides comparable outcomes to the ICS. Initial general comments to the consultation generally centered around concerns that the draft criteria would preclude at the outset the AM as an outcome equivalent approach to the ICS. As a general matter, interested parties noted that the criteria could preclude comparability insomuch as the criteria disregard fundamental differences between the two approaches to group capital and set up a comparison that expects the AM to operate the same as the ICS. Other commenters noted that the criteria appeared to not sufficiently weight both qualitative and quantitative data, with the current draft criteria focused on a quantitative comparison and not a qualitative comparison. In addition, commenters noted that the process of comparing the AM to the ICS appeared to be unduly burdensome, as it would require a large amount of work while ignoring the existing data previously provided during field testing and the monitoring period.

The feedback on the draft criteria from a large number of respondents expressed a desire to further engage on the design of the scenarios that would be used in the comparability assessment. In response, the IAIS decided to provide additional opportunity for stakeholder engagement on the development of the scenarios that will be used to inform the assessment and agreed to extend the period for comment on the design of the scenarios and move consideration of the final criteria from November 2022 to March 2023; however, this will not impact the timing of the actual AM comparability assessment, which is scheduled to begin in the second half of 2023.

b. IAIS Reviews Systemic Risk in the Insurance Sector

On December 9, 2022, the Financial Stability Board ("**FSB**") announced that, in consultation with the IAIS, the FSB had decided to discontinue the annual identification of global systemically important insurers ("**G-SIIs**") and endorsed the use of the IAIS's Holistic Framework for Systemic Risk in the Insurance Sector (the "**Holistic Framework**") to inform its considerations of systemic risk in the insurance sector. The NAIC, which was in favor of the Holistic Framework and actively contributed to the IAIS's work to inform the FSB decision, was supportive of the announcement.

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In 2019, the IAIS adopted the Holistic Framework, which comprises three key elements: (i) a risk assessment through the annual GME to detect key risks and trends, and buildup of systemic risk in the global insurance sector, (ii) an enhanced set of supervisory measures to help prevent vulnerabilities and exposures in the insurance sector, and (iii) a robust assessment of the comprehensive and consistent implementation of such supervisory measures across jurisdictions. The FSB will use assessments available through the Holistic Framework to inform its considerations of systemic risk in the insurance sector and will receive an annual update of the outcomes of the GME, including the IAIS assessment of systemic risk in the global insurance sector, possible concentration of systemic risks at an individual insurer level, and the supervisory response to identified risks.

10. NAIC Takes Action Regarding Various Investment Monitoring Activities

a. NAIC Reviews Collateralized Loan Obligations

On May 25, 2022, the Valuation of Securities (E) Task Force (the "**VOS Task Force**") received a letter from Eric Kolchinsky, Director of the NAIC Structured Securities Group ("**SSG**") and Capital Markets Bureau, Charles A. Therriault, Director of the NAIC Securities Valuation Office ("**SVO**"), and Marc Perlman, Managing Investment Counsel of the SVO, setting forth concerns regarding the risk assessment of structured securities, including collateralized loan obligations ("**CLOs**"). Notably, the letter asserted that an insurer that purchases every tranche of a CLO holds the exact same investment risk as if the insurer had directly purchased the entire pool of loans backing the CLO; therefore, the aggregate risk-based capital ("**RBC**") factor for owning all of the CLO tranches should be the same as the required factor for owning all of the underlying loan collateral, and a lesser factor would constitute RBC arbitrage.

the letter asserted that an insurer that purchases every tranche of a CLO holds the exact same investment risk as if the insurer had directly purchased the entire pool of loans backing the CLO; therefore, the aggregate risk-based capital ("RBC") factor for owning all of the CLO tranches should be the same as the required factor for owning all of the underlying loan collateral

On June 9, 2022, the VOS Task Force exposed for comment an issue paper (the "**CLO Issue Paper**") prepared by the NAIC's Investment Analysis Office that discussed the concerns regarding the opportunity for RBC arbitrage for CLOs and proposed the following recommendations to address the RBC arbitrage concerns with respect to CLOs:

- **Revised CLO Modeling**. A proposal for the SSG to model CLO investments and evaluate all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designations that eliminate RBC arbitrage.

- **New RBC Factors**. A proposed referral to the Capital Adequacy (E) Task Force and its Risk-Based Capital Investment Risk and Evaluation (E) Working Group (the "**Investment RBC Working Group**") to request consideration of adding new (i) RBC factors to account for the tail risk in any structured finance tranche and (ii) subcategories within the 6th NAIC Designation Category (e.g., 6.A, 6.B, and 6.C) with recommended RBC factors of 30%, 75%, and 100%, respectively.

The main conclusions of the Academy's report were (i) CLOs do not currently present a material risk to the aggregate solvency of the life insurance industry; (ii) it is not appropriate to use existing C-1 factors for CLOs due to a lack of equivalence between the risk models for corporate bonds, equities, and structured securities; and (iii) capturing the risks that CLOs pose to an insurer's surplus requires complex models, and regulators should balance the need for measurement of complex risks with the cost of measuring those risks.

The NAIC has expressed concern that credit rating provider ("CRP") ratings do not adequately represent the risks of privately issued securities purchased by insurers, which can affect an insurer's RBC calculation, resulting in lower RBC charges for higher-risk investments.

In response to comments received from interested parties regarding the CLO Issue Paper, the SSG prepared a presentation deck, Staff Discussion of Responses to CLO, which is available at https://content.naic.org/sites/default/files/inline-files/2022-004.02 CLO Response SMN 2022 vF.pdf ("**SSG Deck**"). The SSG Deck includes a summary of interested party responses regarding the CLO Issue Paper. The responses were cautiously supportive but expressed the following concerns with the recommended proposals described above: (i) timeline concerns insofar as there should be sufficient timing for interested parties to provide comments on the proposal as it develops, (ii) policy arguments regarding the importance of CLOs to U.S. capital markets and the excellent historical performance of the CLO asset class, (iii) transparency, and (iv) methodology. The SSG Deck generally acknowledges that if the proposal is approved, there will be many opportunities for interested parties to comment on all elements of the proposal, including with respect to process, methodology, scenarios, and probabilities, and the process is intended to be transparent. The SSG Deck also includes additional information regarding methodology, transparency, and tail risk considerations in response to comments from interested parties.

The SSG Deck concludes with a recommendation that the VOS Task Force proceed with the proposal, which specifically contemplates (i) authorizing NAIC staff to draft for exposure an amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office ("**P&P Manual**") permitting the SSG to model CLO investments, (ii) referring the RBC matters to the Investment RBC Working Group, and (iii) directing the staff to work with interested parties to fine tune the methodology and develop scenarios and probabilities.

In August 2022, the VOS Task Force exposed an updated amendment to the P&P Manual to add reporting instructions for the financial modeling of CLOs, an amended version of which was exposed at the Fall 2022 National Meeting for a brief 15-day period. Under the amendment, the NAIC would perform annual surveillance work for CLOs and some regulatory treatment analysis services similar to the work currently performed for residential mortgage-backed securities and commercial mortgage-backed securities.

The P&P Manual amendment is intended to be the first step in allowing the SSG to model CLOs and ensuring the SSG has the resources it needs to start working on the project, which will be followed by development and exposure of a proposed methodology. The VOS Task Force anticipates that the proposed changes would be implemented with an effective date of January 1, 2024, with the first reporting year-end being December 31, 2024, in order to provide sufficient time to develop the scenarios and methodology.

The VOS Task Force also sent an informational referral to the Investment RBC Working Group to continue discussions on the RBC charges for CLOs and develop a potential interim approach to address the concern regarding potential RBC arbitrage in the structuring of assets through CLOs and other similar assets.

At the request of the Investment RBC Working Group, the C1 Work Group of the American Academy of Actuaries ("**Academy**") has been investigating CLOs to understand the risk they pose to life insurers' statutory capital and considerations for establishing capital requirements. During the Fall 2022 National Meeting, the Academy presented a report to the Investment RBC Working Group regarding the status of the Academy's work on this topic, including commentary on the Investment Analysis Office letter proposing a new approach to CLO C-1, including modeling by the SSG and the introduction of new subcategories of NAIC-6 having 30%, 75%, and 100% factors.

The main conclusions of the Academy's report were (i) CLOs do not currently present a material risk to the aggregate solvency of the life insurance industry; (ii) it is not appropriate to use existing C-1 factors for CLOs due to a lack of equivalence between the risk models for corporate bonds, equities, and structured securities; and (iii) capturing the risks that CLOs pose to an insurer's surplus requires complex models, and regulators should balance the need for measurement of complex risks with the cost of measuring those risks.

b. NAIC Evaluates Rating Information and Process for Privately Issued Securities

The NAIC has expressed concern that credit rating provider ("**CRP**") ratings do not adequately represent the risks of privately issued securities purchased by insurers, which can affect an insurer's RBC calculation, resulting in lower RBC charges for higher-risk investments. In particular, the VOS Task Force is interested in the evaluation of CRPs and formed an ad hoc CRP study group (the "**CRP Study Group**") composed of regulators, insurer personnel, and NAIC staff, which held its first meeting in March 2022 for the purpose of presenting CRP-related recommendations for the VOS Task Force's consideration. The CRP Study Group will no longer meet in 2023 because the VOS Task Force is now prepared to move forward in a regulator-only format with a plan to create a list of questions to begin preliminary conversations with CRPs.

Additionally, prompted by the desire to reduce the SVO's reliance on CRPs with respect to the assessment of bond investment risks and pursuant to the SVO's recommendation, the VOS Task Force considered a proposed referral to the Blanks (E) Working Group to add certain fixed income analytical risk measures to bond investments reported on Schedule D, Part 1, of an insurer's statutory financial statements. Industry comments expressed concerns that the proposal would be operationally burdensome and suggested that the SVO produce the additional market data fields for the bond investments. The VOS Task Force has not yet made any determination as to whether the SVO or insurers should produce the analytical data elements in connection with the proposal.

c. NAIC Adopts Amendment to Definition of Principal Protected Securities

In August 2022, the VOS Task Force adopted an amendment to the definition of principal protected securities ("**PPS**") in the P&P Manual to include certain alternate securities ("**Alternate PPS**") that pose many of the same investment risks as PPS but are structured in a manner that does not fit squarely within the P&P Manual's current PPS definition as further described below. As PPS are ineligible for the "filing exempt" process of the SVO, the rationale for the amendment is to include Alternate PPS within the PPS definition, such that Alternate PPS also are ineligible for the SVO's "filing exempt" process.

By way of background, in May 2020, the VOS Task Force adopted an amendment to the P&P Manual to include PPS as a new security type that is ineligible for the SVO's "filing exempt" process. At that time, the types of PPS considered were combinations of (i) a typical bond or bonds and (ii) additional performance assets with various characteristics, including derivatives, common stock, and/or commodities and equity indices, that were intended to generate additional returns. The performance assets generally included undisclosed assets and were typically not securities that would otherwise be permitted on Schedule D, Part 1 as a bond. In each case, the CRP rating was based solely on the component dedicated to the repayment of principal and ignored the risks and statutory prohibitions of reporting the performance asset on Schedule D, Part 1.

The impetus for the 2022 amendment to address Alternate PPS was the SVO's receipt of a proposed security that had many of the same risks as PPS but was structured in a way that was not captured by the PPS definition in the P&P Manual as adopted in May 2020. Specifically, the proposed security was not issued by a special purpose vehicle holding both the bond and the performance asset; rather, the security was the direct obligation of a large financial institution that was obligated to pay principal at maturity and any additional return based on the performance of certain referenced indices of equities, fixed-income instruments, futures, and other financial assets. Although the financial institution issuing the security was the sole obligor under the security, such that there were no underlying bonds or performance assets, the structure posed the same risk of exposure to a performance asset because the amount of the issuing financial institution's payment obligation depended directly on the performance of the referenced indices or assets. Additionally, unlike a PPS transaction with an underlying bond and performance asset, the likelihood of payment of any performance asset return was linked directly to the creditworthiness of the issuing financial institution.

The revision to the PPS definition, which was coordinated by the SVO and industry representatives, is intended to capture the Alternate PPS structure within the PPS definition. Accordingly, Alternate PPS also are ineligible for the SVO's "filing exempt" process.

d. NAIC Task Force Adopts Updated Instructions for Filing Exemption of Related Party and Subsidiary, Controlled, and Affiliated Investments

In December 2022, the VOS Task Force adopted an amendment to the P&P Manual to update the instructions for the filing of related party and subsidiary, controlled, and affiliated ("**SCA**") investments to clarify when SCA or related party investments are filing exempt.

The amendments are the result of a referral from the SAP Working Group following the SAP Working Group's recent adoption of revisions to SSAP No. 25 and SSAP No. 43R, which require new reporting information for investments that involve a related party as sponsor, originator, manager, or other similar transaction party, regardless of whether the investment is captured on the affiliate reporting line, as described below.

The Subsidiary, Controlled and Affiliated Debt or Preferred Stock Investments section of the P&P Manual previously only required insurers to file with the SVO bonds or preferred stock issued by an SCA entity and therefore, a transaction with an affiliate or related party originator, sponsor, manager, or underlying obligor, as opposed to issuer, did not constitute an SCA investment. In its referral, the SAP Working Group noted that because the definition of "affiliate" is determined by an evaluation of control of the issuer, for structured securities, the issuer is typically a special purpose entity ("**SPE**") and therefore it is possible for an investment that involves an affiliate or related party issuer to not be considered affiliated because the insurer has no control over the issuing SPE.

The amendments to the P&P Manual include the following:

- Renaming the Subsidiary, Controlled and Affiliated Debt or Preferred Stock Investments section of the P&P Manual to Subsidiary, Controlled and Affiliated and Related Party Debt or Preferred Stock Investments in order to clarify that the section includes related party non-control relationships, which is further clarified by amendments to the definitions of "SCA investment," "SCA debt," and "SCA preferred stock" to include related parties.

- Expanding the definition of "SCA and related party debt" to include structures in which the non-issuer underlying credit exposure would qualify as a related party pursuant to SSAP No. 43R.

- Creating a new category of SCA and related party investment called "SCA and Related Party Filing Exempt Investments" that provides that any investment issued either by an affiliate or related party SPE, which itself is not an obligor or ultimate source of the investment repayment, or as part of a structure in which the originator, sponsor, manager, servicer, or other influential transaction party is an affiliate or related party of the reporting insurance company would be eligible for filing exemption unless otherwise determined to be ineligible.

- Clarifying that state insurance regulators are permitted to require an insurance company to file what would otherwise be an SCA and Related Party Filing Exempt Investment (as described above) for analysis by the SVO, thereby making it ineligible for filing exemption in the future.

e. NAIC Exposes Instructions for Structured Equity and Funds

In December 2022, the VOS Task Force exposed an amendment to the P&P Manual to add instructions that would require transactions meeting the criteria of "Structured Equity and Funds" (as specified in the P&P Manual) to be ineligible for the SVO's "filing exempt" process and thereby be subject to assessment by the SVO. The VOS Task Force also directed SVO staff to refer the proposed amendment to the Capital Adequacy (E) Task Force and the Investment RBC Working Group for additional consideration.

The SVO proposed the amendments in response to its recent review of several private letter rating filings for investments in notes issued by, and of equity or limited partnership interests in, a special purpose vehicle, trust, limited liability company, limited partnership, or other legal entity that operates as a feeder fund that itself invests, directly or indirectly, in one or more funds or other equity investments. The SVO cited a number of concerns with respect to such investments, including (i) the potential to circumvent regulatory guidance established by the VOS Task Force, SAP Working Group, and Capital Adequacy (E) Task Force with respect to the reporting of equity investments, (ii) the reporting of such investments as bonds in order to receive favorable RBC treatment, and (iii) the lack of transparency regarding the true underlying risks, credit exposure, and nature of the investment.

The proposed amendment defines "Structured Equity and Fund" as "a note issued by, or equity or limited partnership interest in, a special purpose vehicle, trust, limited liability company, limited partnership, or other legal entity type, as issuer, the contractually promised payments of which are wholly dependent, directly or indirectly, upon payments or distributions from one or more underlying equity or fund investments."

The proposed amendment defines "Structured Equity and Fund" as "a note issued by, or equity or limited partnership interest in, a special purpose vehicle, trust, limited liability company, limited partnership, or other legal entity type, as issuer, the contractually promised payments of which are wholly dependent, directly or indirectly, upon payments or distributions from one or more underlying equity or fund investments." The SVO noted that any structure that circumvents the definition (including through the inclusion of an intervening legal entity (or entities) between the Structured Equity and Fund investment issuer and the underlying equity or fund(s)), which in substance achieves the same ends or poses the same risk, will be deemed a Structured Equity and Fund.

Any investment meeting the criteria of a Structured Equity and Fund would be ineligible for the SVO's "filing exempt" process, and an insurer investing in a Structured Equity and Fund issuance would be required to provide information sufficient for the SVO to conduct a look-through assessment and credit risk assessment. The proposed amendment was exposed for a 60-day public comment period ending on February 13, 2023.

11. NAIC Revisions to Statements of Statutory Accounting Principles

a. Identification of Related Parties and Affiliates

In 2021, the NAIC adopted revisions to SSAP No. 25 that incorporate new disclosures regarding the identification of related parties and affiliates, largely aimed at aligning related party and affiliate reporting under statutory accounting principles with reporting requirements of the U.S. Securities and Exchange Commission ("**SEC**"), the latter of which focus on beneficial ownership and do not include the concept of a disclaimer of control or affiliation.

The revisions make the following clarifications:

- Any related party identified under U.S. generally accepted accounting principles or SEC reporting requirements will be considered a related party under statutory accounting principles.
- Noncontrolling ownership over 10% results in a "related party" classification regardless of any disclaimer of control or affiliation.
- A disclaimer of control or affiliation 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 SAP Working Group made minor modifications to the proposed revisions to SSAP No. 25 to clarify that "ownership," as referenced in SSAP No. 25, includes both direct and indirect ownership. In addition, the Blanks (E) Working Group adopted a new Schedule Y, Part 3, to reflect the new disclosure required by SSAP No. 25 as adopted by the SAP Working Group and to capture data items, such as owners of more than 10% and identification of an insurer's ultimate controlling party. Reporting on the new Schedule Y, Part 3, became required commencing with the filing of the 2021 Annual Statement.

At its May 24, 2022 meeting, the SAP Working Group adopted additional revisions to SSAP No. 25 to clarify the reporting of affiliate transactions and incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of whether they meet the "affiliate" definition under the Insurance Holding Company Model Act (#440). In connection with such adoption, the SAP Working Group identified the need to further clarify when an investment is considered an affiliated investment and reported on the "parent, subsidiaries and affiliates" reporting lines (referred to as the "affiliated" lines) in the investment schedules.

At the Fall 2022 National Meeting, the SAP Working Group exposed for comment revisions to SSAP No. 25 to clarify that any invested asset held by a reporting entity, which is issued by an affiliated entity, or which includes the obligations of an affiliated entity, should be treated as an affiliated investment. NAIC staff proposed that further revisions to SSAP No. 25 are needed to clarify that any invested asset held by a reporting entity that (i) is issued by an affiliated entity or (ii) includes the obligations of an affiliated entity should be categorized as an "affiliated investment" for purposes of SSAP No. 25. Specifically, SSAP No. 25 would be revised to add language to specifically state that "[a]ny invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of any affiliated entity is an affiliate investment." The SAP Working Group will also direct the Blanks (E) Working Group to modify the annual statement instructions where the "Parent, Subsidiaries and Affiliates" header appears to include the same clarifying language.

During 2022, the SAP Working Group continued to make progress on its principles-based bond definition project (the "Bond Project").

b. Bond Project

During 2022, the SAP Working Group continued to make progress on its principles-based bond definition project (the "**Bond Project**"). At the Fall 2022 National Meeting, the SAP Working Group exposed revisions to (i) SSAP No. 26R — Bonds ("**SSAP No. 26R**") and SSAP No. 43R as well as certain other identified SSAPs and guidance that will be affected by the revisions to be made under the Bond Project, (ii) reporting changes to Schedule D-1 as well as other identified schedules and instructions relating to bond reporting, and (iii) the revised issue paper, which details the discussions and decisions on the Bond Project to date. The SAP Working Group is currently targeting a January 1, 2025 effective date for the proposed changes to be adopted as part of the Bond Project.

The SAP Working Group began its work on the Bond Project in October 2020 through the development of a principle-based bond definition to be used for all securities in determining whether they qualify for reporting on Schedule D-1. Within the bond definition, bonds are classified as an "issuer credit obligation" or an "asset-backed security." An "issuer credit obligation" is defined as a bond where repayment is supported by the general creditworthiness of an operating entity, and an "asset-backed security" is defined as a bond issued by an entity created for the primary purpose of raising debt capital backed by financial assets. The exposed revisions to SSAP No. 26R and SSAP No. 43R incorporate these concepts into the SSAPs. The most recent exposed revisions to these SSAPs incorporate comments received from industry representatives as well as structural changes to include the entire bond definition in SSAP No. 26R and the description of securities that qualify as an asset-backed security under the bond definition in SSAP No. 43R.

At its July 18, 2022, meeting, the SAP Working Group also exposed revisions to the annual statement general instructions to clarify that only those investments that meet the bond definition or are otherwise in scope of SSAP No. 26R or SSAP No. 43R may be reported on Schedule D-1. The proposal would require that Schedule D-1, Section 1 detail issuer credit obligations (within the scope of SSAP No. 26R) while Schedule D-2, Section 2 would detail asset-backed securities (within the scope of SSAP No. 43R). With respect to the proposed reporting changes, in addition to the revisions made to the general instructions and Schedule D-1-1 and Schedule D-1-2 in response to industry comments from the prior exposure, NAIC staff also reviewed the full schedule and annual statement instructions and identified all areas that may require revision to reflect the more granular reporting under the Bond Project. The Fall 2022 National Meeting exposure includes a list of all such additional schedules and instructions where additional edits may be required for consideration. The SAP Working Group will sponsor a proposal to the Blanks (E) Working Group to incorporate the proposed reporting changes.

As previously noted by the SAP Working Group, investments that do not qualify as bonds after such revisions are adopted will not be permitted to be reported as bonds on Schedule D-1 thereafter, as there will be no grandfathering for existing investments that do not qualify under the revised SSAPs. However, certain accommodations may be made to prevent undue hardship for reporting entities complying with the new guidance.

As a result of the rising interest rate environment, prior to the Fall 2022 National Meeting the SAP Working Group developed an agenda item to discuss the interest maintenance reserve ("IMR") within statutory accounting …

c. Interest Maintenance Reserve Guidance

As a result of the rising interest rate environment, prior to the Fall 2022 National Meeting the SAP Working Group developed an agenda item to discuss the interest maintenance reserve ("**IMR**") within statutory accounting; specifically the current guidance for the nonadmittance of disallowed negative IMR. At the Fall 2022 National Meeting, the SAP Working Group exposed a request for comment from industry on potential guardrails and considerations related to the existing statutory accounting guidance on IMR, with a specific focus on the treatment of negative IMR in response to the recent decreases in insurers' IMR balances as a result of rising interest rates.

The agenda item was brought to the attention of the SAP Working Group through a letter received from the ACLI raising concerns regarding negative IMR. The ACLI's letter was sent in connection with discussions among LATF on recommended guidance for year-end 2022 on the allocation of IMR for asset adequacy testing and principle-based reserving purposes in response to concerns that, given the rising interest rate environment over the last year, insurers selling fixed income assets for a loss would see their IMR balances decrease or become negative. A negative IMR occurs when net realized interest-related losses are greater than net realized interest-related gains, both of which are amortized in the IMR calculation.

The current statutory accounting guidance regarding IMR is limited, but generally provides that a negative IMR is a nonadmitted asset. The ACLI's letter noted that, with the inclusion of a negative IMR balance in asset adequacy testing, the disallowance of a negative IMR can result in double counting of losses (i.e., through the disallowance on the balance sheet and the potential asset adequacy testing-related reserve deficiency). The ACLI argues that such treatment is contrary to the original intent of IMR, which recognized that both interest-related gains and losses are transitory without any true economic substance as the proceeds would be reinvested at offsetting lower or higher interest rates, respectively, and therefore proposed the allowance of a negative IMR balance in statutory accounting in order to fulfill its original purpose.

The current statutory accounting guidance regarding IMR is limited, but generally provides that a negative IMR is a nonadmitted asset.

In response to these concerns, as well as the discussions by LATF, the SAP Working Group has undertaken this review to evaluate the existing statutory guidance and determine whether the changes proposed by the ACLI should be implemented. As such, the SAP Working Group has requested that industry provide comments on potential guardrails and other considerations in respect of such proposal. In addition, the SAP Working Group directed NAIC staff to coordinate with LATF and request regulator-only sessions with industry to receive specific company information on the current treatment of IMR. In the meantime, the SAP Working Group encouraged companies to discuss the issue with their domiciliary regulators regarding any permitted practices that would need to be implemented with respect to year-end 2022 reporting.

d. Definitions of "Asset" and "Liability"

The SAP Working Group has been considering revisions to SSAP No. 4 — Assets and Nonadmitted Assets ("**SSAP No. 4**") and SSAP No. 5R — Liabilities, Contingencies and Impairments of Assets ("**SSAP No. 5R**") that would revise the definition of an "asset" and a "liability." In December 2021, the Financial Accounting Standards Board ("**FASB**") issued two new chapters of its conceptual framework, which FASB uses to set standards and concepts to consider with respect to proposed accounting and reporting guidance. One such chapter of the new FASB concepts included revisions to the definition of an "asset" and a "liability." Under the FASB concepts, an "asset" is defined as "a present right of an entity to an economic benefit," and a "liability" is defined as "a present obligation of an entity to transfer an economic benefit."

As the FASB concepts are not automatically authoritative, the SAP Working Group undertook a review of the newly issued chapters and proposed updates to determine how to incorporate those concepts into the statutory accounting guidance. In April 2022, the SAP Working Group exposed revisions to SSAP No. 4 and SSAP No. 5R to incorporate the new definitions of an "asset" and a "liability" into the statutory accounting guidance. The exposure also included two issue papers, each articulating the changes for SSAP No. 4 and SSAP No. 5R and FASB's rationale for the changes. Both SSAP No. 4 and SSAP No. 5R are regarded as foundational statements for statutory accounting, as many other statements reference them.

The SAP Working Group adopted the proposed revisions to SSAP No. 4 (and related issue paper) in August 2022; however, interested parties raised concerns with respect to the change of the definition of a "liability" as proposed in SSAP No. 5R, noting that FASB itself recognized that the revised definition "potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets," which could result in instruments with characteristics of both liabilities and equity being in fact classified as liabilities in certain situations. Interested parties asked the SAP Working Group to undertake a SSAP-by-SSAP analysis to identify potential effects of the new definition prior to adoption to avoid unintended consequences and to determine whether the adoption of the exposed liabilities guidance would have an impact. The SAP Working Group, however, sent this request back to interested parties to complete the in-depth review.

Following this additional exposure, interested parties suggested the following language be added to both the definition of "liability" as well as the "asset" definition to ensure there are no conflicts between the new definition and specific guidance in the SSAPs: "The guidance in this statement shall only be applicable to the extent there is not contradictory guidance regarding liabilities addressed in other existing statements." In response, NAIC staff recommended that the Working Group adopt the exposed revisions and incorporate alternative language drafted, which would state: "The guidance in this statement for (asset or liability) recognition is applicable unless another authoritative statement provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply."

… interested parties suggested the following language be added to both the definition of "liability" as well as the "asset" definition to ensure there are no conflicts between the new definition and specific guidance in the SSAPs …

At the Fall 2022 National Meeting, the SAP Working Group re-exposed the revised definition of "liability" and directed NAIC staff to collaborate with interested parties on the proposed clarifying language.

e. Statutory Accounting Treatment for Cryptocurrencies

In 2021, the SAP Working Group addressed inquiries regarding the statutory accounting treatment for cryptocurrencies. Specifically, the SAP Working Group determined that, because cryptocurrencies are not expressly identified as an admitted asset in the Accounting Practices and Procedures Manual, cryptocurrencies are nonadmitted assets. In addition, the SAP Working Group adopted interpretive guidance in "INT-21-01T: Statutory Accounting Treatment for Cryptocurrencies" to clarify that cryptocurrencies do not meet the definition of cash in SSAP No. 2R — Cash, Cash Equivalents, Drafts, and Short-Term Investments. The SAP Working Group also sponsored a referral to the Blanks (E) Working Group to add a new general interrogatory to require disclosure of when cryptocurrencies are directly held by insurance companies or permitted to be used as a form of payment for remittance of premiums.

... in May 2022, the Blanks (E) Working Group added a new general interrogatory to require disclosure pertaining to cryptocurrencies directly held by insurers or permitted for the remittance of premiums to insurers and to better understand if and how cryptocurrencies are being utilized by insurance companies.

In response to such referral, in May 2022, the Blanks (E) Working Group added a new general interrogatory to require disclosure pertaining to cryptocurrencies directly held by insurers or permitted for the remittance of premiums to insurers and to better understand if and how cryptocurrencies are being utilized by insurance companies. Specifically, the changes add new questions to General Interrogatories Part 1 on whether the reporting entity accepts cryptocurrency for payment of premiums, which cryptocurrencies are accepted, and whether they are held for investment or immediately converted to U.S. dollars. The new interrogatory is effective for 2022 year-end reporting in the annual statutory financial statements.

12. NAIC and States Prioritize Climate and Resiliency Issues

a. Enhancements to Financial Solvency Regulation Manuals to Address Climate Risk

Climate-related risk and resiliency issues continued to be areas of NAIC interest in 2022.

Climate-related risk and resiliency issues continued to be areas of NAIC interest in 2022. In furtherance of its charge to evaluate financial regulatory approaches to climate risk and resiliency, the Climate and Resiliency (EX) Task Force made a series of referrals to various task forces and working groups under the (E) Committee intended to explore potential enhancements to existing solvency monitoring processes with respect to climate risk and resiliency.

Over the course of 2021, the Solvency Workstream of the Climate and Resiliency (EX) Task Force held a series of public panels on existing regulatory tools in relation to climate issues and their potential effect on insurer solvency, and solicited public input on potential enhancement to such tools. As a result of comments received, the Solvency Workstream suggested that the applicable task forces and working groups under the (E) Committee consider modifications to the NAIC's Financial Analysis Handbook, Financial Condition Examiners Handbook, and ORSA Guidance Manual.

The proposed enhancements include the following, among others:

- Incorporation of procedures into the Financial Analysis Handbook for using Climate Risk Exposure Survey results in conducting ongoing financial analysis;
- Addition of sample interview questions to the Financial Condition Examiners Handbook related to climate change risks for various executive and board member positions;
- Enhancements to repository risks in the Financial Condition Examiners Handbook to encourage consideration of energy transition and physical risks in an insurer's investment portfolio and strategy; and
- Provision of guidance in the ORSA Guidance Manual indicating that the insurer should include a description of how climate change risk is addressed through its risk management framework.

The proposed enhancements were presented as high-level principles for the (E) Committee to consider and develop as appropriate. Work on modifications to the NAIC's Financial Analysis Handbook, Financial Condition Examiners Handbook, and ORSA Guidance Manual is expected to begin in 2023.

b. Redesigned Climate Risk Disclosure Survey

At the Spring 2022 National Meeting, the Executive (EX) Committee adopted a redesigned NAIC Climate Risk Disclosure Survey (the "**Climate Risk Disclosure Survey**") as a voluntary tool for state use. The purpose of the redesign was to make the Climate Risk Disclosure Survey consistent with the international Task Force on Climate-Related Financial Disclosures (the "**TCFD**").

At the Spring 2022 National Meeting, the Executive (EX) Committee adopted a redesigned NAIC Climate Risk Disclosure Survey (the "Climate Risk Disclosure Survey") as a voluntary tool for state use.

The TCFD was developed by the FSB as a global voluntary framework for public disclosure of climate-related risks and opportunities. Use of the TCFD framework has been supported by various industries both within and outside the U.S., as mandates for climate-related disclosures grow and regulators look for a more standardized method of reporting. Use of the TCFD framework by the insurance industry has been supported by both the IAIS and the United Nations ("**UN**")-convened Sustainable Insurance Forum, a network of insurance supervisors and regulators that includes as members the U.S. Department of the Treasury ("**Treasury Department**") and the NAIC, as well as certain individual state insurance regulators from California, New York, Vermont, and Washington. In March 2021, the SEC published its proposals for climate risk disclosures that would also require disclosures in line with the TCFD framework.

The Climate Risk Disclosure Survey applies to insurers that meet the reporting threshold of US$100 million in countrywide direct premium and are licensed in one of the participating jurisdictions. The following 15 states/jurisdictions committed to utilize the Climate Risk Disclosure Survey in 2022 for insurance companies licensed in their jurisdictions: California, Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington. Insurance companies were required to comply with reporting by November 30, 2022. The California Department of Insurance provides a publicly available database containing each insurer's response to the survey.

Responses to the Climate Risk Disclosure Survey will be due from insurers by August 31, 2023. Extensions may be granted by the relevant state.

13. NAIC Continues Efforts to Address Innovation and Technology in the Insurance Sector

a. NAIC Establishes Working Group to Examine Innovation in Technology and Regulation

At the Spring 2022 National Meeting, the Innovation, Cybersecurity, and Technology (H) Committee ("**(H) Committee**") appointed a new working group, the Innovation in Technology and Regulation (H) Working Group, and adopted its proposed charges. The Innovation in Technology and Regulation (H) Working Group is co-chaired by Evan Daniels (Arizona) and Dana Popish Severinghaus (Illinois). The Innovation in Technology and Regulation (H) Working Group functions as a regulatory sandbox to provide a forum for discussion among all stakeholders regarding technology and the ways in which regulators are facilitating innovation. The Innovation in Technology and Regulation (H) Working Group's specific charges are the following:

At the Spring 2022 National Meeting, the Innovation, Cybersecurity, and Technology (H) Committee ("(H) Committee") appointed a new working group, the Innovation in Technology and Regulation (H) Working Group ...

- Develop forums, resources, and materials for discussing innovation and technology regarding companies, producers, state insurance regulators, and licensees relevant to the state-based insurance regulatory structure, including new products, services, business models, and distribution mechanisms.
- In conjunction with NAIC staff, explore developing a forum that provides insurers or third parties working with insurers the opportunity to confidentially brief state insurance regulators regarding innovation and technology applications, tests, use cases, and results.
- Identify and discuss regulatory models or programs that may assist state insurance regulators to identify and better understand innovation taking place within the insurance industry.
- Monitor innovation work occurring in other NAIC letter committees, task forces, and working groups, and identify areas of possible coordination for the (H) Committee.

Over the course of 2022, the working group met quarterly to discuss various topics relating to state approaches to facilitating innovation across the country.

Over the course of 2022, the working group met quarterly to discuss various topics relating to state approaches to facilitating innovation across the country.

b. NAIC Considers Regulatory Framework for Use of AI by the Insurance Industry

During the Fall 2022 National Meeting, the (H) Committee announced its intention to begin drafting an interpretive bulletin outlining a regulatory framework for the use of AI by the insurance industry …

Among other things, the AI Model Bulletin is anticipated to describe regulatory expectations for the use of AI by insurers (including both governance and enterprise risk management standards) as well as provide standards for insurance regulators to oversee and examine the use of AI by insurance carriers. The AI Model Bulletin is expected to articulate standards at a high level and to apply to the use of AI-supported decision-making in general.

During the Fall 2022 National Meeting, the (H) Committee announced its intention to begin drafting an interpretive bulletin outlining a regulatory framework for the use of AI by the insurance industry (the "**AI Model Bulletin**").

Among other things, the AI Model Bulletin is anticipated to describe regulatory expectations for the use of AI by insurers (including both governance and enterprise risk management standards) as well as provide standards for insurance regulators to oversee and examine the use of AI by insurance carriers. The AI Model Bulletin is expected to articulate standards at a high level and to apply to the use of AI-supported decision-making in general.

The (H) Committee considers AI to be a means by which the insurance industry engages in conduct that is already subject to regulatory standards (including, among others, regulations relating to underwriting, rating, and unfair trade practices). As a result, the (H) Committee believes that a model bulletin is the appropriate form for this guidance. While the (H) Committee has not yet set a timeline for drafting the AI Model Bulletin, it expects to provide an update on the process at the Spring 2023 National Meeting.

The (H) Committee's work on the AI Model Bulletin is an outgrowth of the work conducted by the Collaboration Forum's Project on Algorithmic Bias. The Collaboration Forum, which was established by the (H) Committee at the Spring 2022 National Meeting, is intended to serve as a platform for multiple NAIC committees to interact to identify and address foundational issues and develop a common framework with respect to innovation, technology, and cybersecurity topics of broad impact across various NAIC workstreams. The objective is to assure that such matters are addressed and decided with the full complement of relevant subject matter experts and disciplines to inform the specific workstreams of relevant NAIC committees.

The Collaboration Forum's initial project was "algorithmic bias," which refers to systematic errors in computing systems driven by predictive models, AI, and machine learning that result in unfair discrimination with respect to insurance consumers. The focus of the project was to develop methods that regulators can use to evaluate predictive models (e.g., a set of models that use statistics to predict outcomes for insurance products, including rating plans) for any unfair bias. The project aligns with activities of the Special (EX) Committee on Race and Insurance, whose charges include research and analysis of insurance, legal, and regulatory approaches to address unfair discrimination, disparate treatment, proxy discrimination, and disparate impact as well as coordinating with other NAIC workstreams on issues or practices that affect or potentially disadvantage people of color and/or historically underrepresented groups, particularly in predictive modeling, price algorithms, and AI.

c. NAIC Proposes Model and Data Regulatory Questions

The Big Data and Artificial Intelligence (H) Working Group (the "**Big Data Working Group**") exposed draft Model and Data Regulatory Questions at the Fall 2022 National Meeting for a public comment period ending February 13, 2023. The document contains questions that regulators can use when investigating any model or data used by insurance companies, whether developed internally or obtained from external sources. The document includes both general questions and detailed technical questions, which can be used as appropriate depending on the underlying reason for the investigation. Ultimately, the questions are not required to be used by regulators and can be supplemented, modified, or omitted as appropriate given the regulatory purpose for the investigation. The document also includes a "Definitions" section to provide clarification regarding some key terms used.

… industry representatives expressed concern that the questions assume legal standards that have not necessarily been adopted by state legislatures. Consumer representatives, on the other hand, focused on the need for regulators to ensure that unregulated entities are not engaged in anticompetitive behavior …

The Model and Data Regulatory Questions are intended to work in concert with similar questions developed by other NAIC working groups and task forces, including questions relating to P&C rate modeling and data, and questions relating to accelerated underwriting.

Initial comments from industry representatives focused on the potential hardships that may be imposed by requiring smaller insurance enterprises to answer the proposed detailed questions. In addition, industry representatives expressed concern that the questions assume legal standards that have not necessarily been adopted by state legislatures (e.g., European-style consumer privacy protections and disparate impact analysis). Consumer representatives, on the other hand, focused on the need for regulators to ensure that unregulated entities are not engaged in anticompetitive behavior by, for example, supplying the same data to multiple insurance carriers and facilitating, in practice, coordinated underwriting decision-making across various companies. Consumer representatives also suggested that regulators should use data scientists to examine models and their outputs directly and to make this data available to the public (subject to trade secret and other confidentiality concerns).

d. NAIC Adopts Accelerated Underwriting in Life Insurance Educational Report

At the Spring 2022 National Meeting, the (A) Committee adopted the Accelerated Underwriting in Life Insurance Educational Report (the "**Accelerated Underwriting Educational Report**"), which was adopted by the Accelerated Underwriting (A) Working Group on March 24, 2022. The Accelerated Underwriting Educational Report summarizes the state of the life insurance industry with regard to its use of accelerated underwriting, contextualizes that summary and the topic of accelerated underwriting within the NAIC's work and standard regulatory product evaluation processes, and makes recommendations for regulators and insurers when evaluating accelerated underwriting.

The Accelerated Underwriting Educational Report summarizes the state of the life insurance industry with regard to its use of accelerated underwriting, contextualizes that summary and the topic of accelerated underwriting within the NAIC's work and standard regulatory product evaluation processes, and makes recommendations for regulators and insurers when evaluating accelerated underwriting.

Following adoption of the Accelerated Underwriting Educational Report, on February 22, 2023 the Accelerated Underwriting (A) Working Group exposed draft regulatory guidance and considerations for state regulators on the use of external data and data analytics in accelerated underwriting for life insurance products (the "**AU Guidance**") for a 45-day public comment period. The AU Guidance is intended to be used by state regulators when reviewing accelerated underwriting programs used by life insurers to ensure the programs are fair, transparent and secure in compliance with existing law. The AU Guidance will also provide sample questions and areas for review for state regulators.

In connection with the issuance of the AU Guidance, the Accelerated Underwriting (A) Working Group intends to make a referral to the Market Conduct Examination Guidelines (D) Working Group with suggested additions to the NAIC's Market Regulation Handbook addressing accelerated underwriting in life insurance. The Accelerated Underwriting (A) Working Group plans to recommend that the additional explanation and review criteria be added to the Market Regulation Handbook to alert market conduct examiners to the novel data and processes utilized by life insurers in accelerated underwriting. The referral was exposed on February 22, 2023 for a 30-day public comment period.

The Accelerated Underwriting (A) Working Group intends to meet publicly in spring 2023 to discuss comments received on the AU Guidance and the referral to the Market Conduct Examination Guidelines (D) Working Group.

e. NAIC Considers Amendments to Model Unfair Trade Practices Act

During the Fall 2022 National Meeting, the Market Regulation and Consumer Affairs (D) Committee (the "**(D) Committee**") adopted a Request for NAIC Model Law Development to amend the Unfair Trade Practices Act (#880) to provide state insurance regulators with appropriate regulatory authority over the activities of lead generators in the health insurance marketplace. The Improper Marketing of Health Insurance (D) Working Group initially requested review of the model in furtherance of its ongoing work to review existing NAIC models that address the use of lead generators for sales of health insurance products and to identify models that need to be updated or developed to address current marketplace activities.

Certain states, including Texas and Ohio, expressed concerns with the approach outlined in the Request for NAIC Model Law Development, indicating that the current proposal may not provide all state insurance departments with greater regulatory oversight over health insurance lead generators than they already have. These states advocated for a more comprehensive approach under which the NAIC would consider input from various stakeholders before proceeding with the proposed changes. Despite these objections, the (D) Committee ultimately adopted the Request for NAIC Model Law Development, with proponents of the request noting that it was only an initial step in the process and that further revisions to the model (or other NAIC model laws or guidelines) may be considered outside of what has initially been proposed.

14. Privacy and Cybersecurity

a. NAIC Continues Development of Privacy Protections Model Act

On January 31, 2023, the Privacy Protections (H) Working Group (the "**Privacy Working Group**") exposed a new Privacy Protections Model Act (#674) (the "**New Privacy Model Act**") for a comment period ending April 3, 2023. The New Privacy Model Act is intended to enhance consumer privacy protections and includes elements of the existing NAIC Insurance Information and Privacy Protection Model Act (#670) (the "**Privacy Model Act**") and the Privacy of Consumer Financial and Health Information Regulation (#672) (the "**Privacy Model Regulation**"), as well as other state, federal, and international privacy protections.

Following the Spring 2022 National Meeting, the Privacy Working Group began a review of state insurance privacy protections regarding the collection, ownership, use, and disclosure of information gathered in connection with insurance transactions and considered revisions to the Privacy Model Act and the Privacy Model Regulation.

Following the Spring 2022 National Meeting, the Privacy Working Group began a review of state insurance privacy protections regarding the collection, ownership, use, and disclosure of information gathered in connection with insurance transactions and considered revisions to the Privacy Model Act and the Privacy Model Regulation. As part of its review, the Privacy Working Group received comments from various industry and consumer representatives asking for one new model to replace the Privacy Model Act and Privacy Model Regulation rather than updating the existing models. After further consideration, the Privacy Working Group determined that because the existing models were adopted several decades ago, a new model law would be necessary to enhance consumer protections and the corresponding obligations of licensed entities to reflect the extensive innovations that have been made in communications and technology over the years.

In parallel with the development of the New Privacy Model Act, the Privacy Working Group is drafting a "reference document" on data ownership and use rights. The purpose of the reference document will be to explain how and why certain changes to the existing regulatory framework will be made under the New Privacy Model Act.

b. State Innovation in Comprehensive Privacy and Data Security Legislation

2022 continued to be an active year for state privacy and data security legislation.

On the privacy front, Utah and Connecticut joined the ranks of states with comprehensive privacy laws.

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On the privacy front, Utah and Connecticut joined the ranks of states with comprehensive privacy laws. As of January 1, 2023, the California Privacy Rights Act ("**CPRA**") amendments to the California Consumer Protection Act and the Virginia Consumer Data Protection Act went into effect and, as of July 1, 2023, the Colorado Privacy Act ("**CPA**") will go into effect. While each of the five comprehensive state privacy laws passed thus far have exemptions or exceptions relevant to entities subject to the Gramm-Leach-Bliley Act, as well as for entities subject to the Health Insurance Portability and Accountability Act, the scope of these provisions are not uniform. Moreover, there is still uncertainty regarding exactly how the obligations in California and Colorado will be implemented, as the states are still finalizing the implementing regulations.

Regarding data security, Kentucky and Maryland joined numerous other states in its adoption of versions of the NAIC's Insurance Data Security Model Law …

Regarding data security, Kentucky and Maryland joined numerous other states in its adoption of versions of the NAIC's Insurance Data Security Model Law (#668), and the New York State Department of Financial Services ("**NYDFS**") continues to be at the forefront of cyber enforcement actions under its Regulation 500 (for which proposed revisions have been published).

i. New State Privacy Laws: Utah and Connecticut

Utah's state data privacy law, the Utah Consumer Privacy Act ("**UCPA**"), goes into effect on December 31, 2023. A few key components of the law: first, the UCPA, like many other state laws, only applies to entities with an annual revenue of US$25 million that conduct business in Utah or produce products or services targeted to Utah consumers and either (i) control or process the personal data for 100,000+ residents during a calendar year, or (ii) derive over 50% of their gross revenue from the sale of personal data, and control or process personal data for 25,000+ consumers; second, it provides Utah residents with data subject rights (e.g., the right to access and delete their personal data) and opt-out of "sale" and "targeted advertising"; third, it exempts personal data relating to individuals acting in an employment or commercial context; and fourth, enforcement resides solely with the Utah Attorney General (i.e., no private right of action).

Connecticut followed suit shortly after Utah when it enacted the Connecticut Data Privacy Act, which will go into effect on July 1, 2023. Similar to the UCPA, there is no private right of action and enforcement will reside with the Connecticut Attorney General. It also does not provide for rulemaking, but does instruct a task force to recommend "possible legislation" in certain hot topics, such as children's privacy and algorithmic bias, by January 1, 2023.

As far as requirements, there are a few notable features: first, the Connecticut Data Privacy Act only applies to "persons" that conduct business in the state or that "produce products or services" targeted at Connecticut residents and either (i) controlled or processed personal data for 100,000+ residents (excluding payment transactions), or (ii) controlled or processed personal data for 25,000+ residents and derived 25+% of their revenue from the sale of personal data; second, similar to other laws, the Connecticut Data Privacy Act provides residents with data subject rights (e.g., the right to access and delete their personal data) and opt-out of "sale" and "targeting advertising and profiling"; third, controllers must provide a mechanism for consumers to revoke consent that is "at least as easy" as the mechanism by which they provided consent.

ii. Further Rulemaking Development in California and Colorado

In California and Colorado, CPRA and CPA rulemaking is still ongoing. The draft rules in both states are expected to impose additional, specific requirements on covered entities beyond what is contemplated by the respective statutes.

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The California Privacy Protection Agency (the "**CPPA**"), the agency tasked with developing the regulations, is expected to finalize its first rulemaking process in the first half of 2023, at which point the CPPA will launch a second rulemaking focused on automated decision-making, risk assessments, and cybersecurity audits. Despite the lack of rulemaking, the California Attorney General has indicated their intent to still pursue enforcement beginning on July 1, 2023.

The Colorado Attorney General has released two drafts of the proposed rules as of January 2023, and observers predict the rulemaking to be complete by the July 1, 2023 enforcement date. Companies should therefore actively monitor developments with these rulemakings and additional state comprehensive privacy laws.

iii. Two Additional States Adopt the NAIC's Insurance Data Security Model Law: Kentucky and Maryland

In addition to these new comprehensive privacy laws, Kentucky and Maryland each adopted a version of the NAIC's Insurance Data Security Model Law (#668). These laws require licensees of their states to, among other things, maintain a comprehensive written information security program, perform a risk assessment to identify appropriateness of implementing certain technical safeguards (such as multifactor authentication and encryption), develop an incident response plan, and require third-party service providers to implement security measures. Licensees must also provide notice of certain cybersecurity events to relevant state insurance commissioners within three business days of a determination that the cybersecurity event has occurred.

c. New York Cybersecurity Enforcement Activity

The NYDFS continues to actively enforce its cybersecurity regulation (23 NYCRR Part 500), which requires all banks, insurance companies, and other financial services institutions and licensees regulated by the NYDFS to establish and maintain a cybersecurity program. The NYDFS cybersecurity regulation includes specific technical safeguards, as well as requirements regarding governance, incident planning, training, data management, system testing, and regulator notification of the occurrence of certain cybersecurity events. Initial portions of the regulation became effective in March 2017, and the regulation became fully effective in March 2019. As discussed in more detail below, the NYDFS recently published its proposed second amendment to the regulation.

The NYDFS continues to actively enforce its cybersecurity regulation (23 NYCRR Part 500), which requires all banks, insurance companies, and other financial services institutions and licensees regulated by the NYDFS to establish and maintain a cybersecurity program.

Throughout 2022, the NYDFS settled enforcement actions relating to its cybersecurity regulation against three companies:

- In June 2022, the NYDFS announced a settlement with Carnival Corporation, imposing a penalty in the amount of US$5 million and requiring Carnival to surrender its producer license.

- In August 2022, the NYDFS announced a settlement with Robinhood Crypto LLC, imposing a penalty in the amount of US$30 million.
- In October 2022, the NYDFS announced a settlement with EyeMed Vision Care LLC, imposing a penalty in the amount of US$4.5 million.

Two of the matters (Carnival and EyeMed) were directly tied to a data breach that each individual company experienced; whereas the Robinhood matter involved alleged violations of bank secrecy act/anti-money laundering ("**BSA/AML**") and cybersecurity obligations. The significant penalty imposed on Robinhood is mostly attributable to the NYDFS's concerns with Robinhood's BSA/AML violations rather than the cybersecurity regulation.

Continuing last year's theme, the NYDFS remains focused on the multi-factor authentication ("**MFA**") requirement, alleging that Carnival and EyeMed failed to implement MFA as required. The NYDFS also appears to be focused on the requirement to conduct cybersecurity risk assessments. It alleged that Robinhood and EyeMed failed to conduct compliant risk assessments as required. As a result, the NYDFS contended that the three companies' certifications of compliance with the cybersecurity regulation were false.

Each of the consent orders also imposed penalties beyond just monetary penalties. Most notably, Carnival surrendered its insurance producer licenses and thereby ceased selling insurance in the State of New York. Meanwhile, Robinhood agreed to retain a third-party consultant to review, report on, and assist in its compliance with the cybersecurity regulation, and EyeMed agreed to conduct a risk assessment and develop a detailed action plan to address the identified gaps.

Companies should immediately consider implementing MFA and performing compliant risk assessments as best practices to proactively defend against potential NYDFS enforcement actions, to the extent they have not already done so.

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d. New York Proposes Revisions to Cybersecurity Regulations

On November 9, 2022, the NYDFS published a proposed second amendment to its cybersecurity regulations. Most of the amendment's proposals are set to go into effect 180 days after its publication in the New York Register, which date is still uncertain. However, certain parts of the amendment have different effective dates, including the new breach notice requirement, which becomes effective 30 days from publication.

The proposal includes substantial revisions that add numerous new, stringent, and more detailed obligations. Broadly, the amendments would heighten management involvement in certification; increase governance requirements; prescribe additional technologies and policies across the information security program; increase audit and testing requirements; expand breach notification requirements; and impose additional requirements on larger "Class A" entities. The NYDFS also proposed more explicit criteria for the calculation of penalties that would increase transparency but also create multipliers that could expose entities to significant fines. Regardless of the final outcome, this proposal indicates the NYDFS's intent to remain at the forefront of cybersecurity regulation amid an increase in state and federal level cybersecurity regulations.

While not exhaustive, the following information previews some of the most significant proposed revisions.

- **New Class of Entities**. Class A companies would include those covered entities with at least US$20 million in gross annual revenue in each of the last two fiscal years from business operations of the covered entity and its affiliates in New York and: (i) over 2,000 employees averaged over the last two fiscal years, including those of both the covered entity and all of its affiliates no matter where located; or (ii) over US$1 billion in gross annual revenue in each of the last two fiscal years from all business operations of the covered entity and all of its affiliates. Class A entities would be required to employ additional standards as identified throughout the regulation.
- **Governance Changes**. Cybersecurity policies would need to be approved annually by the senior governing body or the senior officer responsible for the cybersecurity program if a senior governing body does not exist. Relatedly, the board would be required to have or be advised by

experts sufficient for effective oversight of cyber risk and have a committee or subcommittee with dedicated cybersecurity responsibility. The entity's chief information security officer would also be required to "timely" report "material cybersecurity issues" to the senior governing body instead of the current annual requirement.

- **Cybersecurity Policy**. Cybersecurity policies would need to be updated annually instead of periodically and implemented in accordance with separate documented procedures for specific issues like access control. In addition to the policy changes, all employees would need at least annual training on cyber awareness, with a special emphasis on social engineering.
- **Technology Requirements**. All covered entities would need to implement: (i) email monitoring and filtering; and (ii) MFA for any remote access to the entity's information systems and third-party applications. Class A companies would need to implement: (i) Endpoint Detection and Response Solution; (ii) a Security Information and Event Management System; (iii) an automated method of blocking commonly used passwords; and (iv) a privileged access management solution.
- **Breach Notification Requirements**. Covered entities would need to provide notice when an unauthorized user has gained access to a privileged account regardless of whether it resulted in a compromise of important data or materially impacted systems. Incidents at third-party service providers that affect the covered entity would need to be reported to the NYDFS no later than 72 hours after awareness. Notice of ransomware within a material part of the entity's information system would be required and notice of payments would need to be filed within 24 hours. Following the initial notification, entities would also have to supplement the filing within 30 days with a detailed explanation of whether and why they paid a ransom, the alternatives they considered, and their diligence conducted to determine payment would not violate sanctions law.

15. Litigation Developments

a. Litigation Related to the COVID-19 Pandemic and Business Interruption Insurance Coverage

In the 2022 edition of the *Sidley Global Insurance Review*, we reported on a wave of litigation against property insurers arising from the COVID-19 pandemic. In roughly 2,400 cases to date, policyholders have claimed that they are entitled to recover income they lost when their businesses were fully or partially closed under government shutdown orders. The plaintiffs in nearly one-third of the cases are businesses in the restaurant industry.[29]

The wave has now slowed to a trickle. After a brief spate of activity in March 2022, when two-year contractual limitations periods in many policies expired, weekly filings are down to the low single digits.

On the merits, insurers have been overwhelmingly successful. The difficulty policyholders have faced is that virtually all policies cover only those income losses caused by a suspension of operations that results from direct physical damage to or direct physical loss of property. In an effort to establish coverage, policyholders have advanced three principal theories, arguing that direct physical damage or loss occurs (i) when they lose the use of property for its intended purposes, (ii) when the coronavirus is physically present on the property, and (iii) when they make alterations required to keep a business open, such as installing plexiglass or rearranging floor space and furniture to ensure that people are distanced from one another.

Courts have consistently rejected all three theories, observing (i) that the term "loss of use" does not appear in the coverage provisions and is often the subject of a policy exclusion, (ii) that a property potentially contaminated by the virus can easily be cleaned, and (iii) that alterations required to keep a business open are distinct from physical loss or damage that causes a business to suspend operations.

In federal trial courts, insurers have won pleading motions in approximately 95% of the cases filed since the beginning of the pandemic. In state trial courts, insurers have won early dismissal in approximately 75% of the cases.

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29 Filing and case resolution statistics are taken from the University of Pennsylvania Carey Law School's COVID Coverage Litigation Tracker at https://cclt.law.upenn.edu/.

The appellate picture continues to be favorable for insurers.

The appellate picture continues to be favorable for insurers. Every federal circuit court has now issued at least one decision affirming dismissal. State appellate courts, on which policyholders initially placed high hopes, are also breaking very largely in insurers' favor. State supreme courts have affirmed dismissal in nine states, and state intermediate courts have affirmed dismissal in another nine states.

There are a few outliers. Policyholders' sole state supreme court victory comes from Vermont. *Huntington Ingalls Indus. Inc. v. Ace Am. Ins. Co.*, – A3d – , 2022 WL 4396475 (Vermont 2022). The plaintiff shipyard in that case alleged that employees began testing positive for COVID-19 as early as March 2020, and that the virus had been continuously present on the property since that time. In a 3-2 decision, the Vermont Supreme Court held that these allegations were sufficient to clear the state's pleading standard, which has been described as "exceedingly low." Other state and federal courts have subsequently criticized or declined to follow *Huntington Ingalls*.

Policyholders also prevailed in cases in intermediate appellate courts in three states — California, Louisiana, and Pennsylvania. But those decisions, two of which were accompanied by vigorous dissents, may ultimately be of limited value to policyholders. Both the California and Pennsylvania decisions led to a division among the intermediate appellate courts of the respective states. In California, other intermediate appellate courts had already affirmed dismissal or summary judgment in insurers' favor, and continued to do so after the pro-policyholder decision was issued. In Pennsylvania, the *en banc* intermediate appellate court issued two arguably contradictory decisions on the same day, making state supreme court review appear likely. In Louisiana, the state supreme court has already accepted review of the intermediate court's decision and has heard argument.

Substantively, two of the decisions — those from California and Louisiana — may, if applied at all, be limited to cases in which (as in Vermont) policyholders are able to allege that the virus was actually present on the property. That is a narrower theory than "loss of use." And with one exception, the decisions address only the initial question of coverage. In none was the broad Insurance Services Office, Inc. virus exclusion at issue; that exclusion is present in many policies. On balance, insurers have overwhelmingly had the upper hand in 2022, as COVID-19 property insurance litigation continues to near its end.

b. Court Interprets California Law Related to Unlawful Lapse of Insurance Policies in *McHugh v. Protective Life Insurance*

In *McHugh v. Protective Life Insurance*, 12 Cal.5th 213 (Cal. 2021) the California Supreme Court addressed the retroactive application of the life insurance policy lapse notice provisions in Sections 10113.71 and 10113.72 of the California Insurance Code. Those statutes, which took effect in 2013, require a 60-day grace period after a missed premium payment and require life insurers to notify both policyholders and persons designated by policyholders to receive notice, at least 30 days before lapsing a policy for unpaid premiums.

In *McHugh*, the insurer issued a 60-year term life insurance policy to Mr. Blakely McHugh in 2005. Premiums were due annually, and the policy provided a 31-day grace period before it could be terminated for non-payment of premium. McHugh made the annual premium payments through January 2012, but paid nothing thereafter. The insurer sent McHugh several letters warning that the policy would lapse on February 9, 2013 absent payment of the premiums. On February 18, 2013, the insurer sent a letter advising McHugh that his policy had lapsed, but could be reinstated if payment was received by March 12, 2013, during his lifetime. McHugh did not pay, and the insurer formally terminated his policy. In June 2013, McHugh passed away. His beneficiaries made a claim for payment and the insurer denied it in light of the policy's lapse. The beneficiaries filed suit, arguing that the lapse was barred by Sections 10113.71 and 10113.72. They asserted claims for breach of contract and breach of the implied covenant of good faith and fair dealing. The insurer responded that those statutes did not apply since the policy was issued prior to their January 1, 2013 effective date.

At the trial court, a jury found for the insurer. Plaintiffs appealed, arguing that the trial court erred in, *inter alia*, failing to conclude as a matter of law that Sections 10113.71 and 10113.72 applied to policies that were in force as of January 1, 2013, and not just policies issued on or after that date. The Court of Appeals affirmed, and added an additional ground for affirmation that the statutes do not apply retroactively. The California Supreme Court granted review, framing the question as whether the statutes apply to all life insurance policies in force as of January 1, 2013, regardless of when they were issued.

The California Supreme Court reversed and ruled for Plaintiffs. In reaching this conclusion, it began its analysis by addressing the canonical presumption against retroactivity. The Court concluded that the presumption was inapplicable to Sections 10113.71 and 10113.72 because the grace and notice provision were procedural modifications that "simply dictate the procedures for terminating policies after January 1, 2013" rather than imposing new or different liabilities based on earlier conduct. *McHugh*, 494 P.3d at 232. According to the Court, the statutes did not implicate the central concerns underlying the retroactivity presumption because they did not "thrust new legal consequences onto [the insurer's] reenactment policy terminations or otherwise appear to cause the insurer to bear significant and unanticipated costs for its pre-2013 policies." *Id.* at 235.

Having concluded that the presumption against retroactivity was inapplicable, the California Supreme Court went on to address "the broader interpretive question" of whether Sections 10113.71 and 10113.72 applied to the policies at issue. After concluding that the language was ambiguous, the Supreme Court moved to examining the purpose of the statute. The Court found that legislative history indicated that lawmakers had contemplated extending the benefits of the statute to all policyholders, regardless of when they had purchased insurance. The Court also emphasized an amendment to a different section of the California Insurance Code that used the language "after the effective date of this section" — which demonstrated that the California legislature knew how to use future-oriented language when it wanted to do so. The Court concluded that the statutes were intended to apply retroactively. Finally, the California Supreme Court concluded that it was not obligated to defer to informal guidance from the California Department of Insurance indicating the statutes did not apply retroactively, as these sources were not authoritative agency interpretations of the statute.

Following *McHugh*, insurers operating in California now face exposure to lawsuits alleging unlawful lapse of life insurance policies issued prior to January 1, 2013 but in-force as of that date. Since the *McHugh* ruling, dozens of other lapse cases have been brought in California federal and state courts, and additional litigation is expected. Insurers with California life insurance policies that were in-force as of January 1, 2013 are well-advised to ensure their notice procedures fully comply with Sections 10113.71 and 10113.72.

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Insurers with California life insurance policies that were in-force as of January 1, 2013 are well-advised to ensure their notice procedures fully comply with Sections 10113.71 and 10113.72.

B. U.S. FEDERAL ACTIVITY

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

On November 22, 2022, the Department of Labor ("**DOL**") finalized its proposed regulations under the Employee Retirement Income Security Act ("**ERISA**") relating to (i) the consideration by retirement plan fiduciaries of climate change and other ESG factors when making investment decisions and (ii) the requirements of exercising shareholder rights, such as proxy voting. In addition, on July 26, 2022, the DOL announced a proposed amendment to Prohibited Transaction Class Exemption 84-14 ("**QPAM Exemption**") applicable to transactions directed by a "qualified professional asset manager" ("**QPAM**") that would make several significant changes to the exemption. The QPAM Exemption permits a manager that qualifies as a QPAM to engage in a variety of transactions on behalf of plans subject to ERISA or the prohibited transaction provisions of the Internal Revenue Code of 1986, as amended (the "**Code**"), that otherwise would constitute "prohibited transactions" under those laws.

a. Final Regulation Relating to Consideration of ESG Factors

The DOL's final regulation relating to the consideration of ESG factors ("**Final ESG Regulation**") clarifies and restates certain aspects of the proposed regulation relating to the consideration of ESG factors that was issued by the DOL in October 2021. Like the proposed regulation, the Final ESG Regulation is a significant departure from the regulation issued by the prior administration, which became subject to a non-enforcement policy after President Biden took office. The Final ESG Regulation confirms the established rule that ERISA fiduciaries, when making investment decisions, must satisfy both a prudence requirement (i.e., acting with the care, skill, and diligence of a prudent professional acting in a like capacity) and a loyalty requirement (i.e., acting for the exclusive purpose of providing benefits to participants and defraying the reasonable expenses of administering the plan). The Final ESG Regulation clarifies how consideration of ESG factors impacts the prudence and loyalty requirements under ERISA.

The Final ESG Regulation emphasizes that a fiduciary's determination with respect to an investment must be based on factors that the fiduciary reasonably determines are relevant to the risk-and-return analysis.

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The Final ESG Regulation specifically states that risk-and-return factors may include the economic effects of climate change and other ESG factors on a particular investment. Whether any particular consideration is a relevant factor depends on the specific facts and circumstances, and the weight given to any factor by a fiduciary should appropriately reflect the fiduciary's reasonable assessment of the factor's impact on risk and return. In any event, the Final ESG Regulation is clear that an ERISA fiduciary may not subordinate the interests of participants and beneficiaries in their plan benefits to other objectives.

The Final ESG Regulation clarifies that ERISA does not require consideration of ESG factors in all cases. The preamble to the Final ESG Regulation states that the new rule is intended to ensure that: "plan fiduciaries do not misinterpret the final rule as a mandate to consider the economic effects of climate change and other ESG factors under all circumstances. Instead, the final rule makes clear that a fiduciary may exercise discretion in determining, in light of the surrounding facts and circumstances, the relevance of any factor to a risk-return analysis of an investment. A fiduciary therefore remains free under the final rule to determine that an ESG-focused investment is not in fact prudent."

To that end, a set of examples included in the proposed regulation, which highlighted certain ESG factors that fiduciaries might consider when selecting an investment, were removed from the Final ESG Regulation, presumably to clarify that the DOL is not mandating that ERISA fiduciaries consider ESG factors in their investment analysis.

The Final ESG Regulation allows ERISA fiduciaries to consider collateral benefits (i.e., benefits other than investment returns) as "tiebreakers" when choosing between competing investments that serve the plan's economic interests equally well.

The Final ESG Regulation allows ERISA fiduciaries to consider collateral benefits (i.e., benefits other than investment returns) as "tiebreakers" when choosing between competing investments that serve the plan's economic interests equally well. The Final ESG Regulation indicates that, unlike the prior rule that is replaced by the Final ESG Regulation, no special documentation is required to support a plan fiduciary's use of collateral factors in making tiebreaker decisions.

The Final ESG Regulation includes a new provision that was not part of the proposed regulation. This new provision states that fiduciaries will not violate their duty of loyalty under ERISA solely because they take participants' preferences into account when selecting investment options for participant-directed individual account plans (such as 401(k) plans). The DOL explained that it could be prudent under ERISA for a fiduciary to accommodate participant preferences in the types of investment options because the accommodation could lead to greater participation levels and deferral rates and, thus, could increase the retirement security of such participants.

The Final ESG Regulation became effective, with respect to the ESG guidance, on January 30, 2023, 60 days after it was published in the Federal Register.

b. Final Regulation Relating to Proxy Voting Under ERISA

The DOL's final regulation relating to proxy voting under ERISA ("**Final Proxy Regulation**") affirms that proxy voting is a "fiduciary act" subject to ERISA requirements. Accordingly, the Final Proxy Regulation changes the prior administration's rule that stated that ERISA does not require the voting of every proxy or the exercise of every shareholder right. The DOL stated that the prior rule's provision was eliminated because it could be misread to suggest that plan fiduciaries should be indifferent to the exercise of their rights as shareholders even if the cost is minimal. The Final Proxy Regulation essentially reinstates the rules that existed before the prior administration issued its guidance and generally requires plan fiduciaries to vote proxies and exercise other shareholder rights unless it would not be in the best interests of the plan participants (such as where the costs of exercising shareholder rights would outweigh the benefits of exercising those rights). The preamble to the Final Proxy Regulation explains that the prudent exercise of proxy voting and other shareholder rights may enhance the value of plan assets or protect plan assets from risk, and is part of an ERISA fiduciary's exercise of its duties under ERISA. In addition, the Final Proxy Regulation eliminated certain specific record maintenance and proxy monitoring requirements contained in the prior rule because, according to the DOL, those requirements are adequately addressed by the statutory obligations of prudence and loyalty that generally apply to other fiduciary activities.

The Final Proxy Regulation indicates that a fiduciary that follows the recommendations of a proxy advisory firm or other service provider must make a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations described in the Final Proxy Regulation.

The Final Proxy Regulation indicates that a fiduciary that follows the recommendations of a proxy advisory firm or other service provider must make a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations described in the Final Proxy Regulation. The Final Proxy Regulation also states that an investment manager managing a pool of assets of different

ERISA plans must take into account the policies of each of those plans in deciding how to vote proxies or, alternatively, provide its investment policy, including its proxy voting policies, to those ERISA plans and require that they agree to those policies. According to the Final Proxy Regulation, the fiduciaries of those ERISA plans, in deciding whether to agree to those policies, must evaluate whether the policies are consistent with ERISA and the requirements of the Final Proxy Regulation.

The effective date of the Final Proxy Regulation was January 30, 2023, except that the rules relating to proxy voting policies described in the preceding paragraph do not become effective until December 1, 2023, to give fiduciaries adequate time to prepare for their implementation.

c. Proposed Amendment to QPAM Exemption

The QPAM Exemption is frequently relied upon by managers of pooled funds or accounts that constitute "plan assets" for purposes of ERISA to engage in a variety of transactions on behalf of such funds or accounts that otherwise would constitute "prohibited transactions." The DOL's proposed amendment to the QPAM Exemption would impose several significant changes to the conditions of the QPAM Exemption, including the following:

The QPAM Exemption is frequently relied upon by managers of pooled funds or accounts that constitute "plan assets" for purposes of ERISA to engage in a variety of transactions on behalf of such funds or accounts that otherwise would constitute "prohibited transactions."

- Although the QPAM Exemption currently may be used without giving notice to the DOL, the proposed amendment would require a QPAM to provide a one-time notice to the DOL that includes the legal name of each business entity relying on the QPAM Exemption and any name under which the QPAM may be operating. This notice would need to be updated upon a change to the legal or operating name of the QPAM or if the QPAM is no longer relying on the QPAM Exemption.

- The proposed amendment would increase the net capital and assets under management ("**AUM**") requirements for QPAM qualification. For a registered investment adviser, the proposed amendment would increase the minimum amount of the adviser's AUM from in excess of US$85 million to in excess of US$135.87 million. In addition, the minimum amount of shareholders' or partners' equity would be increased from in excess of US$1 million to in excess of US$2.04 million. These amounts would be subject to annual increases for inflation.

- A QPAM currently cannot rely on the QPAM Exemption during the 10-year period following its (or certain of its affiliates') conviction of (or, if later, release from imprisonment with respect to) certain financial crimes. The proposed amendment would expand the types of criminal convictions that result in loss of QPAM status to include convictions by a foreign court of competent jurisdiction for crimes that are substantially equivalent to the covered crimes under U.S. law.

- The proposed amendment would also add a "prohibited misconduct" concept that would expand the circumstances under which the DOL can disqualify a QPAM. "Prohibited misconduct" would include (i) conduct forming the basis for a non-prosecution or deferred prosecution agreement that, if successfully prosecuted, would have constituted a covered crime; (ii) intentionally violating (or engaging in a systematic pattern or practice of violating) the conditions of the QPAM Exemption in connection with otherwise non-exempt prohibited transactions; and (iii) providing materially misleading information to the DOL in connection with the conditions of the QPAM Exemption.

- The proposed amendment would require that any investment management agreement entered into with a QPAM provides, among other things, that if the manager loses its QPAM status as a result of a criminal conviction or certain prohibited misconduct, then for at least 10 years the QPAM (i) will not restrict the ability of a plan investor to terminate or withdraw from its arrangement with the QPAM; (ii) will not impose any fees or penalties on any such investor in connection with its withdrawal (except for certain reasonable fees disclosed in advance); (iii) must agree to indemnify and promptly restore actual losses to such investors for any damages that directly result from a violation of applicable laws, a breach of contract, or any claim arising out of the conduct that causes the QPAM's disqualification; and (iv) will not employ or knowingly engage any individual that participated in the conduct that causes the QPAM's disqualification.

The proposed amendment was published in the Federal Register on July 27, 2022, with an initial comment period until September 26, 2022 (although the DOL subsequently extended such period until October

11, 2022). The DOL held a virtual public hearing on the proposed amendment on November 17, 2022, and following such hearing, the DOL re-opened the comment period until January 6, 2023. The proposed amendment would begin to apply 60 days after the date of final adoption in the Federal Register.

2. Regulatory Initial Margin Requirements Under Dodd-Frank

The final phase-in date for the initial margin requirements (the "**IM Rules**"), which are part of the margin regulatory requirements adopted by the Commodity Futures Trading Commission and the SEC collectively with the Treasury Department, 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, occurred on September 1, 2022.

As of September 1, 2022, any "Financial End-users" that had an aggregate average notional amount ("**AANA**") of US$8 billion or more during the relevant test period were captured by the last phase of the IM Rules, which generally required amendments to existing trading documentation to incorporate initial margin ("**IM**") compliant documentation, including a custodial relationship with a third-party custodian. However, many Financial End-users whose relevant IM with individual counterparties was significantly below the US$50 million threshold for posting IM ("**Low IM FEUs**") were allowed to defer the required amendments to their trading documentation and implementation of custodial relationships until such time as the relevant IM gets closer to the US$50 million threshold with each such counterparty. Additionally, Financial End-users who were below the US$8 billion AANA for the relevant test period ("**Exempt FEUs**"), were not required to comply with the IM Rules by the September 1, 2022 deadline.

However, any Low IM FEUs will be required to continuously monitor their IM levels with each counterparty and be ready to implement the required IM Rule amendments and third-party custodial relationships in the event their IM levels with a counterparty start to approach the US$50 million threshold. The exact level at which this implementation for Low IM FEUs will be triggered will vary from dealer to dealer and be a function of the types of transactions that the parties enter into.

Additionally, Exempt FEUs will need to continue to monitor their AANA during the relevant test period each year to ensure that they remain below the US$8 billion AANA threshold, and thus continue to qualify as an Exempt FEU. If an Exempt FEU exceeds the US$8 billion AANA during the test period for any year, then it will need to come into compliance with the IM Rules, as noted above. The annual calculation of AANA for Exempt FEUs will require a series of calculations with respect to the average gross notional amount of all in-scope derivatives contracts in effect on the last business day of each of March, April, and May of the relevant calendar year for each Financial End-user, including all relevant affiliated group members.[30]

3. U.S. Transition From U.S. Dollar LIBOR

The transition from U.S. Dollar ("USD") LIBOR in the U.S. continued during 2022 and saw two major developments as USD LIBOR is scheduled to cease publication as of June 30, 2023.

The transition from U.S. Dollar ("**USD**") LIBOR in the U.S. continued during 2022 and saw two major developments as USD LIBOR is scheduled to cease publication as of June 30, 2023.

- First, in March 2022 President Biden signed into law the U.S. Adjustable Interest Rate (LIBOR) Act (the "**LIBOR Act**"). The LIBOR Act allows certain U.S. law-governed agreements to automatically fall back to a SOFR-based alternate rate upon the permanent discontinuation of USD LIBOR. Specifically, the LIBOR Act allows agreements that would otherwise have no functional fallback to fall back to SOFR if the parties are not otherwise able to amend the agreements to address the LIBOR discontinuation. The LIBOR Act will be helpful for agreements that would otherwise be difficult to amend, such as securitizations and publicly held bonds and notes, among others.
- Second, in November 2022 the FCA issued a consultation seeking feedback on the FCA's proposed methodology for building synthetic one-, three-, and six-month USD LIBOR rates that would be published after the June 30, 2023 cessation of USD LIBOR rates for a 15-month period, until September 30, 2024.

As a result of the impending cessation of USD LIBOR and the regulatory initiatives that the U.S. bank regulators imposed on U.S. banks in late 2021, the migration of the finance and derivatives markets from USD LIBOR to risk-free interest rates accelerated during 2022.

As a result of the impending cessation of USD LIBOR and the regulatory initiatives that the U.S. bank regulators imposed on U.S. banks in late 2021, the migration of the finance and derivatives markets from

30 Sidley has prepared a worksheet to assist FEUs with their ongoing AANA calculations. Please reach out to your relevant Sidley contact if you would like to obtain a copy of the worksheet.

USD LIBOR to risk-free interest rates accelerated during 2022. Despite the availability of various risk-free alternative interest rates, including several variations of the Secured Financing Overnight Rate ("**SOFR**"), the prevailing trend has been to use Term SOFR as the new benchmark rate in the financing market. Term SOFR has become the choice because, like USD LIBOR, it is a forward-looking rate for a specified tenor (i.e., one, three, six, and 12 months) that allows parties to know the relevant rate at the beginning of each relevant accrual period, providing certainty regarding financing obligations. However, because the Term SOFR license available from the Term SOFR administrator (CME Group) limits the ability to use Term SOFR for certain types of derivatives transactions, the use of Term SOFR in the derivatives market has been less prevalent. Instead the derivatives market is also using compounded SOFR in arrears, or simple, daily SOFR in many instances.

As the migration of the finance and derivatives markets continues through the scheduled discontinuation of the publication of USD LIBOR on June 30, 2023, it is important for market participants to fully understand the specific rates (and the related mechanics of such rates) being used for their financing and derivatives transactions, and in particular for any derivatives transactions intended to hedge related financing transactions. Because of the different adoption of fallback rates between the financing and derivatives markets, there is potential for the fallback rates being used after June 30, 2023 to be different between the different markets, resulting in unexpected basis risk between derivatives and related financing/cash positions. Such unexpected basis risk could give rise to potential economic, financial, and regulatory implications that will be important for market participants to understand.

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

1. The Continuing 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, "passporting" rights continued to be available.

On December 24, 2020, the EU and the UK concluded an agreement on their future economic relationship (the "**Trade and Cooperation Agreement**"). The Trade and Cooperation Agreement did not provide for a continuation of passporting as between the UK and EU. In February 2022, a UK-EU Financial Services inquiry was launched by the UK Parliament. The European Affairs Committee (the "**Committee**") published a report in June 2022, finding that the Trade and Cooperation Agreement contains only limited provisions relating to insurance and financial services and raised concerns about the lack of a functioning framework for UK and EU cooperation. Overall, the Committee called on the UK government to step up its political and diplomatic engagement with the EU regarding financial services. In June 2022, the Treasury Select Committee announced the formation of a subcommittee to scrutinize proposed post-Brexit financial regulations in the UK, replacing the role previously held by the EU.

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The UK and EU published declarations, alongside the Trade and Cooperation Agreement, agreeing to establish a structured regulatory cooperation on financial services. In March 2021, the UK and EU agreed on a memorandum of understanding ("**MoU**") which set out the framework for this further cooperation. The MoU laid out the groundwork for future cooperation between the two sides, but it did not address regulatory equivalence. The MoU also established the Joint UK-EU Financial Regulatory Forum, which provides a platform between the European government and the UK government to facilitate dialogue on financial services issues. However, there has thus far been no meaningful progress in this respect.

b. Passporting

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 that the UK has left the single market.

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).

EU firms that previously 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 falling away 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. 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 HM Treasury having the power to extend the duration of the regime by increments of 12 months.

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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. The TPR is currently set to last until the end of 2023. Once the TPR comes to an end, deemed authorization will fall away. Insurers operating under the TPR regime had until December 31, 2022 to apply for full UK authorization.

There is also an additional "backstop" for European Economic Area ("**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 pre-existing 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.

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. 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, which provided some level of comfort to UK insurers. 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 ("**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 any Solvency II equivalence decisions 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 unlevel 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 cedants.

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. The Solvency II (Group Supervision) (Amendment) Regulations 2021, which was published on December 10, 2021, came into force on January 24, 2022. The amendment regulations provide that if a third country is equivalent for group supervision purposes, as determined in accordance with Solvency II Regulations 2015, then the PRA (where it is group supervisor of an insurance group with a parent in an equivalent third country) can, in some situations, defer to the supervisory authority in the relevant third country. The UK government believes that this may be advantageous for UK insurance groups with a parent in a third country, as it can reduce duplicative supervisory work.

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In relation to group solvency, a finding of equivalence in this area is ultimately 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.

In relation to group solvency, a finding of equivalence in this area is ultimately 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.

d. Application of Solvency II in the UK

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.

For details on the proposed amendments to Solvency II in the new Solvency UK regime, see section V.C.9.

e. The Financial Services and Markets Bill

The Financial Services and Markets Bill (the "**FSMB**") was introduced into Parliament on July 20, 2022 and follows on from the UK government's Future Regulatory Framework review (the "**FRF**"), which assessed whether the current regulatory framework is both fit for purpose and able to support future growth in light of Brexit.

The Financial Services and Markets Bill (the "FSMB") was introduced into Parliament on July 20, 2022 and follows on from the UK government's Future Regulatory Framework review …

The FSMB proposes fundamental changes to the regulation of the UK financial services sector, revamping the existing model under the Financial Services and Markets Act 2000. One of the core elements of the FSMB is that it establishes a new regulatory framework under which the UK's financial services regulators, the PRA and the FCA, will have considerably more rulemaking powers. This includes significant revisions to the PRA and the FCA's delegated powers, with enhanced oversight from Parliament. The FSMB introduces various accountability measures for the regulators including a requirement to respond to formal recommendation letters, to keep their rules under review, and a mechanism to enable HM Treasury to direct the regulators to review their rules in the public interest. The regulators will also have a new secondary objective to advance the international competitiveness and medium- to long-term growth of the UK economy.

The FSMB proposes fundamental changes to the regulation of the UK financial services sector, revamping the existing model under the Financial Services and Markets Act 2000.

The FSMB was set to contain a "call-in" power whereby the UK government would have had the authority to intervene in regulatory policy and revise, amend, or revoke rules made by the PRA or FCA where it is found to be in the public interest, to be used only in exceptional circumstances. The UK regulators had warned that this power could have eroded their operational independence and have an adverse impact on the international perception of the UK's insurance regulatory regime and its equivalence to international standards, undermining the UK's competitiveness. The UK government recently announced it has now decided not to proceed with the intervention power "at this time."

f. U.S.-UK Covered Agreement

In December 2018, in anticipation of the UK's exit from the EU, the U.S. Department of the Treasury and the Office of the U.S. Trade Representative announced their intent to enter into a "Bilateral Agreement between the United States and the United Kingdom on Prudential Measures Regarding Insurance and

The U.S.-UK Covered Agreement is based on similar provisions to the U.S.-EU Covered Agreement which was previously entered into between the U.S. and the EU. This means that little has changed in the regulatory insurance relationship between the U.S. and the UK in a post-Brexit landscape.

Reinsurance" (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. The U.S.-UK Covered Agreement is based on similar provisions to the U.S.-EU Covered Agreement which was previously entered into between the U.S. and the EU. This means that little has changed in the regulatory insurance relationship between the U.S. and the UK in a post-Brexit landscape.

At the end of the Transitional Period both countries exchanged notices, bringing the U.S.-UK Covered Agreement into force as of December 31, 2020. A Joint Committee was established under the U.S.-UK Covered Agreement, which held its second meeting on October 18, 2022, where both sides provided updates regarding the implementation and administration of the provisions on reinsurance and group supervision. Both sides also reaffirmed their commitment to continuous review of progress on the U.S.-UK Covered Agreement and continue to encourage the relevant authorities to refrain from taking any measures that are inconsistent with the provisions of the agreement.

2. Lloyd's Update

a. Blueprint Two

Lloyd's released Blueprint Two on November 5, 2020, in the third installment of their "Future At Lloyd's" market modernization and transformation program.

Blueprint Two is targeting significant cost savings for market participants ...

Lloyd's released Blueprint Two on November 5, 2020, in the third installment of 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 the CEO of Lloyd's 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.

In May 2021, Lloyd's released the first edition of their Interactive Guide, designed to help the market prepare for the new digital marketplace. The second edition of their Interactive Guide was released on January 28, 2022. The guide provides details on what the solutions and changes are, when they will be delivered, and how the market can prepare for digital adoption, accompanied by an illustrated roadmap focused on open market placement, delegated authority placement, and claims. The roadmap runs from Q1 2022 to Q2 2024 and details: (i) when the solutions and changes will be delivered; (ii) the action the market needs to take to prepare for them; and (iii) plans of Lloyd's to provide support.

In December 2022, Lloyd's indicated that all London market technology vendors that interact with the existing central services have pledged their intent to introduce changes to accommodate Blueprint Two. Lloyd's has indicated that it remains in a strong position to close off the other milestones.

b. The Lloyd's Oversight Framework

The Lloyd's Oversight Framework has three interlinking elements that work together to support oversight, namely: (i) The Principles for doing business at Lloyd's (the "**Principles**"); (ii) Syndicate Categorization; and (iii) Interventions and Incentives.

The Principles set out the fundamental responsibilities and outcomes expected of all managing agents in order to support the market's overall performance, capital strength, and financial and reputational credibility.

The Principles set out the fundamental responsibilities and outcomes expected of all managing agents in order to support the market's overall performance, capital strength, and financial and reputational credibility. The suite of 13 Principles are outcomes-based and replaced the prescriptive rules-based minimum standards. Underpinning the Principles are sub-principles and technical level guidance, which is expressed in terms of outcomes, capabilities, and processes, but is not prescriptive.

The Syndicate Categorization is the process of allocating syndicates to one of five categories: outperforming, good, moderate, underperforming, and unacceptable. The assessment is a qualitative and quantitative review across the Principles, and creates a consistent approach to syndicate and agent categorization. The overall category can only be as high as the lowest of the four fundamental Principles of underwriting profitability; reserving; governance, risk management, and reporting; and culture.

There is an escalating scale of interventions which is linked to the Principles and overall syndicate categorization. For businesses on the lower end of the scale, a range of interventions can be applied to remediate deficiencies and ensure an underperforming business returns to the expected financial and non-financial performance. For those businesses at the top end of scale, there will be a range of incentives to support growth and development (e.g., proactive support of new syndicates, special purpose arrangements/syndicates, and "syndicate in a box").

The switch took place gradually with a full transition to the Principles from the beginning of Q3 2022. By April 2022, managing agents were required to complete a best-efforts self-assessment against the new Principles. However, Lloyd's expected the self-assessment to be discussed with the board of the relevant managing agent to ensure it maintains a view on performance and how to address any gaps identified.

Beginning in 2023, Lloyd's will expect boards of managing agents formally to sign off on the self-assessment against the Principles. Conducting the self-assessment in an outcomes-based regime requires a different mindset than a prescriptive, rules-based oversight approach. While offering greater flexibility, the principles-based oversight will result in intensified reliance on managing agents to interpret and apply the rules.

Beginning in 2023, Lloyd's will expect boards of managing agents formally to sign off on the self-assessment against the Principles.

c. Lloyd's Market Oversight Plan for 2023

The Lloyd's Market Oversight Plan (the "**Lloyd's Plan**") for 2023 sets out the view of Lloyd's on the key risks and issues facing the market, and provides transparency over the planned oversight activity of Lloyd's to manage those risks. The Lloyd's Plan includes a broad range of topics including, for example: (i) Economic uncertainty — Lloyd's notes the high inflation and ongoing geopolitical concerns (e.g., the Russia-Ukraine conflict) facing the market and Lloyd's plans to engage across all elements of business, from underwriting to investments, liquidity, outwards reinsurance, capital, and reserving; (ii) Cyber and systemic risk — Lloyd's intends to qualify the impact of a major cyber claims event on the market, and it plans to reintroduce a cyber attestation process to ensure compliance with the Lloyd's market Bulletin Y5381 — *State backed cyber-attack exclusions*, and utilize ongoing pricing maturity matrix work to focus on pricing of cyber risks; (iii) Delegated authority oversight — Lloyd's expects the market to evolve to align more with Lloyd's Principles-based oversight approach; (iv) Climate risk — Lloyd's intends to engage with the market to consider the work needed to deepen Lloyd's understanding of how syndicates are managing this risk and its impact on exposures, reserving assumptions, and capital; Lloyd's plans a thematic review into capital and reserving for 2024, with preparation starting in 2023, which will involve designing a market survey on the capabilities and current approaches; (v) ESG and ensuring the transition to low-carbon environment — Lloyd's intends to engage with the market to understand the steps taken to understand their exposures and ESG strategies, with further ESG guidance due to be issued in Q1 2023; (vi) Consumer focus — with Lloyd's planning to ensure the market is compliant with the newly implemented FCA rules on Fair Value and is preparing adequately for Consumer Duty requirements; and (vii) Regulatory priorities such as operational resilience (including cyber resilience), Lloyd's Europe operating model requirements, and overseas legislative changes will continue to shape planned oversight work.

The Lloyd's Market Oversight Plan (the "Lloyd's Plan") for 2023 sets out the view of Lloyd's on the key risks and issues facing the market, and provides transparency over the planned oversight activity of Lloyd's to manage those risks.

It is important for firms to understand the key issues and risks in the context of their business model and ensure they are proactively and appropriately managed.

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d. ESG

In December 2020, Lloyd's published its first ESG report and strategy which set out its ambition to become a sustainable marketplace and to support the global transition towards net zero. To support Lloyd's and the market's overall social purpose and environmental goals, Lloyd's issued directional guidance and best practice for establishing an ESG governance framework, including sustainable underwriting and responsible investment strategies. Lloyd's has indicated that moving away from carbon makes good business sense, as continuing to provide (re)insurance for carbon intensive businesses or projects will become increasingly unsustainable as the world moves towards the 2050 net zero goal.

In 2022, as a minimum, Lloyd's expected managing agents to create a first version of their own ESG frameworks, governance, and strategies. In addition, managing agents should have considered the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their ESG strategy.

Since the publication, Lloyd's has issued further guidance to support managing agents to put in place ESG governance frameworks, including sustainable underwriting and responsible investment strategies. In 2022, as a minimum, Lloyd's expected managing agents to create a first version of their own ESG frameworks, governance, and strategies. In addition, managing agents should have considered the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their ESG strategy. Lloyd's has also asked managing agents to submit an appropriate ESG strategy as part of the 2023 business planning process (see section V.C.7. for further details on ESG developments).

Lloyd's has also imposed ESG-focused outcomes by way of the Principles. In particular, managing agents are expected to comply with Principle 1 (Underwriting Profitability), Principle 8 (Investment), and Principle 13 (Culture).

e. Lloyd's Europe

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 Europe**") which is authorized and regulated by the National Bank of Belgium and regulated by the Financial Services and Markets Authority. Since January 1, 2019, Lloyd's Europe has been exercising its passporting rights to write all new Lloyd's market EEA nonlife insurance. Lloyd's Europe is also licensed to write nonlife risks from Monaco and the UK.

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 Europe in a Part VII transfer, which was sanctioned by the UK's High Court on November 25, 2020.

During 2021, Lloyd's Europe designed a new operating model for activities that fall within the scope of the Insurance Distribution Directive. While the non-insurance distribution directive business continues to be performed within the outsourcing framework, the majority of the insurance distribution directive business will be handled by underwriters seconded by managing agents to Lloyd's Europe.

A few managing agents have decided to route their insurance distribution directive business to an existing (or to be established) service company based and authorized in the EEA, that then enters into a delegated authority agreement with Lloyd's Europe.

The Lloyd's Plan for 2023 will include a focus on managing agents' compliance with the Lloyd's Europe operating model requirements — it was noted that Lloyd's Europe needs to gain assurance over the key processes and controls operating within its UK branch.

The Lloyd's Plan for 2023 will include a focus on managing agents' compliance with the Lloyd's Europe operating model requirements — it was noted that Lloyd's Europe needs to gain assurance over the key processes and controls operating within its UK branch. As such, all managing agents were requested to include a placeholder in their internal audit plan for 2023. Throughout 2023, Lloyd's Europe will develop a dedicated assurance plan to assess compliance.

In addition, Lloyd's Europe compliance will undertake the following assurance work over 2023: (i) gifts and hospitality monitoring — review process and policy; (ii) conflicts of interest; (iii) whistleblowing; (iv) cloud service providers; and (v) delegated claims administrators ("**DCA**") — assess the design and effectiveness of controls regarding DCA oversight by managing agents.

3. Regulatory Updates in the UK Insurance Sector

Businesses in the UK insurance sector are regulated by either 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 an underwriting platform in the Lloyd's insurance market are also regulated by Lloyd's, which in turn is regulated by the FCA and the PRA.

a. FCA Consumer Duty

Following two consultation papers issued in 2021, the FCA published its Policy Statement 22/9 and Final Guidance 22/5, setting out how it intends to implement the new Consumer Duty (the "**Duty**") on July 27, 2022. The Duty marks a more outcome-focused approach by the FCA and is described as the "cornerstone" of the FCA's strategy of establishing higher standards of consumer protection in the financial services sector.

The Duty is made up of the following components:

- An overarching principle (set out in Principle 12 of the FCA's Principles for Business) which reflects the overall standard of behavior expected from firms.
- A set of "cross-cutting rules" which comprise three requirements that explain how firms should act to deliver good outcomes by requiring firms to act in good faith, avoid foreseeable harm, and enable and support retail customers to pursue their financial objectives.
- The "four outcomes" are a set of rules and guidance detailing the expectations for firm conduct in four areas that represent key elements of the firm-consumer relationship (the governance of products and services, price and value, consumer understanding, and consumer support).

The new principle will replace Customers' interests (Principle 6) and Communications with clients (Principle 7) for retail business and require firms to act to deliver good outcomes for retail customers. Principles 6 and 7 will continue to apply to firms dealing with wholesale or retail customers outside the scope of the Duty.

The scope of the Duty for insurance entities will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS), and applies to firms dealing with high-net-worth individuals, unless that status takes conduct outside of the regulatory parameter of the FCA. The Duty will also apply to prospective customers and unregulated activities that are ancillary to regulated activities.

The fundamental elements of the FCA's proposals have not changed from those outlined in Consultation Paper CP21/36, published in December 2021. The Duty's hierarchy and its components comprising the Consumer Principle, cross-cutting rules, and four outcomes remain the same. However, there are some important clarifications on the Duty's scope of application to "retail customers," including in respect of a distribution chain and new sector-specific guidance.

The Duty is being phased in throughout the implementation period. By the end of October 2022, firms' boards should have agreed their implementation plans, and the evidence that they have scrutinized these to ensure they are robust in meeting the new standards, and manufacturers should complete necessary reviews for open products and services by the end of April 2023. The Duty will apply to all open products and services from July 31, 2023, and will apply to closed books of business from July 31, 2024. The FCA has made it clear that it will take an "assertive" approach to firms' implementation of the new rules, particularly to firms' plans on monitoring customer outcomes.

b. PRA Policy Statement on the Definition of Insurance Holding Company

In response to feedback received from the PRA's Consultation Paper CP17/21,[31] published in September 2021, the PRA published a policy statement ("**PS6/22**") on July 7, 2022, setting out its approach to interpreting and applying the definition of an insurance holding company ("**IHC**"), for the purposes of the Group Supervision Part of the PRA Rulebook.

The issue is a significant one because the designation of an entity's parent as an "insurance holding company" brings that group within the scope of a full group solvency calculation. By contrast, if the holding company was not considered to be an "insurance holding company," the solvency calculation would be performed at a lower level, and wider group supervision would be limited to a much lighter touch regime. An "insurance holding company" is currently defined in both legislation and the PRA Rulebook as a parent whose "main business" is to acquire and hold participations in subsidiaries, where those subsidiaries are "exclusively or mainly" insurers or reinsurers. What is meant in this context by "mainly" is not defined in Solvency II, the PRA Rulebook, or any other related guidance. Following a report by the EIOPA in 2018, it became clear that different methods are used in different EU member states to interpret the definition of "insurance holding company" and, therefore, the treatment in one member state may be more favorable than another.

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31 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/september/cp1721.pdf?la=en&hash=C3A476A91A1101ED946B6B84C000648A04CD4026.

In PS6/22, the PRA clarifies its expectations regarding the information required from firms to distinguish an IHC from a mixed-activity insurance holding company ("**MAIHC**"). If a group wishes to demonstrate that a holding company is in fact a MAIHC, it must satisfy certain quantitative tests in relation to capital requirements, revenue, and assets, which are derived from (re)insurance undertakings.

- Quantitative criteria — a holding company is now considered an IHC where at least two of three measures (of capital requirements, revenue, and assets), derived from (re)insurance undertakings exceed the 50% threshold. Firms must also include ancillary insurance undertakings in the threshold calculation.

- Reference period — the threshold calculations must be performed using the latest full year financials. Only when there is material year-on-year volatility in the figures will a three-year average be accepted.

- The existing holding company classifications will not be revisited, unless a trigger event occurs. These triggers include acquisitions, disposals, or changes in control which impact the assets, revenue, and capital requirements of a firm.

- If the new rules are deemed unduly burdensome, the PRA may consider granting a waiver to the qualitative thresholds, or the inclusion of ancillary insurance services undertakings.

The PRA has made some significant changes to provide greater flexibility and discretion on the asset measure, and helpfully provided clarity on how it will implement the new requirements.

The PRA has made some significant changes to provide greater flexibility and discretion on the asset measure, and helpfully provided clarity on how it will implement the new requirements. Nonetheless, the new rules are likely to cause some groups currently classified as "mixed activity" to be reclassified as insurance groups in the future.

The PRA has delayed the implementation of PS6/22 until July 2023 to enable affected groups to prepare themselves for the new regime. Groups should be reviewing their potential designation under the new rules and consider the impact this classification could have on capital management, group structuring, strategy, and potential acquisitions and disposals.

4. EU and Member State Competition Law Enforcement Activity

2022 saw similar levels of enforcement activity by the Commission, the Court of Justice of the European Union ("CJEU"), and the EU's General Court …

2022 saw similar levels of enforcement activity by the Commission, the Court of Justice of the European Union ("**CJEU**"), and the EU's General Court ("**General Court**" — the CJEU and the General Court together, "**EU Courts**"). Likewise, the enforcement actions of national competition authorities throughout the EU remained broadly in line with the previous year as well.

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

i. European Commission

In February 2022, the Commission concluded that Hungary's decision to veto the acquisition of the insurance, pension, and asset management Hungarian businesses of the AEGON Group by Vienna Insurance Group AG Wiener Versicherung Gruppe ("**VIG**"), based on emergency legislation on foreign direct investments, breached Article 21 of the EU Merger Regulation, which confers upon the Commission exclusive competence to review transactions having an EU dimension. According to the Commission, the veto restricted VIG's right to engage in a cross-border transaction, and the Hungarian authorities failed to show that the measure was justified and proportionate. Hungary was ordered to (and did) withdraw its veto by March 18, 2022.

In March 2022, the Commission approved under EU State aid rules the modification of an existing Irish risk equalization scheme to compensate insurers for the provision of private medical insurance. Under the scheme, private health insurers whose customers have a higher risk profile than the market average obtain payments from a Risk Equalization Fund. Modifications to the scheme include: (i) the introduction of a "high cost claims pool" whereby the excess of claims over €50,000 will be reimbursed at 40%; (ii) an increase from 4.4% to 6% in return on sales made by the beneficiary of the scheme; and (iii) the scheme's prolongation until March 2027.

Between March and May 2022, the Commission approved under EU State aid rules the reintroduction of Romanian and Danish short-term export credit ("**STEC**") schemes and modifications to a Finnish STEC scheme. Under those schemes, originally approved between 2013 and 2014, the countries in question can cover risks associated with single export transactions. In addition, Romania and Finland can also cover risks incurred by SMEs with a small export turnover. Compared to the original schemes, the maximum annual export turnover for Romanian and Finnish SMEs to be eligible is set at €2.5 million, representing an increase of €0.5 million.

In June 2022, the Commission made legally binding under EU competition rules the commitments offered by Insurance Ireland, an Irish association of motor insurance companies/agents. The commitments have the objective of ensuring fair and non-discriminatory access to the so-called "Insurance Link" information exchange system of Insurance Ireland. Insurance Link allows insurers to better assess customers' risk profiles and consequently to price insurance policies for motor vehicles. The commitments address the Commission's initial concerns that Insurance Ireland infringed EU competition rules by preventing and/or obstructing access of non-members to Insurance Link, thereby potentially hindering competitive pricing in the Irish motor vehicle insurance market.

In November 2022, the Commission approved under EU State aid rules the prolongation of a Spanish scheme to support agricultural producers to pay insurance premiums. The aim of the scheme, originally approved in 2015, is to ensure coverage for the risk of damage to certain vegetable products and livestock species, notably in the context of the Russia-Ukraine conflict and the volcano eruption of La Palma on September 19, 2021. The Commission approved the prolongation of the scheme until December 31, 2023.

ii. EU Courts

a) CJEU Judgment on Key Aspects of Directive 2002/83 Regarding Life Assurance

In February 2022, the CJEU delivered its ruling on the questions referred by the Warsaw District Court in March 2020 on the interpretation of key aspects of Directive 2002/83 regarding life assurance (the "**Life Assurance Directive**"). The questions concerned unit-linked life insurance contracts where the underlying assets of the fund are derivatives (or structured financial instruments with embedded derivatives).

In line with AG Bobek's Opinion (discussed in the 2022 edition of the *Sidley Global Insurance Review*), the CJEU held that the information listed in Annex III(A) to the Life Assurance Directive must be communicated to consumers prior to the conclusion of the contracts. This includes clear, accurate, and understandable information as to the economic and legal nature of the underlying assets, including the structural risks associated with them. Failure to provide such information is likely to constitute a misleading omission as referred to in Directive 2005/29 (the "Unfair Commercial Practices Directive") and confers on the consumers who acceded to such contracts the right to recover the premiums paid.

b. National-Level Enforcement in the UK

i. Home and Motor Insurance Pricing Rules of the FCA Come Into Effect

On January 1, 2022, the FCA's home and motor insurance pricing rules ("**FCA Rules**") came into effect. Issued in May 2021, the FCA Rules are designed to: (i) promote competition and protect customers through ensuring that consumers have a realistic picture of the long-term cost of their chosen product when purchasing it; (ii) end price-walking (i.e., price increases at each renewal) by ensuring that consumers renewing their home/motor insurance pay no more than they would as a new customer. In December 2022, the FCA published the findings of its multi-firm review assessing compliance with the FCA Rules.

On January 1, 2022, the FCA's home and motor insurance pricing rules ("FCA Rules") came into effect.

ii. Competition and Markets Authority Publishes a Letter to Tesco Bank in Relation to its Breach of the Private Motor Insurance Market Investigation Order of 2015

In January 2022, the Competition and Markets Authority ("**CMA**") published a letter addressed to Tesco Bank concerning its breach of the Private Motor Insurance Market Investigation Order of 2015. The Order prescribes that the additional cost of the No Claims Bonus Protection is made clear to customers.

Tesco Bank failed to do so, providing misleading information in renewal letters to customers. Tesco Bank, however, committed to undertake remedy actions that the CMA considered sufficient, so the CMA did not initiate an enforcement procedure.

iii. FCA Issues its Report on the Multi-Occupancy Buildings Insurance Market

In September 2022, the FCA issued its report on the multi-occupancy buildings insurance market commissioned in January 2022 by the Secretary of State for Levelling Up, Housing and Communities following the Grenfell fire tragedy in 2017. The FCA found a decrease in insurance supply, accompanied by the doubling of insurance premium prices between 2016 and 2021. The FCA suggested the following remedies: (i) creating a cross industry pool to limit the risk to individual insurers posed by certain buildings affected by material fire safety risks; (ii) increasing pricing transparency for leaseholders; and (iii) facilitating challenges against high passed-on insurance costs for leaseholders.

iv. Price Comparison Website Comparethemarket Overturns the CMA's Infringement Decision Against it Relating to Price-Parity Clauses

In August 2022, the Competition Appeal Tribunal ("**CAT**") overturned the CMA's fining decision of £17.9 million against the price comparison website Comparethemarket (a significant distributor of retail insurance in the UK). In its decision, the CMA found that Comparethemarket used price parity clauses to prevent home insurers from pricing lower than the price quoted on Comparethemarket's website. However, the CAT ruled that the CMA had failed to establish that those price parity clauses had the anticompetitive effects articulated in the CMA's Decision.

v. CMA Revokes Directions Issued to Royal Bank of Scotland in August 2019 Regarding Compliance With the Payment Protection Insurance Market Investigation Order 2011

In August 2022, the CMA revoked the directions issued to Royal Bank of Scotland ("**RBS**") (now NatWest Group plc) concerning its breach of the Payment Protection Insurance ("**PPI**") Market Investigation Order of 2011 ("**Order**"). In April 2018, the CMA found that RBS failed to send Annual Reviews to former Mortgage PPI policyholders as required by the Order. Annual Reviews ensure that policyholders receive information about their PPI policies and prompt them to consider the suitability of alternative policies. The CMA's directions, issued in August 2019, imposed on RBS the appointment of independent assurance auditors regarding compliance with the Order.

vi. CMA Sends Letter to Barclays Bank plc Regarding its Breach of the Order

In November 2022, the CMA sent a letter to Barclays Bank plc ("**Barclays**") about an alleged breach of the Order. The CMA found that Barclays failed to send Annual Reviews to former Mortgage PPI policyholders between 2014 and 2017 as required by the Order. Annual Reviews are designed to ensure that policyholders receive information about their PPI policies and to prompt them to consider the suitability of alternative policies. Barclays, however, committed to undertake remedy actions that the CMA considered sufficient so the CMA did not initiate an enforcement procedure.

c. National-Level Enforcement in Austria

In March 2022, the Austrian Competition Authority cleared the acquisition of a 45% non-controlling stake in the Hungarian business of AEGON Group by Corvinus Nemzetközi Befektetési ("**Corvinus**"), a Hungarian state-owned company. The aim of the deal was to overcome the Hungarian veto of April 2021, lifted by Hungary in March 2022 at the request of the European Commission, regarding the acquisition of the insurance, pension, and asset management Hungarian businesses of AEGON Group by VIG (see section V.C.4.a. for further information regarding European Commission enforcement).

d. National-Level Enforcement in Denmark

In April 2022, the Danish insurance group Alm. Brand obtained approval from the Danish Consumer and Competition Authority to acquire the Danish nonlife insurance business of Codan Forsikring. By way of this acquisition, Alm. Brand became the second-largest provider of nonlife insurance for business clients and the third-largest in insurance for private customers in Denmark.

e. National-Level Enforcement in Finland

In January 2022, the Finnish Competition and Consumer Authority ("**FCCA**") cleared the acquisition of Pohjola Hospital Ltd ("**Pohjola**") by Pihlajalinna Terveys Ltd. ("**Pihlajalinna**"). Pohjola is a provider of orthopaedic and hand surgery services, while Pihlajalinna is a Finnish provider of private social and healthcare services. The deal was approved after an in-depth review conducted by the FCCA focused on possible impediments to competition in the market for health services offered to insurance companies.

f. National-Level Enforcement in Germany

In May 2022, the German Competition Authority ("**Bundeskartellamt**") initiated a cartel investigation against members of associations active in the medical aid sector in Germany organized under the "ARGE" umbrella. The ARGE associations applied coordinated price increases to health insurance companies for existing supply contracts in the rehabilitation and care sectors to allegedly compensate for increased supply costs caused by the COVID-19 pandemic.

g. National-Level Enforcement in Greece

In December 2022, the Hellenic Competition Commission ("**HCC**") published its report on the financial technologies (fintech) sector inquiry. The HCC found that the market power of already established banking and insurance operators may be strengthened by their access and use of extensive, non-public, multi-level data (i.e., big data). This may lead to market foreclosure of competitors that do not have the same capabilities and that can be, for instance, denied access to the data or be overcharged to obtain data access.

h. National-Level Enforcement in Ireland

In February 2022, the Irish Competition and Consumer Protection Commission ("**CCPC**") published the full report of its investigation into potential anticompetitive conduct in the private motor insurance sector in Ireland. The CCPC started an investigation into price signaling in the insurance sector in August 2016. The investigation closed in August 2021 after AIG Europe S.A. Ireland Branch Office, Allianz PLC, AXA Insurance DAC, Aviva Insurance Ireland DAC, FBD Insurance PLC, and AA Ireland Limited entered into legally binding commitments regarding the implementation of internal competition law compliance programs.

i. National-Level Enforcement in Italy

In May 2022, Italy's Autorità Garante della Concorrenza e del Mercato ("**AGCM**") made legally binding under competition rules the commitments offered by car insurers and price comparison firms to address concerns of suspected exchanges of competitively sensitive information. The commitments include *inter alia* the removal of customer identification data from reports sent by comparison websites to insurers and the further anonymization/aggregation of data concerning insurance premiums.

j. National-Level Enforcement in the Netherlands

In July 2022, the ACM decided that collective agreements between hospitals and health insurers about the reimbursement of COVID-19 treatment costs — initially authorized in 2021 and then resized in January 2022 — may be made only in special, new circumstances, i.e., if the nationwide continuity of healthcare provision is seriously jeopardized.

In September 2022, The Hague District Court ruled that a new discount policy operated by the Dutch health insurer Zilveren Kruis is not in breach of national and EU competition rules. The complainant and parallel trader, Eureco-Pharma, alleged that Zilveren Kruis illegally reduced parallel imports of the product Imbruvica by applying discounts to hospitals that would purchase the product directly from the producer and competitor Janssen-Cilag.

In December 2021, the ACM blocked the acquisition of the Dutch healthcare provider Mauritskliniek by its rival Bergman Clinics ("**Bergman**"). The ACM concluded that Bergman had a very strong position vis-à-vis health insurers, and that acquiring Mauritskliniek would have only strengthened its position in negotiations with them, thus leading to further price increases.

In December 2022, the Authority for Consumers and Markets ("**ACM**") launched investigations against industry organizations of healthcare providers that may have influenced individual negotiations with health insurers. According to the ACM, trade associations have for instance recommended using a certain percentage for price increases in negotiations, which could lead to higher healthcare costs and higher healthcare insurance premiums.

k. National-Level Enforcement in Portugal

In January 2023, the Portuguese Autoridade da Concorrência ("**AdC**") opposed the proposal of the Competition, Regulation and Supervision Court to withdraw fines imposed on employees of the non-settling firms sanctioned in the insurance cartel investigation concluded in 2019 (involving market-sharing agreements in insurance contracts purchased by large corporate clients). The Court held that the AdC treated differently the individuals working for the non-settling entities and those working for the companies that decide to settle the case, also arguing that administrative sanctions should only affect legal persons.

l. National-Level Enforcement in Romania

In December 2022, Romania's Competition Council ("**CC**") imposed fines of around €3 million on three insurance companies and an insurance broker in relation to a market-sharing agreement affecting the local aviation insurance market. The CC found that the undertakings had divided among themselves important aviation clients during four tenders.

In December 2022, the CC imposed fines of around €26 million on more than 60 automotive repair companies, as well as a dealers' association and a number of insurance companies in Romania. The CC found that the repair companies had agreed through the Association of Dacia, Renault and Nissan Dealers (ACODAREN) on a fixed level of spare parts prices and workmanship tariffs used in relation with some insurers, with a view to eliminating competition. This CC considered that the conduct was assisted by insurance companies.

m. National-Level Enforcement in Spain

In June 2022, The Provincial Court of Madrid ("**PCM**") annulled a €2.6 million damages award granted in first instance against Asefa, S.A. Compañía Española de Seguros y Reaseguros and Scor Global P&C, S.E in relation to their participation in an insurance cartel regarding construction damage in buildings. The PCM found that the claimant passed on the cartel overcharge to its customers, and therefore did not suffer any damage as a result of the cartel.

In July 2022, the Spanish competition authority ("**CNMC**") fined subsidiaries of the insurance groups Santa Lucía Group and Mapfre Group for failing to notify their acquisition of three companies in the funeral sector. At the time of their execution, these operations exceeded the market share threshold set by law for companies to notify such operations.

5. Impact of EU and UK Data Protection Developments on the Insurance and Reinsurance Industry

In the EU, the primary obligations for (re)insurers relating to data protection stem from the EU General Data Protection Regulation 2016/679 ("**EU GDPR**") and the Privacy and Electronic Communications Directive 2002/58 ("**e-Privacy Directive**").

In the UK, the main obligations relating to data protection now stem from the GDPR as implemented in the UK ("**UK GDPR**") and the Data Protection Act 2018 ("**DPA 2018**"). The UK has also implemented the e-Privacy Directive as the Privacy and Electronic Communications Regulations ("**PECR**").

For the time being the UK GDPR is largely aligned with the EU GDPR (although, see section V.C.5.e. below for how the UK data protection regime may develop post-Brexit), and so for the purposes of this section, all references to the "GDPR" shall include both the EU GDPR and the UK GDPR, and all references to the EEA shall also include the UK — in each case to the extent they relate to the UK and unless otherwise indicated.

We set out below some of the key considerations for the (re)insurance industry from a data protection perspective in 2023.

a. GDPR Enforcement and Fines

The last year saw a continued trend for landmark fines for GDPR breaches from European DPAs, with sources indicating that the total number of cases passed 1,000 in early 2022. The largest fines of the past year included two fines against multinational technology companies for €265 million in November 2022 and €390 million in early January 2023. The fines related to alleged insufficient technical and organizational measures being in place and a failure to comply with the GDPR's requirement for privacy "by design and by default" for the first fine and for alleged unlawful data processing and breaching transparency obligations for the second.

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A facial recognition database company was also subject to a number of fines in 2022, including a fine of €9 million in May 2022 by the UK Information Commissioner's Office ("**ICO**") and of €20 million in October 2022 by the French DPA. The company was fined for various breaches of the GDPR, including its failure to collect consent from data subjects for the use of their personal data and to demonstrate a legitimate interest in the processing activities.

Although these fines have not been issued against companies in the (re)insurance industry, it does not mean that the issues raised in these cases are not relevant with respect to the general compliance concepts they address. Sources suggest that in 2022, DPAs across Europe issued 108 fines against companies in the finance, insurance, and consulting sector, amounting to a total of €29.19 million (an increase of €12.7 million from 2021). It is also noted that a significant volume of the fines related to either an insufficient legal basis for processing or a failure to implement sufficient technical and organizational security measures.[32] This is of particular relevance in the UK given the PRA's Supervisory Statement (the "**Statement**") that came into force on March 31, 2022. Among other things, the Statement requires that outsourcing agreements entered into by (re)insurers include: "if relevant: appropriate and proportionate information security related objectives and measures, including requirements such as minimum ICT security requirements, specifications of firms' data lifecycles, and any requirements regarding data security (see Chapter 7), network security, and security monitoring processes; and operational and security incident handling procedures, including escalation and reporting."

b. International Transfers and Schrems II

2022 saw continued developments regarding the international transfer of personal data. 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 by the EU unless "appropriate safeguards" are implemented. These restrictions affect many international (re)insurers who routinely transfer e.g., EU policyholder personal data to their headquarters (and other entities) outside of the EU/UK for analysis and other processing. Following the CJEU decision in the case of *Data Protection Commissioner v. Facebook Ireland, Max Schrems* ("**Schrems II**") on July 16, 2020, further obligations were imposed on organizations relying on Standard Contractual Clauses ("**EU SCCs**") including a requirement to conduct a transfer impact assessment ("**TIA**") to assess the laws and practices of the country to which personal data is being transferred to ensure an "essentially equivalent" level of protection for the personal data.

2022 saw continued developments regarding the international transfer of personal data.

Following the Schrems II decision, the European Commission ("**Commission**") published new EU SCCs which were adopted on June 4, 2021 ("**June SCCs**"). The June SCCs applied to new contracts from September 27, 2021 and must now be used with all existing contracts (as of December 27, 2022).

(Re)insurers transferring personal data outside of the EEA will need to take into account both the Schrems II decision and the June SCCs when transferring personal data.

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Following those significant developments, there have been a number of further developments in 2022 which are set to progress in 2023, in particular in relation to EU-U.S. data transfers. On October 7, 2022, the U.S. President introduced an Executive Order to facilitate a new Trans-Atlantic Data Privacy Framework ("**Framework**"), which will act as a successor to the Privacy Shield (which was invalidated by Schrems II). Following this, on December 13, 2022 the Commission published its draft adequacy decision, which stated that the new Executive Order and Framework are able to meet the concerns raised in Schrems II. If the draft adequacy decision is approved by the Commission and implemented, the agreement will facilitate the transatlantic flow of personal data and provide additional safeguards to data

Following those significant developments, there have been a number of further developments in 2022 which are set to progress in 2023, in particular in relation to EU-U.S. data transfers.

32 *GDPR Enforcement Tracker Report*, CMS (March 2022).

transfer mechanisms (including in addition to the June SCCs) for (re)insurers transferring personal data from the EU to the U.S. The decision will also allow TIAs assessing transfers to the U.S. to be simplified in reliance on both the adequacy decision and Framework. However, before parties can rely on the new Framework as a transfer safeguard, there are still legislative and regulatory steps that must be undertaken in both the U.S. and in the EU, which we expect to see in 2023 ahead of any final adequacy decision.

While such an adequacy decision will not apply to UK transfers post-Brexit, the UK government has indicated that its own "adequacy arrangement" with the U.S. could also be agreed in 2023.[33]

As a reminder, the current TIA process should include: (i) carrying out a data mapping exercise of their data transfers to get a clear overview of each data transfer from the EEA; (ii) verifying whether the recipient jurisdiction has obtained an adequacy decision (e.g., Switzerland or Japan) and if not, determining which GDPR data transfer mechanism, such as the June SCCs, can be used; (iii) assessing the third country's legal order (e.g., the U.S., Bermuda, India, etc.) to determine to what extent it impinges on the effectiveness of the GDPR's safeguards; (iv) implementing supplementary protection measures, if needed based on the outcome in (iii); (v) complying with all procedural formalities to implement the safeguards; and, finally, (vi) ensuring the reevaluation of the situation at appropriate intervals, especially in relation to the potential further SCCs to be released.

In terms of specific guidance to assist (re)insurance companies with these assessments, the Lloyd's Market Association ("**LMA**") and other relevant industry bodies have to date provided more limited market guidance beyond responses to the public consultations with respect to the EU SCCs and the Schrems II decision. It follows that companies should continue to rely on industry-agnostic guidance (e.g., from the EDPB) at present.

Following Brexit, the EU SCCs do not automatically apply in the UK. In turn, the UK government and ICO have developed a UK equivalent to the EU SCCs — the UK International Data Transfer Agreement ("**IDTA**"). In addition, they have also published a new UK addendum which can be used with the June SCCs, (the "**Addendum**"). Both the Addendum and the IDTA came into force on March 21, 2022. Any agreements concluded after September 21, 2022 which involve transfers of personal data from the UK to a third country, will need to use the IDTA or Addendum to the June SCCs, and all agreements (whether concluded before September 21, 2022 or subsequently) will need to be updated to address either the IDTA or Addendum by March 21, 2024.

(Re)insurers with operations in the UK should consider their current data processing agreements and consider in particular if they intend to adopt the IDTA or the Addendum, as well as the implementation deadlines for new and existing contracts.

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In November 2022, the ICO published its much anticipated guidance on transfer risk assessments, proposing an alternative approach to the EDPB's TIA, discussed above. The ICO-style TIA has been termed a Transfer Risk Assessment Tool ("**TRA Tool**"), and organizations can use the 41-page tool as a template to conduct their risk assessment for any international data transfers. The TRA Tool consists of six questions, with the overriding concern being whether the transfer would result in an increase in the risk to people's privacy or other human rights, compared to if the data were to remain in the UK. Importantly, the ICO makes clear that either the UK or EDPB TIA is acceptable. As such, (re)insurers should consider whether to adopt the UK's TRA Tool or continue use of the EDPB TIA, if already in progress. There are likely some scenarios where the TRA Tool appears to be helpful (e.g., where (re)insurers are only transferring "low risk" data, such as B2B personal data), as the TRA Tool does not require further analysis for "low risk" data transfers, including analysis of the destination country's laws, which is always required under the EDPB TIA.

… (re)insurers should consider the ICO's "clause-by-clause" guidance on how to use the UK's IDTA and Addendum, which is expected this year.

Finally, (re)insurers should consider the ICO's "clause-by-clause" guidance on how to use the UK's IDTA and Addendum, which is expected this year. The ICO is also considering producing "worked examples" as to how the TRA Tool will work in practice and will hold sessions next year to feedback on the tool — it remains to be seen whether any of these examples will be targeted towards the (re)insurance industry.

33 https://www.gov.uk/government/publications/uk-and-us-progress-tech-and-data-partnership/explanatory-note.

c. Profiling and AI

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 EU Member State (or UK) law; or (c) is conducted with the individual's explicit consent, and appropriate safeguards are implemented.

This prohibition is of particular relevance to the (re)insurance industry in the context of underwriting platforms designed to process information about individuals and make certain predictions in order to price risk and allocate premiums. Given the high threshold for valid consent under the GDPR, the most relevant exemption for the (re)insurance industry when undertaking this processing activity is likely where this is necessary to enter into or perform a contract with this individual. This will likely also be the most appropriate exemption for (re)insurers when, for example, they use big data to assist in market analyses, targeted marketing, and fraud detection. Having said this, the scope of reliance on this exemption is not fully clear. For example, in EDPB guidelines published on solely automated processing in October 2017, the concept of "necessity" has been interpreted restrictively and, in turn, this will need to be carefully considered by (re)insurers when implementing any automated decision-making or profiling. In addition, the requirement that the processing is necessary to enter into or perform a contract with an individual will need to be considered where the direct customer is a corporate. Where the performance of a contract exemption cannot be used, (re)insurers may need to consider whether they can obtain and track valid consent.

AI is an area which has undergone significant changes in the last few years, with further developments expected in 2023. For example, in April 2021, the Commission published a draft Artificial Intelligence Act ("**AI Act**") centralizing EU Member State obligations when designing and deploying AI. Several compromise texts have since been published, with the latest adopted by the European Council on November 25, 2022. Although contentious issues involving the contents of the AI Act remain, there is potential for it to be finalized by the European Parliament this year.

AI is an area which has undergone significant changes in the last few years, with further developments expected in 2023.

The AI Act is part of a broader package of legislation on AI, with the ultimate goal being to strengthen Europe's potential to compete in AI at a global level. The AI Act takes a risk-based approach categorizing all AI into: (i) unacceptable risk — activities which are prohibited under the AI Act such as those relating to social scoring; (ii) high-risk activities (e.g., those relating to medical devices and consumer creditworthiness); and (iii) low-risk activities like chatbots. The relevant legal obligations imposed by the AI Act reduce as the perceived risk level posed by the AI system reduces. Notably, the text adopted by the European Council suggests that "AI systems intended to be used for risk assessment and pricing in relation to natural persons in the case of life and health insurance" will be categorized as "high-risk" activities and subject to more stringent regulatory obligations. Activities not mentioned in the AI Act are deemed to be of "minimal risk" and are not regulated.

The AI Act is notable for its wide scope of application with the Act, among other things, applying where the output of the system is in the EU, even if an organization has no commercial presence within the EU. This continues to be a controversial point for organizations who will not always know where the output of their AI technologies will be used. The AI Act is also significant because of its proposed fines for non-compliance of €30 million or up to 6% of worldwide turnover, whichever is higher. However, (re)insurers should note that the Commission is particularly cautious when it comes to using AI in areas like insurance, noting that (re)insurers who utilize AI may have to undertake a "risk assessment in relation to natural persons and pricing in the case of life and health insurance" and that there are risks if such systems are "not duly designed, developed and used, [which] can lead to serious consequences for people's life and health, including financial exclusion and discrimination."

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As a result of these developments, many DPAs have started to issue guidance on AI, with the French DPA publishing a GDPR compliance guide and self-assessment tool for AI systems in April 2022. In addition, while the AI Act will not apply to the UK, the ICO has also updated their AI and data protection risk toolkit as of May 2022. (Re)insurers will find these new tools and guidance useful in designing their compliance regime in relation to AI. Furthermore, in July 2022, the UK government published an AI regulation policy statement for consultation titled "Establishing a pro-innovation approach to regulating AI." The statement provides that the outcomes of the use of AI can have a significant impact on people's

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Cybersecurity and data breach reporting requirements have remained priority issues for both companies and regulators throughout 2022 and into 2023. According to the European Council, ransomware is one of the biggest cyber threats in the EU, with phishing now identified as the most common initial vector of such attacks.

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lives, using insurance as an example. It states that such high-impact outcomes should be justifiable and not arbitrary, and that accountability for those outcomes and legal liability must always rest with an identifiable legal person (whether corporate or natural). The UK's regulatory approach to AI is still to be determined in a forthcoming AI Whitepaper ("**AI Whitepaper**"). In particular, the AI Whitepaper must determine whether AI regulation should be centralized to cover all industries, such as with the proposed EU's AI Act, or decentralized with regulation of AI and other emerging technologies being dealt with at an industry level.

d. Cybersecurity and Data Breaches

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 DPAs, and when damages are awarded in favor of individuals and organizations affected by a personal data breach.

Cybersecurity and data breach reporting requirements have remained priority issues for both companies and regulators throughout 2022 and into 2023. According to the European Council, ransomware is one of the biggest cyber threats in the EU,[34] with phishing now identified as the most common initial vector of such attacks. Distributed denial-of-service ("**DDoS**") attacks now also rank among the highest threats. The 2022 Verizon report[35] states that DDoS attacks account for approximately twice the proportion of security incidents in the financial and insurance industry as they do in other industries. Cybersecurity has become an even more prominent global issue in the past year as a result of the Russia-Ukraine conflict, with Ukraine suffering cyberattacks on its public sector, energy supply, media, financial industry, general business, and non-profit sectors.[36] The conflict has demonstrated the power of cyberwarfare and, in response, cybersecurity agencies around the world are pushing for organizations to take action to improve their resilience to such attacks.[37]

In turn, efforts are being made by regulators to respond to the increasing threat of cyberattacks more generally, as evidenced by the EU's draft Cyber Resilience Act ("**CRA**"), the updated EU Network and Information Systems Security Directive ("**NIS2**"), and the EU Digital Operational Resilience Act ("**DORA**").

The draft CRA, published in September 2022, aims to harmonize and bolster cybersecurity rules across all technologies with "digital elements." The CRA would apply to manufacturers, importers, and distributors who place products on the EU internal market, with the largest burdens being placed on manufacturers. Similarly to the AI Act, the CRA would take a risk-based approach, and would incorporate more transparency and reporting obligations throughout the lifecycle of the digital product. The maximum fine for violations of the CRA would be €15 million or up to 2.5% worldwide turnover, whichever is higher.

NIS2 formally entered into force on January 16, 2023 and will need to be implemented into EU Member State national law by October 17, 2024. NIS2 builds on its predecessor, the NIS Directive, and applies to "operators of essential services" ("**OES**") including banks, healthcare providers, and energy companies. NIS2 further broadens its application to include additional "essential services" providers such as telecommunications companies and social media platforms. Regulators in France, Germany, and Spain have in the past deemed certain (re)insurers to be OES under the former NIS Directive. (Re)insurers should consider whether they are in scope of NIS2 and, if so, what compliance actions they need to take to comply. Perhaps most significantly, NIS2 now imposes direct obligations and liability on senior management for companies in scope, meaning senior management individuals could face administrative fines and/or a potential ban or discharge from managerial functions. Compared to the NIS Directive, NIS2 is more explicit in terms of the cybersecurity measures which companies in scope must implement, and NIS2 provides that these must be aimed at protecting network and information systems, as well as the physical environment of those systems, against security incidents. EU Member States are competent

34 https://www.consilium.europa.eu/en/infographics/cyber-threats-eu/.

35 https://www.verizon.com/business/resources/reports/dbir/.

36 https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2022)733549.

37 https://www.ncsc.gov.uk/news/organisations-urged-to-bolster-defences.

to set the maximum amount for administrative fines for non-compliance with NIS2 obligations, but NIS2 provides that this maximum amount in national law should at least be set at €10 million or 2% of worldwide turnover, whichever is higher.

The (re)insurance industry is also in scope of EU sector-specific legislation in relation to cyber resilience. DORA, which came into force on December 14, 2022, imposes specific and prescriptive technical standards on financial services firms (including (re)insurers) to harmonize how EU financial institutions deal with cyber incidents. Under DORA, companies must create and adhere to an ICT risk management framework, classify and report incidents, periodically test systems according to so called "Threat Led Penetration Testing" processes, and critically evaluate the risks with data sharing. Like NIS2, DORA also imposes key obligations on senior management, including to sign off company cyber resilience strategies, meaning that the board of (re)insurance firms need to understand how their IT and data systems work in practice. Moreover, given that DORA will apply just 24 months after its entry into force on January 16, 2023, (re)insurers should already be considering their obligations under the Act and how they will comply with it.

It is clear that (re)insurers must seek to be proactive in maintaining strong, state-of-the-art security systems, particularly in light of the PRA's Statement in relation to the inclusion of appropriate security measures in outsourcing agreements (see above). Measures that (re)insurers should consider will vary depending on the circumstances, but should include: (i) pseudo-anonymization (this is especially important so individuals, e.g., policyholders, cannot be identified when personal data is being used for, say, analysis purposes) and encryption of personal data (personal data should be encrypted both in transit and at rest); (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.

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e. UK Data Protection Post-Brexit

In addition to some of the UK divergences we have noted throughout the rest of this section, while the UK has implemented much of the EU GDPR into its own domestic laws, and continues to maintain a data protection regime which is substantially aligned with the EU GDPR in structure and core principles, the UK has continued to take advantage of its post-Brexit independence from a data protection perspective. The 2021 public consultation entitled: "Data: A new direction" (the "**Consultation**") proposed far reaching reforms to the UK's data protection regime. Following the Consultation, the UK government introduced the Data Protection and Digital Information Bill (the "**Data Reform Bill**") in July 2022 which, as of January 2023, is currently awaiting its second reading in Parliament.

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Important potential changes in the Data Reform Bill, which could be particularly relevant to the (re) insurance industry include:

- A proposed clarification as to the meaning of "identifiable" data. The Data Reform Bill clarifies that an individual is only "identifiable" if the data controller or processor can use "reasonable means" (i.e., means that party is reasonably likely to use) to identify them. This narrows the test for identifiability and makes it relatively in line with the Council of Europe's modernized Convention 108. This may impact (re)insurers who in theory can access personal data (e.g., data on policyholders) but in reality will never use it to identify individuals. Being able to use such data as "anonymized data" has the potential to open up the possibilities for (re)insurers to utilize such data for analytics and innovation without having to comply with further obligations under the GDPR for their processing activities.

- The proposed removal of the requirement to log all personal data processed in a Record of Processing Activities or "ROPA." The Data Reform Bill proposes that organizations maintain a simplified form, including by removing the obligation for a controller to list all categories of data subjects and personal data (with such records only needing to be maintained in relation to special category and crime-related personal data). This should simplify data logging for (re)insurers who may process large volumes of data which is not special category or crime-related.

- A proposal to relax the currently strict requirement for human review of decisions based solely on automated processing under Article 22 of the UK GDPR. The enactment of such a proposal could unlock the benefits of AI for the (re)insurance industry as algorithms could be used to streamline underwriting, determine policy and payout pricing, and predict the outcome of insurance claims without needing to employ a team to review every AI-based decision where an exemption does not apply. It should be noted, however, that there may be further regulatory guidance given in relation to how AI and machine learning technologies will be used within the (re)insurance industry in particular, as the original Consultation focused on the insurance industry when providing examples of potential bias in AI systems and the potential for this to cause significant risks to individuals (e.g., "insurers predicting someone's fitness levels from their purchasing habits" or "red lining poorer neighborhoods within the insurance industry"). This suggests (re)insurers will need to carefully consider how they use automated decision-making in a fair and transparent manner, notwithstanding the apparently more lenient provisions in the Data Reform Bill.

f. New Legislative Updates

Other than the significant pieces of EU legislation relating to AI and cybersecurity, the EU has also introduced a new "Digital Package" encompassing various new pieces of legislation, some of which may be of relevance to (re)insurers.

Other than the significant pieces of EU legislation relating to AI and cybersecurity, the EU has also introduced a new "Digital Package" encompassing various new pieces of legislation, some of which may be of relevance to (re)insurers. In particular, (re)insurers should take note of the Data Governance Act ("**DGA**"), which was adopted on May 30, 2022, and established a legal framework to promote the availability of data and increase trust in data sharing across sectors in the EU. The DGA creates a new EU-wide service called data intermediation services, which is a service meant to connect data subjects and potential data users. The DGA also provides for additional measures to foster the reuse of public sector data, which may be relevant to accessing data which can feed into price modeling and the assessment of risk. The DGA does not establish specific penalties for the infringement of its provisions, but EU Member States are expected to establish sanctions for the infringement of the DGA provisions at the national level. The DGA is set to become fully applicable by September 24, 2023.

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In addition, (re)insurers should also consider the Data Act, which imposes significant obligations on manufacturers of connected products and cloud service providers, to provide real time access to the data generated and processed by or through their products or services. Providers of connected products and services (or products and services of the Internet of Things) will be required to design products in a way that will allow users (consumers and businesses) to have easy access to personal and non-personal data collected and generated by the devices. The Data Act may be relevant to those who will utilize connected devices to calculate insurance premiums — for example, car insurers who offer "black box insurance," which monitors young drivers and rewards safe driving with the offer of cheaper car insurance policies. The Data Act has not yet been adopted by the EU and may be subject to further amendments.

These legislative updates highlight the ever-growing relevance of the digital world and the regulatory demands that it brings. The new laws are likely to impact many (re)insurers as well as their clients and business partners, so it is vital that (re)insurers stay up-to-date with the legal obligations of the digital industry …

These legislative updates highlight the ever-growing relevance of the digital world and the regulatory demands that it brings. The new laws are likely to impact many (re)insurers as well as their clients and business partners, so it is vital that (re)insurers stay up-to-date with the legal obligations of the digital industry and consider if they may fall in scope of them or even be indirectly affected by them.

g. Final Thoughts

The GDPR has entered its fifth year in force, and while (re)insurers are now somewhat used to those compliance requirements, the continued development of new legislation and guidance, as well as ongoing enforcement efforts both at the EU and national level, will continue to challenge firms in 2023.

The GDPR has entered its fifth year in force, and while (re)insurers are now somewhat used to those compliance requirements, the continued development of new legislation and guidance, as well as ongoing enforcement efforts both at the EU and national level, will continue to challenge firms in 2023. (Re)insurers will need to monitor and assess the new legislation being adopted across the EU, including the AI Act and Digital Package, which will have a significant impact on the (re)insurance industry's use of big data sets and predictive AI-based modeling on pricing and risk assessment. The sector should also continue to monitor any potential divergence of the EU and UK data protection regimes, in particular progress of the Data Reform Bill. In addition, given increasing threats in the cybersecurity landscape, (re)insurers should continue to monitor for such system vulnerabilities and develop their cybersecurity programs to address such issues. With respect to international transfers, (re)insurers should reassess their current Schrems II compliance plans to address any changes required either by UK developments (where relevant) or in relation to EU-U.S. data transfers, in anticipation of the U.S. Executive Order, Framework, and draft adequacy decision.

6. UK Cyber and Operational Resilience Update

While the restrictions arising from the COVID-19 pandemic were lifted over 2022, many businesses continued to operate hybrid working models. According to business support data, UK workers have increased their working week by nearly 25%, while working remotely. This has meant a broader attack surface for cybercrime, thus increasing the likelihood of a major cyber breach.

Cyberattacks have left brokers inundated with claims from large-scale ransomware attacks. The rise in cybercrime activity shows cyber criminals to be aware of this increased opportunity for extortion, theft, and sabotage. Ransomware has remained a persistent cyber risk with legal challenges. GDPR notification obligations are not the only considerations for compliance. Companies must also consider anti-terrorism, anti-money laundering laws, sanctions, and internal compliance. Some insurers are changing their policies to reduce the cover they offer for organizations with lower cyber controls. While complete cybersecurity is not realistic, there are core cyber risk management controls that organizations may consider in order to reduce the likelihood that they will be victimized by a cyber breach. Technical mitigations may be put into place, such as multifactor authentication, secure backups, privilege access management, training, and awareness raising.

Where a cyber threat looms, managing such a crisis should be at the forefront of firms' minds. Particularly, navigating key stakeholder communications is crucial. The importance of resilience preparation and continuity planning is not lost on investors, shareholders, or regulators. An organization should have a well-defined, stress-tested plan in place to ensure that effective decisions can be made, should a cyber event occur.

a. Cyber Insurance Market

On June 30, 2022, Lloyd's issued its *Shift powers: Physical cyber risk in a changing geopolitical landscape* risk report to the market. In the report, Lloyd's notes that cybersecurity is at the top of the agenda for businesses, boards, risk managers, and consumers. Notably, malware and ransomware attacks have been causing severe disruption for global businesses and their supply chains and heightened scrutiny on the mitigation strategies and insurance coverage of those businesses. These trends have been caused by an increase in criminal ransomware activity caused by the COVID-19 pandemic and the changing geopolitical landscape from the Russia-Ukraine conflict. With the rise in cyberattacks, and resulting rise in insurance claims, the rates for buying cyber insurance are unsurprisingly going up. According to market commentary,[38] market expansion for cyber insurance remains strong, with estimated annual premiums of US$8-10 billion. Annual premium is predicted to reach up to US$22.5 billion by 2025.

b. PRA, FCA, EIOPA, and European Commission Initiatives and Communications

i. PRA

In May 2022, the PRA published a Dear CEO letter addressed to the CEOs of the largest regulated life and general insurance firms. The letter explained that the PRA is launching its biennial insurance stress test ("**IST**"). The IST is one of the key priorities for the PRA and insurers, and the objectives of the exercise are to: (i) assess sector resilience to severe but plausible adverse scenarios; (ii) guide supervisory activity; and (iii) enhance the PRA's and firms' ability to respond to future shocks. The deadline for submission to the IST was September 28, 2022.

On January 23, 2023, the PRA issued a Dear CEO letter with feedback on the May 2022 stress test. The letter sets out the PRA's findings on sector resilience and provides thematic observations that support improvements in risk management. The results indicated that the UK insurance sector is resilient to the test's specified scenarios, subject to a number of mitigating measures, but highlighted the need for ongoing focus in a number of priority areas. Notably, the PRA mentions that insurers will need to demonstrate their ability to operate within impact tolerances under a range of severe but plausible scenarios, including cyberattacks. The PRA has also indicated that individual responses will not be published, but will inform the PRA's supervisory priorities which may result in follow-up discussions and actions.

While the restrictions arising from the COVID-19 pandemic were lifted over 2022, many businesses continued to operate hybrid working models. According to business support data, UK workers have increased their working week by nearly 25%, while working remotely. This has meant a broader attack surface for cybercrime, thus increasing the likelihood of a major cyber breach.

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38 https://www.fitchratings.com/research/insurance/cyber-insurance-premium-hikes-to-support-returns-amid-rising-claims-31-08-2022.

ii. FCA, PRA, and Lloyd's

Robust cyber practices of firms is a high priority item to the UK regulators, and this requires increasing attention from firms in order to adhere to the regulators' standards of expectation.

Robust cyber practices of firms is a high priority item to the UK regulators, and this requires increasing attention from firms in order to adhere to the regulators' standards of expectation. In this respect, the FCA and PRA's Operational Resilience Requirements is a key consideration for firms in their cyber practice, as the new requirements will have a bearing on the systems and controls that firms use to deal with operational risks, such as cyber incidents.

In their 2019 shared consultation paper (CP29/19 in relation to the PRA and CP19/32 in relation to the FCA), the FCA and the PRA described operational resilience as the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover from, and learn from operational disruptions. Causes of operational disruptions include technology failures, cyberattacks, and telecommunications or power failures. Firms are to take actions such as replacing outdated or weak infrastructure, increasing system capacity, achieving full fail-over capability, addressing key person dependencies, and being able to communicate with all affected parties. This would include taking action to address vulnerabilities in legacy systems. Further, the FCA's Senior Management Arrangements, Systems and Controls Sourcebook 3.1.2 requires firms to carry out regular reviews of its systems and controls.

The FCA and PRA published their final policy statements on March 29, 2021, which announces the new operational resilience requirements that came into force on March 31, 2022. The requirements apply to insurers, banks, building societies, designated investment firms, and e-money and payment services firms. By now, in-scope firms should have identified important business services, set impact tolerances, and mapped and commenced a program of scenario testing.

As soon as possible after March 31, 2022, and in any case no later than March 31, 2025, firms must have performed mapping and testing so that they are able to remain within impact tolerances for each important business service. Firms must have also made the necessary investments to enable them to operate consistently within their impact tolerance during severe but plausible scenarios.

In 2022, Lloyd's introduced Principle 12 (Operational Resilience) which requires managing agents to maintain robust and resilient operations, embedding cyber resilience and effective third-party risk management. The principle requires, among other things, to prioritize resilience of the most importance services; invest in operational resilience, including a managing agents' control environments; and embed cyber resilience into operations.

…firms must take active steps to prevent disruptions to a practicable extent, adapt systems and processes to continue to provide services and functions in the event of an incident, return to normal running promptly after a disruption is over, and learn and evolve from incidents.

In order to comply with these requirements, firms must take active steps to prevent disruptions to a practicable extent, adapt systems and processes to continue to provide services and functions in the event of an incident, return to normal running promptly after a disruption is over, and learn and evolve from incidents.

In addition, the policy statements acknowledge links with work by other regulators including: the European Banking Authority; the Basel Committee for Banking Supervision's proposed Principles for Operational Resilience; the European Commission's proposed Digital Operational Resilience Act; and the International Organization of Securities Commission's Principles on Outsourcing. Many of the initiatives share strong similarities in approach, with firms being asked to understand their critically important functions, tolerance for disruption, interdependencies with third parties, and risk appetite. The regulatory alignment across jurisdictions should alleviate some of the burden of cross-border compliance by reducing divergence and driving greater consistency in global standards.

Most notably, the initiatives make clear that regulators expect certain disruptive events — such as cyber incidents — will take place, and therefore firms must shift their focus from avoiding these disruptive events to assuming they will happen.

Most notably, the initiatives make clear that regulators expect certain disruptive events — such as cyber incidents — will take place, and therefore firms must shift their focus from avoiding these disruptive events to assuming they will happen. In the event of a major operational incident, firms will not be able to argue that a disruptive event was unforeseen, and must be able to maintain continuity of services.

Firms should anticipate the likelihood of increased supervisory scrutiny on compliance with operational resilience requirements from their home state and foreign regulators. For example, the PRA's Dear CEO letter from January 2023 on Insurance Supervision confirms that operational resilience of the financial sector remains a strategic priority area and the regulator intends to review firms' programs and implementation (and in particular, the appropriateness of impact tolerances, the identification of dependencies, and the robustness of testing plans). Most notably, over the next three years, insurers will need to demonstrate their ability to operate within certain impact tolerances under a range of severe but plausible scenarios, including cyberattacks. In addition, the Lloyd's Plan for 2023 confirms that cyber resilience will continue to shape some of Lloyd's planned oversight work during the year. For example, Lloyd's is planning to ask managing agents to complete a cyber resilience survey in Q1 2023, as an update to the survey undertaken in 2021.

It would do firms well to also bear in mind cyber reporting requirements, as set out by the FCA, PRA, and Lloyd's. Principle 11 of the FCA's Principles for Businesses and Lloyd's Principles for Doing Business 11 (Regulatory and Financial Crime) assert that notification may be required for any material cyber incidents. The Lloyd's Principles for Doing Business glossary and the FCA Handbook indicate that a cyber/operational incident may be "material" if it: results in significant loss of data, or the availability or control of IT systems, affects a large number of customers, or results in unauthorized access to, or malicious software present on, information and communication systems. Such incidents would need to be reported to the FCA and PRA immediately upon awareness. For Lloyd's, a personal data breach must be reported by the managing agents as soon as they become aware and within 72 hours at the latest.

The cyber threat landscape represents a complex and evolving challenge for the insurance sector. A clear understanding of the legal and regulatory environment, and a comprehensive operational resilience program will be key to ensuring firms manage their cyber risk.

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On October 11, 2022, the PRA and FCA published a discussion paper (DP5/22 in relation to the PRA and DP22/4 in relation to the FCA) on AI and machine learning. The DP focuses on the regulation of AI in UK financial services. The regulators seek to encourage a discussion with stakeholders on the challenges associated with the use and regulation of AI (and in particular, to explore how best to mitigate potential risks and enable innovation in a way that aligns with the statutory objectives).

The deadline for submission was February 10, 2023.

iii. EIOPA

In June 2021, the EIOPA published its report on AI Governance Principles, which was developed by its Consultative Expert Group on Digital Ethics. The consultative group was established in 2019 to assist EIOPA in developing digital responsibility principles in insurance. The increasing use of powerful data storing and processing technologies such as AI are notably relevant to the insurance sector, given the significance of data analytics to underwriting, pricing, and claims management strategies.

The report is addressed to both insurance undertakings and intermediaries when using AI in the respective areas of the insurance value chain where they are involved. It asserts that there is, however, a distinction between the different roles that are involved in the implementation of specific AI use between insurance undertakings and intermediaries.

The report sets out six governance principles which underline EIOPA's approach to an ethical and trustworthy AI in the EU insurance sector. The principles relate to proportionality, fairness and non-discrimination, transparency and explainability, human oversight, data governance of recordkeeping, and robustness and performance. Given the increased adoption of AI in the sector to potentially achieve higher levels of accuracy, automation, and cost and process efficiency, these principles should serve to mitigate the related risks.

The six AI governance principles follow the High-Level Expert Group's Ethics Guidelines for Trustworthy AI and serve as a starting point for establishing boundaries for the appropriate use of AI in insurance. It aims to use the expert group's findings to assist with identifying possible supervisory initiatives relating to the ongoing developments to digitization and AI at the EU level.

Though the six governance principles are not binding, they can be viewed as an indication of the changes to the cyber-related regulatory approach that will affect the insurance market in the future. EIOPA encourages firms to adhere to the six principles by designing and implementing risk-based measures towards a trustworthy AI solution.

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iv. European Commission

In 2021, the European Commission ("**Commission**") announced its plans to launch a Joint Cyber Unit which will act as a platform to ensure an EU-coordinated response to large-scale cyber incidents and crises. It will allow national capitals that have been hit by cyberattacks to seek help from other countries and the EU, such as through rapid response teams that will look to fight off hackers in real time. All relevant actors in the EU are to be prepared to respond collectively and exchange relevant information on a "need to share" rather than only a "need to know" basis. Hence, there will be a need for coordination, sharing of knowledge, and even advance warning.

This comes following a wave of cyberattacks on the continent, leading to concerns about Europe's abilities to defend itself against these attacks. The Joint Cyber Unit will also prepare regular threat reports, test crisis response plans, and set up information-sharing agreements between authorities and private cybersecurity firms.

The Commission proposed to build the Joint Cyber Unit ("**JCU**") through a four-step process, namely: (i) assess the organizational aspects and identify EU operational capabilities; (ii) prepare national incident and crisis response plans, and roll out joint preparedness activities; (iii) operationalize the JCU by mobilizing EU Rapid Reaction teams; and (iv) involve private sector partners, users, and providers of cybersecurity solutions and services. The European Union Agency for Cybersecurity will serve as secretariat for the preparatory phase.

... the Commission is introducing new cyber legislation which will impact the insurance industry.

In addition, the Commission is introducing new cyber legislation which will impact the insurance industry. First, there is DORA, which will apply to financial services firms (including (re)insurance companies, (re) insurance intermediaries, and ancillary insurance intermediaries), and will impose an obligation on these firms to maintain an ICT risk management framework, report incidents adequately, and allow for periodic testing of their IT systems. DORA will also impose certain obligations in relation to financial firms' engagement of ICT service providers and, more importantly, DORA imposes certain obligations on senior management, including in relation to defining, signing off, overseeing, and being responsible for the company's ICT risk management framework. DORA will be fully enforceable as of January 17, 2025. Penalties for breaches of DORA will be imposed by competent authorities at the national EU Member State level, and may include criminal penalties, administrative fines, and mandatory implementation of remedial measures.

Second, the Commission has proposed a draft Cyber Resilience Act ("**CRA**") which aims to regulate all technologies with "digital elements" and harmonizes cyber standards and incident-related reporting obligations across digital products for manufacturers, importers, and distributors of such products placed on the EU internal market. The maximum fine for violations of the CRA would be €15 million or up to 2.5% worldwide turnover, whichever is higher, and enforcement will also take place at the national EU Member State level.

Finally, the Commission has updated its EU Network and Information Systems Security Directive ("**NIS2**"). NIS2 imposes its obligations on "essential" and "important" entities, including energy, transport, health, and certain digital and cloud companies, as well as credit institutions, operators of trading venues, and managed service providers. It remains to be seen to what extent insurance companies would be impacted by NIS2, as they are not explicitly covered by NIS2, though they could be covered as and when NIS2 is implemented in EU Member State national legislation. NIS2 imposes a number of prescriptive cyber security measures to protect network and information systems, as well as requirements relating to the reporting of security incidents which have a "significant impact" on the provision of services covered. NIS2 also imposes direct liability on senior management for non-compliance, meaning that senior management individuals could face administrative fines and/or a potential ban from managerial functions. NIS2 will need to be implemented into EU Member State national law by October 17, 2024, and provides for fines at a maximum, following EU Member State implementation, of at least €10 million or 2% of worldwide turnover, whichever is higher.

7. ESG Update

Initiatives relating to ESG have increasingly become a priority in the (re)insurance sector and the past year saw companies increasingly taking action to evidence their commitment to ESG priorities. For insurers, this includes the integration of ESG within core business and operations. Insurers are exposed to ESG

Initiatives relating to ESG have increasingly become a priority in the (re)insurance sector and the past year saw companies increasingly taking action to evidence their commitment to ESG priorities.

risks both in terms of their underwriting and investment activities, as well as regulatory risks, as regulators persist in developing a more comprehensive ESG framework, which undoubtedly will need to play a key role in the governance of companies. The other relevant lens is the role of investors in driving ESG objectives, thus inviting a financial incentive to sustainable investing.

a. ESG in the Insurance Market

The UN-convened Net-Zero Insurance Alliance, formed in July 2021, consists of some of the world's leading insurers and reinsurers who play a part in accelerating the transition to net zero emissions economies. The participants commit individually to transition their underwriting portfolios to net zero greenhouse gas emissions by 2050, in line with the 1.5 degrees Celsius target of the Paris Agreement, which came into force on November 4, 2016. The Net-Zero Insurance Alliance will work under the auspices of the UN Principles for Sustainable Insurance ("**PSI**") with participants being required to become a signatory of the PSI, or commit to sign the PSI within one year upon joining. The Net-Zero Insurance Alliance will be chaired by AXA, and other founding members include Allianz, Aviva, Generali, Munich Re, SCOR, Swiss Re, and Zurich.

In February 2021, the UK's HM Treasury published a press release announcing that the UK joined the International Platform on Sustainable Finance (the "**Platform**"). The Platform serves as a forum for public authorities to coordinate approaches in developing environmentally sustainable finance policies and initiatives. This is in line with the UK's decision to extend the scope of non-financial reporting, such as in requiring the Task Force on Climate-Related Financial Disclosures ("**TCFD**") aligned disclosures on a comply or explain basis, as detailed below. This is intended to enable the market to analyze where most carbon is emitted and allocate capital accordingly. The past year saw the Platform continue work on two main policy areas: (i) comparison of taxonomies and (ii) transition finance.

b. EU and ESG

The Commission published its proposal to amend Solvency II on September 22, 2021. It highlighted that its review of Solvency II was an opportunity to ensure that the regulatory framework promotes long-term investment by the insurance sector and that the sector should play a role in financing the post-COVID-19 economic recovery. The Commission also considered whether the insurance sector could contribute to the EU's political priorities, including climate and environmental targets under the European Green Deal. The European Green Deal is the EU's new growth strategy, which aims to transform the EU into a modern, resource-efficient, and competitive economy with no net emissions of greenhouse gases by 2050.

The proposal states that COVID-19 has caused concerning socio-economic damage whereby the EU economy is in need of a sustainable, inclusive, and fair recovery. This has made the objectives of the European Green Deal even more urgent. The insurance and reinsurance sector can support these objectives by providing private sources of financing to European businesses and supplying protection against a wide range of risks to make the economy more resilient. The proposal pushes for some amendments to the European Green Deal. Under a new Article 45a, the proposal introduces a new take on climate scenario analysis. Insurers will have to identify any material exposure to climate change risks, and assess the impact of long-term climate change scenarios on their business, where relevant. Insurers classified as low-risk profile undertakings are exempted from scenario analyses. The amendments provide two mandates to the EIOPA relating to sustainability risks where, by 2023 (we understand this to mean by the end of the year), it may explore a dedicated prudential treatment of asset or activity exposures which relate substantially to environmental and/or social objectives, including a regular review of the scope of the standard formula relating to natural catastrophe risk.

Additionally, the Commission takes the view that the prudential framework should be adjusted better to take into account the long-term nature of the insurance business. In particular, in the context of the relevant insurer calculating its required regulatory capital. Solvency II sets out specific rules and the Commission considers that these could be adjusted to allow for more favorable capital charges for certain equity investments that are held with a long-term perspective. The Commission considers this approach should not undermine policyholder protection and financial stability. This view comes after the Commission made a commitment to integrate the management of climate and environmental risks better into the EU's prudential framework in its Communication of December 11, 2019 on the European Green Deal. In its Communication of July 6, 2021, on a Strategy for Financing the Transition to a Sustainable Economy, the Commission committed to propose amendments to Solvency II to consistently integrate sustainability risks in risk management of insurers. Fitch Ratings suggests that while life insurers are well-placed to invest in longer-term assets, such as environmentally sustainable infrastructure and renewable energy projects, given their long-term investment horizon, they are constrained by somewhat unduly onerous capital charges when valuing such investment for regulatory capital purposes. Such requirements may be set to change through reforms, to reduce the risk margin provision that insurers must hold against certain long-term business and to lower the capital charges for equities that are treated as "long-term." The benefit of this for insurers and their policyholders may come in higher returns that may be available in the longer-term, though often illiquid, assets. The change is expected to be gradual, as time will be needed to source the investments that are considered to be suitable.

On August 2, 2022, the secretariat of the Committee on Economic and Financial Affairs in the European Parliament published three amendment reports. These reports contain all of the proposed amendments to the earlier draft report on the revision of Solvency II. The proposed amendments ranged from proposals for more far-reaching buffer capital requirements and reporting by insurers, to proposals for capital relief and the deletion of certain articles from the directive, in order to reduce the administrative burden on insurers. An agreement on this is expected at the earliest in mid-2023, after which the revision is expected to enter into force from the end of 2024. In April 2021, a comprehensive package of measures to facilitate the progression towards sustainable economic activities was approved in principle by the Commission. In August 2021, two delegated regulations (the "**EC Regulations**") amending sectoral legislation, including Solvency II and the Insurance Distribution Directive ("**IDD**"), were published. The EU Regulations came into force after Brexit and therefore do not apply to UK regulated entities. The EC Regulations focus on the integration of sustainability into key activities including product oversight and governance, risk management, and suitability assessment procedures. The EC Regulations applied from August 2022, and implement changes that have been made to wider financial services regulation in an EU context. For further details, please see the section below on EU Non-Financial and Sustainability Reporting.

Supplemental guidance was also issued earlier in the year by EIOPA on the integration of sustainability preferences in the suitability assessment under the IDD. Insurance undertakings that manufacture and/or distribute insurance products, and insurance undertakings (and intermediaries) that advise on insurance-based investment products ("IBIPs"), will need to ensure compliance with the requirements.

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EU Non-Financial and Sustainability Reporting

The EU Non-Financial Reporting Directive (2014/95/EU) ("**NFRD**") amends the EU Accounting Directive (2013/34/EU) and requires a large public interest entity (e.g., listed companies, insurance undertakings) with more than 500 employees to make disclosures on the company's development, performance, position, and impact of its activity in relation to environmental, social, employee, human rights, and anti-corruption matters. The NFRD's disclosures involve the concept of double-materiality (i.e., disclosures on the impact the company has, as well as the impact of external factors on the company). As an EU directive, the NFRD applies to member states' in-scope entities in accordance with its implementation under member states' local law.

On January 5, 2023, the EU Corporate Sustainability Reporting Directive (2022/2464) ("**CSRD**") entered into force. The CSRD widens the scope and extent of disclosures required by the NFRD with further amendments to the Accounting Directive. The CSRD applies to: (i) all large EU companies; (ii) small and medium-size enterprises, except microenterprises, that are "public interest entities," which includes listed small and medium-sized enterprises ("**SMEs**"), credit institutions, and insurance undertakings; and (iii) non-EU undertakings with annual EU-generated revenues in excess of €150 million and which also have either a large EU subsidiary that is a public interest entity or a significant EU branch (generating €40 million in revenues). Entities in scope of CSRD are required to comply with detailed sustainability reporting standards (the European Sustainability Reporting Standards ("**ESRS**") being developed by the European Financial Reporting Advisory Group ("**EFRAG**")). On November 22, 2022, EFRAG submitted the first set of draft ESRS to the Commission. The Commission is required to adopt the first set of final standards as delegated acts by June 30, 2023 and will subsequently be required to adopt a second set by June 30, 2024 that will specify complementary information requirements and sector-specific standards.

Companies that are already subject to NFRD,[39] are required to produce their first report in 2025 for the financial year starting on or after January 1, 2024. Large companies that are not presently subject to NFRD will have to report in 2026 in relation to the financial year starting on or after January 1, 2025. The CSRD will be rolled out to listed SMEs in 2027, albeit subject to an opt-out until 2028, reporting on the financial year starting on or after 2026.

Under Article 8 of the EU Taxonomy Regulation ((EU) 2020/852), any large public interest entity that is required to make non-financial disclosures under NFRD is also required to disclose the proportion of its turnover derived from, and capital expenditure related to, economic activities that qualify as environmentally sustainable under the EU Taxonomy Regulation.

c. UK Rules on Climate-Related ESG Disclosures

FCA ESG Sourcebook

On December 17, 2021, the FCA published its policy statement on enhancing climate-related disclosures by life insurers, FCA-regulated pension providers, and asset managers. In the policy statement, the FCA clarified its intended scope of firms and products. It also made some changes to the rules and guidance it previously consulted on in June 2021, which proposed mandatory annual disclosures at entity and product level. The policy statement aims to increase transparency on climate-related risks and opportunities, and to enable clients and consumers to make considered choices. It summarizes the feedback received to its earlier consultation and confirms the FCA's final policy position. The rules take effect through a new ESG sourcebook in the FCA handbook and came into effect on January 1, 2022, for the largest in-scope firms, and from January 1, 2023, for smaller firms above the £5 billion exemption threshold. The first public disclosures must be made by June 30, 2023.

The new rules introduce entity level and product level disclosures relating to sustainability risks, which are aligned with the TCFD recommendations. For insurance companies, TCFD in-scope business covers the provision of IBIPs, operating a personal pension scheme or stakeholder pension scheme, and operating a self-invested personal pension (that contains an IBIP). Only disclosures of core metrics, including scope 1-3 emissions, total carbon emissions, total carbon footprint, and weighted average carbon intensity are mandated by the FCA. Meanwhile, additional metrics will only need to be disclosed as far as reasonably practicable.

Firms will not be required to disclose information if data gaps cannot be addressed by using proxies and assumptions, or where doing so would result in misleading disclosures. Where firms have not been able to disclose, they will be required to explain why and where, and the steps taken to improve the quality of their disclosure.

Further, under the amended "on demand" obligation, firms will be required to provide a report to clients at a single reference point which is consistent with public disclosures.

Where a firm is headquartered or operating in a country which has made a commitment to a net zero economy, it will be encouraged to consider its commitment to developing and disclosing its transition plan.

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Companies Act 2006

The current regime under the UK Companies Act 2006 ("**CA 2006**") implements the requirements of the Non-Financial Reporting Directive and the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, and requires a large UK company with over 500 employees, including an authorized insurance company and a company carrying on insurance market activity, to include a non-financial and sustainability information statement in their strategic report that includes climate-related financial disclosures aligned with the TCFD's recommendations and recommended disclosures.

In addition, a director's annual report, as outlined in the CA 2006, must disclose a company's annual energy consumption and greenhouse gas emissions if that company consumes more than 40,000 kWh

39 I.e., "large undertakings" that are public interest entities with over an average of 500 employees during the financial year.

The consultation proposes new sustainability-related labeling, disclosure, and naming and marketing rules that will complement the existing TCFD-aligned reporting regime for asset managers, primarily in the interests of retail investors.

… it is important that Boards and senior management, including the designated senior manager function for climate, demonstrate appropriate oversight and control of the firm-wide climate agenda.

Lloyd's has mandated that managing agents must create an ESG framework and strategy in 2022, for sign off in the 2023 business planning cycle. Managing agents will need to consider the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their ESG strategy.

The drive within Lloyd's on ESG is further illustrated by the Lloyd's Plan. The 2023 Plan includes climate risk and ESG, so managing agents can expect supervisory engagement over the coming year.

of energy in the UK during the annual reporting period. The UK government has expressed an intention to extend the scope of non-financial reporting over the next two to five years. This includes UK Green Taxonomy[40] alignment reporting and disclosure of net zero transition plans.

FCA SDR

On October 25, 2022, the FCA published its consultation paper on the UK Sustainability Disclosure Requirements ("**SDR**") and investment labels (CP22/20).

The consultation proposes new sustainability-related labeling, disclosure, and naming and marketing rules that will complement the existing TCFD-aligned reporting regime for asset managers, primarily in the interests of retail investors. As currently proposed, the SDR does not apply to IBIPs; however, the FCA has indicated its intention to consider expanding the scope of the SDR requirements in the future to other investment products marketed to retail investors such as IBIPs.

d. PRA Supervisory Statement on Enhancing Banks' and Insurers' Approaches to Managing the Financial Risks From Climate Change

On April 15, 2019, the PRA published a policy statement (PS11/19) and a supervisory statement (SS3/19) on enhancing banks' and insurers' approaches to managing the financial risks from climate change. In accordance with SS3/19, by the end of 2021, insurance and reinsurance firms and groups (i.e., those within the scope of Solvency II including managing agents and non-Solvency II firms, banks, building societies, and PRA designated investment firms) were expected to:

- Fully embed consideration of climate-related financial risks into their governance arrangements;
- Incorporate climate-related financial risks into existing risk management practice;
- Use (long-term) scenario analysis to inform strategy setting, risk assessment, and risk identification; and
- Develop and maintain an appropriate approach to the disclosure of climate-related financial risks.

In October 2022, the PRA issued thematic feedback on the PRA's supervision of climate-related financial risk and the Bank of England's Climate Biennial Exploratory Scenario exercise. The letter provides a summary of capabilities, which the PRA would want firms to be able to demonstrate, sets out thematic observations of firms' levels of embeddedness, and provides examples of effective practices identified. It also provides updates on the Bank of England's work in related areas.

The PRA has indicated that compliance with the expectations in SS3/19 will be assessed on an ongoing basis and firms should continue to demonstrate effective management of climate risks through regular supervisory engagements and reviews. In particular, it is important that Boards and senior management, including the designated senior manager function for climate, demonstrate appropriate oversight and control of the firm-wide climate agenda.

e. Lloyd's and ESG

Announced in its October 2021 release, Lloyd's has mandated that managing agents must create an ESG framework and strategy in 2022, for sign off in the 2023 business planning cycle. Managing agents will need to consider the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their ESG strategy.

Lloyd's has also imposed ESG-focused outcomes by way of the Principles which became effective from Q3 2022. The Principles set out the fundamental responsibilities expected of all managing agents and is the basis against which Lloyd's will review and categorize all syndicates and managing agents in terms of their capacity and performance. In particular, the culture, investment, and underwriting profitability Principles have introduced requirements on managing agents further to support the ESG initiatives.

The drive within Lloyd's on ESG is further illustrated by the Lloyd's Plan. The 2023 Plan includes climate risk and ESG, so managing agents can expect supervisory engagement over the coming year.

40 We note that at the time of writing, development of the UK Green Taxonomy has been put on hold.

Further highlighting the Lloyd's market's focus on ESG, specialty insurer Beazley announced the launch of its ESG-focused Lloyd's syndicate, Syndicate 4321, with effect from January 1, 2022. Syndicate 4321, serving as the first ESG-focused syndicate of Lloyd's, concentrates on offering additional capacity to businesses which perform well against ESG metrics. Beazley has partnered with rating agencies to provide ESG data, and will use the rating agencies' scoring categorizations to determine which clients are eligible. The premiums received by Syndicate 4321 will be invested in line with the company's Responsible Investment Strategy. In December 2022, Beazley's head of portfolio underwriting said Syndicate 4321 will "really take off" next year, with a 14% increase in stamp capacity for 2023 year of account.

8. Appointed Representative

The UK has a regime which was developed, in part, to assist new businesses, enabling such a business to rely on another firm's regulatory authorization, rather than having to seek its own. The regulators responsible for this regime, the FCA together with various UK government bodies (including HM Treasury), have been analyzing whether or not the regime remains appropriate in its current form.

The UK has a regime which was developed, in part, to assist new businesses, enabling such a business to rely on another firm's regulatory authorization, rather than having to seek its own. The regulators responsible for this regime, the FCA together with various UK government bodies (including HM Treasury), have been analyzing whether or not the regime remains appropriate in its current form.

The regime currently allows firms which are not authorized by the FCA to be appointed representatives ("**AR**") of authorized firms ("**Principals**"). This enables the AR to carry out certain regulated activities, which the Principal itself is authorized to carry out, and the Principal then takes responsibility for the acts and/or omissions of its AR when the AR is carrying out these regulated activities.

a. The Need for Reform

FCA Consultation

In its July 2021 Business Plan, the FCA indicated that tightening their "supervision and supervisory expectations of ARs and their principal firms to reduce risks that the use of ARs in wholesale markets weakens conduct standards" was one of its priorities for 2021 and 2022. Shortly thereafter, on December 3, 2021, the FCA published a consultation paper ("**CP21/34**") on "Improving the Appointed Representatives regime" to consult on proposed changes to the AR regime. The FCA has identified a wide range of harms across all sectors where Principals and ARs operate, which often occur because Principals do not perform sufficient due diligence before appointing an AR and/or have inadequate oversight and control after an AR has been appointed. The FCA has noted that Principals often do not understand their regulatory responsibilities in relation to their ARs, or they fail to ensure that their ARs are complying with the necessary regulatory requirements and remaining within scope of their appointments.

The FCA's aim was to address the potential harms it had identified while retaining the cost, competition, and innovation benefits of the AR regime. The consultation paper focused on two key areas of change to target more effective supervisory interventions, namely: collecting additional information from ARs and strengthening reporting requirements for Principals; and clarifying and strengthening the responsibilities and expectations of Principals.

First, the FCA consulted on requiring additional information and notification requirements from Principals in order to better assess whether the relevant Principal has the expertise and systems and controls in place to effectively oversee its ARs. The FCA's main information requirement proposals included requiring Principals to provide the FCA with detailed information on the AR's business, revenue, complaints data, and regulated and non-regulated activities; to report any significant changes concerning their ARs to the FCA; and to include details on the UK Financial Services Register of the precise regulated activities the AR is appointed to carry out.

Second, the FCA proposed to enhance and clarify the FCA's expectations of Principals and their responsibilities. The proposals included: requiring Principals to check the accuracy of the details held by the FCA on their ARs on an annual basis and to attest the accuracy of that information, increasing the level of oversight with a focus on the AR's senior management competency and expertise, and requiring Principals to complete an annual self-assessment of their compliance with the AR regime.

As a part of the consultation, the FCA also considered firms that operate regulatory hosting models. In a regulatory hosting business model, the main business of the Principal is to act as a regulatory host, as opposed to having its own wider business. For that reason, the ARs are generally all independent, unconnected businesses, and may operate in different markets. This contrasts with the traditional AR model whereby ARs and Principals share a common commercial objective and operate in a similar sector.

The FCA has concerns that regulatory hosting models allow for more potential harm. Through its supervisory work, the FCA identified that most issues arising from regulatory hosting are related to Principals applying limited resources to oversee their ARs, lacking skills and experience in the different markets in which the ARs operate, and lacking adequate systems and controls to effectively oversee their ARs. With that in mind, proposals were put forward that included the following: requiring the FCA to consent to regulatory hosting services or to ARs being of larger size and scale than their Principal; limiting the range or scope of regulated activities that Principals can oversee and/or the number of ARs they can have; and prohibiting the engagement of ARs which operate businesses which are materially distinct from that of the Principal.

HM Treasury: Call For Evidence

In December 2021, HM Treasury published a "Call for Evidence" on the AR regime in parallel with the FCA's consultation paper. The Call For Evidence was designed as an information gathering exercise on how market participants use the AR regime and how effectively the regime works in practice. The HM Treasury identified several areas where legislative changes could be required, such as: changing the scope of the AR regime in section 39 of the Financial Services and Markets Act, including the regulated activities that an AR is permitted to carry on; enhancing the role of the FCA with respect to how it deals with ARs; placing more regulatory obligations on ARs; and extending the ability of the Financial Ombudsman Service to investigate complaints involving the activities undertaken by ARs.

In addition to the above, the Call for Evidence also asked for views on potential challenges to the safe operation of the AR regime and whether the current regulatory approach is appropriate and effective in considering the different ways in which the AR regime is used. The HM Treasury noted that the use of the AR regime has evolved, and there are now diverse AR business models in the market which include introducer ARs, larger and more complex ARs, and regulatory hosting firms.

The Call for Evidence closed on March 3, 2022. It is not yet known when the HM Treasury will publish a response.

b. Key Developments and Impact on Insurance Industry — FCA Policy Statement

On August 3, 2022, the FCA released its subsequent policy statement ("**PS22/11**"). The fundamental changes in the policy statement require Principals to implement new governance and control systems, and requirements and procedures in relation to their ARs, and thus amend their contractual agreements.

Key Changes for Principals

- **Notification**. Principals will be required to notify the FCA of a new AR appointment 30 calendar days before the appointment and to pre-notify the FCA of any proposed changes to the types of regulated activities carried on by its ARs, at least 10 days before the change takes effect.

- **Reporting Requirements**. Principals now have to provide the FCA with a more detailed breakdown of revenue (with an introduction of revenue bands) and complaints data. The time Principals have annually to report AR complaints and revenue data will be up to 60 business days after the Principal firm's accounting reference date.

- **Annual Review**. Principals will be required to carry out annual reviews of their AR's business and senior management, to ensure adequate monitoring and oversight of their ARs. These requirements can be satisfied by integrating these into existing internal reporting requirements.

- **Self-Assessments**. Principals must conduct annual self-assessments, to be signed off by the Principal's governing body and available to the FCA on request.

- **Termination of Appointed Representative Agreements**. If a Principal is no longer able adequately to monitor and oversee its AR's activities, the Principal should terminate the Appointed Representative Agreements and inform the FCA within 10 business days of the decision. Principals will have an obligation to take "reasonable steps" to assist an AR in winding down its business in an orderly manner.

- **Regulatory Hosting**. The FCA has introduced a new definition of "regulatory host." In summary, this is to pick up firms whose business model is just to act as a Principal and not conduct their own customer facing regulated business. These firms are required to notify the FCA of their status as a "regulatory host." At present, they have no additional rules or restrictions on firms that provide such services. The notification requirement applies if they currently provide such services, or intend to provide such services (where there is a requirement to notify 60 days in advance of providing those services). The FCA is not proposing any additional rules on such firms at this stage, but this is being kept under review.

- **FCA Consumer Duty**. The policy statement references the FCA's new consumer duty rules published in July 2022. This duty imposes clearer and higher standards of consumer protection across financial services, requiring firms to put their customers' needs first. The FCA's consumer duty applies to four outcomes: (i) products and services; (ii) price and value; (iii) consumer understanding; and (iv) consumer support. The duty applies to all relevant ARs and Principals. Principals will need to consider the changes they need to take to meet the new duty alongside the changes to the AR regime, as both inevitably reinforce one another by increasing protection for consumers dealing with ARs.

Key Changes for ARs

While the policy statement focuses on Principals, it will also have an impact on ARs. ARs will need to adapt to the new expectations on Principals, which will have to implement more stringent expectations on the ARs with respect to, for example, data collection and reporting.

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c. Important Next Steps and Dates

Contractual arrangements and processes were required to have been reviewed and amended to ensure compliance with the new rules by December 8, 2022.

The FCA has implemented transitional arrangements to enable firms more time to comply with the updated rules:

- Principals will need to complete their first self-assessment and AR annual review on or before November 30, 2023.

- Annual verification of the details of Principals' ARs on the Financial Services Register will not have to be reported until their first accounting reference date on or after December 1, 2023.

- Principals will not have to report complaints data and revenue information of their ARs until their first accounting reference date, on or after December 1, 2023.

d. Future of the AR Regime

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9. EU and UK Solvency II Updates

a. European Updates

Improvements to the Solvency II Directive ("**Solvency II**") were proposed in September 2021 by the European Commission, aimed at improving proportionality, long-term guarantee measures, and cross-border supervision issues, and creating macroprudential tools.

On June 17, 2022, the European Council "agreed its position" on amendments to Solvency II. The agreed position is to ensure a balanced review of the Solvency II prudential framework in terms of capital requirements; to improve the protection of insurance policyholders through enhanced cooperation between supervisory authorities; and to continue to prevent insurer failure. This will help to make the insurance and reinsurance sector more resilient and prepared for future challenges, while stabilizing insurers' capital requirements, giving them room to maneuver in the short term.

On June 17, 2022, the European Council "agreed its position" on amendments to Solvency II. The agreed position is to ensure a balanced review of the Solvency II prudential framework in terms of capital requirements; to improve the protection of insurance policyholders through enhanced cooperation between supervisory authorities; and to continue to prevent insurer failure.

The European Council also assigned new tasks to the EIOPA. These include:

- Preparing a report on the assessment of risks related to biodiversity loss by insurers, along with climate-related risks and natural disasters; and
- Defining consistent guidelines for national rules followed by insurers when assessing their macroprudential risks, i.e., risks impacting an entire sector or the economy as a whole.

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On August 2, 2022, the secretariat of ECON in the European Parliament published three amendment reports. These reports contain all the proposed amendments to the earlier draft report on the revision of Solvency II. In total, the various members of the European Parliament tabled more than 600 amendments. These ranged from proposals for more far-reaching buffer capital requirements and reporting by insurers, to proposals for capital relief and the deletion of certain articles from Solvency II in order to reduce the administrative burden on insurers. An agreement on this is expected at the earliest in mid-2023, after which the revision is expected to enter into force from the end of 2024.

On April 7, 2022, EIOPA published a supervisory statement on supervision of run-off undertakings. The term "run-off" in this context includes situations where a (re)insurer has stopped underwriting new business and the transfer of old underwriting years of an active portfolio from one active insurer or reinsurer to another. The statement is addressed to authorities with responsibility for insurance supervision within the EU, National Competent Authorities ("**NCAs**"), to ensure that high-quality supervision is applied to run-off undertakings subject to the Solvency II regime, while considering their specific nature and risks, and the prudent person principle and proportionality principle.

EIOPA sets out its supervisory expectations for the supervision of run-off undertakings in the context of: (i) portfolio transfers; (ii) M&A; and (iii) ongoing supervision. In its statement, EIOPA emphasizes the need for supervisors to understand a firm's decision to go into run-off, any information requirements for acquiring firms, consideration of success rates of private equity companies seeking to acquire run-off undertakings, and establishing expectations for conduct of business supervision. EIOPA recognizes the benefit of run-off for the insurance industry, enabling an efficient use of capital and orderly exits from lines of business. However, EIOPA also notes that the supervision of run-off is challenging, given the lack of specific regulation in respect of run-off business under the existing Solvency II framework.

On February 3, 2023, EIOPA published a supervisory statement (the "**Statement**") on the supervision and monitoring of insurance undertakings' and intermediaries' activities when using governance arrangements in third countries (e.g., third-country branches). In the Statement, EIOPA emphasizes the need for appropriate levels of corporate substance (to include the presence of board members and key function holders, and appropriate levels of staff) within EEA-based insurance undertakings and intermediaries, proportionate to the nature, scale, and complexity of the business. EIOPA expects third-country branches to serve primarily the markets in which they are established, and that third-country branches with the sole objective of supporting EEA-based undertakings and intermediaries should be avoided. Undertakings and intermediaries should not be disproportionately dependent on their third-country arrangements for activities in the EEA.

b. UK Updates: UK Solvency II Reform

On April 28, 2022, the HM Treasury announced a third consultation period for Solvency II, which will inform the design of the final reform package. In HM Treasury's consultation response, published on November 17, 2022, the UK government stated it will introduce a simpler, clearer, and more tailored regime. The UK government intends to legislate as necessary to implement the new "Solvency UK" regime in a number of key areas, including solvency capital reform, with significant changes to the risk margin and matching adjustment components of solvency capital.

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While life insurers will benefit considerably from these changes, seeing a 60-70% cut in the risk margin component of the solvency capital calculation, general insurers will also benefit by a 30% reduction. The UK government hopes that the released capital might lead to a more competitive product pricing environment as life insurers in particular look to increase their policyholder base and ultimately improve

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balance sheet stability. However, the UK government has also stated that it does not intend to restrict commercial decisions about capital allocation and, therefore, the consequence could also be a distribution of surplus capital to shareholders.

Long-term care insurers are also expected to benefit from changes to the matching adjustment. The requirement that all eligible assets have fixed cashflows will be replaced with a more flexible requirement that they have highly predictable cashflows, including assets with prepayment risk or construction phases. This reform will enable insurers to invest more solvency capital in long-term productive assets, especially in infrastructure.

Significant changes are also set to be introduced in respect of branch capital requirements. This will benefit branches of foreign insurers based in the UK immediately upon implementation, as well as reduce barriers for foreign insurers wishing to establish a UK branch in the future.

The UK government has also decided to introduce a new mobilization scheme for insurers, which would create an optional stage in a prospective insurer's entry to the market, including adjusted entry requirements such as a lower capital floor, lower expectations for key personnel and governance structures, and exemptions from certain reporting requirements. This should help startup firms to raise the capital they need for authorization and market entry, boost competition in the sector, and support firms to launch new, innovative products.

The UK government has also decided to increase the thresholds for the size and complexity of insurers before Solvency UK applies, to £15 million in annual gross written premiums and to £50 million in gross technical provisions.

10. Cross Border Conversion Directive

From the end of January 2023, limited liability companies in the EEA will be able to move their registered office from one EEA Member State to another, while retaining their legal personality. As a result, all the assets and liabilities will be retained by the re-domiciled company. For insurers based in EEA jurisdictions, this means that they will be able to move their authorized head office within the EEA without the need to undergo the often expensive and cumbersome insurance business transfer process.

This new Cross Border Conversion (the "**CBC**") mechanism is being introduced by Directive (EU) 2019/2121. It aims to both improve the functioning of the single market and the concept of freedom of establishment by simplifying and harmonizing cross-border mobility. It is expected to be a useful tool for insurance groups looking to reorganize their operations within the EEA.

Prior to the CBC, the only options for the transformation of corporate entities across the EEA were: (i) a cross-border merger (which does not provide for the continuation of legal personality, and still requires a separate insurance business transfer) or (ii) the "Societas Europaea" ("**SE**") or European Company regime. The SE regime requires groups to have subsidiaries/branches in different EEA jurisdictions for a period of time and, in some jurisdictions, an insurance business transfer is still required.

The CBC process will be relatively straightforward, and similar to the procedure for cross-border mergers. Key procedural steps include: the preparation of a number of documents (including a draft conversion proposal); corporate registry filings; the holding of a general meeting; the issuance of a pre-conversion certificate; and the scrutiny of the pre-conversion certificate by the relevant authority (e.g., a court or a registrar) in the destination Member State. It is anticipated that the process will take between six and 12 months.

From a regulatory perspective, a moving insurer will be required to apply for authorization in the destination EEA Member State. The regulatory authorization process should be undertaken in parallel with the re-domiciliation process under the CBC. Typically, regulatory authorization will take between six and 12 months (depending on the jurisdiction and the quality of the application submitted).

Re-domiciling EEA insurers with a Solvency II-compliant operating model should be in a better position to undertake an authorization application than a new entrant to the EEA market (and this may lead to authorization times being on the lower end of the scale).

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However, Member State regulators will need to be satisfied that the insurer can meet and maintain its threshold authorization requirements. These regulators are likely to be particularly focused on anticipated levels of substance in the insurer's new head office, ensuring that the "heart and mind" of the insurer is located in the destination Member State.

While no EEA regulator likes "jurisdiction shopping," it is expected that where there is a strong business case for a move from one EEA Member State to another the regulators will be open to the re-domiciliation. However, managing the timings of regulatory engagement (with both the home and destination Member State regulators) will be important for ensuring a smooth process. The regulator in the destination Member State will expect the insurer to engage in open and honest communication with the home Member State regulator.

Regulators are also likely to want to review the pre-conversion certificate and confirm that the safeguards for members, creditors, and employees have been complied with, and that there will be no detriment to policyholders as a result of the move. The CBC provides safeguards against the use of the mechanism for abusive or fraudulent purposes leading to or aimed at evading EU or national law. Where the relevant authority believes a contemplated cross-border transaction could be used for abusive, fraudulent, or criminal purposes, an additional three-month period may be used to further verify the nature of the re-domiciliation. This should provide additional comfort to regulators as to the *bona fide* nature of the move.

From a UK perspective, there is currently no mechanism which permits a re-domiciliation or cross-border merger. In October 2021, the UK government consulted on a re-domiciliation regime (following which a feedback statement was issued in April 2022). However, no further details have since been released. It is understood that detailed analysis is needed and a further round of public consultation is expected. It is possible that the introduction of the CBC at the EU level may ignite renewed focus by the UK government on the re-domiciliation regime.

The re-domiciliation regime on which the UK government consulted would allow a foreign-incorporated company to change its place of incorporation to the UK, while maintaining its legal identity as a corporate body. While the detail of any UK re-domiciliation is to be confirmed, in principle it is expected that a separate insurance business transfer process would not be required. However, similar to the position in the EEA, authorization by the relevant regulators, the PRA and the FCA, would still be required for insurers relocating to the UK.

It is anticipated that the UK regime would provide an opportunity for insurers in both EEA and non-EEA jurisdictions to relocate to the UK.

It is anticipated that the UK regime would provide an opportunity for insurers in both EEA and non-EEA jurisdictions to relocate to the UK. However, post-Brexit, UK-authorized insurers do not have passporting rights into EEA jurisdictions, and there may accordingly be limited appetite from EEA-based insurers to move to the UK. Nonetheless, for non-EEA insurance groups looking to focus on the UK market, a re-domiciliation regime is likely to be welcomed. Currently, however, there is no timeframe for the introduction of a UK re-domiciliation regime or any certainty that it will in fact proceed.

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