SIDLEY

SIDLEY GLOBAL INSURANCE REVIEW

MARCH 2024

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March 2024

The insurance industry constantly evolves, requiring regulatory regimes and market participants to adapt to changing global circumstances. For a full understanding of the insurance industry, it is essential to consider the global trends and developments that shape it.

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* is produced by Sidley's Financial Institutions group (FIG). Sidley is an elite global law firm, with 2,300 lawyers across 21 offices in North America, Europe, and Asia Pacific, who represent clients in more than 70 countries on a wide range of complex matters. Our nearly 100 FIG lawyers provide practical guidance tailored to the business, regulatory, and operational paradigms unique to insurance companies and other financial institutions, including M&A, reinsurance, capital markets, insurance-linked securities, private equity, tax, class action defense, reinsurance disputes, insolvency, and other transactional, regulatory, and litigation services. Our clients include many of the most prominent publicly traded and private financial institutions globally, including insurance and reinsurance companies, their investors and capital providers, brokers, banks, regulatory agencies, and myriad others.

We hope you find the 2024 edition of the *Sidley Global Insurance Review* to be a valuable tool in navigating the insurance market.

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A. NORTH AMERICAN MARKET

1. Introduction

Insurance mergers and acquisitions ("**M&A**") activity in 2023 was characterized by both challenges and resilience. Insurance M&A activity in the North American market (both in terms of number of transactions and transaction value) continued to decline in the first half of 2023 from 2022 levels.[1] However, after two quarters of a downward trend, deal activity in the second half of 2023 rebounded, resulting in a strong finish for the year. This third and fourth quarter rebound in both total deal volume and average deal value resulted in an aggregate 2023 transaction value of US$16.23 billion, a 16.8% increase from 2022, despite the total number of transactions falling from 98 to 96 over the same period.[2] These strong second-half results provide hope for a continuing upward trend in 2024. In addition, private equity ("**PE**")-backed investments across the industry remained resilient in 2023. Although total PE insurance deal volume fell from 228 transactions in 2022 to 165 in 2023, PE deal value increased 7.7% to US$12.49 billion in 2023. PE investors also continued to find opportunities in reinsurance and sidecar transactions.[3]

Notable Transactions Tables – M&A and Reinsurance

NOTABLE M&A TRANSACTIONS				
Buyer	**Target / Industry**	**Seller**	**Announcement Date**	**Equity Value**
Investor Group Led by Stone Point Capital and Clayton, Dubilier & Rice	Truist Insurance Holdings, Inc. / Broker	Truist Insurance Holdings, Inc.	February 20, 2024 (pending)	US$15.5 billion
Aon plc	NFP / P&C	Madison Dearborn Partners / HPS Investment Partners	December 20, 2023 (pending)	US$13.4 billion
Brookfield Reinsurance Ltd.	American Equity Investment Life Holding Company / Life and Annuity	American Equity Investment Life Holding Company	July 5, 2023 (pending)	US$4.3 billion
Health Care Service Corporation	Medicare Advantage, Cigna Supplemental Benefits, Medicare Part D, and CareAllies Businesses / Healthcare	The Cigna Group	January 31, 2024 (pending)	US$3.7 billion
Elevance Health, Inc.	Blue Cross Blue Shield of Louisiana / Healthcare	Blue Cross Blue Shield of Louisiana	January 23, 2023 (pending)	US$3.5 billion
RenaissanceRe Holdings Ltd.	Validus Re / P&C Reinsurance	American International Group, Inc.	May 22, 2023	US$2.985 billion
KKR & Co. Inc.	Global Atlantic Financial Group LLC / Life and Annuity	Minority Shareholders of Global Atlantic Financial Group LLC	November 29, 2023	US$2.7 billion
Vista Equity Partners	Duck Creek Technologies / Insurtech	Duck Creek Technologies	March 30, 2023	US$2.6 billion
Stone Point Capital	Truist Insurance Holdings, Inc. (Minority Stake) / Broker	Truist Insurance Holdings, Inc.	February 16, 2023	US$1.95 billion
S. USA Life Insurance Company, an affiliate of Prosperity Life Group	National Western Life Group, Inc. / Life and Annuity	National Western Life Group, Inc.	October 9, 2023 (pending)	US$1.9 billion

1 *Global Insurance M&A Drops Sharply in First Half 2023*, Insurance Journal (August 2023).

2 *North American Insurer M&A Bucks Wider Downward Trend as Deal Value Ticks Up*, S&P (March 2024).

3 *Private Equity Insurance Deals Fall in 2023*, S&P (February 2024).

NOTABLE M&A TRANSACTIONS (CON'T)				
Buyer	Target / Industry	Seller	Announcement Date	Equity Value
Brookfield Reinsurance Ltd.	Argo Group International Holdings, Ltd. / P&C	Take-Private Transaction	February 8, 2023	US$1.1 billion
American Financial Group	Crop Risk Services / P&C	American International Group, Inc.	May 2, 2023	US$240 million
Zinnia Corporate Holdings, LLC	Policygenius Inc. / Broker	Policygenius Inc.	April 25, 2023	Undisclosed

NOTABLE REINSURANCE TRANSACTIONS				
Assuming Reinsurer / Parent	Subject Business	Ceding Insurer	Announcement Date	Ceded Reserves
Fortitude Re	Universal life with secondary guarantees, MoneyGuard® and fixed annuity statutory reserves	Lincoln Financial	May 2, 2023	US$28 billion
Global Atlantic Financial Group LLC	Retail annuity and life insurance	MetLife, Inc.	November 16, 2023	US$19.2 billion
Manulife Financial Corporate	Long-term care reserves, structured settlements and Japanese whole life products	Global Atlantic Financial Group LLC	December 11, 2023	CAN$13 billion
Somerset Re	Guaranteed universal life	Prudential Financial, Inc.	July 24, 2023	US$12.5 billion
Constellation Insurance Holdings, Inc.	Variable annuities	Prudential Financial, Inc.	May 24, 2023	US$10 billion
Enstar Group Limited	Financial lines, reinsurance portfolio and discontinued programs	QBE Insurance Group	February 16, 2023	US$1.9 billion
Security Life of Denver Insurance Company, a subsidiary of Resolution Life	Individual life	Farmers New World Life Insurance Company	May 17, 2023	Undisclosed

Various factors have been noted for the decline in M&A deal activity during the first half of 2023, including continued elevated interest rates and inflation, which may continue to be of concern in 2024. Moreover, the conflicts in Ukraine and the Middle East continue to disrupt global stability and have similarly contributed to uneasiness and uncertainty among dealmakers. Rising interest rates have increased the cost of acquisition financing for certain buyers in certain segments, dampening deal activity, although perhaps not to the same extent as in the broader M&A market given the lesser degree of reliance on traditional leveraged financing in the insurance industry.

In the property and casualty ("**P&C**") sector, the M&A rebound has been slow. Some insurers, particularly in the personal lines space, have experienced elevated claims levels, leading to depressed valuations and price dislocation between buyers and sellers, while a "hard market" has helped increase valuations in other segments (particularly commercial lines), leading those insurers to focus on organic growth rather than through M&A. Although traditional life and annuity insurers continue to look to de-risk their balance sheets by selling off legacy blocks, and PE-backed insurers and reinsurers continue to demonstrate strong demand to acquire these blocks, maturation and saturation of the North American life and annuity insurance M&A market has made sourcing transactions more difficult. Additionally, traditional insurers are looking to alternative means to offload the risk of legacy blocks, through varying structures, such as sidecar transactions. As a result, PE-backed reinsurers are looking for opportunities outside of the U.S., and in particular in Japan and the broader Asia Pacific region. With that in mind, questions remain about whether the strong reinsurance market of 2023, which balanced the lagging M&A market, can continue into 2024 and beyond.

2. Life and Annuity

Consistent with the difficult general market conditions, the life and annuity M&A segment contracted significantly in 2023. Fewer deals were announced than in either 2022 or in 2021, with only 19 deals announced in 2023, compared to 27 in 2022 and 39 in 2021. The life and annuity M&A deals that were announced in 2023 largely involved PE firms and other financial buyers. The decline in life and annuity M&A was offset in large part by alternative transaction structures, such as reinsurance and sidecars, which were relied on heavily by insurers as a means to de-risk their balance sheets and for investors to continue to invest in the life and annuity sector.

At the end of 2023, KKR & Co. Inc. ("**KKR**") announced its acquisition of the remaining 37% of The Global Atlantic Financial Group LLC (together with its subsidiaries, "**Global Atlantic**"), which, following the closing in January 2024, made Global Atlantic a wholly owned subsidiary of KKR. KKR initially acquired a majority stake in Global Atlantic in 2021 and, during the approximately two years since, an affiliate of KKR has served as the asset manager for Global Atlantic. Similarly, S. USA Life Insurance Company, an affiliate of Prosperity Life Group (together with its affiliates, "**Prosperity**"), entered into a definitive merger agreement to acquire National Western Life Group, Inc. ("**National Western**") in an all-cash transaction valued at approximately US$1.9 billion. National Western affirmed that the transaction was the result of the company's "thorough review of a range of strategic alternatives" and its view that this result presented the best value for its shareholders. The transaction has been approved by National Western's board of directors and is expected to close in the first half of 2024.

Insurance mergers and acquisitions ("M&A") activity in 2023 was characterized by both challenges and resilience.

In July 2023, American Equity Investment Life Holding Company ("**AEL**") and Brookfield Reinsurance ("**Brookfield**") announced that the parties had entered into a definitive agreement pursuant to which Brookfield, a shareholder of AEL, would acquire, for cash and stock consideration, all of the remaining outstanding shares of AEL not already owned by Brookfield. This transaction follows an earlier transaction announced in 2020, whereby Brookfield agreed to acquire up to a 19.9% stake in AEL and agreed to certain key terms to pursue a transaction in which Brookfield would reinsure US$5 billion of AEL's existing liabilities and up to an incremental US$5 billion of new sales of AEL's fixed index annuity products. Similarly, Canadian insurance and wealth management company iA Financial Corporation, Inc. ("**iA**") entered into an agreement in October 2023 to acquire Vericity, Inc. ("**Vericity**"), in an effort to grow iA's U.S. footprint. Vericity is a middle market life insurer that operates through Fidelity Life, an Illinois insurance carrier, and eFinancial, a direct-to-consumer online insurance agency. The all-cash transaction was valued at US$170 million and is expected to close in 2024, subject to Canadian and U.S. regulatory approval.

In addition to M&A activity and the continued investment and reinvestment by PE firms (as discussed in the *Sidecars and Other Strategic Partnerships* section of this publication), insurers have placed block reinsurance transactions in the spotlight of 2023 as another way to mitigate long-term risk. In fact, 2023 proved to be a strong year for block reinsurance, with several multibillion dollar transactions, as discussed in detail below, primarily motivated by a desire of cedants to de-risk their balance sheets.

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For example, Lincoln Financial ("**Lincoln**") entered into a blockbuster US$28 billion reinsurance transaction with Fortitude Re ("**Fortitude**"), which is Bermuda's largest multi-line reinsurer. S&P Global Market intelligence reported that this transaction is among the largest ever conducted by unaffiliated parties in the U.S. life and annuity sector. Pursuant to the terms of the transaction, effective October 1, 2023, Lincoln ceded in-force universal life with secondary guarantees, MoneyGuard® and fixed annuity statutory reserves to Fortitude. Lincoln specifically noted that the closing of this transaction represents "a big step forward in our efforts to de-risk, strengthen the company's balance sheet and improve ongoing free cash flow."

Lincoln Financial ("Lincoln") entered into a blockbuster US$28 billion reinsurance transaction with Fortitude Re ("Fortitude"), which is Bermuda's largest multi-line reinsurer. S&P Global Market intelligence reported that this transaction is among the largest ever conducted by unaffiliated parties in the U.S. life and annuity sector.

In a similar effort to de-risk its operations, Farmers New World Life Insurance Company ("**FNWL**") ceded its in-force individual life insurance business to Security Life of Denver Insurance Company ("**SLD**"), an insurance company subsidiary of Resolution Life ("**Resolution**"). SLD, in turn, retroceded all of the reinsured term life insurance liabilities to Swiss Re. It is worth noting that, pursuant to the terms of the transaction, SLD provides for the administration of the reinsured policies.

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In May of 2023, Global Atlantic entered into a definitive agreement under which Global Atlantic reinsured a US$19.2 billion block of retail annuity and life insurance business from MetLife, Inc. ("**MetLife**"). MetLife retained the servicing and administration of the policies. In addition, Global Atlantic entered into a reinsurance transaction with Manulife Financial Corporate ("**Manulife**") in 2023, whereby Manulife agreed to reinsure to Global Atlantic CAN$13 billion of reserves, CAN$6 billion of which were long-term care reserves, making this the largest long-term care reinsurance transaction completed to date. Global Atlantic, in turn, retroceded the long-term care liabilities to a third-party reinsurer, retaining the spread-based risk on a subset of the business. The transaction also included the transfer of CAN$5.6 billion of Japanese whole life policy reserves and marked Global Atlantic's first Japanese block life reinsurance transaction. Manulife highlighted that a key benefit of this transaction was the risk reduction it provided with respect to legacy blocks, including its long-term care and variable annuities portfolio.

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Another noteworthy reinsurance transaction was announced in May 2023, whereby Prudential Financial, Inc. ("**Prudential**") agreed to cede a block of approximately US$10 billion of variable annuity policies to an affiliate of Constellation Insurance Holdings, Inc. ("**Constellation**"). Prudential highlighted as the strategic objective to reduce the traditional variable annuity portion of its liabilities in an effort to enable the company to expand its other offerings going forward. In July 2023, Prudential also announced an agreement to cede approximately US$12.5 billion of reserves relating to its universal life policies to Somerset Re (which was acquired by Aquarian Holdings in a transaction that closed in January 2023). At signing, Prudential indicated that it expects the transaction to result in approximately US$450 million of proceeds for Prudential upon closing (including approximately US$425 million of capital expected to be freed up).

In the face of ongoing maturation and increasing saturation of the U.S. market, there has been a continued connectivity between U.S.-based reinsurers and the rest of the world, particularly Japan and the broader Asia Pacific region.

These large-scale, transformational reinsurance transactions, however, were not limited to U.S.-based insurers. In the face of ongoing maturation and increasing saturation of the U.S. market, there has been a continued connectivity between U.S.-based reinsurers and the rest of the world, particularly Japan and the broader Asia Pacific region. This interest in the Asian market has been driven by market demand, as well as changing capital requirements and regulatory constraints on invested assets in this region, generally. For example, in an effort to continue expanding its global reach, Athene Holding Ltd. ("**Athene**") entered into several forward-looking (flow) and block reinsurance transactions both in the U.S. and with leading life insurers in Asia over the last year. One transaction of note was effectuated between Athene and FWD Life Insurance Co. Ltd. ("**FWD**"), a Japanese-domiciled insurer, whereby Athene agreed to reinsure a block of in-force whole life insurance policies. In addition, Kuvare Holdings LP ("**Kuvare**") announced its acquisition of a block of in-force annuities issued by a large, highly rated multinational carrier through its Hong Kong platform, as well as two flow reinsurance arrangements, each with a separate highly rated Japanese life insurer. Global Atlantic was also active in Asia in 2023. As noted above, Global Atlantic reinsured a block of Japanese whole life policies from Manulife as part of a broader reinsurance transaction. In addition, KKR and Global Atlantic announced a strategic partnership with Japan Post Insurance Co., Ltd. ("**Japan Post**"), pursuant to which Japan Post will make a material investment in a reinsurance co-investment vehicle sponsored by Global Atlantic. Finally, Fortitude entered into two separate reinsurance transactions to reinsure blocks of whole life insurance policies, through its subsidiary, Fortitude International Reinsurance Limited, with leading Japanese life insurance companies.

One new issue that has emerged in life reinsurance transactions over the course of the past two years is the treatment of negative interest maintenance reserve ("Negative IMR") caused by the higher interest rate environment, in the calculation of both the initial asset transfer and the required collateral balance.

One new issue that has emerged in life reinsurance transactions over the course of the past two years is the treatment of negative interest maintenance reserve ("**Negative IMR**") caused by the higher interest rate environment, in the calculation of both the initial asset transfer and the required collateral balance. As described in more detail in the *Global Regulatory and Litigation Developments* section below (see V.A.10.b.), the National Association of Insurance Commissioners ("**NAIC**") adopted a temporary statutory interpretation at its 2023 Summer National Meeting to allow limited admittance of Negative IMR on life insurers' balance sheets effective through the end of 2025. More definitive regulatory guidance on the issue is likely to impact how it is addressed in future deals.

3. Health Insurance and Managed Care

The primary driver of transactions in the health insurance/managed care sector has been the continued need for companies to consolidate in order to better manage expense ratios, and the transactions in 2023 were reflective of this trend.

A strong increase in managed care M&A transactions in 2023 somewhat offset the decline in M&A activity in the life and annuity and P&C sectors. The total number of health insurance and managed care transactions increased in 2023, from only six deals in 2022 to 11 in 2023.[4] However, although the number of deals nearly doubled between 2022 and 2023, deal activity in the health insurance/managed care sector was still well below the levels in the recent past (21 deals in 2019, 14 deals in 2020, and 17 deals in 2021).[5] The primary driver of transactions in the health insurance/managed care sector has been the continued need for companies to consolidate in order to better manage expense ratios, and the transactions in 2023 were reflective of this trend. The need to consolidate has been particularly compelling for the smaller Blue Cross and Blue Shield ("**BCBS**") association insurers, due to challenges associated with lack of scale in the health insurance space.

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4 *North American Insurer M&A Bucks Wider Downward Trend as Deal Value Ticks Up*, S&P (March 2024).

5 *Id.*

BCBS of Michigan announced in May 2023 that BCBS Vermont would join its organization as an affiliate. Approved by regulators and finalized in October 2023, this non-traditional affiliation provides for each organization to retain its local headquarters and governance while still pooling technology and operational expertise.

In January 2023, Elevance Health, Inc. ("**Elevance**") announced a US$3.5 billion merger whereby it would acquire BCBS of Louisiana. However, the deal was paused in September, when state regulators expressed concerns regarding the terms of the transaction and its impact on the local Louisiana market. In December 2023, BCBS of Louisiana announced the deal would move forward, but it was paused again in February 2024 in response to further regulatory and stakeholder objections. The deal's outcome remains uncertain, but the potential transaction indicates an increased appetite for future M&A activity in the health insurance space.

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Looking into the year 2024, Health Care Services Corporation ("**HCSC**") announced in January 2024 that it would acquire the Medicare businesses of the Cigna Group ("**Cigna**"), including Medicare Advantage, Medicare Supplemental Benefits, Medicare Part D, and CareAllies. The deal is valued at approximately US$3.7 billion and is expected to close in 2025, pending regulatory approval. The deal also includes an arrangement with Cigna's subsidiary, Evernorth Health Services ("**Evernorth**"), whereby Evernorth will continue to provide pharmacy services to the acquired companies for four years from the time of the sale. This transaction highlights the increased interest in health insurance/managed care deals, which is expected to continue.

4. P&C

Within the P&C sector, M&A activity remained slow in 2023, with US$5.9 billion in total deal value, down from US$14.4 billion in 2022.[6] Although overall deal volume was down in the P&C sector, 2023 saw several strategic transactions, often focused on increasing scale and consolidation.

Although overall deal volume was down in the P&C sector, 2023 saw several strategic transactions, often focused on increasing scale and consolidation.

One of the larger P&C deals in 2023 was the acquisition by RenaissanceRe Holdings Ltd. ("**RenaissanceRe**") of the treaty reinsurance business of AIG, which included Validus Re ("**Validus**"), at a value of US$2.985 billion. In a separate but related transaction, a subsidiary of Enstar Group Limited ("**Enstar**") agreed to provide AIG with protection against adverse developments with respect to the portion of the Validus risk retained by AIG in the RenaissanceRe transaction. In another risk transfer effort, in April 2023, wholly owned subsidiaries of Enstar completed a loss portfolio transfer transaction with QBE Insurance Group ("**QBE**"). In that transaction, Enstar assumed US$1.9 billion of QBE's net loss reserves and approximately US$900 million of excess cover.

A transaction between American International Group Inc. ("**AIG**") and American Financial Group ("**AFG**") is another example of a consolidation transaction in 2023. AIG sold Crop Risk Services ("**CRS**") to AFG subsidiary Great American Insurance Group ("**Great American**") for approximately US$240 million in cash. Prior to the transaction, CRS and Great American were the seventh- and fifth-largest providers, respectively, of multi-peril crop insurance in the U.S.

Other transactions in the P&C space highlight efforts to expand capabilities and services offered. In late 2023, Brookfield acquired Argo Group International Holdings, Ltd. ("**Argo**"), at an all-cash cost of US$1.1 billion. The addition of Argo's U.S. specialty platform increases Brookfield's U.S. P&C operations, which is consistent with the platform-building seen elsewhere in the insurance industry this year. Additionally, Fleming Insurance Holdings ("**Fleming**"), a portfolio company of Altamont Capital Partners ("**Altamont**"), entered into an agreement to acquire JRG Reinsurance Company ("**JRG Re**") from James River in a US$277 million transaction, pending at the time of publication, increasing Fleming's scale for future cedants.

5. Sidecars and Other Strategic Partnerships

a. Life and Annuity Sidecars

Though long used in the P&C market (see section III.A.3.), sidecars remain a relatively novel — and increasingly popular — structure for life and annuity insurers. Market participants generally refer to sidecar transactions as those involving a life and annuity company or companies (referred to as the

... sidecars remain a relatively novel – and increasingly popular – structure for life and annuity insurers.

6 *P&C Insurance Monthly Market Snapshot*, J.P. Morgan (February 2024).

A sidecar allows the sponsor to access third-party capital at a lower cost (and with a shorter regulatory timeline) than an equity investment into the sponsor itself and, if desired, access to the asset management capabilities of certain third-party investors.

"sponsor") forming a reinsurer (the "sidecar"), often domiciled in Bermuda or the Cayman Islands, that is funded by third-party investors. The sponsor agrees to cede or retrocede certain types of business to the sidecar – potentially a single block at closing, or for a fixed period of time or until all the investor capital commitments have been deployed. A sidecar allows the sponsor to access third-party capital at a lower cost (and with a shorter regulatory timeline) than an equity investment into the sponsor itself and, if desired, access to the asset management capabilities of certain third-party investors. In addition, the ability to select the types of business to be ceded to a sidecar allows both sponsor and investor to carve out particular risks to share, with sidecars focused on new flow business written by the sponsor, new or existing reinsurance blocks, or a mix of both. For sponsors, this business selection generally translates into the ability to deconsolidate and de-risk their liability portfolio. For investors, sidecars are a way to share more easily in the economics of particular types of reinsurance while limiting their risk profile in a manner and to an extent that is generally not possible in traditional M&A. We anticipate the use of sidecars to continue to grow, especially as sponsors and investors continue to creatively vary the structure described above to address new opportunities.

One notable reinsurance sidecar, announced in December 2023, is Ruby Reinsurance Company ("**Ruby Re**"), established by Reinsurance Group of America, Incorporated ("**RGA**") and initially funded by Golub Capital, Hudson Structured Capital Management Ltd., and Sammons Financial Group, which involved an initial cession of a US$2.5 billion block from RGA. The Ruby Re sidecar exemplifies the rare use of an "on-shore" reinsurer, as opposed to the more common creation of an offshore reinsurer registered in Bermuda or the Cayman Islands noted above. As mentioned in last year's publication, in January 2023, Kuvare and Davidson Kempner Capital Management LP ("**Davidson Kempner**") joined forces to form a sidecar, Kindley Re Limited ("**Kindley**"). Kindley began with US$400 million in funding, including an initial capital commitment from Davidson Kempner, and will participate alongside Kuvare in certain life and annuity transactions, including both block and flow reinsurance. Kuvare Asset Management serves as investment manager for Kindley, with Davidson Kempner also providing asset management for certain asset classes. Similarly, in September 2023, Prudential and Warburg Pincus ("**Warburg**"), formed and agreed, along with a group of third-party investors, to make equity investments in Prismic Life Reinsurance, Ltd. ("**Prismic**"). As part of the transaction, Prudential agreed to reinsure a block of structured settlement annuity contracts with reserves of approximately US$10 billion to Prismic.

The success of the sidecar structure is perhaps best demonstrated, however, by early sidecar sponsors repeating the model with additional sizeable capital commitments.

The success of the sidecar structure is perhaps best demonstrated, however, by early sidecar sponsors repeating the model with additional sizeable capital commitments. In February 2023, Athene and Apollo Global Management announced the first closing of the Apollo/Athene Dedicated Investment Program II fund, with approximately US$2 billion in capital commitments to be invested together with Athene in Athene Co-Invest Reinsurance Affiliate Holding 2 Ltd ("**ACRA II**"). ACRA II was built on the success of ACRA I, the franchise's first vehicle, which launched in 2019. In a similar vein, in July 2023, Global Atlantic announced the final closing of its Ivy Co-Invest Vehicle II LLC ("**Ivy II**"), with total capital funding of more than US$2.4 billion at such time, in a model similar to Ivy I, which launched in 2020. We anticipate that more existing sponsors will look to increase their sidecar capacity — whether through additional funding of existing vehicles or launching second generation vehicles like ACRA II or Ivy II — in 2024 and beyond.

Instead of acquiring the full balance sheet of an insurance group through whole company acquisitions and the significant equity investment that goes with that, some investors are electing to enter into a strategic partnership with an insurance company by acquiring a minority interest in the company and concurrently entering into an investment management arrangement with the company …

… 2023 brought continuing investment in existing strategic partnerships.

b. Other Strategic Partnerships

Instead of acquiring the full balance sheet of an insurance group through whole company acquisitions and the significant equity investment that goes with that, some investors are electing to enter into a strategic partnership with an insurance company by acquiring a minority interest in the company and concurrently entering into an investment management arrangement with the company to reduce the capital and operating burdens of a typical M&A transaction. One example of this arrangement in 2023 was Nassau Financial Group ("**Nassau**"), a provider of fixed annuities and asset management, entering into a strategic partnership with Fortress Investment Group LLC ("**Fortress**"), a global investment management firm, under which Fortress made a minority non-voting common equity investment in Nassau valued at US$130 million. In connection with the transaction, Nassau and Fortress entered into a long-term investment management agreement. Similarly, 2023 brought continuing investment in existing strategic partnerships. For example, Blackstone Inc. ("**Blackstone**") and Resolution, which began their relationship in 2022, announced the completion of an equity raise in October 2023 of US$3 billion from a range of third-party and Resolution-affiliated investors. In addition to this joint effort to raise capital, Blackstone serves as Resolution's investment manager with respect to certain asset classes.

6. Producer, Specialty Distributor, and MGA Deals

Similar to the insurer M&A market, 2023 also represented a significant downturn for major insurance producer M&A transactions. In 2023, insurance broker transactions declined from 721 announced transactions in 2022 to 597 announced transactions in 2023, representing a 17% decrease.[7]

Despite a slower market overall, there were still many notable broker transactions. One example is Aon plc's ("**Aon**") acquisition of NFP Corp., a middle market P&C broker, benefits consultant, wealth manager, and retirement plan adviser, for approximately US$13.4 billion in cash and stock. In addition, in February 2023, Stone Point Capital ("**Stone Point**") announced its purchase of a 20% stake in Truist Insurance Holdings ("**Truist Insurance**") from Truist Financial Corporation, a company that provides insurance products and risk management strategies, for US$1.95 billion. Stone Point, which received co-investor support from a Middle Eastern sovereign wealth fund, also obtained a board seat on the five-member board, which was formed to oversee Truist Insurance. Subsequently, in February 2024, Stone Point along with Clayton, Dubilier & Rice, led an investor group that acquired Truist Financial Corporation's remaining 80% stake in Truist Insurance in an all-cash deal that gave Truist Insurance an implied enterprise value of US$15.5 billion. And in November 2023, Arthur J. Gallagher Co. ("**Gallagher**") completed its acquisition of Cadence Insurance, Inc., a bank-owned P&C broker focused on the Southeast U.S. for US$904 million. As a result of this transaction, Gallagher will become the preferred insurance brokering partner of Cadence Bank, parent company of Cadence Insurance.

The downward trend in producer M&A was not uniform across the entire sector, however. Transactions with specialized managing general agencies ("**MGAs**") were still completed at high valuations in 2023. Much of this relative success can be attributed to increased interest in MGAs and managing general underwriters ("**MGUs**"), especially as specialty and small commercial carrier lines have increasingly begun to shift in-house underwriting functions to MGAs in order to reduce expenses and improve underwriting results, meaning that deals involving specialty distributors have continued to account for a larger percentage of total producer deal volume.[8] MGAs are particularly proficient in specialized underwriting. Approximately 40% of carriers maintain relationships with MGAs to handle specialty risks, resulting in more than US$85 billion in annual premiums, equivalent to around 10% of all P&C premiums.[9] Finally, specialty distributors have become particularly attractive to PE firms. Insurance distributors can be seen as stable, in that they generate a steady cash flow and can often weather significant macroeconomic shifts (such as by generating increased commissions during inflationary periods). Furthermore, insurance distributors can offer PE firms an investment in leverageable entities that require minimal capital intensity, potentially allowing for an easier, lower stakes entry into the insurance space.

2023 saw several significant acquisitions and partnerships in the specialty distributor space. In the third quarter, Velocity HoldCo, LLC ("**Velocity**"), the holding entity for Velocity Risk Underwriters, Velocity Specialty Insurance, and Velocity Claims, completed its acquisition of Insight Risk, a loss prevention and risk transfer solution provider. Large carriers are also looking to get in on the action. The Travelers Companies ("**Travelers**"), announced in November the US$435 million acquisition of Corvus Insurance Holdings ("**Corvus**"), a cyber insurance MGA.

In 2023, there were also several significant partnerships in the MGA and MGU space. One example is Altamont's launch of Hadron Specialty Insurance Co. ("**Hadron**"), a hybrid insurer designed to bring capacity to MGU partners, backed by over US$250 million in capital support from Altamont and other institutional investors. Another example is AIG's partnership with Stone Point, which formed Private Client Select Insurance Services, an independent MGA targeting high and ultra-high net worth markets. Other deals of note include Onex Partners V's acquisition of Accredited, R&Q Insurance Holdings' global program management business, which provides underwriting capacity to MGAs, and the acquisition by White Mountains Insurance Group, Ltd. ("**White Mountains**") of a 70% stake in Bamboo Ide8 Insurance Services, LLC, an MGA focused on the California home insurance market, for US$285 million.

Pet insurance companies have also actively engaged in M&A and consolidation. One such deal, announced in November 2023, was the sale of Embrace Pet Insurance ("**Embrace**") by NSM Insurance

Similar to the insurer M&A market, 2023 also represented a significant downturn for major insurance producer M&A transactions.

Despite a slower market overall, there were still many notable broker transactions.

The downward trend in producer M&A was not uniform across the entire sector, however. Transactions with specialized managing general agencies ("MGAs") were still completed at high valuations in 2023.

… specialty distributors have become particularly attractive to PE firms. Insurance distributors can be seen as stable, in that they generate a steady cash flow and can often weather significant macroeconomic shifts (such as by generating increased commissions during inflationary periods).

2023 saw several significant acquisitions and partnerships in the specialty distributor space.

In 2023, there were also several significant partnerships in the MGA and MGU space.

Pet insurance companies have also actively engaged in M&A and consolidation.

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7 *North American Insurance Broker M&A Activity Slows in 2023*, S&P (February 2024).

8 *M&A Market Update*, MarshBerry (June 2023).

9 *Insurance Investors: Priorities and Opportunities*, McKinsey (October 2023).

Group ("**NSM**"), a Carlyle company, to JAB Holding Company ("**JAB**") at a value of US$1.5 billion. Similarly, Synchrony Financial ("**Synchrony**") agreed to sell its Pets Best subsidiary to Poodle Holdings ("**Poodle**"), a subsidiary of JAB, in exchange for cash and equity in Independence Pet Holdings ("**IPH**"), which owns several insurance brands and is an affiliate of Poodle. Previously, in May 2023, JAB also acquired a majority interest in Pumpkin Insurance Services Inc. ("**Pumpkin**"), through Zoetis Inc. ("**Zoetis**"), which founded Pumpkin in 2020 and will retain a minority stake in Pumpkin.

7. Insurtech

The insurtech subsector, which has long sought to disrupt the broader insurance industry, has also been affected by the larger macroeconomic challenges discussed throughout this publication.

The insurtech subsector, which has long sought to disrupt the broader insurance industry, has also been affected by the larger macroeconomic challenges discussed throughout this publication. Inflationary pressures, restricted access to capital, and a shortage of insurtech startups entering the market all contributed to a decline in insurtech M&A transactions in 2023. Insurtechs also continued to struggle to compete against more established insurers due to lack of scale.

Despite the decrease in insurtech deal activity, 2023 still saw a handful of notable acquisitions, particularly with involvement from private capital sources.

Despite the decrease in insurtech deal activity, 2023 still saw a handful of notable acquisitions, particularly with involvement from private capital sources. One such transaction occurred in January, when Vista Equity Partners announced its acquisition of Duck Creek Technologies ("**Duck Creek**") for US$2.6 billion, at US$19 per share (a 46% premium to Duck Creek's closing share price on January 6, 2023). Duck Creek is a provider of insurance software assistance and other technology services to industry mainstays, such as AIG, Chubb Limited, Progressive Corporation, Tokio Marine Holdings, Inc., and Berkshire Hathaway, Inc. M&A activity for P&C insurtech ended the year on a high note with Travelers' US$435 million acquisition of Corvus, which provides cyber insurance solutions (as further discussed above in *Producer, Specialty Distributor, and MGA Deals*).

In April 2023, Zinnia Corporate Holdings, LLC ("**Zinnia**") announced its strategic acquisition of producer Policygenius Inc. ("**Policygenius**"), a digital insurance marketplace. Upon consummation, the parties announced that the deal resulted in the industry's first end-to-end insurance platform, offering not just life and annuity services, but also disability and P&C insurance. KKR, which was previously a lead investor in Policygenius, remains an investor in the combined company. Similarly, Zinnia will acquire Ebix Life & Annuity ("**Ebix**"), a provider of software solutions to the life and annuity industry, after receiving court approval for the transaction on February 15, 2024, and the transaction is expected to close in March 2024.

Additionally, the industry is starting to see an increase in strategic partnership opportunities in the insurtech space.

Additionally, the industry is starting to see an increase in strategic partnership opportunities in the insurtech space. Such partnerships include the strategic partnership among Next Insurance Inc. ("**Next Insurance**"), Allstate Corporation ("**Allstate**"), and Allianz SE ("**Allianz**"), whereby Allstate and Allianz will provide Next Insurance with expertise in small business insurance and the development of associated technology to provide this underserved market with access to such solutions. This arrangement is coupled with a US$265 million investment from Allstate and Allianz in Next Insurance. Another example is FINEOS Corporation's ("**FINEOS**") arrangement with The Guardian Life Insurance Company of America ("**Guardian**"), an employee benefits and financial wellness solutions provider, whereby FINEOS will provide Guardian with access to its FINEOS AdminSuite platform in an attempt to increase efficiency in its group employee benefits division through streamlined policy administration, customer billings, claims management, and integrated absence management. With this arrangement, FINEOS has reported that it now serves seven of the 10 largest U.S. employee benefits insurers, suggesting that insurtechs will continue to actively seek opportunities for advancement even during periods of suppressed M&A activity.

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8. Representations and Warranties Insurance

Representations and warranties insurance ("RWI") rates and required retention amounts continued to decrease in 2023 as a result of lower deal volume and greater competition among RWI carriers.

Representations and warranties insurance ("**RWI**") rates and required retention amounts continued to decrease in 2023 as a result of lower deal volume and greater competition among RWI carriers. Relatively smaller transactions received significantly more quotes than in prior years where deal volume was greater. In order to offer more attractive quotes with more insured-friendly terms, carriers decreased rates and broadened coverage in 2023 by offering fewer exclusions to coverage and fewer deemed changes to representations and warranties. Additionally, RWI carriers increasingly offered insureds the option to add interim breach coverage, which provides coverage for representations and warranties breaches during the interim period between signing and closing.

For most transactions, premium pricing decreased throughout 2023. Current premium rates range from 2.5% to 3.5% of the coverage amount. Additionally, retention amounts have also decreased. Retention amounts refer to the amount that insureds must pay out of pocket before the RWI policy begins paying on a claim. In prior years, typical initial retentions for most deals was around 1% of the transaction's enterprise value, with the retention dropping down to 0.5% at the retention dropdown date (i.e., 12 months from closing); now, initial retention amounts are as low as 0.5%, dropping down to as low as 0.3% at the retention drop down date. This decrease in retention amounts signifies that the threshold for recovery in RWI claims is significantly lower than in recent years.

Although RWI rates and required retention amounts decreased, it has been reported that RWI claims activity rose in 2023, largely attributable to the high M&A deal volume of 2021 and early 2022. Claims related to breaches of financial statements representations, material contracts representations, no undisclosed liabilities representations, cybersecurity/privacy representations, and tax representations are reported to be on the rise. We expect RWI to remain vital to insurance M&A in 2024, and we will likely continue to see more insured-friendly terms in RWI policies (at least in the near term), unless M&A deal volume drastically increases.

Although RWI rates and required retention amounts decreased, it has been reported that RWI claims activity rose in 2023, largely attributable to the high M&A deal volume of 2021 and early 2022.

9. Outlook

Despite continued uncertainties and challenges in 2023, the U.S. insurance M&A market remained somewhat resilient, bringing a sense of optimism as we look ahead into 2024 and beyond. We expect that reinsurance will continue to help close the gaps in the insurance M&A market, as it allows companies to isolate specific risks and assets to be sold without the need for the buyer to assume all enterprise-wide liabilities. At the same time, however, buyers may be weary, given the cost of debt remaining inflated and the tumult caused by two ongoing conflicts in the Middle East and Ukraine.

Despite continued uncertainties and challenges in 2023, the U.S. insurance M&A market remained somewhat resilient, bringing a sense of optimism as we look ahead into 2024 and beyond.

For information about tax, regulatory, and litigation developments that may impact insurance M&A or otherwise be of interest to insurance M&A market participants, please see:

TOPIC	SECTION
Bermuda Corporate Income Tax	IV.A.1.
Global Anti-Base Erosion Model (GloBE) Rules	IV.A.1.
NAIC Adopts Revisions to Guaranty Association Model Act to Address Insurance Business Transfers and Corporate Divisions	V.A.3.a.
NAIC Adopts Guidance to Regulators Related to Reviewing the Fairness and Reasonableness of Affiliated Services Contracts	V.A.5.
NAIC Adopts Accreditation Standard for 2020 Holding Company Act Revisions	V.A.7.
NAIC Activities Relating to International Insurance Activities	V.A.8.
NAIC Takes Action Regarding Various Investment Monitoring Activities	V.A.9.
NAIC Revisions to Statements of Statutory Accounting Principles With Respect to Affiliated Investments	V.A.10.c.
U.S. Department of Labor Guidance Relating to the Management of Assets	V.B.1.
U.S. Litigation Developments – Cost of Insurance Litigation Overview	V.C.1.
International (Non-U.S.) Insurance Regulatory Issues	V.D.
Impact of EU and UK Data Protection Developments on the Insurance and Reinsurance Industry	V.D.5.
Bermuda Imposes New Regulatory Approval Process for Block Transactions	V.D.9.

In the face of rising interest rates, inflation, and market volatility, 2023 was a challenging year for the UK insurance sector. Although the number of M&A transactions saw an increase, deal value fell significantly.

… with the emergence of alternative methods for making new investments at Lloyd's, the principal M&A focus for Lloyd's in 2023, as in recent years, has continued to be on the legacy market.

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.

MCI Syndicate 1966 will introduce to the biotech industry an innovative product that insures clinical trial funding in the event a trial fails and is targeting commencing underwriting from April 2024.

Consolidation in the UK broker market continued throughout 2023 and deal volume held up relatively well in the face of geopolitical uncertainty and interest rate volatility.

B. UK AND EUROPEAN MARKETS

1. Introduction

In the face of rising interest rates, inflation, and market volatility, 2023 was a challenging year for the UK insurance sector. Although the number of M&A transactions saw an increase, deal value fell significantly. The trends across 2023 broadly mirrored those of recent years, with the majority of M&A activity in the broker market and continued interest in run-off transactions.

2. Lloyd's of London

Historically, the long lead time and associated costs of establishing a Lloyd's of London ("**Lloyd's**") platform organically via a turnkey operation have meant that M&A has, for many, been a preferable route to market entry. However, with the emergence of alternative methods for making new investments at Lloyd's (see further below), the principal M&A focus for Lloyd's in 2023, as in recent years, has continued to be on the legacy market. This 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. Among the more significant Lloyd's legacy deals in 2023, Marco Capital Holdings Limited ("**Marco**") entered into a loss portfolio transfer with Markel Group Inc. in respect of a portfolio of UK motor insurance claims. Marco's Syndicate 1254 will provide cover of up to £200 million in claims reserves.

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. In February 2024, Asta Managing Agency Ltd., a third-party managing agent at Lloyd's, announced that Lloyd's has granted an "in principle" approval for MCI Syndicate 1966. MCI Syndicate 1966 will introduce to the biotech industry an innovative product that insures clinical trial funding in the event a trial fails and is targeting commencing underwriting from April 2024.

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. Lloyd's has commented that the current LB2 structure has a capital pipeline of US$500 million to US$1 billion, and predicted that a third transformer would be launched to meet demand. In January 2024, the first 144A catastrophe bond was issued on LB2. The US$100 million transaction was sponsored by Beazley PLC.

3. Broker M&A

Consolidation in the UK broker market continued throughout 2023 and deal volume held up relatively well in the face of geopolitical uncertainty and interest rate volatility. Transactions included the merger between Markerstudy Group and Atlanta Group (the Ardonagh Group's personal lines broking business) announced in September 2023. Since securing new investment from its PE backers in December 2021 and announcing a refinancing in February 2024, the Ardonagh Group ("**Ardonagh**") continues on its growth trajectory and remains active in the European broker M&A market, completing several acquisitions in 2023. These included the Oxford Insurance Group, a majority shareholding in broker Stanhope Cooper Insurance Brokers Limited, and an acquisition of brokers Pace Ward Ltd, PB Curran Insurance Brokers, and Westfield Brokers Ltd. In Europe, Ardonagh built its Dutch platform by acquiring Dutch brokers Classicus and Klap, as well as announcing its agreement to acquire ASSEPRO in Switzerland.

In July 2023, Howden Broking Group Ltd. acquired Media Insurance Brokers International Ltd and expanded with its acquisition of Laurie Ross Limited, a local personal and commercial lines Scottish broker, in January 2024. In April 2023, Arthur J. Gallagher (through its subsidiary, Pen Underwriting, based in the UK), completed its acquisition of Tay River Holdings Ltd. In December 2023, the sovereign wealth fund, GIC Private Limited, agreed to buy out its investment partner Cinven Limited and take a majority stake in UK broker Miller Insurance Services LLP. In addition, Ryan Specialty Holdings Inc. is to acquire Castel Underwriting Agencies Ltd., the UK-based insurance brokerage firm, from Arch Capital Group Ltd.

As in previous years, PE interest in insurance broking firms continued to hold up throughout 2023. Acrisure LLC acquired Ten Insurance Services Ltd., subject to regulatory approvals, and AssuredPartners Inc. and NSM Insurance Group Inc. acquired Acquis Insurance Management Ltd. from Dunedin LLP, the UK-based PE firm. In November 2023, AssuredPartners Inc. also acquired the UK regional broker Romero Group. In December 2023, NFP Corp acquired Advanced Insurance Consultants Ltd, the UK-based company providing commercial insurance brokerage services. Also in December, Stonepeak Partners LP acquired an undisclosed stake in AA Ltd. Per the parties, the acquisition is expected to be completed in the first half of 2024 and is subject to receiving the relevant regulatory approvals. In July 2023, Augment Risk, a reinsurance broker backed by PE firm Altamont Capital Management LLC, entered the UK market and Carbon Underwriting Ltd. secured significant investment from Apiary Capital LLP. In September 2023, PE firm Eurazeo SA acquired 34% of BMS Group Ltd.

As in previous years, PE interest in insurance broking firms continued to hold up throughout 2023.

Given that many UK brokerage firms are now backed by PE, this is likely to continue to drive further broker M&A (and possibly initial public offerings ("**IPOs**")) over the course of 2024, as PE owners look to maximize and realize returns from their investments.

4. Insurance Company Transactions

Despite the volume of transactions being down, there were still some noteworthy insurance company M&A transactions in the UK in 2023. These included the completion in April 2023 of Phoenix Group Holdings plc's acquisition of Sun Life UK, a closed book UK life insurance company, from Sun Life Financial Inc. in a deal worth £248 million. In September 2023, Aviva plc acquired AIG Life Ltd. for an estimated £460 million. Also in September 2023, RSA Insurance Group Limited acquired the brokered commercial insurance business of Direct Line Insurance Group plc ("**Direct Line**") for a consideration of £520 million in cash and £30 million in earnout.

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In the wider European market, in October 2023, Allianz S.p.A. announced its agreement to acquire Tua Assicurazioni from Assicurazioni Generali S.p.A. in a transaction worth €280 million. A potentially more significant European transaction was announced in June 2022 when Zurich had agreed to the sale of its US$20 billion life insurance book to PE-backed Viridium in Germany. Viridium is majority owned by PE firm Cinven and the transaction was subject to regulatory approvals. In January 2024, however, it was reported that the deal was not proceeding owing to considerations relating to Viridium's ownership structure.

In addition, for an update on UK regulatory activity with respect to *Change of Control Applications – Financial Services and Markets Act 2023 and the UK Regulators Consultation Paper on Prudential Assessment of Acquisitions and Increases in Control*, see section V.D.1.c.

5. Bulk Annuities, Longevity, and Funded Re Transactions

Industry commentary on the UK de-risking market indicates that in 2023 there were over £50 billion of bulk annuity transactions executed, with a marked increase in larger deals in the second half of the year, driven by a combination of an increase in reinsurance capacity, availability of capital, and improvements in funding levels due to rising gilt yields.

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The largest single bulk annuity transaction concluded in 2023 was the £4.8 million Boots Pension Scheme full-scheme buy-in with Legal & General. This followed the earlier 2023 buy-in transactions for two of RSA Insurance Group's pension schemes with Pension Insurance Corporation, covering 40,000 members and £6.5 billion of liabilities. It is anticipated that the trend towards larger bulk annuity deals will continue with a focus on full-scheme buy-ins and buyouts. The deal volume is predicted to reach £60 billion in 2024.

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The first ever pension superfund transaction was executed in 2023. A "superfund" is a vehicle that receives transfers of assets and liabilities from defined benefit pension schemes, and enables the original sponsor to end its responsibility for the pension scheme. The structure involves the set-up of a capital

The first ever pension superfund transaction was executed in 2023. A "superfund" is a vehicle that receives transfers of assets and liabilities from defined benefit pension schemes, and enables the original sponsor to end its responsibility for the pension scheme.

Deal activity with respect to pure longevity de-risking transactions remained strong throughout 2023, with UK deal volumes expected to reach more than £10 billion.

It is expected that 2024 will be another busy year for the longevity swap market, with deal volumes predicted to reach £20 billion.

Although there has been an increased regulatory focus on Funded Reinsurance ("Funded Re") transactions, there have been very few publicly announced Funded Re deals in recent years.

buffer (comprised of funding from investors and the original scheme sponsor), which provides security to scheme members by serving to guarantee the pensions. In order to enter a superfund transaction, the pension scheme must have no realistic prospect of buyout in the foreseeable future.

In November 2023, Clara Pensions Trust entered into a £590 million transaction with Sears Retail Pension Scheme, which has not had a sponsoring employer since Sears ceased trading in 2000. Under the terms of the transaction, approximately 9,000 scheme members' pension benefits will transfer to Clara Pensions Trust, and the scheme members will benefit from an additional £30 million of new ring-fenced capital.

Deal activity with respect to pure longevity de-risking transactions remained strong throughout 2023, with UK deal volumes expected to reach more than £10 billion. Market commentary has indicated that demand and supply for longevity swaps and reinsurance remains strong, which has helped to drive more favorable pricing for pension schemes in comparison to previous years. It is expected that 2024 will be another busy year for the longevity swap market, with deal volumes predicted to reach £20 billion.

The more significant longevity transactions in 2023 included the longevity swap and reinsurance arrangement entered into between The Prudential Insurance Company of America ("**Prudential Insurance**") and Swiss Re in respect of approximately €13 billion of longevity risk associated with NN Group's subsidiary's ("**NN Life**") pension liabilities in the Netherlands. Under the transaction, Prudential Insurance entered into a longevity risk transfer agreement with NN Life whereby it reinsured more than 200,000 policies, with the remainder of the risk being reinsured by Swiss Re. Another significant longevity transaction involved Reinsurance Group of America in respect of approximately £5 billion of longevity risk associated with the BT Pension Scheme.

Although there has been an increased regulatory focus on Funded Reinsurance ("**Funded Re**") transactions (see section V.D.1.b. below), there have been very few publicly announced Funded Re deals in recent years. Funded Re is a form of collateralized quota share reinsurance contract whereby part or all of the asset/investment risk and the longevity risk associated with a portfolio of annuities is transferred to a reinsurer. Collateral is used to secure the reinsurer's obligations to the cedant and a premium is paid by the cedant to the reinsurer.

In October 2023, Resolution Re announced that it had executed its first Funded Re transaction, covering the longevity and asset risks associated with the pension liabilities of a UK-regulated insurer in respect of both deferred pensions and pensions in payment. This was soon followed in December 2023, when Resolution Re announced the execution of a second Funded Re transaction with another UK-regulated insurer, covering the market and longevity risks of 90,000 policyholders and approximately £2 billion individual in-payment UK annuity liabilities.

II. Traditional Capital Markets

1. Transactions Overview

Capital markets endured a turbulent 2023 after a down year in 2022. However, the market started to stabilize towards the end of 2023, providing cautious optimism for 2024. The last two years have seen a significant slowdown in IPOs across most industries from the high transaction volume in 2020-2021. The slowdown may, in part, be due to factors such as high interest rates, economic indicators of an impending recession, the Russia-Ukraine and Israel-Palestine conflicts, and the fallout from the special purpose acquisition company (SPAC) boom in 2020-2021.[10] The insurance industry was no different. The volatile market in 2022 forced Skyward Specialty Insurance Group ("**Skyward**"), a commercial P&C insurance company headquartered in Houston, Texas, to delay its IPO until the start of 2023. On January 9, 2023, Skyward issued 8,952,383 shares of common stock at a price of US$15 per share.

Capital markets endured a turbulent 2023 after a down year in 2022. However, the market started to stabilize towards the end of 2023, providing cautious optimism for 2024.

Following the Skyward IPO, IPO activity across the insurance industry remained relatively quiet during the first half of 2023, before slightly picking up towards the second half of the year. In June, Fidelis Insurance Holdings Limited, a Bermuda company which offers specialty, reinsurance, and bespoke segment products, completed its IPO of 15 million shares at a per-share price of US$14. In November 2023, Hamilton Insurance Group, Ltd., a Bermuda company that engages in underwriting specialty insurance and reinsurance risks, completed its IPO of 15 million shares at a per-share price of US$15.

Following the Skyward IPO, IPO activity across the insurance industry remained relatively quiet during the first half of 2023, before slightly picking up towards the second half of the year.

There were also a few secondary offerings throughout the insurance industry in 2023. In May, Everest Re Group, Ltd. offered 3.6 million common shares, as a follow-on offering, at a price of US$360 per share. Also in May, RenaissanceRe offered 6.3 million shares, as a follow-on offering, at a price of US$192 per share. The proceeds from the offering were used to fund a portion of the cash consideration for the acquisition of certain subsidiaries of AIG. Corebridge Financial, Inc. priced two secondary offerings in 2023. The first, in June, was an offering of US$65 million of shares of common stock at a per-share price of US$16.25. The second, in December, was an offering of US$35 million of shares at a per-share price of US$21.03.

Looking towards 2024, there is optimism that the IPO market will ramp back up. Aspen Insurance Holdings Limited, an insurance company that provides property, agricultural, cyber risk, business, and casualty insurance and reinsurance products, filed its initial Form S-1 with the U.S. Securities and Exchange Commission ("**SEC**") at the end of December 2023.

Looking towards 2024, there is optimism that the IPO market will ramp back up.

Similar to the equity markets, companies within the insurance industry raised funds via traditional debt offerings (including funding agreement-backed note ("**FABN**") programs used by life insurance companies) at a slower rate than in years past. However, debt offerings have picked up since the start of 2024, along with issuances through FABN programs.

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In March 2023, The Northwestern Mutual Life Insurance Company ("**Northwestern Mutual**") issued US$1.3 billion of 4.71% and 4.11% senior notes due 2026 and 2030, respectively. In June, Northwestern Mutual issued another US$1 billion of variable rate senior notes and 4.9% senior notes due 2025 and 2028, respectively. Also in June 2023, Global Atlantic Limited (Delaware) (formerly Global Atlantic Financial Limited) issued US$750 million of 7.95% senior notes due 2033. In August, Mutual of Omaha Insurance Company issued US$400 million of 5.8% surplus notes due 2026. In September, Marsh & McLennan issued US$1.6 billion in 5.4% senior notes due 2033 and 5.700% senior notes due 2053. The proceeds were used for general corporate purposes. Also in September, Corebridge Life Holdings, Inc. issued US$500 million in 5.200% senior notes due 2028. In November, Humana, Inc. issued US$1.35 billion in 5.75% and 5.950% senior notes due 2028 and 2034, respectively. The proceeds were used, in part, to pay off existing debt. To round out 2023, in December, Athene Holding Ltd. issued US$600 million of 5.87% senior notes due 2034.

10 Preston Brewer, *After Touch-and-Go 2023, IPOs Step Carefully Into 2024*, Bloomberg Law (2024), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-after-touch-and-go-2023-ipos-step-carefully-into-2024.

The capital markets space has had several key regulatory changes in the past few years directly impacting the insurance industry.

… effective October 30, 2023, the SEC adopted an order exempting securities issued pursuant to Rule 144A from the quotation restrictions of Rule 15c2-11.

Throughout 2023, the SEC issued various comment letters applicable to the insurance industry …

2. Regulatory Updates

The capital markets space has had several key regulatory changes in the past few years directly impacting the insurance industry. In 2018, the Financial Accounting Standards Board ("**FASB**") issued accounting standards update (ASU) 2018-12.[11] This update, commonly referred to as long-duration targeted improvements ("**LDTI**"), affects all insurers involved in issuing long-duration contracts, such as life insurance and long-term disability. The update was in effect beginning on December 15, 2022 for public SEC filers, and required such filers to retrospectively apply the rule to financial statements for years ended December 15, 2020. All other entities will be required to apply the standard in calendar year annual financial statements ended December 15, 2024 and interim financial statements ended December 15, 2025.[12] LDTI only affects financial statements prepared under Generally Accepted Accounting Principles ("**GAAP**") and, therefore, does not apply to financial statements prepared under SAP. The amendments were designed to modernize the rule and to enhance investor protection by requiring that current and publicly available issuer information be accessible to investors.

In 2020, the SEC adopted amendments to Rule 15c2-11, requiring broker-dealers to, among other things, make current and publicly available issuer information accessible for investors before initiating a quotation in a quotation medium other than a national securities exchange. However, effective October 30, 2023, the SEC adopted an order exempting securities issued pursuant to Rule 144A from the quotation restrictions of Rule 15c2-11. This ruling came after extensive pushback by industry participants and the Securities Industry and Financial Markets Association ("**SIFMA**"), who argued that the rule conflicted with Rule 144A.[13] SIFMA argued that requiring public disclosure of 144A issuer information is contrary to 144A, where issuer information is only provided at the request of holders and prospective holders who are qualified institutional buyers.[14] Had the SEC chosen not to exempt Rule 144A issuances, insurance companies looking to raise capital may have turned to other markets. It should be noted, however, that the exemption only applies to securities issued pursuant to 144A, meaning securities filed under Regulation S are not exempt from 15c2-11. Rule 15c2-11 will restrict the ability of market participants to publish quotations after January 4, 2025.

Throughout 2023, the SEC issued various comment letters applicable to the insurance industry, including with respect to the following areas:

- **Management's Discussion and Analysis.** The SEC has asked registrants to expand their discussions on any known trends or uncertainties that may have a material impact on cash flows, liquidity, capital resources, cash requirements, or financial position.

- **Non-GAAP Measures.** The SEC last updated non-GAAP financial measures in December 2022, when it supplemented its Compliance and Disclosure Interpretations to provide guidance on the use of non-GAAP financial measures. The SEC continues to focus on whether non-GAAP financial measures comply with Item 10(e) of Regulation S-K, with an emphasis on when a financial measure is not identified as a non-GAAP measure despite not conforming to the U.S. GAAP typical calculation of that measure.

- **Revenue Recognition.** The SEC continues to focus on revenue disclosures under ASC 606, which took effect on January 1, 2018. The SEC has asked for more guidance about disaggregated revenue disclosures, identification of performance obligations in customer contracts, and satisfaction of performance obligations.

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11 Financial Accounting Standards Board, *Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts 1* ((ASU) 2018-12 2018), https://www.fasb.org/page/ShowPdf?path=ASU%202018-12.pdf&title=Accounting%20Standards%20Update%202018-12%E2%80%94Financial%20Services%E2%80%94Insurance%20(Topic%20944):%20Targeted%20Improvements.

12 *Financial Reporting Manual*, SEC Division of Corporation Finance (December 31, 2022), https://www.sec.gov/files/cf-frm.pdf.

13 Joseph Corcoran and Chris Killian, *The Collision of Rule 15c2-11 and Rule 144A*, SIFMA (2022), https://www.sifma.org/resources/news/the-collision-of-rule-15c2-11-and-rule-144a/.

14 *Id.*

III. The Global P&C Alternative Risk Transfer Market

A. P&C ALTERNATIVE RISK TRANSFER MARKET

1. Catastrophe Bonds

The insurance-linked securities ("**ILS**") market experienced a record year in 2023, with approximately 95 transactions coming to market, totaling more than US$16.4 billion of issuances, surpassing previous records set in 2021 for both categories, and representing a 57% increase from 2022.[15] More than one-third of these issuances came to market in the fourth quarter of 2023. In Q4 2023, 33 separate transactions were issued, amounting to approximately US$5.6 billion. In total, the outstanding catastrophe bond market grew by 19% over the course of 2023 and reached a new year-end high at US$45 billion. While investors had pushed for and achieved very strong pricing on transactions in late 2022, 2023 represented a somewhat more stable pricing environment, although investors remained disciplined in requiring satisfactory levels of risk-adjusted returns.

The insurance-linked securities ("ILS") market experienced a record year in 2023, with approximately 95 transactions coming to market, totaling more than US$16.4 billion of issuances …

In total, the outstanding catastrophe bond market grew by 19% over the course of 2023 and reached a new year-end high at US$45 billion.

A number of notable transactions occurred in 2023. In March 2023, the World Bank sponsored a US$350 million catastrophe bond providing the government of Chile with loss protection against severe earthquake events for a three-year term. This issuance was paired with a US$280 million transaction of catastrophe bond swaps, resulting in a total US$630 million of earthquake insurance coverage for the Chilean government from the combined transaction. The U.S. Federal Emergency Management Agency ("**FEMA**") returned to the catastrophe bond market for its sixth FloodSmart Re issuance. FEMA has obtained US$275 million of reinsurance coverage, totaling US$2.5 billion of collateralized reinsurance from the capital markets across six catastrophe bonds issued under its FloodSmart Re Ltd. program since 2018. The California Earthquake Authority also returned to the catastrophe bond market, with three separate issuances in 2023 totaling US$1.08 billion. Ursa Re 2023-3 constituted the largest of these issuances at US$650 million.

A number of notable transactions occurred in 2023.

2023 featured the first cyber catastrophe bond issuances, with seven total issuances: four Rule 144A issuances and three private deals. These four public cyber catastrophe bond issuances totaled US$415 million and consisted of: Long Walk Reinsurance Ltd., Series 2024-1 (US$75 million and sponsored by AXIS Capital); PoleStar Re Ltd., Series 2024-1 (US$140 million and sponsored by Beazley); Matterhorn Re Ltd., Series 2023-1 (US$50 million and sponsored by Swiss Re); and East Lane Re VII Ltd., Series 2024-1 (US$150 million and sponsored by Chubb). The three Section 4(a)(2) private placement issuances were sponsored by Beazley, the London-headquartered insurance and reinsurance company, totaling US$81.5 million across the three issuances (Cairney I, II, and III respectively). The Long Walk Reinsurance Ltd. Series 2024-1 issuance was significant for being the first-ever Rule 144A cyber catastrophe bond, and provided protection against the risk of systemic cyber catastrophes on a per occurrence basis. The Matterhorn Re Ltd. Series 2023-1 issuance was the first cyber catastrophe bond sponsored by Swiss Re, utilizing its Bermuda-based special purpose reinsurance vehicle, and also represented the first cyber catastrophe bond utilizing an industry-loss index trigger. In January 2024, Swiss Re also purchased a first-of-its-kind US$50 million cyber retro industry loss warranty, brokered by Gallagher Re and supported by a number of specialist reinsurers.

2023 featured the first cyber catastrophe bond issuances …

The Long Walk Reinsurance Ltd. Series 2024-1 issuance was significant for being the first-ever Rule 144A cyber catastrophe bond, and provided protection against the risk of systemic cyber catastrophes on a per occurrence basis.

2. 2023 Global Insured Catastrophe Losses

Global insured catastrophe losses in 2023 are estimated to be approximately US$123 billion.[16] The estimated total is above the 10-year average (US$111 billion) and 21st century average (US$91 billion). Private sector insurers paid approximately US$110 billion in losses, while public sector insurance entities covered the remaining US$13 billion. While roughly two-thirds of such insured losses stemmed from events that occurred in the U.S., there were a record 34 individual billion-dollar insured loss natural disasters globally in 2023. Approximately US$71 billion, or 57%, of insured losses resulted from severe convective storms, of which US$60 billion occurred in the U.S. — setting a record for insurers both globally and in the U.S., and constituting the costliest peril for the insurance industry. Insured losses from

15 *Q4 2023 Catastrophe Bond & ILS Market Report*, Artemis.bm (January 2024).

16 *Natural Catastrophe and Climate Report: 2023*, Gallagher Re (January 2024). Note that Gallagher Re's insured loss estimate is higher than Munich Re's estimate of US$95 billion and Swiss Re's estimate of US$100 billion, but in line with broker BMS Group's December 29 estimate. *See Insured net cat losses hit $123bn in record-setting 2023: Gallagher Re*, Reinsurance News (January 2023).

The protection gap provides the insurance industry and the financial markets with an indication of where there is opportunity for growth and assistance.

tropical cyclone were markedly lower than in 2022, when tropical cyclone constituted the costliest peril (largely due to Hurricane Ian), and industry losses from the 2023 North Atlantic hurricane season were the lowest since 2015.

Approximately 34% of direct aggregated economic losses were insured by public sector and private sector entities, resulting in a 66% protection gap. The protection gap provides the insurance industry and the financial markets with an indication of where there is opportunity for growth and assistance.

3. Sidecars and ILS Funds

The performance of the P&C reinsurance sidecar market rebounded in 2023, a positive development for investors who had experienced challenges after consecutive years of losses and poor performance.

The performance of the P&C reinsurance sidecar market rebounded in 2023, a positive development for investors who had experienced challenges after consecutive years of losses and poor performance. Strong underlying reinsurance margins and the absence of major global natural catastrophes led some sidecar investors to achieve returns of more than 30%.[17]

The sidecar market saw a number of noteworthy transactions.

The sidecar market saw a number of noteworthy transactions. Ark Insurance Holdings Limited, a P&C insurance and reinsurance subsidiary of the White Mountains Insurance Group, Ltd., entered into a US$250 million collateralized reinsurance sidecar using an existing vehicle, Outrigger Re Ltd. (with US$165 million in renewal capital and US$85 million in fresh capital from new investors). The quota share arrangement provides reinsurance protection on a portion of Ark Bermuda's global property catastrophe reinsurance portfolio. Vantage Risk, which in 2022 had established a substantial reinsurance capacity facility primarily funded by third-party capital, secured additional capital with approximately US$1.5 billion available to deploy in 2024. Specialty insurance and reinsurance company AXIS Capital launched Monarch Point Re in the fall of 2023, a third-party capitalized casualty reinsurance sidecar structure (with a launch capital raise of over US$400 million in equity, including a US$75 million equity investment from the credit-investing platform of investment manager Stone Point Capital). In January 2024, reinsurer MS Amlin renewed its Singapore-domiciled special purpose reinsurance vehicle Phoenix 2 Re Pte. Ltd., securing an additional US$35.25 million across three tranches of notes (the first-ever ILS renewal in Singapore). Munich Re's collateralized reinsurance sidecar Eden Re II, which regularly issues tranches of notes in December and January of each year to support its retrocessional arrangements, returned to the market with a US$28.5 million issuance of Series 2024-1 Class A notes and a US$121.5 million issuance of Series 2024-1 Class B notes.

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), and continue to be an efficient and attractive investment for longer-term investors with an appetite for diversifying risks.

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Like the reinsurance sidecar market, the performance of funds investing in ILS also exhibited positive returns. In fact, ILS funds experienced a record year in 2023…

Like the reinsurance sidecar market, the performance of funds investing in ILS also exhibited positive returns. In fact, ILS funds experienced a record year in 2023, with the Swiss Re Global Cat Bond Performance Index rising almost 20% (compared to gains of 13% for U.S. high-yield corporate bonds and 4% for U.S. treasuries).[18] As the performance of catastrophe bonds in 2023 buoyed the returns of corresponding hedge fund investors, more mainstream institutional investors are building a presence in the space. The combination of record catastrophe bond issuances and record investor returns in 2023 may bode well for continued growth of the market in 2024.

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4. Global ILS Initiatives

a. Singapore

In April 2023, the Monetary Authority of Singapore ("MAS") announced that it planned to renew its ILS grant scheme, aimed at defraying the costs of ILS issuance for three years.

In April 2023, the Monetary Authority of Singapore ("**MAS**") announced that it planned to renew its ILS grant scheme, aimed at defraying the costs of ILS issuance for three years. Finance minister and Deputy Prime Minister Lawrence Wong expressed hope that the grant's extension would "support the continued growth of catastrophe bonds and additional climate risk financing instruments such as sidecars and collateralized reinsurance arrangements." Notably, the MAS identifies the ILS grant scheme (and its other efforts to support the alternative risk transfer market) not solely as a means of encouraging transactions for protection against disaster risk, but also within the context of Singapore's net zero transition and decarbonization efforts.

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17 *Reinsurance Market Dynamics*, Aon (January 2024).

18 *Hedge Funds' Mega Returns Set Off Demand Spiral for Catastrophe Bonds*, Bloomberg (January 2024).

b. Bermuda

Bermuda experienced the strongest year since 2014 in terms of overall new company registrations for catastrophe bond-, ILS-, and collateralized reinsurance-related vehicles. Catastrophe bond issuer formations led the way. There were 29 new special purpose insurer ("**SPI**") registrations in Bermuda in 2023, the most in one year since 2013. 2023 also saw three new Collateralized Insurer class of company structures registered in Bermuda.

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c. Hong Kong

Like Singapore, in February 2023 Hong Kong Financial Secretary Paul Chan announced that Hong Kong would extend its pilot ILS grant scheme, in an effort to "continue attracting more issuing institutions and nurturing talent, with a view to supporting industry development and assisting our country in expansion of channels for risk diversification and management." In March 2023, the World Bank/Chile catastrophe bond issuance (discussed earlier) became the first-ever catastrophe bond listed on the Hong Kong Stock Exchange.

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Looking ahead, observers and industry professionals foresee continued growth of the Hong Kong ILS market. A poll conducted at Bloomberg's 2023 Insurance Forum indicated that Hong Kong's catastrophe bond market may grow to at least US$1.5 billion by the end of 2025 (according to more than half of respondents), and potentially as much as US$2 billion (according to 22% of respondents).[19]

… observers and industry professionals foresee continued growth of the Hong Kong ILS market.

5. Vesttoo Scandal

In 2023, the ILS market experienced a fraud scandal involving Vesttoo Ltd. ("**Vesttoo**"), an Israeli insurtech startup firm focused on using AI technology to connect the insurance industry and capital markets. Vesttoo had previously established its first underwriting structure in Bermuda, Vesttoo Alpha P&C Ltd., in 2022. Over the course of the summer of 2023, it was discovered that billions of dollars of standby letters of credit serving as collateral for Vesttoo's collateralized reinsurance transactions were forged. Vesttoo Alpha P&C Ltd. entered into liquidation in August 2023, and the Bermuda Monetary Authority issued proceedings in the Bermuda courts for the appointment of joint provisional liquidators. Ongoing Chapter 11 proceedings in the Delaware bankruptcy courts indicate that Vesttoo creditors have submitted claims of over US$4.8 billion against the company and its affiliated entities, but recoveries are expected to be below US$100 million.

The Vesttoo proceedings should be closely watched, as a filing by the joint provisional liquidators stated that the company has "admitted it perpetrated what is likely the largest fraud ever in the Bermuda (re)insurance market." And the Vesttoo case is significant not only for its scale, but also as a case study for the application of insolvency proceeding principles to collateralized reinsurance and segregated cell arrangements. A major question in the proceedings will concern ownership of the segregated cells, as among Vesttoo and its affiliates, third-party investors with respect to certain cells, and the creditors of the bankruptcy estate; a related question will be whether such cells should be consolidated in the bankruptcy estate.

The Vesttoo scandal has resulted in heightened sensitivity and increased due diligence in Bermuda and other jurisdictions around collateral arrangements.

6. M&A Activity

M&A activity remained relatively muted throughout 2023, continuing a trend that began in 2022 as the market continued to face headwinds such as inflation and heightened interest rates. In January 2023, international insurance group Howden Group Holdings completed the acquisition of reinsurance and risk capital adviser TigerRisk Partners, closing a transaction that had been signed and announced in June 2022 at a purchase price of US$1.6 billion. The combined firm, Howden Tiger, stated that the combined organization constitutes "the world's fourth largest global reinsurance broker" and suggested that it now operated the largest managing general agent in the world (Howden Tiger SabRE).

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In May 2023, RenaissanceRe Holdings Ltd. ("**RenaissanceRe**") announced its acquisition of Validus Re from American International Group ("**AIG**"), which included Validus Reinsurance Ltd. and its consolidated

19 *Hong Kong's catastrophe bond market can reach $2 billion by 2025*, Bloomberg (May 2023).

subsidiaries, AlphaCat Managers Ltd. and all renewal rights to the Assumed Reinsurance Treaty Unit of Talbot (together, "**Validus Re**"). The acquisition closed in November 2023, with AIG receiving a consideration of US$3.3 billion in cash and approximately US$275 million in common shares of RenaissanceRe.

7. Outlook

While investors were rewarded with elevated risk-adjusted margins as well as strong investment returns on collateral assets, a number of uncertainties are deterring potential new investors – including the impact of climate change (and corresponding increased catastrophe losses), persistent above-average inflation, and geopolitical risk.

As previously noted, 2023 was a record year for the ILS market. According to Aon's *Reinsurance Market Dynamics* report, reinsurers leveraged alternative capital more in 2023 than in any year in the market's history, and alternative capital crossed the US$100 billion mark for the first time (an estimated growth of 7% from the prior year). While investors were rewarded with elevated risk-adjusted margins as well as strong investment returns on collateral assets, a number of uncertainties are deterring potential new investors — including the impact of climate change (and corresponding increased catastrophe losses), persistent above-average inflation, and geopolitical risk. While it appears that most reinsurers will comfortably cover their costs of capital in 2023 (reversing a long-term trend), ceding insurers continued to experience challenges in 2023, especially smaller mutual insurance companies that faced difficult renewals.

We expect the cyber ILS market to continue to evolve, as 2023 was a landmark year for the market.

We expect the cyber ILS market to continue to evolve, as 2023 was a landmark year for the market. Specialist risk modelling firm CyberCube has noted that the first Rule 144A cyber catastrophe bonds mark the start of the financial markets being capable of pricing systemic cyber event coverage, and the 2023 transactions create a strong foundation for future growth in 2024.

We expect investor focus on ESG to persist, and the need for corresponding disclosures in ILS transactions to continue to evolve.

Environmental, social, and governance ("**ESG**") continues to be a focus for some investors, and its influence has reached the ILS space as well. The ILS ESG Transparency Initiative, formed in 2022 as a collection of ILS fund managers working to advance ESG data transparency in the ILS market, added new members in 2023 and now consists of a group that includes funds such as Credit Suisse Insurance-Linked Strategies and AXA Investment Managers. We expect investor focus on ESG to persist, and the need for corresponding disclosures in ILS transactions to continue to evolve.

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 rules and regulations. The FCA has also 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.

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, 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 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.

20 See SS8/17 *Authorisation and supervision of insurance special purpose vehicles* (December 2022).

21 See PS13/20 *Insurance Special Purpose Vehicles: Updates to authorisation 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.*

In relation to the "green channel" authorization process for standard applications, the PRA is now communicating decisions on applications in less than four weeks. The PRA has stated publicly that the majority of catastrophe bond transactions should be assessed under the standard process and go through the green channel. The PRA also noted that the scope of what is considered to be a standard application is likely to expand as the market develops.

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. Firms should have contingency plans in place in the event that this individual can no longer perform these roles.

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).

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:

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.

- 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 a multi-arrangement ISPV). 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 it clear 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 multi-arrangement ISPV) 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.

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.

… 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.

The UK government is committed to making the UK ILS regime a more attractive market and, while this has not led to a significant increase in the volume of new UK-based ILS transactions yet, there have been some interesting innovations, particularly in Lloyd's.

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.

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

The UK government is committed to making the UK ILS regime a more attractive market and, while this has not led to a significant increase in the volume of new UK-based ILS transactions yet, there have been some interesting innovations, particularly in Lloyd's.

In January 2024, Lloyd's announced the issuance of the first 144A catastrophe bond through its ILS platform, London Bridge 2 PCC Limited ("**London Bridge Risk 2**") valued at US$100 million. The transaction was sponsored by Beazley on behalf of its Lloyd's syndicates and its European insurance carrier. Lloyd's has also stated that London Bridge Risk 2 has the capacity to surpass £1.5 billion in 2024.

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. 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 the Solvency II Directive ("**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.

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

IV. Select Tax Issues Affecting Insurance Companies and Products

A. U.S. TAX ISSUES

1. Bermuda Corporate Income Tax

On December 27, 2023, Bermuda enacted legislation that will impose a new corporate income tax on certain Bermuda entities that are part of large multinational groups (the "**Bermuda Corporate Income Tax**"). The highlights of this important industry tax development are as follows:

On December 27, 2023, Bermuda enacted legislation that will impose a new corporate income tax on certain Bermuda entities that are part of large multinational groups …

- The Bermuda Corporate Income Tax will be determined based on a statutory tax rate of 15%, subject to reductions for foreign tax credits, and will be effective for fiscal years beginning on or after January 1, 2025.
- The Bermuda Corporate Income Tax will generally apply to each Bermuda tax resident entity (e.g., an entity organized in Bermuda) or Bermuda permanent establishment that is a constituent entity of a multinational entity ("**MNE**") group with consolidated revenue of at least €750 million in at least two of the four preceding fiscal years, subject to certain exemptions.
- The calculation of taxable income for purposes of the Bermuda Corporate Income Tax will start with "financial accounting net income or loss," which will generally be determined in accordance with the acceptable financial accounting standard used in preparing the consolidated financial statements of the ultimate parent entity of the MNE group.

The Bermuda Corporate Income Tax was designed to align with the Global Anti-Base Erosion Model Rules (Pillar 2) published by the Organisation for Economic Cooperation and Development (the "**GloBE Rules**"). The GloBE Rules became effective in a number of jurisdictions starting this year and are intended to ensure large multinational taxpayers pay tax at a minimum rate of 15% on their income in each jurisdiction where they operate. The GloBE Rules accomplish this result by collecting a top-up tax from (i) first, the ultimate parent entity or intermediate parent entities in the group through an "Income Inclusion Rule," and (ii) if needed, other entities in the group through an "Undertaxed Payments Rule." The Bermuda Corporate Income Tax is expected to qualify as a "Covered Tax" that is taken into account for purposes of the GloBE Rules (thereby allowing Bermuda to collect tax that may have otherwise been due in another GloBE jurisdiction).

The Bermuda Corporate Income Tax was designed to align with the Global Anti-Base Erosion Model Rules (Pillar 2) published by the Organisation for Economic Cooperation and Development …

Of note for the industry, the Bermuda Corporate Income Tax provides for foreign tax credits with respect to certain income taxes and taxes in lieu of income taxes (e.g., the U.S. federal excise tax on insurance and reinsurance premiums) accrued in the Bermuda constituent entity's financial accounting net income or loss.

Industry participants should monitor and prepare for potential compliance obligations now that the Bermuda Corporate Income Tax has been enacted. In particular, various elections can be made prior to the effective date of the Bermuda Corporate Income Tax that may be worth considering depending on a taxpayer's circumstances.

Industry participants should monitor and prepare for potential compliance obligations now that the Bermuda Corporate Income Tax has been enacted.

2. Treasury Department Releases More Interim Guidance on the Corporate Alternative Minimum Tax, but Insurance Industry-Specific Issues Remain Open

The U.S. Department of the Treasury ("**Treasury Department**") has released five notices that provide interim guidance on the 15% corporate alternative minimum tax ("**CAMT**") that was enacted as part of the Inflation Reduction Act of 2022 (Public Law No: 117-169): Notice 2023-7, Notice 2023-10, Notice 2023-20, Notice 2023-64, and Notice 2024-10 (collectively, the "**Notices**"). The Notices address various topics of general applicability under the CAMT, but with the exception of Notice 2023-20 do not focus on issues specific to the insurance industry. Readers are encouraged to revisit last year's *Sidley Global Insurance Review* for an overview of the insurance industry-specific issues addressed in Notice 2023-20 and the industry-specific issues that still require further guidance. Guidance on the interaction between the CAMT and the rules governing life-nonlife consolidated groups would be particularly useful. Over the course of 2024, industry members and members of the legal community are expected to continue monitoring the publication of further interim guidance, if any, and proposed regulations on the CAMT.

Over the course of 2024, industry members and members of the legal community are expected to continue monitoring the publication of further interim guidance, if any, and proposed regulations on the CAMT.

3. PLR 202401015: Investment Advisory Fees That a Life Insurance Company Deducts from Non-Qualified Deferred Annuity Contract's Cash Value Won't Be Treated as "Amount Received" by Contract Owner

On January 5, 2024, the U.S. Internal Revenue Service ("**IRS**") issued Private Letter Ruling 202401015 (the "**Letter Ruling**"), which addresses the treatment of investment advisory fees that a life insurance company deducts from a non-qualified deferred annuity contract's cash value and remits to an investment adviser that provides ongoing advice on how to allocate the contract's cash value. The investment advisory fees in the Letter Ruling were capped at an annual rate of 1.5% of the contract's cash value and served as consideration for the investment advice provided by the investment adviser solely in relation to the contract. The contract was also solely liable for paying the investment advisory fee.

In light of the foregoing, the IRS determined that the investment advisory fee was an expense under the contract and not a distribution to the contract owner. Accordingly, the IRS ruled that the investment advisory fees will not be treated as an "amount received" by the contract owner for purposes of Section 72(e) of the Internal Revenue Code of 1986, as amended (the "**Code**"), with the result that the fees were not required to be included in the contract owner's gross income.

… the Letter Ruling is notable from an industry perspective because it provides illustrative guidance on how the IRS may view products with similar investment advisory features and fee structures.

The Letter Ruling is the most recent in a series of four recently published private letter rulings in which the IRS has reached a similar conclusion on similar facts (see PLRs 202232004, 202232005, 202232012, and 202232013). As with other private letter rulings, the Letter Ruling was directed only to the taxpayer that requested it and may not be used or cited as precedent. Nonetheless, the Letter Ruling is notable from an industry perspective because it provides illustrative guidance on how the IRS may view products with similar investment advisory features and fee structures.

4. Treasury Department Issues Proposed Regulations Regarding "Reportable Policy Sales" and Section 1035 Exchanges

U.S. federal income tax law generally provides an exclusion from gross income for death benefits received under a life insurance contract. However, under the so-called "transfer for value" rule, if a life insurance contract or an interest therein is sold or otherwise transferred for valuable consideration, then subject to certain exceptions, the amount of the death benefit excluded from gross income generally cannot exceed the sum of the actual value of the consideration and premiums subsequently paid by the transferee.

With this background in mind, as part of the 2017 Tax Cuts and Jobs Act (Public Law No: 115-97) (the "**TCJA**"), Congress made two notable changes to transactions involving the transfer of an interest in a life insurance contract. First, it imposed reporting requirements on the parties to a transaction in which an interest in a life insurance contract is transferred and the acquirer does not have a substantial family, business, or financial relationship with the insured apart from the acquirer's interest in the life insurance contract (defined as a "reportable policy sale"). The reporting requirements can require a life insurance company to report information to the IRS regarding the amount of death benefits paid with respect to the contract acquired in the reportable policy sale. Second, the TCJA provided that a life insurance contract acquired in a reportable policy sale is subject to the transfer for value rule. Accordingly, at least some portion of the death benefit payable under a life insurance contract transferred in a reportable policy sale may be includable in income. The scope of a "reportable policy sale" definition is quite broad, potentially encompassing transactions such as like-kind exchanges and asset reorganizations. There was a concern that the interaction of the reporting rules with the transfer for value exception would change the tax treatment of death benefits from a life insurance contract when that life insurance contract was transferred in a transaction that would generally be tax-deferred.

In 2019, the Treasury Department issued regulations that address the interaction between the new reportable policy sale rules and the rules governing exchanges under Section 1035 of the Code (which involve tax-deferred like-kind exchanges of life insurance contracts) (the "**2019 Regulations**"). Of note, the 2019 Regulations would have treated a life insurance contract issued in an exchange under Section 1035 of the Code as a transfer of an interest in a life insurance contract that is subject to the transfer for value rule. As such, a portion of the death benefit could be includable as income, and commenters were quick to point out that this result seemed inconsistent with Congressional intent to allow for deferral in the case of a like-kind exchange of life insurance contracts.

The 2019 Regulations also created a potential way around the reportable policy sales rules by providing that a life insurance contract issued in an exchange under Section 1035 of the Code would not be considered a reportable policy sale. Accordingly, the reporting obligations and transfer for value implications for a reportable policy sale could be avoided by transferring a life insurance contract that was acquired in a reportable policy sale for a new life insurance contract in an exchange that qualifies under Section 1035 of the Code.

On May 10, 2023, the Treasury Department issued proposed regulations that were intended in large part to address these outcomes under the 2019 Regulations (the "**2023 Proposed Regulations**"). Specifically, the 2023 Proposed Regulations would not treat the issuance of a life insurance contract as a transfer of an interest in a life insurance contract that is subject to the reportable policy sale rules, even if the life insurance contract is issued in an exchange covered by Section 1035 of the Code. The 2023 Proposed Regulations would also generally prevent the use of an exchange covered by Section 1035 of the Code as a means to avoid the reportable policy sale rules applicable to the original life insurance contract.

… the 2023 Proposed Regulations would not treat the issuance of a life insurance contract as a transfer of an interest in a life insurance contract that is subject to the reportable policy sale rules, even if the life insurance contract is issued in an exchange covered by Section 1035 of the Code.

In addition, the 2023 Proposed Regulations would introduce a new rule that provides guidance on how to determine the amount of proceeds excludable from gross income in the case of an interest in a life insurance contract (the "**new interest**") that was exchanged for an interest in an existing life insurance contract (the "**old interest**") as part of an exchange covered by Section 1035 of the Code. This rule would sensibly provide that if the entire amount of the proceeds attributable to the old interest would have been excludable from gross income at the time of the exchange under Section 1035 of the Code, then the entire amount of the proceeds attributable to the new interest is excludable from gross income as well. If less than the entire amount of the proceeds attributable to the old interest would have been excludable from gross income at the time of an exchange covered by Section 1035 of the Code, then the amount of the proceeds attributable to the new interest that is excludable from gross income is limited to the sum of (i) the amount of the proceeds attributable to the old interest that would have been excludable at the time of the exchange covered by Section 1035 of the Code and (ii) the premiums and other amounts subsequently paid by the policyholder with respect to the new interest.

Finally, the 2023 Proposed Regulations would not treat the direct acquisition of an interest in a life insurance contract by a C corporation in a tax-free reorganization as a reportable policy sale if, among other requirements, neither the target C corporation nor the acquiring C corporation hold life insurance contracts that represent more than 5% of their gross asset value. In the preamble to the 2023 Proposed Regulations, the Treasury Department acknowledged that C corporations are not often used as vehicles for investing in life insurance contracts covering insureds with respect to which the corporation does not have a substantial business, financial, or family relationship at the time the contract is issued. This is due to entity-level income tax that is imposed on corporate earnings, as well as the potential shareholder-level tax on distributions. This aspect of the 2023 Proposed Regulations is therefore intended to provide relief from the reportable policy sale rules that may otherwise apply to certain ordinary course trade or business acquisitions involving C corporations.

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The 2023 Proposed Regulations will generally be applicable to exchanges of life insurance contracts that occur on or after the date that final regulations are published in the Federal Register, although taxpayers may choose to apply certain aspects of the 2023 Proposed Regulations to exchanges covered by Section 1035 of the Code that occur after December 31, 2017.

5. Senate Committee on Finance Investigation Into Private Placement Life Insurance Contracts

As anticipated in last year's *Sidley Global Insurance Review*, the Senate Committee on Finance (the "**Committee**") continued its investigation into a product commonly known as "private placement life insurance" ("**PPLI**"). The Committee is chaired by Senator Ron Wyden (Democrat-Oregon), who on November 30, 2023 introduced draft legislation known as the "Billionaires Income Tax Act." The draft legislation primarily seeks to eliminate deferral by imposing a mark-to-market system of taxation on high-net worth taxpayers (generally, taxpayers that have annual adjusted gross income in excess of US$100 million or assets with an aggregate value of US$1 billion). Of note for the industry, the draft legislation would also (i) require amounts received under a PPLI contract to be included in gross income under Code Section 72(e), (ii) impose a 10% additional tax on taxable distributions from a PPLI contract (similar to the

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The report notes that it is difficult for the IRS to even detect a taxpayer's ownership of a PPLI policy because the insurance company (rather than the policyholder) typically receives the Schedule K-1 or other information reporting forms with respect to an underlying investment. The report raises similar concerns about compliance with the Foreign Account Tax Compliance Act in the case of offshore transactions involving PPLI.

… the current list includes only American Samoa, Anguilla, Antigua and Barbuda, the Bahamas, Belize, Fiji, Guam, Palau, Panama, Russia, Samoa, Seychelles, Trinidad and Tobago, Turks and Caicos Islands, the U.S. Virgin Islands, and Vanuatu.

treatment of "modified endowment contracts"), (iii) repeal the exclusion from gross income for death benefits under a PPLI contract, and (iv) expand the foregoing provisions to apply to annuities for which the holder has made certain representations regarding accredited investor or qualified purchaser status.

The Committee subsequently issued a report on February 21, 2024, summarizing the findings of its investigation into PPLI. Among other notable aspects, the report calls for increased IRS scrutiny of the PPLI industry's compliance with the "investor control doctrine." This doctrine generally requires a policy owner to relinquish control over investment decisions involving the assets supporting a policy; otherwise, the taxpayer (rather than the insurance company) can be treated as the owner of such assets and lose the benefit of deferral or the elimination of tax attributable to income or gains funded by insurance premiums (the so-called "inside buildup"). The report notes that it is difficult for the IRS to even detect a taxpayer's ownership of a PPLI policy because the insurance company (rather than the policyholder) typically receives the Schedule K-1 or other information reporting forms with respect to an underlying investment. The report raises similar concerns about compliance with the Foreign Account Tax Compliance Act in the case of offshore transactions involving PPLI.

The Committee's report calls for legislation to curb the perceived abuses of PPLI products as well, and notes that the Committee is currently working to introduce such legislation. Interestingly, although the report focuses on perceived tax rules specific to life insurance (specifically, the exclusion of death benefits from income), the report indicates the Committee believes that private placement annuities offer a similar opportunity for abuse, although the report does not appear to specify what those might be. The PPLI-specific aspects of the "Billionaires Income Tax Act" described above may provide an indication of any legislation that is yet to come, although the details of any such legislation are uncertain as of the date hereof.

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 17, 2023, such that the current list includes only American Samoa, Anguilla, Antigua and Barbuda, the Bahamas, Belize, Fiji, Guam, Palau, Panama, Russia, Samoa, Seychelles, 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 OECD BEPS minimum standards. Similarly to the EU Blacklist, the greylist was most recently modified on October 17, 2023, such that it now includes 14 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," have been recommended by the EU, and member states were encouraged to implement at least one of these measures by January 1, 2021. These include, for example, the imposition of withholding taxes and the denial of tax deductions on payments made to entities based in blacklisted jurisdictions. 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.

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2. The EU Anti-Tax Avoidance Directives

On January 28, 2016, the EU presented its proposal for an Anti-Tax Avoidance Directive ("**ATAD**"). On May 29, 2017, the EU amended ATAD with Directive (EU) 2017/952 ("**ATAD 2**"). ATAD and ATAD 2 contain various measures that could have an effect on insurance companies. Of particular note to insurance companies are (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. ATAD 3 was originally intended to be implemented during 2023, but this has not yet happened, and it has been proposed that the Directive be stripped back in an effort to reach agreement, with the first phase instead involving only the exchange of information between EU member states regarding minimum substance holding companies.

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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 any proposals related to ATAD 3 If the EU did commit to introducing ATAD 3, it is 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 has substantially progressed its plans to implement the OECD's "Pillar Two" proposals, which set out global minimum tax rules designed to ensure that multinational businesses pay a minimum effective rate of tax of 15% in each jurisdiction in which they operate. The Pillar Two proposals consist of two interlocking domestic rules (known as the GloBE Rules): (1) an Income Inclusion Rule ("**IIR**"), which imposes top-up tax on a parent entity in respect of the low-taxed income of a constituent entity; and (2) an Undertaxed Payment Rule ("**UTPR**"), which denies deductions or requires an equivalent adjustment to the extent the low-taxed income of a constituent entity is not subject to tax under an IIR. On July 11, 2023, the UK enacted legislation introducing the UK IIR ("**multinational top-up tax**") and a domestic minimum top-up tax in line with the OECD rules, with such taxes now applying to multinational enterprises for accounting periods beginning on or after December 31, 2023. The UK has expressed commitment to introducing a UTPR in 2024 for which draft legislation was published in July 2023. The legislation applies to multinational enterprises with global revenues exceeding €750 million in at least two of the previous four years.

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It remains to be seen when and in what form other countries will implement the recommended model GloBE Rules and how businesses will respond and adapt to these rules. The UK multinational top-up tax is now live, which will already require relevant multinationals with UK entities to consider their position carefully.

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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 buy-backs by the AHC.
- Simplification of existing UK anti-hybrid rules.
- Certain exemptions from UK stamp taxes on share buy-backs.

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.

The UK tax authorities have been working closely with stakeholders since the regime came into effect, and a number of clarifications and improvements to the regime have been given effect through 2023 to address practical concerns identified by stakeholders.

The UK tax authorities have been working closely with stakeholders since the regime came into effect, and a number of clarifications and improvements to the regime have been given effect through 2023 to address practical concerns identified by stakeholders. By way of example: (i) it is now confirmed that partnerships which have legal personality (such as Delaware LPs) can fit within the AHC ownership rules; (ii) changes have been made to accommodate the use of parallel feeder partnerships and other common fund structures within the AHC ownership rules; and (iii) the rules which prohibit a qualifying AHC from holding listed equities have been adapted to allow AHCs to elect out of this blunt "all or nothing" prohibition (at the expense of incurring some UK tax on listed equity dividends).

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.

C. IMPACT OF GLOBAL MINIMUM TAX REGIMES

In addition to the UK, EU member states were required to adopt the EU Minimum Tax Directive 2022/2523 by December 31, 2023, for entry into force on January 1, 2024. This remains at varying degrees of implementation by member states. Other countries outside the EU have also announced an intention to implement the recommended model GloBE Rules (including either or both of the IIR or UTPR) as drafted or in modified form.

Bermuda in particular has enacted a new corporate income tax regime in response to the Pillar Two initiative. The implications of this new regime for the insurance industry remain uncertain, both at a domestic level in Bermuda and in terms of how the Bermuda corporate income tax (which does not come into full effect until January 1, 2025) might interact with the UK's multinational top-up tax legislation or other Pillar Two implementing legislation in relevant jurisdictions.

In addition, while the Cayman Islands has not indicated that it will introduce the Pillar Two proposal, the Minister is considering an additional level of reporting for companies to ensure the proposal works as intended.

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/.

V. Global Regulatory and Litigation Developments

Throughout 2023, regulators and industry members around the world navigated ongoing changes with respect to both insurance and non-insurance regulation. State insurance regulators are developing laws and regulations addressing PE ownership of insurers, innovative restructuring mechanisms, cybersecurity, affiliated service contracts, international group supervision and group capital standards, and many other areas. Regulators have also been considering regulations in diverse areas of the industry, including with respect to life insurance, annuities, and mortgage guaranty insurance. The industry and regulators continue to react to the changing social and economic landscape where regulation with respect to climate and resiliency, innovation and technology, and privacy and cybersecurity is developing. Growth in the legalized cannabis business, where the intersection of state and federal regulation is particularly complex, also remains under consideration by the NAIC.

A. U.S. NAIC AND STATE ACTIVITY

1. NAIC Continues Review of PE Ownership in the Insurance Industry

Over the last year, the NAIC's Macroprudential (E) Working Group (the "**Macroprudential Working Group**") has continued to monitor the various workstreams in progress related to the NAIC's review of private equity ("**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**") 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. The List of PE Considerations was developed after the topic of PE ownership in the insurance industry gained attention internationally, as well as at the state and federal levels in the U.S. After the NAIC adopted the List of PE Considerations in August 2022, various NAIC groups received referrals from the Macroprudential Working Group for further assessment. A copy of the List of PE Considerations can be found at https://content.naic.org/sites/default/files/inline-files/Plan for the List of MWG Considerations - PE Related and Other.pdf.

Below is a summary of the status of various working groups' review of the relevant considerations:

- ***Item 1 (Holding Company Structures) and Item 2 (Ownership and Control)***. The Macroprudential Working Group referred Items 1 and 2 to the Group Solvency Issues (E) Working Group, which has formed a drafting group to develop best practices for insurance company acquisition transactions and "control" determinations. The drafting group has met multiple times and continues to work on the development of written best practices. After the best practices are developed, the drafting group will consider whether any such practices should be proposed for inclusion in NAIC handbooks or whether other action should be considered.

In addition to the UK, EU member states were required to adopt the EU Minimum Tax Directive 2022/2523 by December 31, 2023, for entry into force on January 1, 2024. This remains at varying degrees of implementation by member states.

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Throughout 2023, regulators and industry members around the world navigated ongoing changes with respect to both insurance and non-insurance regulation. State insurance regulators are developing laws and regulations addressing PE ownership of insurers, innovative restructuring mechanisms, cybersecurity, affiliated service contracts, international group supervision and group capital standards, and many other areas.

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After the best practices are developed, the drafting group will consider whether any such practices should be proposed for inclusion in NAIC handbooks or whether other action should be considered.

The drafting group also discussed the need for enhancements to the existing guidance to directly address regulatory review and monitoring of investment advisory services provided by an affiliate. The drafting group plans to present proposed revisions for consideration early in 2024.

- ***Item 3 (Investment Management Agreements)***. The Macroprudential Working Group sent a referral to the Risk-Focused Surveillance (E) Working Group (the "**RFS Working Group**") to be considered in connection with the RFS Working Group's existing work involving affiliated agreements and Form D filings. The RFS Working Group agreed to form a drafting group to develop guidance for the NAIC Financial Analysis Handbook and Financial Condition Examiners Handbook (the "**NAIC Handbooks**") regarding affiliated investment management agreements ("**IMAs**"). An affiliated IMA drafting group has been formed and first met in September 2023 to discuss existing guidance in the NAIC Handbooks related to investment advisers and IMAs. The drafting group also discussed the need for enhancements to the existing guidance to directly address regulatory review and monitoring of investment advisory services provided by an affiliate. The drafting group plans to present proposed revisions for consideration early in 2024.

- ***Item 4 (Ownership of Insurers with Short-Term Focus) and Item 10 (Privately Structured Securities)***. The Macroprudential Working Group sent a referral to the RFS Working Group to add this consideration to existing work involving affiliated agreements and fees and to the Life Actuarial (A) Task Force ("**LATF**") in connection with its existing work to ensure that the long-term life liabilities (reserves) and future fees to be paid by insurers are supported by appropriately modeled assets. LATF provided an update that regulators are conducting targeted reviews of the disclosures provided under Actuarial Guideline LIII — Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves ("**AG 53**"), which was adopted in 2022 and became effective for year-end 2022, to ensure that long-term liabilities are appropriately supported and that complex and/or privately structured securities' risks are appropriately modeled.

  AG 53 was adopted in 2022 with the purpose of helping regulators to ensure an insurer's claims-paying ability continues if complex assets held by the insurer do not perform as expected. AG 53 requires annual disclosures and asset-related information for most life insurers. The first submissions were received earlier in 2023 from approximately 246 life insurers.

  Review of the AG 53 disclosures has been conducted by a group formed by the Valuation Analysis (E) Working Group consisting of actuaries, investment experts, and other financial staff. Regulators have been conducting targeted reviews of the disclosures provided under AG 53 to ensure that long-term liabilities are appropriately supported and that complex and/or privately structured securities' risks are appropriately modeled. The review process started with a prioritization of insurers, based on prior knowledge and template information, and insurers with outlier yield assumptions have been identified. The review group has been engaging with regulators on the review of such insurers, with the goal of decreasing the highest net yield assumptions to remove such insurers from the outlier list. The review group will also coordinate a review of investment expense assumptions and reasonability in 2024.

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- ***Item 5 (Operational, Governance, and Market Conduct Practices)***. The Macroprudential Working Group will soon begin considering this item now that the Reinsurance Worksheet to address Item 13 (Offshore/Complex Reinsurance) is complete, as discussed below.

- ***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)***. The Macroprudential Working Group had sent a referral to the Statutory Accounting Principles (E) Working Group (the "**SAP Working Group**") regarding these items, which have been addressed by the SAP Working Group's recent adoption of revisions to SSAP No. 25 — *Affiliates and Other Related Parties* to (i) add coding to identity related party involvement for investment reporting and (ii) clarify that any invested asset held by a reporting entity that is issued by an affiliated entity, or that includes the obligations of an affiliated entity, is an affiliated investment. Additional work on these considerations may be forthcoming, as regulators gain more insights from reviewing statutory financial statements, including the disclosure and accounting clarifications.

The VOS Task Force has had, and will continue to have, discussion and activity around this consideration, and is in the process of submitting questions to the credit rating providers for further review by the VOS Task Force. As those discussions continue, this consideration may expand in scope.

- ***Item 11 (Reliance on Rating Agencies)***. The Macroprudential Working Group sent a referral to the Valuation of Securities (E) Task Force (the "**VOS Task Force**") in connection with the VOS Task Force's ongoing work to address various rating agency considerations. The VOS Task Force has had, and will continue to have, discussion and activity around this consideration, and is in the process of submitting questions to the credit rating providers for further review by the VOS Task Force. As those discussions continue, this consideration may expand in scope.

- ***Item 12 (Pension Risk Transfer ("PRT") Business Supported by Complex Investments)***. The Macroprudential Working Group has sent referrals to LATF and the SAP Working Group, and projects remain underway to address such considerations in respect of LATF's work on VM-22 (Statutory Maximum Valuation Interest Rates for Income Annuities) and to address the risk-based capital ("**RBC**") treatment of PRT business. The Macroprudential Working Group is also monitoring updates by the U.S. Department of Labor ("**DOL**") to the fiduciary requirements under Interpretive Bulletin 95-1, which require due diligence in assessing an insurer prior to a PRT transaction.

- ***Item 13 (Offshore/Complex Reinsurance)***. In August 2023, the Financial Condition (E) Committee adopted the reinsurance comparison worksheet ("**Reinsurance Worksheet**"), which the Macroprudential Working Group and Financial Stability Task Force adopted at an interim meeting held on June 20, 2023. The Reinsurance Worksheet is designed as an optional tool to allow regulators to obtain additional information to understand the economic effects of a reinsurance transaction, either upon initial review of the proposed transaction or when the regulator is performing a historical review of the transaction for some specific purpose. While the Reinsurance Worksheet was designed with affiliated life reinsurance transactions as the initial focus, the template is not fixed and may be altered to be used by regulators for nonaffiliate transactions or property-casualty reinsurance transactions where the regulator requires such information in connection with its review. Completed worksheets will be treated as confidential under state-specific confidentiality laws and regulations.

While the Reinsurance Worksheet was designed with affiliated life reinsurance transactions as the initial focus, the template is not fixed and may be altered to be used by regulators for nonaffiliate transactions or property-casualty reinsurance transactions where the regulator requires such information in connection with its review. Completed worksheets will be treated as confidential under state-specific confidentiality laws and regulations.

2. NAIC Adopts Actuarial Guidelines Related to Life Insurance and Annuities

In March 2023, the NAIC adopted (i) revisions to Actuarial Guideline XLIX-A — The Application of the Life Illustrations Model Regulation to Policies With Index-Based Interest to Policies Sold on or After December 14, 2020 ("**Actuarial Guideline 49-A**") and (ii) Actuarial Guideline LIV — Nonforfeiture Requirements for Index-Linked Variable Annuity Products ("**Actuarial Guideline 54**").

a. Actuarial Guideline 49-A

The NAIC adopted revisions to Actuarial Guideline 49-A during the Joint Meeting of Executive (EX) Committee and Plenary on March 25, 2023. The Life Insurance and Annuities (A) Committee previously adopted the revisions to Actuarial Guideline 49-A on February 24, 2023.

The revisions to Actuarial Guideline 49-A are intended to address regulators' concerns that illustrations prepared in accordance with the Life Insurance Illustrations Model Regulation (#582) produce more favorable results for unbenchmarked indices than for benchmarked indices. In particular, the revisions are intended to address concerns related to illustrations for indexed universal life products with uncapped volatility-controlled funds and a fixed bonus. The revisions to Actuarial Guideline 49-A apply to policies sold on or after May 1, 2023.

The revisions to Actuarial Guideline 49-A are the first step in the NAIC's phased approach to addressing life insurance illustration issues, and the Life Insurance and Annuities (A) Committee has emphasized that it will continue to consider whether to pursue more significant changes to the life insurance illustration regulations.

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b. Actuarial Guideline 54

The NAIC adopted Actuarial Guideline 54 during the Joint Meeting of Executive (EX) Committee and Plenary on March 25, 2023. The Life Insurance and Annuities (A) Committee previously adopted Actuarial Guideline 54 on February 24, 2023. Actuarial Guideline 54 prescribes the 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) ("**Model 805**").

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 may be considered a variable annuity and thereby exempt from Model 805. In particular, a basic principle

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 may be considered a variable annuity and thereby exempt from Model 805.

In December 2023, the NAIC adopted amendments to the Property and Casualty Insurance Guaranty Association Model Act (#540) to address the effect of certain restructuring mechanisms, such as insurance business transfer ("IBT") and corporate division ("CD") transactions, on the availability of guaranty association coverage.

In December 2023, the NAIC also adopted amendments to the Guaranty Association Model Act to address guaranty association coverage for cybersecurity insurance.

of Actuarial Guideline ILVA is that an ILVA must provide for interim values 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 final version of Actuarial Guideline ILVA does not codify alternative methods of determining interim values that industry commenters had suggested, the final 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.

Actuarial Guideline ILVA requires 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).
- Any trading costs represent reasonably expected or actual costs at the time the interim value is calculated.

Actuarial Guideline ILVA will apply to all contracts issued on or after July 1, 2024. For ILVAs issued after this date, if an ILVA does not comply with the principles and requirements of Actuarial Guideline ILVA, such ILVA will not be considered a variable annuity and therefore will be subject to Model 805.

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

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

In December 2023, the NAIC adopted amendments to the Property and Casualty Insurance Guaranty Association Model Act (#540) (the "**Guaranty Association Model Act**") to address the effect of certain restructuring mechanisms, such as insurance business transfer ("**IBT**") and corporate division ("**CD**") transactions, on the availability of guaranty association coverage.

As adopted, the amendments provide that guaranty fund coverage for policyholders subject to IBTs and CDs will be preserved if such coverage existed before an IBT or CD transaction. The amendments, which were initially adopted by an NAIC working group in July 2023, also include technical corrections to ensure that assumed claims (i.e., claims related to obligations assumed by the insolvent insurer — such as via an assumption reinsurance transaction — notwithstanding that the original insurer was not a member insurer) would continue to fall within the definition of claims afforded guaranty association coverage.

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

In December 2023, the NAIC also adopted amendments to the Guaranty Association Model Act to address guaranty association coverage for cybersecurity insurance. The amendments, which had been in development since late 2022 in response to the migration of cybersecurity insurance coverage into the admitted market, 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.

4. NAIC Adopts Amendments to Mortgage Guaranty Insurance Model Act

At the 2023 Summer National Meeting, the NAIC adopted amendments to the Mortgage Guaranty Insurance Model Act (#630) ("**MGI Model Act**"). The amendments were adopted by the Mortgage Guaranty Insurance (E) Working Group ("**MGI Working Group**") prior to the Summer Meeting.

At the 2023 Summer National Meeting, the NAIC adopted amendments to the Mortgage Guaranty Insurance Model Act (#630) …

As adopted, the amendments to the MGI Model Act include (among other changes) updated capital and surplus requirements and new sections on risk concentration, reinsurance, sound underwriting practices, quality assurance, rescission, and records retention.

The amendments to the MGI Model Act also authorize the amount of the required contingency reserve to be calculated net of contingency reserves maintained by reinsurers. The specific provision is "The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve." Although industry raised concerns regarding this language because many reinsurers do not complete statutory financial statements in which they would record contingency reserves, the MGI Working Group ultimately decided not to revise the language to reference ways in which the reinsurer may satisfy the requirement (e.g., by maintaining separately held collateral in a trust or segregated account to support the reinsurer's obligation).

As adopted, the amendments to the MGI Model Act also omit a section that was included in a prior version, which would have prohibited a private right of action to enforce compliance with the MGI Model Act. The MGI Working Group removed that provision after criticism from consumer groups. As a result, the amendments to the MGI Model Act, as adopted, are silent as to whether a private right of action exists.

5. NAIC Adopts Guidance to Regulators Related to Reviewing the Fairness and Reasonableness of Affiliated Services Contracts

In 2023, the NAIC adopted revisions to the NAIC's Financial Analysis Handbook and the Financial Condition Examiners Handbook that are intended to provide guidance to regulators in reviewing the fairness and reasonableness of affiliated service contracts, and to incorporate the 2021 revisions to the NAIC's Insurance Holding Company System Regulatory Act (related to continuity of affiliate services during a receivership).

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As revised, the handbooks include guidance related to reviewing the fairness and reasonableness of agreements that provide for services to be provided at cost or at market value. The revisions also include guidance for reviewing "cost-plus" arrangements in cases where the services provided by an affiliate are not directly comparable to services available in the open market. In these situations, the updated guidance provides that it is the responsibility of management to justify the use of a "cost-plus" approach and to provide adequate supporting rationale and documentation demonstrating its analysis supporting the profit margin selected under the approach. The guidance cautions regulators to review transactions at "cost-plus" carefully to ensure that they meet the "fair and reasonable" standard.

The revisions were initially proposed by the Risk-Focused Surveillance (E) Working Group in March 2023. After an initial comment period, during which interested parties provided input on the tools and benchmarks available for regulators to assess whether "cost-plus" arrangements are fair and reasonable, the working group referred the updated guidance to the Financial Analysis Solvency Tools (E) Working Group and the Financial Condition Examiners (E) Handbook Technical Group for consideration. The revisions to the Financial Conduction Examiners Handbook and the Financial Analysis Handbook were ultimately adopted in August and October 2023, respectively.

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6. NAIC Adopts Updated Cannabis Insurance White Paper

In August 2023, the NAIC adopted the Understanding the Market for Cannabis Insurance: 2023 Update white paper (the "**Cannabis Insurance White Paper**"). The Cannabis Insurance White Paper provides an update on activities and trends with respect to insurance coverage for the cannabis industry since the adoption in 2019 of the prior NAIC white paper, Understanding the Market for Cannabis Insurance.

The Cannabis Insurance White Paper focuses on issues affecting affordability and availability of insurance for cannabis-related risks in states that have legalized its use. The Cannabis Insurance White Paper finds that although capacity has improved since the 2019 version of the white paper, most commercial insurance for cannabis-related businesses is still found in the nonadmitted market. According to the Cannabis Insurance White Paper, insurance gaps are most prevalent in the emerging areas of the cannabis industry, such as ancillary services, cannabis-infused products, and social consumption lounges. The Cannabis Insurance White Paper finds that the potential structures being explored to facilitate cannabis-related business coverage include the use of state-based commercial insurance programs, risk retention groups, captives, and joint underwriting associations.

7. NAIC Adopts Accreditation Standard for 2020 Holding Company Act Revisions

In December 2023, the NAIC Executive (EX) Committee and Plenary adopted the 2020 revisions to the Insurance Holding Company System Regulatory Act (#440) and Insurance Holding Company System Model Regulation (#450) …

In December 2023, the NAIC Executive (EX) Committee and Plenary adopted the 2020 revisions to the Insurance Holding Company System Regulatory Act (#440) (the "**Holding Company Model Act**") and Insurance Holding Company System Model Regulation (#450) (the "**Holding Company Model Regulation**") as an update to the Financial Regulation Standards (the "**Accreditation Standards**") effective January 1, 2026.

In December 2020, the NAIC adopted revisions to the Holding Company Model Act and Holding Company Model Regulation to implement (i) the group capital calculation ("**GCC**") for the purpose of group solvency supervision for U.S. insurance groups and (ii) the liquidity stress test ("**LST**") for macroprudential surveillance of certain large life insurance companies that meet the in-scope criteria outlined in the Holding Company Model Act. The GCC is intended to comply with the requirements under the bilateral agreements between the U.S. and the EU and between the U.S. and the UK ("**Covered Agreements**"), which require that states have a "worldwide group capital calculation" in place, with the initial deadline of November 7, 2022, or otherwise be subject to the imposition of Solvency II requirements by such group's supervisors in the EU or UK.

The NAIC previously exposed, for a one-year public comment period that ended on December 31, 2022, the significant elements of the December 2020 revisions to the Holding Company Model Act that states would be required to adopt in order to maintain their NAIC accreditation. While the December 2020 revisions require that a group file an initial GCC before it may seek an exemption from further filings, the significant elements for the Accreditation Standard were modified to allow state regulators to grant exemptions to groups meeting the qualifications set forth in the Holding Company Model Regulation without the requirement to file a GCC at least once.

The effective date for the Accreditation Standard is January 1, 2026; however, to date, approximately 27 states have adopted the December 2020 revisions to the Holding Company Model Act, and approximately 15 states have adopted the revisions to the Holding Company Model Regulation …

The effective date for the Accreditation Standard is January 1, 2026; however, to date, approximately 27 states have adopted the December 2020 revisions to the Holding Company Model Act, and approximately 15 states have adopted the revisions to the Holding Company Model Regulation, as the NAIC previously encouraged all states with a group affected by the Covered Agreements with the EU and UK to adopt the GCC revisions to the Holding Company Model Act and Holding Company Model Regulation (prior to the November 7, 2022 deadline under the Covered Agreements) and all states with a group affected by the LST to adopt the relevant revisions to the Holding Company Model Act as soon as possible.

8. 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 International Association of Insurance Supervisors ("**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 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.

On June 23, 2023, the IAIS released a public consultation on a "candidate" version of the ICS to solicit feedback from stakeholders on the global ICS ahead of its adoption as a group PCR for internationally active insurance groups at year-end 2024. To help provide more detailed information about the AM, the U.S. IAIS members committed to producing a document describing a provisional AM ("**Provisional AM**") that is being used in the comparability assessment before the process begins. Industry members were asked to provide any feedback to the Provisional AM document, before a final version of the document was provided to the IAIS in September 2023. A decision on whether the AM provides comparable outcomes to the ICS is expected in the third quarter of 2024.

On June 23, 2023, the IAIS released a public consultation on a "candidate" version of the ICS to solicit feedback from stakeholders on the global ICS ahead of its adoption as a group PCR for internationally active insurance groups at year-end 2024.

b. IAIS Reviews Systemic Risk in the Insurance Sector

On December 9, 2022, the Financial Stability Board (the "**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.

The global monitoring exercise ("**GME**") includes individual insurer monitoring ("**IIM**") and sectorwide monitoring ("**SWM**"), and the data collections from the IIM and SWM will help determine the scope for an annual collective discussion by the IAIS on potential systemic risk issues. Key themes identified for 2023 include (i) risks faced by insurers in light of the challenging macroeconomic backdrop, notably interest rate, liquidity, and credit risk; (ii) structural shifts in the life insurance sector, specifically the use of cross-border asset-intensive reinsurance; and (iii) the increased allocation of capital to alternative assets.

The IAIS has also released its first public consultation regarding climate risk and governance, which outlined proposed changes to the IAIS' Insurance Core Principles to position climate risk within the global framework for insurance supervision and sought feedback on whether changes were also needed related to governance, risk management, and internal controls. In November 2023, the IAIS published draft application paper materials on both climate-related market conduct considerations and climate scenario analysis.

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9. NAIC Takes Action Regarding Various Investment Monitoring Activities

a. NAIC Reviews Collateralized Loan Obligations

In February 2023, the VOS Task Force adopted an amendment to the Purposes and Procedures Manual (the "**P&P Manual**") to add instructions for the financial modeling of collateralized loan obligations ("**CLOs**"). Specifically, the P&P Manual amendment makes CLOs ineligible to use credit rating provider ("**CRP**") ratings to determine an NAIC designation if the NAIC's Structured Securities Group (the "**SSG**") can model the security. The P&P Manual amendment was introduced after the NAIC's Investment Analysis Office ("**IAO**") identified that CLOs had inconsistently assigned NAIC designations when relying on CRP ratings, and had recommended this change to the VOS Task Force to ensure reporting equivalency for NAIC regulatory purposes. The amendment became effective January 1, 2024, with insurers first reporting the financially modeled NAIC designations for CLOs with their year-end 2024 financial statement filings.

In February 2023, the VOS Task Force adopted an amendment to the Purposes and Procedures Manual to add instructions for the financial modeling of collateralized loan obligations …

After the adoption of the amendment to the P&P Manual, to ensure transparency, the SSG asked the VOS Task Force to form an ad hoc group to model CLO deals. The ad hoc group began its work in the spring of 2023 and while its work was only expected to last a couple of months, it is currently expected to take until 2025 to complete. As of December 2023, the ad hoc group had proposed 10 scenarios. Detail on these scenarios has been posted on the CLO web page. The VOS Task Force will be informed at the 2024 Spring National Meeting if the ad hoc group will need additional time to complete its work, in which case an amendment to the P&P Manual to replace the January 1, 2024 effective date with a January 1, 2025 effective date will be submitted for the VOS Task Force's consideration at the NAIC's 2024 Summer National Meeting.

In addition, related to the CLO modeling project, the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (the "**Investment RBC Working Group**") has been working to update the RBC C-1 factors for CLOs. An informational referral had been sent 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 C-1 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. In December 2022, 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 IAO 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.

In August 2023, during a Joint Meeting of Executive (EX) Committee and Plenary, the NAIC adopted an interim solution to address residual tranches, which was developed by the Investment RBC Working Group.

In August 2023, during a Joint Meeting of Executive (EX) Committee and Plenary, the NAIC adopted an interim solution to address residual tranches, which was developed by the Investment RBC Working Group. As adopted under the interim solution to address residual tranches, for reporting as of year-end 2023, the residual tranche base factor will be 30%, with a 15% sensitivity test factor. For reporting as of year-end 2024, the residual tranche base factor will increase to 45%, although the Investment RBC Working Group has agreed to hear additional information from industry that could support a factor other than 45% prior to that factor's taking effect. For reporting as of year-end 2024, the sensitivity test factor would be reduced to 0%, although that may also be adjusted if the residual tranche base factor is set at an amount other than 45%. The interim solution will apply to all residual tranches, not just CLOs. As adopted, the factors are consistent with the compromise approach proposed in the June 9, 2023, comment letter submitted by the Texas Department of Insurance. Texas explained that the proposal is intended to address concern that changing the charge for year-end 2023 reporting may be too disruptive and may cause companies to divest assets at depressed prices, resulting in adverse impacts to surplus.

The Academy intends to develop a model specification document that takes a *de novo* look at how to model CLOs for RBC purposes. The Investment RBC Working Group acknowledged this is a large project, thus updating the C-1 factors for CLOs will be a longer-term project.

In August 2023, the Investment RBC Working Group heard a presentation from the Academy regarding principles for structured securities RBC.

In August 2023, the Investment RBC Working Group heard a presentation from the Academy regarding principles for structured securities RBC. In the presentation, the Academy proposed a flowchart to determine whether (i) an asset class needs to be modeled and (ii) whether securities within an asset class need to be modeled individually to determine C-1 factors.

With respect to C-1 asset modeling, the Academy emphasized its preference for simpler solutions, meaning that if an existing factor can be used, it should be used, and that individual security modeling for C-1 determination should be a last resort. If the result of following the flowchart is that an asset class requires modeling, then the Academy supports a principles-based approach to the derivation of C-1 factors. In December 2023, the Investment RBC Working Group and the Academy agreed upon seven principles for the development of an RBC methodology for CLOs:

- Principle #1 (The RBC formula is a blunt filtering tool). "The purpose of RBC is to help regulators identify potentially weakly capitalized insurers, therefore changes that have a small impact on RBC ratios may not justify a change to the RBC formula."
- Principle #2 (Emerging risks require regulatory scrutiny). "Emerging investment risks create concerns for regulators, and existing regulatory tools can be considered alongside RBC for addressing these newer risks — but RBC needs to be considered when there are material solvency issues."
- Principle #3 (RBC is based on statutory accounting). "C-1 requirements should generally reflect the impact of risk on statutory surplus. Changes in accounting treatment will affect RBC."
- Principle #4 (C-1 aligns with risk). "C-1 requirements for a given tranche should align with that tranche's risk, to the extent practical."

- Principle #5 (C-1 requirements reflect likely future trading activity). "C-1 requirements on asset backed securities ("**ABS**") should treat the collateral as a dynamic pool of assets, incorporating future trading activities that are reasonable and vary appropriately by economic scenario."

- Principle #6 (Appropriate risk measures). "Each C-1 factor is based on the asset class's risk profile. However, the risk profile for ABS differs from the risk profile for bonds. Therefore, C-1 requirements for ABS should be calibrated to different risk measures where appropriate."

b. NAIC Designations and Filing Exempt Process

In March 2023, the VOS Task Force exposed a proposed amendment to the P&P Manual that would remove a new category of investment, defined as "Structured Equity and Funds," from the filing exempt ("**FE**") process, based on review by the NAIC's Securities Valuation Office ("**SVO**") of private letter rating rationale reports. As part of that review, the VOS Task Force noted that when the SVO finds a significant potential issue with the CRP rating for an investment, the SVO should bring that issue to the VOS Task Force, along with a proposed solution, which may include a change to the NAIC Designation.

In March 2023, the VOS Task Force exposed a proposed amendment to the P&P Manual that would remove a new category of investment, defined as "Structured Equity and Funds," from the filing exempt ("FE") process, based on review by the NAIC's Securities Valuation Office ("SVO") of private letter rating rationale reports.

In response to industry comments to that exposure, the VOS Task Force directed NAIC staff to draft a distinct process for the SVO's challenge of an NAIC Designation assigned from a CRP rating in the FE process that the SVO believes does not represent a reasonable assessment of risk for regulatory purposes. The proposed amendment to the P&P Manual outlining this process was initially exposed in May 2023.

The process, as initially proposed, would permit either a state insurance regulator (subject to confirmation by the SVO) or the SVO itself to identify any FE-eligible security for which a determination has been made that the NAIC Designation equivalent is not a reasonable assessment of risk of the security for regulatory purposes. The process includes a materiality threshold wherein the difference between the CRP rating used in the FE process and the SVO's own assessment of the risk must be three or more notches different than the SVO's assessment based on the SVO's review (e.g., NAIC Designation Category 1.G versus 2.C). Once a security has been identified as being subject to the SVO's analytical review, the SVO will have 120 days to make a final determination, during which time the insurer will have the option to submit an appeal. Following this 120-day notice period and optional appeal by the insurer, the CRP rating or the security's filing exemption eligibility could be maintained or revoked. If revoked, the insurer would then have the option of filing the security with the SVO for assignment of an NAIC Designation. An insurer can appeal revocation in subsequent filing years.

Several members of the U.S. House of Representatives submitted a joint letter dated July 13, 2023, to the NAIC noting that the proposed amendment has the potential to provide RBC uncertainty for all FE investments held by U.S. insurance companies, creating liquidity and market disruption, and urging the NAIC to withdraw the proposed changes to the P&P Manual. In a July 25, 2023 response letter, the NAIC stated that it believes the process "is an appropriate approach to ensure that insurers are holding sufficient capital based on the risk they are taking with their investments," noting that the materiality thresholds included in the proposal "ensure that challenging a CRP will only commence when a significant red flag occurs, and even then, the notice and appeal process ensures fair treatment for all parties."

Several members of the U.S. House of Representatives submitted a joint letter dated July 13, 2023, to the NAIC noting that the proposed amendment has the potential to provide RBC uncertainty for all FE investments held by U.S. insurance companies, creating liquidity and market disruption, and urging the NAIC to withdraw the proposed changes to the P&P Manual.

Both the NAIC in its response letter and the VOS Task Force have stated that the SVO does not have any intention of challenging the methodologies or opinions of CRPs or disrupting the important role they play in public markets, but do not feel obligated to defer to them without judgment or exception as the *de facto* driver of the NAIC's RBC framework.

In August 2023, the VOS Task Force heard comments from industry members to the proposed amendment, which (i) requested clarity as to whether the SVO's review may be focused on a specific security or an entire class of securities; (ii) requested the opportunity for additional time in the process for insurers to provide information, as the SVO would be making its decision based on incomplete information; and (iii) reiterated concerns regarding the uncertainty the process could impose on insurers and the financial markets.

In August 2023, the VOS Task Force heard comments from industry members to the proposed amendment …

In response to those comments, in December 2023, the VOS Task Force exposed a revised version of the amendment that implemented the actionable comments received from VOS Task Force members and interested parties.

In response to those comments, in December 2023, the VOS Task Force exposed a revised version of the amendment that implemented the actionable comments received from VOS Task Force members and interested parties.

In August 2023, the (E) Committee exposed a draft Framework for Insurer Investment Regulation that highlights areas that regulators have identified where the insurance regulatory framework for investments could be enhanced based on the NAIC's past several years of work, as well as various proposals for the modernization of the role and capabilities of the SVO …

The following is a summary of those revisions, in relevant part:

- When an SVO staff member identifies an FE security for review, the SVO will convene the Senior Credit Committee to meet and determine whether it agrees that the rating appears to be an unreasonable assessment of risk and, if so, place the security under review.

- If the security is placed under review, an information request will be sent to the insurer(s) holding such security to request additional information. Upon receipt of such additional information, the SVO would perform a full analysis of the security and coordinate with the insurer(s) on any questions or issues.

- Following the completion of the analysis, the SVO Senior Credit Committee will reconvene and determine whether, based on the full analysis, the NAIC designation from the FE process is three or more notches different than the committee's opinion. If so, the security will be removed from FE. The Senior Credit Committee will present its analysis to a subgroup of the VOS Task Force to provide oversight of the FE removal process and to enable the VOS Task Force to provide feedback to the SVO.

- An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency. In addition, the SVO Director will summarize FE discretion actions taken during the preceding year at every NAIC Spring National Meeting.

- An insurer may appeal to the VOS Task Force chair if they believe the SVO did not follow the procedures set forth in the P&P Manual.

- The insurer will also have the right to appeal the SVO's determination, through an assessment by an independent third party who may conduct a blind review of the security (i.e., without knowledge of the SVO or CRP assessment) with the information provided through the information request process. If the independent third party determines that the NAIC designation is one or fewer notches different than the FE NAIC designation, the SVO's opinion will be overridden by the reinstatement of the CRP's rating(s). If the independent third party determines that the NAIC designation is more than one notch different than the FE NAIC designation, the SVO's decision will remain.

VOS Task Force Chair Carrie Mears (IA) reiterated that these changes align with the charges given to the task force by the Financial Condition (E) Committee ("**(E) Committee**") to identify improvements to the use of CRP ratings in the FE process to ensure greater consistency, uniformity, and appropriateness; implement policies to oversee the NAIC staff's administration of rating agency ratings; and establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process.

The VOS Task Force exposed these revisions until January 26, 2024. The SVO is currently recommending adoption of the proposed amendment effective January 1, 2025, which may be delayed if needed for full implementation within certain NAIC applications.

c. NAIC Develops Holistic Framework for Insurer Investments

In August 2023, the (E) Committee exposed a draft Framework for Insurer Investment Regulation ("**Investment Framework**") that highlights areas that regulators have identified where the insurance regulatory framework for investments could be enhanced based on the NAIC's past several years of work, as well as various proposals for the modernization of the role and capabilities of the SVO, including implementing a strong due diligence framework on the use of CRP ratings, increasing staffing of the SVO to enhance the SVO's portfolio risk analysis capabilities and structured asset modeling capabilities, and building out a broad advisory function at the SVO.

Superintendent Beth Dwyer (RI), Chair of the (E) Committee, stated that the purpose of the Investment Framework is to provide a holistic overview of the work being undertaken by various working groups and task forces at the NAIC related to insurer investments, including (i) the Investment RBC Working Group updates to the life RBC formula; (ii) VOS Task Force's amendment to the P&P Manual to authorize the SSG to model CLOs; and (iii) the VOS Task Force project for the SVO's review of FE securities, and clarify that this work is under the purview of the state insurance regulators that comprise the (E) Committee.

Carrie Mears (IA), Chair of the VOS Task Force, noted that the framework provides a future vision of what centralized investment expertise is available to U.S. regulators, although many of the proposed initiatives would be costly and take time to implement.

In response to the initial exposure of the Investment Framework, the (E) Committee received 16 comment letters. While many of the commenters agreed that reform is necessary for how investment risk is evaluated, many comment letters raised concerns regarding discretion provided to the SVO without appropriate transparency and due process. Commenters noted that while regulators have been appropriately focused on reducing the industry's "blind reliance" on CRP ratings, the use of CRP ratings should continue, with proper oversight to ensure that resources of the SVO are best utilized.

In response to the initial exposure of the Investment Framework, the (E) Committee received 16 comment letters.

The Investment Framework also sets a goal to create a consistent approach in calculating C-1 capital across a diverse set of asset classes and structures. Many comment letters were supportive of this goal but raised concerns with the consistency of undertaking this review of the Investment Framework in light of various ongoing related projects at the NAIC. Commenters called for the (E) Committee to reevaluate the timelines for certain of these projects and in particular called for the delay of the modeling of collateralized loan obligations and to generally revisit the role of existing working groups, task forces, and ad hoc groups currently engaged on related issues to determine how to facilitate an overarching workstream.

One comment letter noted that the Investment Framework should supplement RBC C-1 capital charges with concentration factors and included a recommendation that the NAIC adopt a system of concentration factors to distinguish among asset-backed security collateral types. Earlier this year, the Risk Evaluation Ad Hoc Group established three Ad Hoc Subgroups to focus on different risk assessments, including an Asset Concentration Ad Hoc Subgroup. The Asset Concentration Ad Hoc Subgroup has been meeting regularly to discuss the concepts of asset concentrations, brainstorm issues related to asset concentrations, and review whether there is adequate data at the NAIC for potential asset concentration considerations. The subgroup members have been tasked with reviewing the inventory further and providing feedback during the next meeting and are also developing a decision tree to help deliberate whether RBC is the right solution for any asset concentration risk identified.

While the (E) Committee members did not discuss the comment letters during the NAIC's Fall 2023 National Meeting, Superintendent Dwyer stated that an update from the (E) Committee on this project could be expected sometime in January 2024.

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10. NAIC Revisions to Statements of Statutory Accounting Principles

a. Bond Project

In August 2023, the SAP Working Group adopted revisions to SSAP No. 26R — *Bonds*, SSAP No. 43R — *Loan-Backed and Structured Securities* and other SSAPs related to the SAP Working Group's principles-based bond definition project (the "**Bond Project**"). These revisions are scheduled to become effective January 1, 2025.

In August 2023, the SAP Working Group adopted revisions to SSAP No. 26R – Bonds, SSAP No. 43R – Loan-Backed and Structured Securities *and other SSAPs related to the SAP Working Group's principles-based bond definition project ...*

The adoption of these revisions marks a significant milestone in the SAP Working Group's Bond Project, which began 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 capital through debt backed by financial assets. The revisions to SSAP No. 26R reflect the principle-based bond definition, and SSAP No. 43R provides revised accounting and reporting guidance for investments that qualify as asset-backed securities under the revised bond definition.

The NAIC has also developed a statutory issue paper entitled "Principles-Based Bond Definition" that details the discussions and directions in developing the bond definition and resulting guidance. NAIC staff will continue to update the issue paper consistent with ongoing discussions on other SSAP revisions related to the Bond Project.

While the SAP Working Group is in the process of finalizing its proposed changes to the SSAPs, it is currently expected that the Bond Project will not be completed and effective until January 2025, once all related workstreams are completed. 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.

b. Interest Maintenance Reserve Guidance

In August 2023, the SAP Working Group adopted INT 23-01T – Net Negative (Disallowed) Interest Maintenance Reserve, an interpretation of statutory accounting principles that provides optional, limited-term guidance for the admittance of net negative (disallowed) interest maintenance reserve ("IMR") under SSAP No. 7 for up to 10% of adjusted general account capital and surplus.

In August 2023, the SAP Working Group adopted INT 23-01T — Net Negative (Disallowed) Interest Maintenance Reserve, an interpretation of statutory accounting principles that provides optional, limited-term guidance for the admittance of net negative (disallowed) interest maintenance reserve ("**IMR**") under SSAP No. 7 for up to 10% of adjusted general account capital and surplus.

The SAP Working Group first discussed the treatment of negative IMR in December 2022, following the receipt by the SAP Working Group of a letter from the American Council of Life Insurers ("**ACLI**") raising concerns regarding negative IMR. The ACLI's letter was sent in connection with discussions among the 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 balance is a nonadmitted asset.

The current statutory accounting guidance regarding IMR is limited, but generally provides that a negative IMR balance 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's letter argued that such treatment is contrary to the original intent of IMR, which recognized that 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 under statutory accounting in order to fulfill its original purpose.

As adopted, an insurer's capital and surplus must first be adjusted to exclude certain "soft assets" including net positive goodwill, electronic data processing equipment and operating system software, net deferred tax assets, and admitted net negative (disallowed) IMR. An insurer will only be permitted to admit the negative IMR if the insurer's RBC is over 300% authorized control level after adjustment to remove the assets described above.

Negative IMR may be admitted first in the insurer's general account and then, if all disallowed IMR in the general account is admitted and the percentage limit is not reached, to a separate account proportionately between insulated and non-insulated accounts. There is no exclusion for derivatives losses included in negative IMR if the insurer can demonstrate historical practice in which realized gains from derivatives were also reversed to IMR (as liabilities) and amortized.

INT 23-01T is effective through December 31, 2025, but may be nullified earlier or extended based on actions by the SAP Working Group to establish specific accounting guidance on net negative (disallowed) IMR to serve as a long-term solution.

INT 23-01T is effective through December 31, 2025, but may be nullified earlier or extended based on actions by the SAP Working Group to establish specific accounting guidance on net negative (disallowed) IMR to serve as a long-term solution.

In December 2023, the SAP Working Group began that process to establish a long-term project to capture accounting guidance for asset valuation reserve ("**AVR**") and IMR in SSAP No. 7.

Historically, SSAP No. 7 included a brief overview of AVR and IMR with the calculation and reporting guidance determined as directed by individual SSAPs or in accordance with the annual statement instructions. The new agenda item is intended to ensure accounting concepts are within the SSAPs and address disconnects with current guidance.

It is anticipated that this project will take time, particularly with the assessment of admittance and nonadmittance for negative IMR as a long-term concept, and interim revisions will be proposed to ensure progress to address potential areas where credit losses may be reported as IMR.

The movement of the accounting guidance to SSAP No. 7, and any revisions from the annual statement instructions incorporating the guidance, will be captured as a new SAP concept and therefore a corresponding issue paper will be drafted to detail the revisions.

c. Affiliated Investments

In March 2023, the SAP Working Group adopted revisions to SSAP No. 25 — *Affiliates and Other Related Parties* that clarify that any invested asset held by a reporting entity, that is issued by an affiliated entity, or that includes the obligations of an affiliated entity should be treated as an affiliated investment.

In March 2023, the SAP Working Group adopted revisions to SSAP No. 25 – Affiliates and Other Related Parties *that clarify that any invested asset held by a reporting entity, that is issued by an affiliated entity, or that includes the obligations of an affiliated entity should be treated as an affiliated investment.*

In May 2022, the SAP Working Group adopted revisions to SSAP No. 25 that clarified the reporting of affiliate transactions and incorporated new disclosure requirements for investments acquired through, or in, related parties, regardless of whether they meet the "affiliate" definition under the Holding Company Model Act. 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.

The adopted amendments to SSAP No. 25 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, under the amendment, SSAP No. 25 was 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."

d. Collateral Loans

In October 2023, the SAP Working Group adopted revisions to SSAP 20 — *Nonadmitted Assets* and SSAP No. 21R — *Other Admitted Assets* which clarify the treatment of collateral loans as admitted assets.

In October 2023, the SAP Working Group adopted revisions to SSAP 20 – Nonadmitted Assets *and SSAP No. 21R –* Other Admitted Assets *which clarify the treatment of collateral loans as admitted assets.*

The SAP Working Group initially exposed revisions to SSAP No. 21R in December 2022 to clarify that invested assets pledged as collateral for admitted collateral loans must themselves qualify as admitted invested assets. If the collateral loan exceeds the fair value of its collateral assets, the excess amount must be treated as a nonadmitted asset. When the collateral pledged to secure a collateral loan would be in the scope of SSAP No. 48 — *Joint Ventures, Partnerships, and Limited Liability Companies* and SSAP No. 97 — *Investments in Subsidiary, Controlled, and Affiliated Entities*, if held directly by the reporting entity, such as a joint venture, partnership, or limited liability company or a subsidiary controlled or affiliated entity, audited financial statements are required for the collateral (and thus the collateral loan) to qualify as an admitted asset. To support the admissibility of collateral loans, reporting entities must maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

In December 2023, the SAP Working Group also exposed revisions to SSAP No. 21R and the definitions for the annual statement reporting categories of SSAP No. 48 and residual interests on Schedule BA. These revisions were exposed for a shortened comment period until January 22, 2024. The revisions to SSAP No. 21R are intended to expand the transparency of reporting for collateral loans on Schedule BA to enable state insurance regulators to quickly identify the type of collateral that supports admittance of collateral loans. The revisions are also intended to further define for consistency purposes the investments captured as nonregistered private funds, joint ventures, partnerships, or limited liability companies, or residual interests, which are to be reported based on the underlying characteristics of assets.

In December 2023, the SAP Working Group also exposed revisions to SSAP No. 21R and the definitions for the annual statement reporting categories of SSAP No. 48 and residual interests on Schedule BA.

The proposed revisions to SSAP No. 21R would expand reporting for collateral loans on Schedule BA in response to comments that the current reporting detail on Schedule BA does not provide sufficient clarity on the type of collateral used in support of admittance of collateral loans. These changes would also be consistent with the NAIC's recent adoption of changes to SSAP No. 20 and SSAP No. 21R described above. The proposed disclosure requirement under SSAP No. 21R would separate collateral loans by the type of collateral investment that secures the loan.

The SAP Working Group also exposed updates to incorporate more detailed definitions for the annual statement reporting categories of SSAP No. 48 and Schedule BA.

The SAP Working Group also exposed updates to incorporate more detailed definitions for the annual statement reporting categories of SSAP No. 48 and Schedule BA. Such investments are reported on designated lines identified by the reporting entity's classification as to the underlying asset characteristics, which include bonds/fixed-income instruments, common stocks, real estate, mortgage loans, and other. Following recent discussions on residual tranches, the NAIC identified that variations exist across industry on the types of investments that should be captured within each of these categories. The proposed revisions are intended to improve consistency in reporting for both ease of industry classifications and for regulator assessment of the type and volume of investment types. The proposed revisions will be used to support a blanks annual statement instruction change, but will not result in statutory accounting revisions.

e. Investments Permitted to Be Reported as Cash Equivalent and Short-Term Reporting

In December 2023, the SAP Working Group adopted revisions to SSAP No. 2R – Cash, Cash Equivalents, Drafts, and Short-Term Investments *that will further restrict the investments permitted for cash equivalent and short-term reporting. These revisions will become effective on January 1, 2025.*

In December 2023, the SAP Working Group adopted revisions to SSAP No. 2R — *Cash, Cash Equivalents, Drafts, and Short-Term Investments* that will further restrict the investments permitted for cash equivalent and short-term reporting. These revisions will become effective on January 1, 2025.

The revisions were drafted in response to concerns regarding certain types of investments, particularly collateral loans or other Schedule BA items, which are viewed as being designed specifically to meet the parameters for short-term reporting; in particular, concerns regarding reporting entities that were effectively ending short-term collateral loan investments, only to reissue those collateral loans from other lenders in the same group to qualify as short-term for reporting on Schedule BA.

The intent of the change is to retain the guidance in SSAP No. 2R that prevents cash equivalent or short-term reporting for related party investments if the reporting entity does not reasonably expect to terminate the investment, the original maturity time has passed, and the reporting entity reacquired a substantially similar investment. This change to SSAP No. 2R, combined with the prior revisions to SSAP No. 2R to exclude certain rolling short-term investments, is intended to effectively eliminate investments (other than money market mutual funds and cash pooling arrangements) from being reported as cash equivalents or short-term investments unless they would qualify under SSAP No. 26R as an issuer credit obligation. The revisions exclude all Schedule BA investments and mortgage loans.

11. NAIC and States Prioritize Climate and Resiliency Issues

a. National Climate Resilience Strategy for Insurance

In December 2023, the Climate and Resiliency (EX) Task Force adopted the National Climate Resilience Strategy for Insurance ("Climate Strategy"), a strategy document intended to show how insurance regulators are collaborating to strengthen climate resilience.

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Pursuant to the Climate Strategy, the NAIC intends to prioritize predisaster mitigation and will take new steps on data collection and solvency tools. The Climate Strategy focuses on five primary regulatory actions: (i) closing protection gaps; (ii) creating a blueprint for the future of flood insurance; (iii) filling long-term insurance data gaps to improve understanding of how coverages are changing within and among jurisdictions; (iv) creating and coordinating new resilience tools to assist all state regulators; and (v) expanding insurance regulators' leadership on new solvency tools.

The Climate Strategy remains subject to further edits before adoption by the Executive (EX) Committee.

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b. Property Insurance Data Call

The Property and Casualty Insurance (C) Committee ("(C) Committee") is in the process of developing a state insurance regulator data call to collect insurer data to better assess homeowners insurance markets.

The Property and Casualty Insurance (C) Committee ("**(C) Committee**") is in the process of developing a state insurance regulator data call to collect insurer data to better assess homeowners insurance markets. The project was initially announced in August 2023, when the (C) Committee formed a drafting group in furtherance of its charge to "[a]ssist state insurance regulators in better assessing their markets and insurer underwriting practices by developing property market data intelligence so regulators can better understand how markets are performing in their states, and identify potential new coverage gaps, including changes in deductibles and coverage types, and affordability and availability issues."

The NAIC has been monitoring dynamics that are making property insurance availability and affordability more challenging for a growing number of regions across the country, including increasing frequency and severity of weather events, rising reinsurance costs, and inflationary pressures. The data call is intended to allow insurance regulators to understand the impact of these forces on insurers' solvency and investments and to assess the strength and resilience of the industry.

Once it is determined which states will participate in the data call, a letter is expected to be sent to requested insurers. The (C) Committee expects that the top 80% of national homeowners insurers will be included.

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

a. NAIC Adopts Model Bulletin Regarding the Use of Artificial Intelligence by the Insurance Industry

In December 2023, the NAIC adopted the NAIC Model Bulletin: Use of Artificial Intelligence Systems by Insurers (the "**AI Model Bulletin**"), an initial draft of which had been released for public comment in July. Individual state insurance departments will now consider the AI Model Bulletin for adoption. As adopted, the AI Model Bulletin reflects the NAIC's view that AI is a means by which the insurance industry engages in conduct already subject to regulatory standards (including, among others, regulations relating to underwriting, rating, and unfair trade practices).

In December 2023, the NAIC adopted the NAIC Model Bulletin: Use of Artificial Intelligence Systems by Insurers ...

The AI Model Bulletin describes regulatory expectations for the use of AI by insurers (including both governance and enterprise risk management standards) and provides standards for insurance regulators to oversee and examine the use of AI by insurance carriers. It articulates standards at a high level and applies to the use of AI-supported decision making in general.

The AI Model Bulletin describes regulatory expectations for the use of AI by insurers (including both governance and enterprise risk management standards) and provides standards for insurance regulators to oversee and examine the use of AI by insurance carriers.

Specifically, the AI Model Bulletin states that insurers must (i) ensure that AI-supported decisions affecting consumers are accurate and do not violate unfair trade practice laws or other legal standards; (ii) maintain a governance framework, risk management framework, and internal controls for oversight of AI systems; and (iii) maintain standards for the use of third-party AI systems (including required contractual terms).

With regard to oversight, the AI Model Bulletin clarifies that regulators' general examination authority may include (i) requesting information on an insurer's compliance with the terms of the AI Model Bulletin and (ii) requesting documentation related to AI systems developed by third parties that are used by an insurer.

As adopted, the AI Model Bulletin omits a definition for the term "bias" that had been included in a prior version. Such definition was removed in response to industry concerns that the AI Model Bulletin referenced a term that had not been previously legislated. As a result, the AI Model Bulletin, which continues to include "bias analysis and minimization" among the data practices and accountability procedures expected of insurers, leaves such term undefined.

b. Colorado Becomes the First State to Regulate the Use of AI by Insurers

In September 2023, Colorado became the first state to adopt regulation specifically aimed at the application of AI technology in the insurance industry. The regulation, which went into effect on November 14, 2023, requires life insurance companies to report how they review AI models to the Colorado Division of Insurance. Additional disclosure is required for the use of External Consumer Data and Information Sources ("**ECDIS**"), which includes nontraditional data such as social media posts, shopping habits, Internet of Things data, and biometric data. Life insurers are obligated to develop a governance and risk management framework that includes thirteen specific components. Principally, the regulation is designed to ensure that life insurers' use of AI, ECDIS, and other predictive models does not discriminate against disadvantaged groups. Recent regulatory trends indicate that other states may soon be following Colorado's lead, and it is certainly foreseeable that AI regulation may soon expand to cover other types of insurance (automotive, property, health, etc.). Potentially covered entities should keep a watchful eye on the ever-shifting regulatory landscape in this area.

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In June 2023, the Big Data and Artificial Intelligence (H) Working Group completed its AI/machine learning ("ML") life insurer survey …

The top two reasons reported for not using, not planning to use, and not exploring use of AI/ML were "no compelling business reason" and "waiting for regulatory guidance."

The Market Regulation and Consumer Affairs (D) Committee ("(D) Committee") adopted revisions to the NAIC Model Unfair Trade Practices Act (#880) …

Notably, the revisions include a new definition of health insurance lead generator and clarify that health insurance lead generators are prohibited from engaging in unfair trade practices set forth in the model.

The revisions to the Unfair Trade Practices Act will be on the agenda for adoption by the Executive (EX) Committee and Plenary at the NAIC's Spring 2024 National Meeting.

c. NAIC Completes AI/Machine Learning Life Survey

In June 2023, the Big Data and Artificial Intelligence (H) Working Group completed its AI/machine learning ("**ML**") life insurer survey ("**AI/ML Life Survey**"), which was intended to allow regulators to gain a better understanding of (i) how life insurance companies are deploying AI/ML technologies in pricing and underwriting, marketing, and loss prevention and (ii) the current level of risk and exposure associated with the industry's use of AI and ML and how the industry is managing or mitigating that risk.

Out of 161 companies completing the survey, 94 companies currently use, plan to use, or plan to explore using AI/ML as defined in the survey. This equates to approximately 68% of reporting companies. For comparison, approximately 88% of the companies responding to an earlier survey of auto insurers, and 70% of companies responding to a similar survey of home insurers reported they currently use, plan to use, or plan to explore using AI/ML.

Among insurer operations areas, companies reported varying levels of AI/ML use, from 11% in the risk management area to 36% in marketing. In order from maximum to minimum use, the percentage of companies using AI/ML by insurer function were marketing, 36%; underwriting, 34%; pricing, 18%; and risk management, 11%.

The top two reasons reported for not using, not planning to use, and not exploring use of AI/ML were "no compelling business reason" and "waiting for regulatory guidance."

The AI/ML Life Survey was issued to a total of 179 life insurance companies meeting the following criteria: life insurance companies with more than US$250 million in premiums on individual policies in 2021, term writers that have issued policies on more than 10,000 lives, and selected insurtech companies. The survey was conducted from May 3 to June 30, 2023, during which time the responses were solicited from insurers in 14 requesting states (Colorado, Connecticut, Illinois, Iowa, Louisiana, Minnesota, Nebraska, North Dakota, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, and Wisconsin).

d. NAIC Considers Amendments to Model Unfair Trade Practices Act

The Market Regulation and Consumer Affairs (D) Committee ("**(D) Committee**") adopted revisions to the NAIC Model Unfair Trade Practices Act (#880) (the "**Unfair Trade Practices Act**") to address concerns regarding unfair and deceptive practices in the marketing and selling of health insurance products in order to provide state insurance regulators with the means to regulate lead generators and protect consumers.

The Improper Marketing of Health Insurance (D) Working Group (the "**Improper Marketing of Health Insurance Working Group**") was charged with reviewing and updating NAIC models and guidelines that address the use of lead generators for sales of health insurance products and to identify models and guidelines that need to be updated or developed to address regulator concerns regarding current market activity. Following up on its review, the Improper Marketing of Health Insurance Working Group proposed revisions to the Unfair Trade Practices Act to incorporate revisions to provide state insurance regulators with broader authority to regulate health insurance lead generators, which would not otherwise be subject to the same unfair practice restrictions as insurers.

Notably, the revisions include a new definition of health insurance lead generator and clarify that health insurance lead generators are prohibited from engaging in unfair trade practices set forth in the model. Under Section 2 of the Unfair Trade Practices Act, "Health Insurance Lead Generator" includes any person that uses a lead-generating device to (i) publicize the availability of what is, or purports to be, a health insurance product or service that the person is not licensed to sell directly to consumers, (ii) identifies consumers who may want to learn more about a health insurance product, or (iii) sells or transmits consumer information to insurers or producers for follow-up contact and sales activity.

In response to the draft revisions to the Unfair Trade Practices Act, industry representatives commented that the definition of "Insurance Lead Generator" was too broad and inadvertently encompassed several persons who are not acting as lead generators. Revisions were made prior to the adoption of the Unfair Trade Practices Act by the (D) Committee to address those concerns by replacing the term "entity" with "person," which is already defined in Section 2.

The revisions to the Unfair Trade Practices Act will be on the agenda for adoption by the Executive (EX) Committee and Plenary at the NAIC's Spring 2024 National Meeting.

13. Privacy and Cybersecurity

a. NAIC Continues Development of Privacy Protections Model Act

In 2023, the Privacy Protections (H) Working Group (the "**Privacy Working Group**") continued to develop the new Privacy Protections Model Act (#674) (the "**New Privacy Model Act**"), which was initially exposed for public comment in January. 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) and the Privacy of Consumer Financial and Health Information Regulation (#672), as well as other state, federal, and international privacy protections.

Industry groups commenting on the initial draft raised concerns with the following provisions of the New Privacy Model Act (among others): (i) broad opt-in rights for consumers with respect to use of data in marketing, use of data in research and actuarial studies, and overseas data processing; (ii) mandatory 90-day deletion requirements; (iii) optional private right of action for consumers to enforce the New Privacy Model Act; (iv) broad requirements for regulated entities to ensure compliance by third-party service providers; (v) broad and detailed notice requirements; and (vi) limited safe harbors for companies compliant with the Health Insurance Portability and Accountability Act ("**HIPAA**").

Over the course of the year, the Privacy Working Group engaged with industry and consumer representatives over their concerns with respect to the New Privacy Model Act and conducted (i) a series of public virtual meetings to discuss comments received; (ii) a public in-person meeting in June 2023 in Kansas City to discuss the more complex issues to be covered; and (iii) a series of private, one-on-one meetings with interested parties (including insurers, trade associations, and consumer representatives).

In July 2023, the Privacy Working Group exposed a second draft of the New Privacy Model Law addressing the comments received in the first half of the year. A further revised draft of the New Privacy Model Law is expected to be exposed early in 2024 for a 60-day comment period to address comments received from interested parties since the previous draft was exposed for comment.

Due to the volume of comments received, the Privacy Working Group obtained approval from the (H) Committee to extend its timeline for developing the New Privacy Model Law. The Privacy Working Group now anticipates presenting the New Privacy Model Law to the (H) Committee for approval at the NAIC's Fall 2024 National Meeting. The extended timeline is intended to allow regulators and interested parties an opportunity to review the revised draft thoroughly and to provide the working group with time to carefully consider input from all stakeholders.

b. State Action in Relation to Comprehensive Privacy and Data Security Legislation

2023 was a record-setting year for the proliferation of state privacy and data security legislation.

The number of states with comprehensive data privacy laws more than doubled in 2023, with eight new states joining the ranks with some version of a comprehensive privacy law. As highlighted below, while the new laws represent a growing focus on consumer privacy, they also contain noteworthy differences, underscoring the patchwork nature of the expanding regulatory environment.

Beyond comprehensive state data privacy laws, new laws regarding the collection and use of health data and AI systems are beginning to develop. Of note, the Washington My Health My Data Act goes into effect later in 2024, and the Colorado Division of Insurance's AI insurance regulations went into effect in November 2023.

Regarding data security, Illinois and Pennsylvania joined numerous other states in their 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 by virtue of its Regulation 500 (which was revised effective November 1, 2023).

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i. New Comprehensive State Privacy Laws: Iowa, Indiana, Montana, Tennessee, Texas, Oregon, Delaware, and Florida

Eight states enacted significant data privacy legislation in 2023.

Eight states enacted significant data privacy legislation in 2023. In March, Iowa became the first state to pass a data privacy law in 2023, followed by Florida, Indiana, Montana, Tennessee, and Texas passing their own laws in the following months, and Oregon and Delaware following suit shortly before the end of the legislative calendar. As of July 1, 2024, the Florida Digital Bill of Rights, Oregon Consumer Privacy Act ("**OCPA**"), and Texas Data Privacy and Security Act ("**TDSPA**") will go into effect, and, as of October 1, 2024, the Montana Consumer Data Privacy Act will go into effect. The data privacy laws for Iowa, Tennessee, and Delaware will go into effect in 2025, and the Indiana law will go into effect in 2026.

While each of the new laws are uniquely nuanced, certain areas of focus are reflected across the board.

While each of the new laws are uniquely nuanced, certain areas of focus are reflected across the board. For instance, similarly to existing state comprehensive privacy laws (e.g., the California Consumer Privacy Act), all of the laws: (a) require covered entities to provide notice to consumers at or before the point of data collection; (b) exempt entities regulated under Title V of the Gramm-Leach-Bliley Act ("**GLBA**"); and (c) require companies to provide a similar assortment of consumer rights (e.g., the data subject's right to obtain a portable and readily usable copy of their personal data, to have their personal data deleted, etc.). None of the new laws provide for a private right of action.

ii. Further Rulemaking Developments in California and Colorado

The California Privacy Rights Act ("CPRA") and Colorado Privacy Act rulemaking yielded important developments in 2023.

The California Privacy Rights Act ("**CPRA**") and Colorado Privacy Act rulemaking yielded important developments in 2023. New rules in both states now impose additional, specific requirements on covered entities beyond what is contemplated by the respective statutes. Rule makers invited public comment and stakeholder feedback to assist in their development of specific obligations under these two privacy laws.

The California Privacy Protection Agency (the "**CPPA**") finalized its first rulemaking process in the beginning of the year by approving the final text of CPRA regulations. In launching its second rulemaking process, the CPPA invited public comments on proposed rulemaking for cybersecurity audits, risk assessments, and automated decision making. The final iteration of the draft regulations was published and subsequently expanded in November. Noteworthy provisions include a revision to cybersecurity audit regulations, a consumer right to opt out of automated decision making, and an increase in the annual gross revenue threshold for applicability.

The Colorado Attorney General's Office began its rulemaking process in late 2022, which culminated in a hearing on the proposed rules in February 2023. The final regulations are fundamentally centered around consumer rights to access, delete, or opt out of personal data processing; the use of personal data for profiling; and data protection assessments.

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iii. New State Health Data Privacy Laws: Washington, Connecticut, and Nevada

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For example, Washington's My Health My Data Act ("**MHMDA**") is a privacy bill focused on consumer health data not regulated by HIPAA. The act requires a separate privacy notice for consumer health data, as well as affirmative, opt-in consent for the collection or sharing of consumer health data for purposes other than providing the product or service that the consumer has requested from the entity. Additionally, a signed authorization from the consumer is required before the sale of any health data. MHMDA goes into effect on March 21, 2024 (June 30, 2024, for "small businesses"). The rights and obligations imposed by MHMDA apply not only to health data related to Washington residents, but may also apply to any health data collected or otherwise processed in the state of Washington. Significantly, MHMDA includes a private right of action and imposes new and operationally challenging obligations on regulated entities. Businesses that function as service providers to regulated entities need service provider contracts in place and will want to strictly follow their obligations under those contracts; failure to do so could render the service provider a "regulated entity" fully subject to MHMDA, regardless of domicile.

Connecticut and Nevada passed similar consumer health privacy laws, though with a narrower focus than MHMDA and without a private right of action. Nevada's law is distinct and separate from its comprehensive data privacy law, while Connecticut's law amended relevant portions of the Connecticut Data Privacy Act. We expect other states to contemplate similar legislation in the years ahead.

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iv. Two Additional States Adopt the NAIC's Insurance Data Security Model Law: Illinois and Pennsylvania

In addition to these new comprehensive privacy laws, Illinois and Pennsylvania each adopted a version of the NAIC's Insurance Data Security Model Law (#668). These laws require licensees to, among other things, maintain a comprehensive written information security program, perform a risk assessment to determine the 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.

v. New York Releases Finalized Revisions to Cybersecurity Regulation 500

On November 1, 2023, NYDFS finalized the second amendment to its cybersecurity regulation, 23 NYCRR Part 500 ("**Regulation 500**"). At its core, the amendment reflects the regulator's continued attempt to keep pace with the perpetually increasing sophistication and frequency of cyberattacks. The finalized version of Regulation 500 includes a number of significant changes that will require prompt implementation by NYDFS-licensed companies. In short, the amendment is centrally focused on: governance (boards of directors and/or senior officers must have a "sufficient understanding of cybersecurity-related matters"), penetration testing/audits, multifactor authentication, encryption, and notice of ransomware attacks and extortion payments.

On November 1, 2023, NYDFS finalized the second amendment to its cybersecurity regulation, 23 NYCRR Part 500.

The amendments will come into effect at various points over 2024 and 2025, with a series of staggered transition periods. NYDFS has published guidance on the implementation timeline for key compliance dates; the next major deadline is April 15, 2024, for compliance with section 500.17(b) (requiring covered entities to submit a Certification of Material Compliance or Acknowledgment of Noncompliance for the year 2023). NYDFS is hosting training webinars to help facilitate compliance with the revised rules, which will be recorded and posted online.

c. NYDFS Cybersecurity Enforcement Activity

Along with making significant amendments to the regulation, NYDFS continues to actively enforce Regulation 500. To list a few examples from this past year:

Along with making significant amendments to the regulation, NYDFS continues to actively enforce Regulation 500.

- NYDFS entered into a Consent Order with a large title insurer for allegedly failing to maintain sufficient policies and practices related to access controls. The consent order included a US$1 million penalty.
- NYDFS announced a settlement with Coinbase, Inc., imposing a US$50 million penalty and requiring Coinbase to invest an additional US$50 million in its compliance program. Along with other alleged violations, NYDFS alleged that Coinbase failed to properly report a phishing incident that affected around 6,000 consumers, thereby violating the requirement to report cybersecurity incidents to the Department (Part 500.17(a)).
- NYDFS announced it had entered into a Consent Agreement with an insurance agency for, among other violations, failing to require MFA or a reasonable equivalent for all users in the U.S. The terms of the Consent Order required the insurance agency to pay a US$1.9 million penalty and conduct a series of cybersecurity-enhancing exercises (including a Cyber Maturity Assessment, MFA audit, and an audit of the insurance agency's audit trail records retention policy).

The enforcement actions highlight NYDFS's longitudinal focus on the MFA requirement (Part 500.12). NYDFS also appears to be particularly concerned with the requirement to conduct cybersecurity risk assessments (Part 500.9).

On October 31, 2023, the DOL issued a proposed rule (the "Proposed Rule") to redefine the meaning of "investment advice fiduciary" under the Employee Retirement Income Security Act …

B. U.S. FEDERAL ACTIVITY

1. DOL Guidance Relating to the Management of Assets

a. Introduction

On October 31, 2023, the DOL issued a proposed rule (the "**Proposed Rule**") to redefine the meaning of "investment advice fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"). For these purposes, an "investment advice fiduciary" is any person who renders "investment advice for a fee or other compensation, direct or indirect." According to the DOL, the Proposed Rule would update the regulatory definition of investment advice fiduciary to better reflect the purpose of ERISA and to close certain loopholes that the currently effective definition may have unintentionally created. Additionally, in connection with the amendment to the definition of investment advice fiduciary, the DOL announced proposed amendments (the "**Proposed Amendments**") to several prohibited transaction class exemptions (each a "**PTCE**") that would change the conditions required for the use of those exemptions and would impact transactions involving insurance products.

b. Proposed Rule

i. Current Regulatory Definition: The Five-Part Test

The current framework for determining whether a person is an investment advice fiduciary (which the DOL reaffirmed in its most recent proposed iteration of the fiduciary rule in 2020) adheres to the longstanding "five-part test." Under this test, a financial institution or investment professional will be an "investment advice fiduciary" if such person (1) renders advice to a plan as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement, or understanding with the plan or plan fiduciary that (4) the advice serves as a primary basis for investment decisions with respect to such plan assets and (5) the advice will be individualized based on the particular needs of the plan.

ii. Proposed Amendment to Definition

In the Proposed Rule, the DOL proposes that a person would be an investment advice fiduciary for purposes of ERISA if:

- The person provides investment advice or makes an investment recommendation to a retirement investor (i.e., a plan, plan fiduciary, plan participant, or beneficiary, individual retirement account ("**IRA**"), IRA owner or beneficiary, or IRA fiduciary),
- The advice or recommendation is provided "for a fee or other compensation, direct or indirect," as defined in the Proposed Rule, and
- The person makes the recommendation in one of the following contexts:
    - The person either directly or indirectly (e.g., through or together with any affiliate) has discretionary authority or control, whether or not pursuant to an agreement, arrangement, or understanding, with respect to purchasing or selling securities or other investment property for the retirement investor;
    - The person either directly or indirectly (e.g., through or together with any affiliate) makes investment recommendations to investors on a regular basis as part of its business and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and the retirement investor may rely on it as a basis for investment decisions that are in the retirement investor's best interest; or
    - The person making the recommendation represents or acknowledges that such person is acting as a fiduciary when making investment recommendations.

According to the DOL, this revised framework is "designed to ensure that ERISA's fiduciary standards uniformly apply to all advice that retirement investors receive concerning investment of their retirement assets in a way that ensures that retirement investors' reasonable expectations are honored when receiving advice from financial professionals who hold themselves out as trusted advice providers."

a) Analysis

In the Proposed Rule, the DOL focused its attention on aspects of the "five-part test" that, in the DOL's opinion, caused it to be underinclusive — particularly, the "regular basis" requirement and the requirement of "a mutual agreement, arrangement, or understanding" that investment advice will serve as "a primary basis for investment decisions."

b) "Regular Basis"

According to the DOL, prior interpretations of the "regular basis" requirement under the five-part test (i.e., effectively excluding one-time advice from being considered fiduciary investment advice) could serve to undermine reasonable expectations of retirement investors. Instead, the Proposed Rule would include any advice given by a person who makes investment recommendations to investors "on a regular basis as part of their business," provided that the other components of the test are satisfied. As an example, the Proposed Rule states that an insurance agent's recommendation to invest a retiree's retirement savings in an annuity would be considered fiduciary advice if the agent regularly makes investment recommendations to investors as part of its business, and the circumstances indicate that the recommendation is based on the retiree's particular needs and circumstances and may be relied on for making an investment decision that is in the investor's best interest.

c) "Mutual Agreement, Arrangement or Understanding"

According to the DOL, the "mutual agreement, arrangement or understanding" requirement under the five-part test has, over time, encouraged the use of fine-print disclaimers of fiduciary status by investment professionals. Although the DOL has previously cautioned that such written disclaimers are not determinative, the Proposed Rule officially removes the "mutual agreement, arrangement or understanding" requirement. Instead, the Proposed Rule purports to focus on the objective circumstances surrounding an investment recommendation, including how an investment professional markets themselves to a retirement investor. Specifically, the DOL noted that it believes that investment professionals' using titles such as financial consultant, financial planner, or wealth manager "routinely involves holding themselves out as making investment recommendations that will be based on the particular needs of the retirement investor and that may be relied upon as a basis for investment decisions that are in the retirement investor's best interest."

d) "Primary Basis"

In the DOL's view, the requirement under the five-part test that advice serve as a "primary basis" for investment decisions with respect to a retirement investor's assets is practically difficult to interpret and is ultimately unrelated to whether a recommendation was presented as investment advice on which an investor could rely in making a decision. Instead, the Proposed Rule looks to whether circumstances indicate that a recommendation "may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest."

In addition to the above analysis, the Proposed Rule is clear that it applies to investment recommendations as to rolling over, transferring, or distributing assets from an employee benefit plan or IRA. The DOL indicated that inclusion of these recommendations as investment advice is intended to address the DOL's "longstanding interests in protecting retirement investors in the context of a recommendation to roll over employee benefit plan assets to an IRA, as well as other recommendations to roll over, transfer, or distribute assets from a plan or IRA."

According to the DOL, this revised framework is "designed to ensure that ERISA's fiduciary standards uniformly apply to all advice that retirement investors receive concerning investment of their retirement assets in a way that ensures that retirement investors' reasonable expectations are honored when receiving advice from financial professionals who hold themselves out as trusted advice providers."

As an example, the Proposed Rule states that an insurance agent's recommendation to invest a retiree's retirement savings in an annuity would be considered fiduciary advice if the agent regularly makes investment recommendations to investors as part of its business, and the circumstances indicate that the recommendation is based on the retiree's particular needs and circumstances and may be relied on for making an investment decision that is in the investor's best interest.

In the DOL's view, the requirement under the five-part test that advice serve as a "primary basis" for investment decisions with respect to a retirement investor's assets is practically difficult to interpret and is ultimately unrelated to whether a recommendation was presented as investment advice on which an investor could rely in making a decision.

PTCE 2020-02 provides a prohibited transaction exemption for the receipt of compensation by an investment advice fiduciary in connection with certain recommendations to plans and IRAs …

The proposed amendment to PTCE 2020-02 does not change the impartial conduct standards; however, the proposed amendment clarifies that omissions of certain information in disclosures could constitute a materially misleading statement.

PTCE 84-24 provides a prohibited transaction exemption for certain transactions relating to the purchase, with plan assets, of insurance contracts or annuities and the payment of related commissions to insurance agents or brokers and certain other parties.

c. Proposed Amendments

i. Proposed Amendment to Exemption for Investment Advice Fiduciaries, PTCE 2020-02

PTCE 2020-02 provides a prohibited transaction exemption for the receipt of compensation by an investment advice fiduciary in connection with certain recommendations to plans and IRAs, including (a) a recommendation to an individual to rollover assets from an employer plan or IRA to another IRA and (b) a recommendation to a plan participant to purchase investment products, including annuities. The conditions for this exemption require the investment advice fiduciary to (a) comply with impartial conduct standards (generally requiring compliance with a best interest standard of care, requiring compensation to be reasonable, and requiring no materially misleading statements); (b) provide certain disclosures; (c) maintain policies and procedures designed to ensure compliance with the impartial conduct standards; and (d) engage in a retrospective review designed to detect any violations of the impartial conduct standards or policies and procedures.

The proposed amendment to PTCE 2020-02 does not change the impartial conduct standards; however, the proposed amendment clarifies that omissions of certain information in disclosures could constitute a materially misleading statement. The proposed amendment expands the required disclosures by (a) adding a requirement that the disclosures contain a description of the best interest standard of care and a description of any payments that would be received from a third party in connection with the fiduciary's recommendations; (b) permitting retirement investors to obtain information, upon request, regarding specific costs, fees, and compensation related to the recommendation; and (c) requiring the advice fiduciary to provide documentation to retirement investors regarding rollover recommendations.

The proposed amendment clarifies that quotas, bonuses, contests, special awards, differential compensation, and similar incentives intended to result in recommendations that are not in retirement investors' best interest would not be permitted. In addition, the proposed amendment requires the Senior Executive Officer who conducts the retrospective review to detect any violations of the impartial conduct standards or policies and procedures to certify that the advice fiduciary has corrected all prohibited transactions that are discovered and that an excise tax return has been, or will be, filed with the IRS to report those prohibited transactions.

The proposed amendment expands the circumstances under which a financial institution would be ineligible to use the exemption as a result of criminal activity and adds ineligibility to use the exemption for systematically failing to correct and report non-exempt prohibited transactions.

ii. Proposed Amendment to Exemption for Transactions Involving Insurance Products, PTCE 84-24

PTCE 84-24 provides a prohibited transaction exemption for certain transactions relating to the purchase, with plan assets, of insurance contracts or annuities and the payment of related commissions to insurance agents or brokers and certain other parties. The proposed amendment to PTCE 84-24 removes the ability of investment advice fiduciaries, other than independent insurance agents, to use PTCE 84-24 for transactions involving insurance contracts or annuities; instead, investment advice fiduciaries, other than independent insurance agents, must rely on the relief provided by PTCE 2020-02. The amendment to PTCE 84-24 includes a new section that applies only to advice fiduciaries that are independent insurance agents who sell insurance products of two or more insurance companies and contains conditions that are similar to those in PTCE 2020-02. Under this amendment, an insurance company selling its product through an independent insurance agent would not be required to assume fiduciary status but would be required to exercise supervisory authority over the independent agent's recommendation of its own products as a condition for relief.

Like the conditions in PTCE 2020-02 relating to ineligibility to use that exemption, the proposed amendment to PTCE 84-24 adds a new section that specifies the circumstances under which an independent agent or an insurance company would be ineligible to rely on PTCE 84-24. Those circumstances include conviction of certain crimes, including foreign crimes, and the receipt of an ineligibility notice from the DOL stating that the agent or insurance company is engaged in a systematic pattern of violating the terms of the exemption, intentionally violated the conditions of the exemption, engaged in a systematic pattern of failing to correct prohibited transactions and failing to report those transactions or provided materially misleading information to the DOL. An independent insurance agent or insurance company who otherwise would be ineligible to use the exemption would have the opportunity to petition to the DOL to seek a determination by the DOL that continued reliance on PTCE 84-24 would not be contrary to the purposes of PTCE 84-24.

The proposed changes to PTCE 84-24 are significant as they effectively eliminate the ability of investment advice fiduciaries in the insurance industry, other than independent insurance agents, to use that exemption. Those fiduciaries have relied upon PTCE 84-24 for the sale of insurance products for decades.

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d. Status

The Proposed Rule and Proposed Amendments were published in the Federal Register on November 3, 2023, with an initial comment period until January 2, 2024. The DOL held a virtual public hearing on the Proposed Rule and Proposed Amendments on December 12-13, 2023. The Proposed Rule and Proposed Amendments would begin to apply 60 days after the date of final adoption in the Federal Register.

2. Central Clearing of U.S. Treasuries

On December 13, 2023, the SEC adopted a final rule under the Securities Exchange Act of 1934 that requires the central clearing of certain secondary market transactions involving U.S. Treasuries (the "**Rule**"). Under the Rule certain secondary market purchases and sales and repurchase and reverse repurchase transactions ("**Repos**") of U.S. Treasuries will be required to be cleared through a central clearinghouse. Currently, the Government Securities Division of Fixed Income Clearing Corporation ("**FICC GSD**") is the only clearing agency in the U.S. that clears U.S. Treasuries.

On December 13, 2023, the SEC adopted a final rule under the Securities Exchange Act of 1934 that requires the central clearing of certain secondary market transactions involving U.S. Treasuries …

Pursuant to the Rule, any secondary market transaction in U.S. Treasuries that is of a type that is accepted for clearing by a registered clearing agency (such as FICC GSD) and that is either (x) a Repo transaction involving U.S. Treasuries with a counterparty that is a FICC GSD direct participant,[26] or (y) a purchase and sale transaction involving U.S. Treasuries with a counterparty that is either a registered broker-dealer, government securities broker, or government securities dealer or a FICC GSD direct participant[27] (if the FICC GSD direct participant brings together multiple buyers and sellers using a trading facility and is counterparty to both the buyer and seller in two separate transactions),[28] will be subject to the Rule's clearing requirements.

The Rule is scheduled to become effective on a staggered basis with a December 31, 2025 effective date for purchase and sale transactions and a June 3, 2026 effective date for Repo transactions. Accordingly, insurers who utilize U.S. Treasuries for investment purposes and/or the posting of margin in connection with uncleared derivatives transactions will need to establish a relationship[29] with a sponsoring member under the FICC GSD sponsoring member program[30] in order to be able to continue to purchase and sell and/or engage in Repo transactions involving U.S. Treasuries after such dates.

The Rule is scheduled to become effective on a staggered basis with a December 31, 2025 effective date for purchase and sale transactions and a June 3, 2026 effective date for Repo transactions.

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26 The Rule excludes, generally, Repo transactions that involve a central bank, sovereign entity, an international financial institution, a natural person, state or local governments, and certain affiliates of FICC GSD direct participants when the Repo is with such FICC GSD direct participant.

27 As of October 31, 2023, there were over 200 direct participants listed in the FICC GSD Member Directory, which can be accessed here: https://www.dtcc.com/client-center/ficc-gov-directories.

28 The Rule excludes, generally, purchase and sale transactions with a central bank, sovereign entity, an international financial institution, or a natural person.

29 Establishing such a relationship will require the negotiation and execution of legal agreements in addition to any applicable "know your customer" (KYC), "anti-money laundering" (AML), and other onboarding requirements.

30 A relationship with a sponsoring member is not required to the extent the insurer itself is otherwise a direct participant in FICC GSD.

C. U.S. LITIGATION DEVELOPMENTS

1. Cost of Insurance Litigation Overview

Class actions over cost of insurance rates are not new: one landmark opinion on the topic was issued more than a decade ago, in 2013. While the pace of new filings has slowed, the litigation persists, including through a new theory that emerged in the wake of the COVID-19 pandemic.

Class actions over cost of insurance rates are not new: one landmark opinion on the topic was issued more than a decade ago, in 2013. *See Norem v. Lincoln Ben. Life Co.*, 737 F.3d 1145 (7th Cir. 2013). While the pace of new filings has slowed, the litigation persists, including through a new theory that emerged in the wake of the COVID-19 pandemic. The sections below detail the emergence of that and other trends.

Cost of insurance litigation refers to lawsuits, often brought as class actions, that assert that the cost of insurance rates in universal life policies are too high. The cases assert that the insurer breached its contract by ignoring policy language that, in plaintiffs' view, requires them to base cost of insurance rates on their expectations of future mortality — nothing else. Although the policy language varies, it typically provides that cost of insurance rates will be "based on" expectations of future mortality, as well as, occasionally, factors like interest, expenses, and lapses. For years, the fight has been over whether "based on" means "based *only* on," as plaintiffs contend, or if insurance companies instead have discretion to consider other factors too. Some insurers have been sued after rate increases, while others have been sued even after keeping their rates unchanged, on the theory that improvements in mortality expectations should have prompted them to lower their rates.

In the Norem *case, the Seventh Circuit (setting precedent that governs cases in federal court in Wisconsin, Illinois, and Indiana) rejected the theory that the insurer was limited to using factors listed in the policy ("the insured's sex, issue age, policy year, and payment class") to set cost of insurance rates.*

The outcomes have been mixed. Some courts have rejected plaintiffs' theory, but enough have allowed them to proceed (and enough cases have yielded lucrative enough settlements) to encourage the plaintiffs' bar to continue pursuing the theory. In the *Norem* case cited above, the Seventh Circuit (setting precedent that governs cases in federal court in Wisconsin, Illinois, and Indiana) rejected the theory that the insurer was limited to using factors listed in the policy ("the insured's sex, issue age, policy year, and payment class") to set cost of insurance rates. The court found that "neither the dictionary definitions nor the common understanding of the phrase 'based on' suggest[ed] that Lincoln Benefit is prohibited from considering factors beyond sex, issue age, policy year, and payment class when calculating its COI rates."

By contrast, in Vogt v. State Farm Life Insurance Co.*, the Eighth Circuit (setting precedent that governs cases in federal court in Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) upheld a jury verdict in favor of the plaintiffs …*

By contrast, in *Vogt v. State Farm Life Insurance Co.*, 963 F.3d 753 (8th Cir. 2020), the Eighth Circuit (setting precedent that governs cases in federal court in Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) upheld a jury verdict in favor of the plaintiffs in a case involving a rate provision that said "[t]hese rates for each policy are based on the Insured's age on the policy anniversary, sex, and applicable rate class." At a minimum, the court said, the policy language was ambiguous, and so the jury was entitled to construe it in favor of the insured.

More recently, in 2021, the Eleventh Circuit, which covers Alabama, Florida, and Georgia, issued a non-precedential ruling that agreed with the Seventh Circuit and rejected plaintiffs' theory. *Slam Dunk I, LLC v. Connecticut Gen. Life Ins. Co.*, 853 F. App'x 451 (11th Cir. 2021). The court found that the plain language of "based on" could not mean "*exclusively* based on." "Nothing about the plain and ordinary meaning of the phrase 'based on' connoted exclusivity, and nothing about it implies the list that follows is exhaustive," the court said. Following *Slam Dunk*, one defendant in that circuit secured the dismissal of similar claims. That ruling is now on appeal, and the appellate opinion may yield further guidance on the strength or weakness of these cases. *Advance Tr. & Life Escrow Servs., LTA v. Protective Life Ins. Co.*, 2022 WL 3159266, at *1 (N.D. Ala. Aug. 8, 2022) (appeal argued, pending decision).

Because courts continue to remain divided, this sort of litigation has persisted around the country.

Because courts continue to remain divided, this sort of litigation has persisted around the country. *See, e.g, Meek v. Kansas City Life Ins. Co.*, 2023 WL 7182127, at *7 (W.D. Mo. Sept. 27, 2023) ("Because only mortality considerations are listed, a reasonable insured would not expect Defendant to use non-mortality factors in setting the COI rate."); *PHT Holding II LLC v. N. Am. Co. for Life & Health Ins.*, 2023 WL 3714746 (S.D. Iowa May 27, 2023) ("[T]he Court finds that 'based on' is also ambiguous as to whether it connotes exclusivity of factors to consider in its calculation."); *Mirkin v. XOOM Energy, LLC*, 2023 WL 5200294, at *5 (E.D.N.Y. Aug. 14, 2023); *Meek v. Kansas City Life Ins. Co.*, 664 F. Supp. 3d 923 (W.D. Mo. 2023); *West v. Wilco Life Ins. Co.*, 2023 WL 2917059 (S.D. Ind. Apr. 12, 2023); *McMillan v. Kansas City Life Ins. Co.*, 2023 WL 2499746 (D. Md. Mar. 14, 2023).

2. The Effect of the COVID-19 Pandemic on Mortality and Cost of Insurance Litigation

For years, plaintiffs in cost of insurance litigation have argued that because insurers' expectations of future mortality keep improving, their cost of insurance rates must be lowered. That premise has always been flawed, especially for older cohorts of insureds, where decades-old estimates of future mortality have proved unduly optimistic. But during the COVID-19 pandemic, excess mortality actually increased.

For years, plaintiffs in cost of insurance litigation have argued that because insurers' expectations of future mortality keep improving, their cost of insurance rates must be lowered. That premise has always been flawed, especially for older cohorts of insureds, where decades-old estimates of future mortality have proved unduly optimistic.

The life insurance industry has extensively discussed how COVID-19 mortality might affect their liabilities and costs. For example, statistics in a 2021 study "show that the liability of the life insurer in the wake of COVID-19 is higher than that in the pre-COVID-19 period" due to "the lower survival probability caused by this pandemic. Consequently, COVID-19 imposes a negative effect on life insurers' financial sustainability."[31] And "[t]rade group American Council of Life Insurers said the pandemic in 2020 drove the biggest annual increase in death benefits paid by U.S. carriers since the 1918 influenza epidemic, totaling billions of dollars."[32]

As a result of the effects of the COVID-19 pandemic and other factors like the opiate crisis and an increase in suicide rates, plaintiffs in cost of insurance cases may have a harder time arguing that cost of insurance rates were improperly raised or that they should have been lowered. And courts are taking note. For example, in dismissing a cost of insurance class action, one court noted that plaintiffs' allegations about ever-improving mortality expectations "do not account for increases in mortality rates in the wake of the COVID-19 pandemic." *Advance Tr.*, 2022 WL 3159266, at *4 n.7.

… plaintiffs in cost of insurance cases may have a harder time arguing that cost of insurance rates were improperly raised or that they should have been lowered.

3. Corporate Tax Cut Cost of Insurance Theories

Perhaps in response to the COVID-19 pandemic's implications for traditional cost of insurance litigation, a new theory has emerged. This one alleges that rates should be lowered (or at least not raised) because of corporate tax cuts under the Tax Cuts and Jobs Act of 2017. For insurance policies that include "taxes" in their list of factors that may be considered in determining cost of insurance rates, plaintiffs say the tax cut should have prompted a cut in cost of insurance rates.

Perhaps in response to the COVID-19 pandemic's implications for traditional cost of insurance litigation, a new theory has emerged. This one alleges that rates should be lowered (or at least not raised) because of corporate tax cuts under the Tax Cuts and Jobs Act of 2017.

In separate lawsuits filed in 2023, Plaintiffs sued John Hancock Life Insurance Company (U.S.A.) and Talcott Resolution Life and Annuity Insurance Co. Both cases are pending in federal court in New York, and both cases are in their early stages. If they survive challenges through motion practice or yield substantial settlements, copycat litigation may quickly ensue.

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

1. 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, reinsurers, or Lloyd's managing agents) (together the "**UK Regulator(s)**"). 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 may also be regulated by Lloyd's, depending upon the structure of their operations, which in turn is regulated by the UK Regulators.

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a. FCA's Consumer Duty

The FCA set out how it intended to implement its Consumer Duty (the "**Duty**") through the publication of the Policy Statement 22/9 and Final Guidance 22/5 on July 27, 2022. The Duty sets higher standards of consumer protection across financial services, and applies to products and services offered to "retail customers." For insurance, the scope of the Duty follows the position in the Insurance Conduct of Business Sourcebook, and in particular does not apply to: (i) reinsurance, (ii) contracts of large risks sold to commercial customers (or other contracts of large risk where the risk is located outside the UK), or (iii) the activities connected to the distribution of group insurance policies or the extension of these policies to new members.

31 See Xun Zhang et al., *The Negative Impact of COVID-19 on Life Insurers*, Fronts. Pub. Health (2021), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC8502979/.

32 See Leslie Scism, *Rise in Non-Covid-19 Deaths Hits Life Insurers*, Wall Street Journal (updated February 23, 2022), https://www.wsj.com/articles/rise-in-non-covid-19-deaths-hits-life-insurers-11645576252.

In the FCA's insurance market priorities 2023-25, published on September 20, 2023, the FCA stated that it has "a strong focus on Consumer Duty implementation especially in the current tough macro-economic environment – for both consumers and firms."

Firms have already seen supervisory action in relation to specific products and business lines where the FCA believes retail customers are not receiving fair value and/or that commissions levels received by distributors cannot be justified by the services they provide.

The PRA continues to be focused on whether high levels of longevity reinsurance and the emergence of Funded Re in the UK life market reduce the protection of UK policyholders.

In November 2023, the PRA published its consultation paper ("CP24/23") on Funded Re, which sets out its proposed expectations for life insurers holding or entering into Funded Re arrangements.

The Duty builds on existing product governance and pricing rules, and requires firms to define, monitor, and evidence how their business models, actions, and culture are delivering good customer outcomes. From the end of July 2023, the Duty applied to all new products and services, and all existing products and services that remain on sale or open for renewal. The Duty will also apply to all closed products and services from the end of July 2024.

In the FCA's insurance market priorities 2023-25, published on September 20, 2023, the FCA stated that it has "*a strong focus on Consumer Duty implementation especially in the current tough macro-economic environment – for both consumers and firms.*" The FCA has made it clear that it will use the full range of supervisory tools available to compel the delivery of better outcomes for retail customers. Similarly, in its Market Oversight Plan for 2024, Lloyd's stated that it will be "*engaging the market to ensure that the expectations of Consumer Duty are embedded within each managing agent's business*" and that the products sold "*offer fair value and are overseen with sufficiently robust governance….*" Lloyd's has indicated that it will be conducting a review of the market's approach to implementing the Duty in 2024 and will have a particular focus on the market's implementation of the Duty in relation to run-off business and the market's adoption of the FCA's expectations for vulnerable customers.

Firms have already seen supervisory action in relation to specific products and business lines where the FCA believes retail customers are not receiving fair value and/or that commissions levels received by distributors cannot be justified by the services they provide.

b. The PRA's View on the UK Longevity and Funded Re Market

The PRA continues to be focused on whether high levels of longevity reinsurance and the emergence of Funded Re in the UK life market reduce the protection of UK policyholders. The PRA has stated that it has seen "*the potential for offshored counterparty concentration risk to arise from rapidly growing levels of reinsurance.*" The PRA has also indicated that it expects UK-authorized firms to consider their compliance with the Prudent Person Principle for the risks associated with their reinsurance activities.

In June 2023, the PRA issued a Dear Chief Risk Officer letter on the role of Funded Re in the UK life market, following its thematic review of the use of Funded Re arrangements by UK insurers in 2022-2023. The PRA's thematic work identified weaknesses in risk management across life insurers transacting Funded Re. In this letter, the PRA indicated that it only sees a limited role for Funded Re as part of a diversified asset strategy, and noted that the "*systematic use of funded reinsurance has the potential to introduce significant risks to our objectives of safety and soundness and policyholder protection.*" Given the PRA's interest and the increasing volume of transactions, the PRA now expects firms to notify their supervisor promptly of individual material Funded Re transactions entered into from June 15, 2023. Materiality is considered in the context of the solvency capital requirement, amount of gross premium, and/or complexity of the arrangement. Gross premium in excess of £200 million would be considered material.

In November 2023, the PRA published its consultation paper ("**CP24/23**") on Funded Re, which sets out its proposed expectations for life insurers holding or entering into Funded Re arrangements. The PRA has seen an increasing appetite for the use of Funded Re in the UK life insurance market to support the writing of the bulk purchase annuity business. The proposals in CP24/23 result in a new draft supervisory statement which covers the PRA's expectations on:

- **Ongoing risk management of Funded Re arrangements** – the PRA is proposing standards to ensure efficient risk management of counterparty exposures (such as clear collateral policies and internal counterparty limits), and financial resources to enable a firm to withstand a recapture of Funded Re arrangements (either single or multiple recaptures). As part of these considerations, the PRA is proposing that firms formulate and document a recapture plan for their Funded Re arrangements;

- **Modelling of the solvency capital requirements associated with Funded Re arrangements** – the PRA notes that internal models may have been approved before Funded Re became material counterparties for firms. The PRA's proposed expectations are aimed at ensuring that the internal model adequately reflects the risks of Funded Re transactions. For firms using the standard formula, the PRA reminds firms of the requirement to ensure its own risk and solvency assessment includes an assessment of the risks retained, as well as the risks to which they are exposed in respect of Funded Re arrangements; and

- **Structuring of Funded Re arrangements** – the PRA proposes to set out an expectation to have a quantitative risk assessment for Funded Re arrangements which would inform the firm's internal investment limit framework. It is expected that this assessment will include an approved internal contractual risk appetite statement which sets out the maximum acceptable loss at the individual Funded Re contract level.

It is anticipated that the changes will come into effect in Q2 2024.

c. Change of Control Applications – Financial Services and Markets Act 2023 and the UK Regulators Consultation Paper on Prudential Assessment of Acquisitions and Increases in Control

Financial Services and Markets Act 2023

The Financial Services and Markets Act 2023 ("**FSMA 2023**") broadens the range of circumstances in which the UK Regulators can impose conditions on an approval for a change in control of a UK-authorized firm. Some provisions of FSMA 2023 came into force on June 29, 2023, when it received royal assent, however provisions on change of control came into force two months later, on August 29, 2023.

Prior to the FSMA 2023, the UK Regulators could impose conditions on such an approval on the following grounds:

a. where the UK Regulator would object to the acquisition if it did not impose conditions; and

b. in response to directions from the other UK Regulator.

As a result of the FSMA 2023, the UK Regulators are now also able to impose conditions where it appears to either UK Regulator that it is desirable to impose the conditions in order to advance any of that UK Regulator's objectives[33] (subject to disregarding the economic needs of the market (see section 185(2)(c) of FSMA 2000, as amended)).

This change applies to any change in control applications received by the UK Regulators on or after August 29, 2023.

UK Regulators Consultation Paper on Prudential Assessment of Acquisitions and Increases in Control

In November 2023, the UK Regulators published a joint consultation paper on the prudential assessment of acquisitions and increases in control (CP25/23). The PRA intends to replace the guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector (JC/GL/2016/01) published by the Joint Committee of the European Supervisory Authorities ("**3L3 Guidelines**") with a new PRA supervisory statement.

The PRA also intends to delete its existing supervisory statement on the aggregation of holdings for the purpose of prudential assessment of controllers ("**SS33/15**") and make minor consequential amendments to its statement of policy for clarity. The wording in the new supervisory statement and guidance will largely replicate the 3L3 Guidelines, and SS33/15.

The deadline for responses is February 24, 2024, and the UK Regulators intend to implement the proposals in Summer 2024.

The Financial Services and Markets Act 2023 ("FSMA 2023") broadens the range of circumstances in which the UK Regulators can impose conditions on an approval for a change in control of a UK-authorized firm.

In November 2023, the UK Regulators published a joint consultation paper on the prudential assessment of acquisitions and increases in control (CP25/23).

33 The FCA's objectives are as follows: (a) ensure the relevant markets function well; (b) to protect consumers; (c) to protect and enhance the integrity of the UK financial system; and (d) to promote healthy competition between financial services providers in the interests of consumers. The FCA also has a secondary objective to facilitate the UK economy's international competitiveness and its growth over the medium to long term, subject to alignment with international standards.

In October 2023, the PRA published a consultation paper ("CP21/23") to consolidate and formalize existing PRA policy on overseas insurers that write business in the UK through the establishment of a third-country branch, to provide more clarity on its approach to the authorization and supervision of insurance branches.

d. PRA Consultation Paper on its Approach to the Authorization and Supervision of Insurance Branches

In October 2023, the PRA published a consultation paper ("**CP21/23**") to consolidate and formalize existing PRA policy on overseas insurers that write business in the UK through the establishment of a third-country branch, to provide more clarity on its approach to the authorization and supervision of insurance branches. CP21/23 includes the PRA's proposed approach to:

i. Assessing risks of third-country branches, including assessing the undertaking's ability to meet the Threshold Conditions, and reviewing the financial resources information that the third-country branch provides to assess that business is conducted in a prudent manner;

ii. Reinsurance arrangements of third-country branches. The PRA focuses on levels of intra-group reinsurance, aggregate reinsurance cessions, and concentration of reinsurance arrangements, as these are areas that could pose risks to third-country branch undertakings' independence and supervisibility; and

iii. Other expectations such as reporting requirements. The PRA proposes to update their supervisory statement on third-country insurance and pure reinsurance branches ("**SS44/15**") to make amendments to the existing text, and to include additional chapters setting out the PRA's expectations in relation to (among other matters): (i) Own Risk and Solvency Assessment reporting, (ii) systems of governance, (iii) senior manager functions, (iv) outsourcing and operational risk, and (v) reinsurance counterparty risk.

The proposals have been informed by three key drivers of change: (i) the UK's withdrawal from the EU, (ii) the PRA's lessons learned during the Temporary Permissions Regime, and (iii) the Solvency II Review, which contains proposals relating to third-country branches.

The PRA proposes that the implementation date for the changes resulting from CP21/23 would be on publication of the proposed final policy documents by Q2 2024.

The consultation period ended on January 12, 2024. The PRA proposes that the implementation date for the changes resulting from CP21/23 would be on publication of the proposed final policy documents by Q2 2024.

2. Insurers in Financial Difficulties

a. UK Developments

Throughout the past year, there have been a number of developments in the areas of exit planning, recovery and resolution regimes, and insurer insolvency.

Throughout the past year, there have been a number of developments in the areas of exit planning, recovery and resolution regimes, and insurer insolvency. HM Treasury ("**HMT**") and the PRA are looking to increase financial stability and resilience in the UK insurance market and reduce risks to public funds in light of a challenging economic environment. In order to do so, HMT and the PRA recognize the need to bring the UK's insurer insolvency regime in line with international standards (including the EU's Insurance Recovery and Resolution Directive) and the existing UK framework for banks.

i. Exit Planning for Solvent Insurers

On January 23, 2024, the PRA published a consultation paper on solvent exit planning for insurers outlining proposals for all PRA-regulated insurers (except for insurers in passive run-off and UK branches of foreign insurers) to prepare for an orderly "solvent exit" as part of business-as-usual ("BAU") activities.

On January 23, 2024, the PRA published a consultation paper on solvent exit planning for insurers ("**CP2/24**")[34] outlining proposals for all PRA-regulated insurers (except for insurers in passive run-off and UK branches of foreign insurers) to prepare for an orderly "solvent exit" as part of business-as-usual ("**BAU**") activities. In this context, a solvent exit means the process through which an insurer ceases its insurance business in an orderly manner while remaining solvent throughout. The PRA considers that a solvent exit is likely to be more efficient, more cost effective, and less disruptive to policyholders compared to insolvency. The proposals include:

- New rules and expectations that insurers must prepare for a solvent exit as part of their BAU activities and document those preparations in a Solvent Exit Analysis ("**SEA**"). The PRA expects that UK Solvency II firms that are part of Internationally Active Insurance Groups will be able to build on their resolution plans under the IAIS ComFrame to meet the new proposed expectations. UK Solvency II firms that are members of a Solvency II group should consider the implications and risks from group membership.

34 See CP2/24 *Solvent Exit Planning for Insurers* (January 2024).

- New expectations on how insurers should prepare a detailed Solvent Exit Execution Plan and monitor and manage a solvent exit. The requirement to prepare a Solvent Exit Execution Plan would apply only if a solvent exit became a reasonable prospect for an insurer.

The consultation is open until April 26, 2024. The PRA intends to publish a policy statement in the second half of 2024 and proposes that the implementation date for the proposed changes would be Q4 2025. CP2/24 builds on the PRA's goal (as outlined in its business plan for 2022/23) to increase confidence that UK insurers can exit the market with minimal disruption, without having to rely on the backstop of an insolvency or resolution process.

The PRA intends to publish a policy statement in the second half of 2024 and proposes that the implementation date for the proposed changes would be Q4 2025.

ii. Write-Down Procedure and Policyholder Protection

a) Write-Down Procedure

The FSMA 2023 introduced a new write-down procedure for insurers in financial difficulties. This procedure is supplemented by new PRA rules and policy (PS12/23). Prior to the introduction of Section 377A of FSMA 2023, UK insurers who were in financial difficulties could apply to the courts for a reduction of their insurance liabilities as an alternative to winding-up. However, there was uncertainty concerning the application of this process and, to our knowledge, it has never been used.

The FSMA 2023 introduced a new write-down procedure for insurers in financial difficulties. This procedure is supplemented by new PRA rules and policy (PS12/23).

The write-down procedure introduced by FSMA 2023 is available to any UK-authorized insurer (except friendly societies and Lloyd's) regardless of their size or location, and in relation to a foreign insurer with a UK-authorized branch.

The following parties can apply to the court for a write-down order: (i) the insurer, (ii) the insurer's shareholders, (iii) the insurer's policyholders or other creditors (including contingent or prospective creditors), (iv) the PRA, or (v) HMT. Other than where an applicant is the PRA or HMT, the PRA (in consultation with the FCA) must consent to the application. The PRA's consent must be: (i) in writing, and (ii) filed with the court alongside the relevant application.

The PRA expects prospective applicants to prepare a write-down plan setting out the proposed terms of the write-down order. Write-down plans should broadly respect the creditor hierarchy. Certain liabilities are excluded from a write-down order. This includes: (a) an amount secured on property of any kind, other than an amount secured by a charge which, as created, was a floating charge, and (b) an amount payable under a contract or other instrument involving financial services. Where an insurer is subject to a write-down order and the insurer has entered into a reinsurance contract, the reinsurer cannot take into account the reduction in the value of the liability under the write-down order.

The PRA expects prospective applicants to prepare a write-down plan setting out the proposed terms of the write-down order. Write-down plans should broadly respect the creditor hierarchy. Certain liabilities are excluded from a write-down order.

Once an application has been made to the court, the court must determine whether: (i) the decision to make a write-down order will lead to a better outcome for the insurer's policyholders and other creditors, and (ii) the insurer is unable to pay its debts or is likely to become unable to pay its debts. If the court thinks that the order will lead to a better outcome, it will sanction the write-down plan and appoint a write-down manager (whose appointment must be approved by the PRA).

When a write-down plan has been sanctioned, the insurer must notify the PRA, the FCA, and each affected person (including policyholders). A write-down order will typically last for the length of time provided for in the order itself. While subject to a write-down order, an insurer cannot, without the PRA's consent, (i) make a distribution, (ii) pay variable remuneration (unless it is regulated by a collective bargaining agreement), or (iii) dispose of, or otherwise deal with, any of its assets (whether in the UK or elsewhere) except in the ordinary course of the insurer's business.

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b) Policyholder Protection

In September 2023, the PRA also issued a revised *Statement of Policy – Policyholder Protection*[35] which takes into account the write-down procedure as set out in Section 377A of FSMA 2023.

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The PRA expects the Financial Services Compensation Scheme ("**FSCS**") to cooperate with the write-down manager following the court sanctioning a write-down order under Section 377A FSMA. In

35 See PS12/23 *Dealing with insurers in financial difficulties*.

particular, the FSCS, in conjunction with the wind-down manager, will need to: (a) enter into a valid and effective trust deed in respect of that account which meets certain minimum requirements, and (b) open an account to which the FSCS can make top-up payments.

Furthermore, the PRA's Policyholder Protection Statement of Policy has been updated, and includes a section on the FSCS's obligations in relation to securing continuity, measures taken in financial difficulty, write-down orders, and paying compensation when an insurer is in difficulty.

The PRA also published a statement of policy: *Dealing with insurers in financial difficulties* (Statement of Policy) which sets out the PRA's expectations relating to giving consent to an application for a write-down order and the appointment of a write-down manager.

iii. Insurer Resolution Regime

On January 26, 2023, HMT issued a consultation on a proposed Insurer Resolution Regime ("IRR"), followed by a response paper in August 2023. In the consultation paper, it was noted that while the UK government considers the UK's insurance sector to be well-capitalized and resilient to shocks, insurers can experience unexpected financial difficulties and, in rare cases, fail, with potential negative impacts on policyholders, other insurers, and the wider economy.

In principle, the IRR will apply to all UK-authorized insurers (other than friendly societies and Lloyd's). The IRR will also apply to Gibraltar insurers, which are to be aligned with UK insurers through a Gibraltar specific regime. It is also proposed that the IRR will apply to: mixed financial holding companies; insurance holding companies; mixed activity insurance holding companies; regulated entities within the corporate group of an insurer; other non-regulated entities within the corporate group of an insurer; and UK branches of foreign insurers.

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Under the proposed IRR, it is intended that the Bank of England (the "**Bank**") will be appointed as the resolution authority ("**RA**") with the PRA and the FCA (where applicable) continuing to work with insurers to support the execution of an orderly recovery or exit of firms in distress, including the use of run-off where necessary.

In principle, the IRR will apply to all UK-authorized insurers (other than friendly societies and Lloyd's). The IRR will also apply to Gibraltar insurers, which are to be aligned with UK insurers through a Gibraltar specific regime. It is also proposed that the IRR will apply to: mixed financial holding companies; insurance holding companies; mixed activity insurance holding companies; regulated entities within the corporate group of an insurer; other non-regulated entities within the corporate group of an insurer; and UK branches of foreign insurers.

However, in order to be able to avail of resolution action, insurers must satisfy a number of statutory tests referred to as Resolution Conditions ("**RCs**") and consultation is required between the PRA, the FCA, and the RA before any action is taken. The RCs include: (a) the PRA assessing whether an insurer is failing or likely to fail; (b) the RA believes that it is reasonably likely that the insurer is failing or is likely to fail; (c) the RA considers that the exercise of its powers is necessary having regard to the public interest and advancement of one or more of its statutory resolution objectives; and (d) one or more of the statutory resolution objectives would not be met to the same extent if stabilization powers were not deployed.

The proposals give the RA powers to initiate one (or a combination) of the following stabilization options:

- Transfer to a private sector purchaser without the requirement for court approval. The RA will be given the power to execute a transfer under its own authority.
- Transfer a failing insurer's business or shares to a bridge insurer as a temporary measure.
- Bail-in a failing insurer by restructuring, modifying, limiting, or writing down its liabilities, including its policyholder liabilities.
- Place the failing insurer into temporary public ownership. This would be a tool of last resort in the event that other stabilization options are not sufficient.

The RA would also have a number of discretionary powers including: taking actions in relation to directors and senior managers, including to remove and/or replace a director or senior manager; appoint a resolution administrator(s); and appoint skilled person(s) or investigator(s).

In relation to pre-resolution planning, the intent is for the RA's requirements to reflect the PRA's priorities for its exit planning regime, including its consultation on exit planning for solvent insurers and the requirements for insurers to prepare proportionate exit plans commensurate with the size and complexity of the insurer. The RA intends to only request further information and data where these provide proportionate benefits for planning firms' resolution under the IRR.

Detail on the IRR resolution plans, and how this interacts with existing PRA requirements, will be set out in due course. It is currently anticipated that legislation will be passed after the next UK General Election with a 12-month implementation lead in time.

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b. EU Developments

The European Commission adopted the Insurance Recovery and Resolution Directive ("**IRRD**") by way of a legislative proposal in September 2021. The IRRD has now entered the ordinary legislative procedure following the Council of the EU and the European Parliament reaching provisional political agreement in December 2023. A final compromise text has been published and the IRRD is expected to be adopted in the first half of 2024.

The IRRD has now entered the ordinary legislative procedure following the Council of the EU and the European Parliament reaching provisional political agreement in December 2023.

The IRRD establishes a legislative framework that aims to reduce the risk of an insurer failing. This covers the recovery and resolution of EU (re)insurers and their groups. The framework establishes procedures for the resolution of a failed insurer to limit the impact on public funds and, more generally, the financial system.

The IRRD framework includes two elements:

1. **Preparatory measures**. The IRRD requires insurers (and their groups) to prepare recovery plans. Resolution authorities are required to: (a) prepare resolution plans based on information shared by insurers (and their groups), (b) assess the resolvability of insurers, and (c) direct insurers to take action to address potential limitations in relation to their resolvability.

2. **Resolution**. Resolution authorities are given the relevant powers and tools to maintain continuity of essential services and manage any failure of an insurer (or member of an insurance group) in an orderly manner. The resolution tools that resolution authorities can utilize include: (a) a solvent run-off tool, (b) a bridge undertaking tool, and (c) a write-down or conversion tool.

Member states will be required to designate resolution authorities. These resolution authorities will establish resolution colleges for insurance groups. Member states will also be expected to transpose the IRRD into its national legal and regulatory framework within 18 months from its effective date.

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3. Lloyd's Update

a. Blueprint Two

Blueprint Two is supporting the transition to a digital marketplace for Lloyd's by building a new digital platform and services. The transition will be implemented in two phases by Velonetic, which represents the joint ventures between DXC Technology, the International Underwriting Association, and Lloyd's. From July 2024, all customers will move to a new single digital platform and processing services for open market and delegated authority business ("**Phase One**"). The Lloyd's Market Oversight Plan for 2024 (the "**Lloyd's Plan 2024**") has indicated that Lloyd's will discuss cut over plans for Phase One with managing agents to ensure that they have a suitable internal readiness plan in place (see section V.D.3.c. below).

Blueprint Two is supporting the transition to a digital marketplace for Lloyd's by building a new digital platform and services.

Following Phase One, market participants can choose when to move to a "full digital" approach ("**Phase Two**") subject to a final cutover date which has not yet been agreed. Blueprint's Phase Two changes will need to be implemented to fully utilize the platform and continue transacting business from April 2025.

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-based oversight continues to evolve in line with the shifting risk environment.

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In 2024, Lloyd's will expand the Culture Principle to include additional levels of maturity beyond the current foundational level, which is the baseline that all syndicates are expected to comply with. The updated principle is expected to launch in Q2 2024 and managing agents will then be given a year to prepare before they are assessed against the updated principle. Lloyd's will also be engaging with the market in respect of the Claims Management Principle. Lloyd's is proposing to collaborate with the market to "*develop the Claims management Principle to be a fifth 'hurdle' principle*."

c. Lloyd's Plan 2024

The Lloyd's Plan 2024 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 2024 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 2024 includes a broad range of topics including, for example:

i. **Macroeconomic uncertainty** – Lloyd's notes that the "*persistent higher inflation has resulted in continued interest rate pressures, which is combined with ongoing geo-political uncertainty facing the market*." Considering the challenging global economic environment, Lloyd's focus will be to ensure managing agents are monitoring and mitigating these risks and are allowing for inflation manifesting in claims.

ii. **Cyber oversight** – The approach by Lloyd's to cyber oversight will be linked to the Cyber Market Management Strategy. This is a three-year plan to strengthen oversight of cyber risk while supporting syndicates' risk appetites in the class. Lloyd's will also continue to ensure that syndicates are adequately capitalized for cyber exposures.

iii. **Delegated Authority Strategy** – The Delegated Authority Strategy of Lloyd's will provide greater focus on delegated underwriting performance and developing a framework that supports the evolving delegated models in the market. Lloyd's will also deliver a more enhanced risk-based approach to oversight, and support greater clarity over parties' roles and responsibilities, to ensure that all relevant regulatory requirements are met.

iv. **Sustainability Including Climate Risk** – Lloyd's has planned oversight activities for the following areas:

   a. **Underwriting** – Lloyd's will request updated sustainability strategies from managing agents to support its assessment against Underwriting Profitability Sub-Principle 8;

   b. **Investments** – Lloyd's will provide good practice guidance to the market during Q1 2024, and request updated Responsible Investment Policies during Q4 2024 to support its assessment against Investments Sub-Principle 5;

   c. **Portfolio risk management** – The Emerging Risk and Exposure Management functions of Lloyd's will be focusing on how managing agents assess and monitor their exposure to climate related risk during 2024; and

   d. **Capital** – Lloyd's will seek to understand syndicates' modeling approaches and allowances in capital for climate change.

v. **Culture** – Managing agents can expect continued regular engagement by Lloyd's on culture throughout 2024. A culture survey is expected to be run in Q1 2024, and further development of the Culture Principle will be carried out to include additional levels of maturity (see section V.D.3.b. above).

It is important for firms to: (i) understand the key issues and risks in the context of their business model; and (ii) ensure that they are proactively and appropriately managed.

It is important for firms to: (i) understand the key issues and risks in the context of their business model; and (ii) ensure that they are proactively and appropriately managed.

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 the overall social purpose and environmental goals of Lloyd's and the market, Lloyd's issued directional guidance and best practice for establishing an ESG governance framework. 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.

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.

In addition, Lloyd's has 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).

During November 2023, Lloyd's published "Sustainability Three-Year Roadmap on *Insuring The Transition*." Lloyd's is proposing to work with the market to seek to develop a climate litigation scenario, and a key performance indicator for physical climate risk. Alongside this, Lloyd's is planning to scope a questionnaire on allowance in capital and reserving, to be collected during 2025. Lloyd's has indicated that it will continue to engage on, and request, sustainability strategies and responsible investment policies, to ensure that Lloyd's is on track with its strategic priority and that policyholders are better able to support the transition to net zero (see section V.D.7. below).

During November 2023, Lloyd's published "Sustainability Three-Year Roadmap on Insuring The Transition.*" Lloyd's is proposing to work with the market to seek to develop a climate litigation scenario, and a key performance indicator for physical climate risk.*

e. London Bridge Risk 2

In January 2024, Lloyd's announced the issuance of the first 144A catastrophe bond through its ILS platform, London Bridge Risk 2, valued at US$100 million. The transaction was sponsored by Beazley on behalf of its Lloyd's syndicates and its European insurance carrier. Lloyd's has also stated that London Bridge Risk 2 has the capacity to surpass £1.5 billion in 2024 (see section III.B.6. above for further information).

In January 2024, Lloyd's announced the issuance of the first 144A catastrophe bond through its ILS platform, London Bridge Risk 2, valued at US$100 million.

4. EU and Member State Competition Law Enforcement Activity

2023 saw relatively little competition law enforcement activity in the insurance sector by the European Commission ("**Commission**"), the UK's competition agencies, in particular the UK Competition and Markets Authority ("**CMA**"), and by national competition authorities in the member states of the EU.

2023 saw relatively little competition law enforcement activity in the insurance sector by the European Commission, the UK's competition agencies, in particular the UK Competition and Markets Authority, and by national competition authorities in the member states of the EU.

a. EU-level Enforcement by the European Commission

In 2023, the Commission did not open, progress, or close competition proceedings in relation to cartels or abuse of dominance infringements in the insurance sector. However, the Commission did review and approve under EU State aid rules a number of support packages pertaining to the insurance sector, including the following:

In 2023, the Commission did not open, progress, or close competition proceedings in relation to cartels or abuse of dominance infringements in the insurance sector.

- In February 2023, a French scheme supporting insurers that cover insolvency events at travel organizers. The scheme consisted of a State Guarantee Fund ("**Fund**") with a budget of €1.5 billion, and ran until December 31, 2023. The scheme was structured around a mechanism under which insurers could pass on 75% of their premiums to the Fund. The Fund would then cover 75% of the potential loss, until the budget of €1.5 billion was reached. The scheme also allowed for compensation for the operating costs that insurers incur for providing insolvency protection.
- In February 2023, the prolongation of a Latvian short-term export credit insurance scheme of March 2017 until December 31, 2023. Export-credit insurance enables exporters established in one member state to insure their receivables against commercial and political risks arising on sales to customers in other member states. The scheme's prolongation was due to the unavailability of export credit insurance in Latvia caused by the Russia-Ukraine conflict and due to high inflation. By decision of September 2023, the Commission further prolonged and modified the scheme until December 31, 2028 (relevant modifications concerned the extension of the scope of eligible enterprises).
- In June 2023, the modification of an existing Croatian scheme under the "Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia." The scheme aims to remedy liquidity shortages faced by undertakings affected by the Russia-Ukraine conflict. The amendment consists in a budget increase from

approximately €551 million to €746 million. Of this budget, the estimated budget for direct grants to subsidize insurance premiums is around €21 million. The duration of the scheme was until December 31, 2023.

b. National Level Enforcement in the UK

i. CMA Revokes Directions Issued to Santander UK Plc and Barclays Bank UK Plc Regarding Compliance With the Payment Protection Insurance Market Investigation Order 2011

In September and November 2023, the CMA revoked directions issued to Santander UK Plc and Barclays Bank UK Plc concerning the Payment Protection Insurance ("PPI") Market Investigation Order of 2011 …

In September and November 2023, the CMA revoked directions issued to Santander UK Plc ("**Santander**") and Barclays Bank UK Plc ("**Barclays**") concerning the Payment Protection Insurance ("**PPI**") Market Investigation Order of 2011 ("**Order**"). In August 2018, the CMA found that Barclays breached the Order by failing to send, between 2016 and 2017, annual statements to certain credit card customers setting out the cost of their PPI and including a reminder of their right to cancel. Similarly, in August 2019, the authority found that Santander sent incorrect annual reminders to former mortgage PPI policyholders between 2012 and 2017. At the time, directions were imposed against the two companies including, among others, the appointment of independent assurance auditors regarding compliance with the Order. The CMA revoked such directions, as both companies had completed the required actions and had exited the PPI market.

ii. The UK's FCA Publishes its Multi-Firm Review Regarding Compliance With its Home and Motor Insurance Pricing Rules and Direct Line Agrees to Review Compliance With the Same

In December 2022, the FCA published its General Insurance Pricing Attestations Multi-Firm Review ("**Review**"). The Review analyzes insurance companies' compliance with the FCA's home and motor insurance pricing rules ("**FCA Rules**"), including the implementation of appropriate control systems ensuring that companies do not discriminate against existing home and motor insurance customers to the advantage of new subscribers. The FCA found that most insurance companies complied with the FCA Rules, and confirmed that it would continue to actively scrutinize the sector.

In September 2023, Direct Line voluntarily agreed to undertake a historical business review to scrutinize its own compliance with the FCA Rules. Direct Line confirmed that it would provide existing customers with compensation in the event that they were overcharged.

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iii. The UK's FCA Publishes Feedback Statement on the Potential Competition Impacts of Big Tech's Entry and Expansion Into Financial Services Sectors (Including Insurance)

In July 2023, the FCA published a feedback statement on its October 2022 discussion paper which sought stakeholder views on the competition impacts of Big Tech's entry and expansion into four retail financial services sectors, including insurance.

In July 2023, the FCA published a feedback statement on its October 2022 discussion paper which sought stakeholder views on the competition impacts of Big Tech's entry and expansion into four retail financial services sectors, including insurance. Respondents (including insurance providers) highlighted that (i) preexisting data sets from other Big Tech activities may result in complementarities with retail financial services, particularly in the assessment and pricing of risk; and (ii) the FCA should consider in more detail the overall ecosystems of Big Tech firms' core products and services, and how that may affect entry into other complementary financial services. Concerning next steps, the FCA proposed to: (i) issue a Call for Inputs on Big Tech firms' role as "gatekeepers;" (ii) review its approach to the supervision of Big Tech firms; and (iii) work with the UK government and the Digital Markets Unit at the CMA on the UK's new pro-competition regime for digital markets.

iv. The PRA Issues its Annual Competition Report

In June 2023, the PRA issued its Annual Competition Report. Insofar as concerns the insurance sector, the PRA focused on a review of the reporting and disclosure requirements under Solvency II.

In June 2023, the PRA issued its Annual Competition Report. Insofar as concerns the insurance sector, the PRA focused on a review of the reporting and disclosure requirements under Solvency II. The PRA concluded that further reforms to Solvency II were required in order to continue to reduce barriers to entry within the insurance market, including the removal of certain reporting requirements. The PRA plans to consult on further measures to reduce barriers to entry, including: (i) raising the threshold at which insurers are required to enter the Solvency II UK regime; (ii) introducing a mobilization regime for insurers; and (iii) removing some capital requirements for branches of international firms.

v. The FCA Warns Insurance Companies to Not Undervalue Items Which Are Subject to Insurance Claims

In December 2022, the FCA warned insurance companies not to undervalue items that are subject to insurance claims. The FCA noted that it had received evidence of insurance companies offering amounts of money which were under fair market value for items subject to the insurance claim (e.g., cars written off in accidents). The FCA's Executive Director for Consumers and Competition noted that the FCA would continue to scrutinize the behavior of firms closely.

c. National Level Enforcement in Bulgaria

In November 2023, the Bulgarian Commission for Protection of Competition ("**BCPC**") opened an in-depth investigation into the acquisition by Unilink Bulgaria EOOD of S.D.I. Group AD. The parties are the two largest insurance brokers in Bulgaria, with significant market presence across the distribution of different insurance classes. As part of its investigation, the BCPC intends to examine the extent to which (among others) competitors may increase their offerings to exert effective competitive pressure.

In November 2023, the Bulgarian Commission for Protection of Competition ("BCPC") opened an in-depth investigation into the acquisition by Unilink Bulgaria EOOD of S.D.I. Group AD.

d. National Level Enforcement in Germany

Between March and May 2023, a number of insurers including the German reinsurance providers Munich Re and Hannover Re, as well as Allianz SE, announced their withdrawal from the Net-Zero Insurance Alliance ("**NZIA**"). NZIA is an industry group convened by the United Nations to facilitate the transition to net-zero by 2050 by key insurers and reinsurers. The companies referred to the existence of material antitrust risks associated with collective decarbonization goals. Such risks were originally raised by a number of Attorneys General in the U.S.

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In November 2023, the German Competition Authority ("**Bundeskartellamt**") concluded its proceedings against ARGE, an association of service providers in the medical aids sector, by accepting the commitments offered by its members. ARGE applied coordinated price increases to health insurance companies to allegedly compensate for increased supply costs caused by the COVID-19 pandemic. In response to the Bundeskartellamt's concerns, ARGE's members dissolved the associations and committed to refrain from such conduct in the future.

e. National Level Enforcement in Greece

In July 2023, the Hellenic Competition Commission ("**HCC**") published an Interim Report related to its sector inquiry into the provision of private health services and related insurance services. According to the Interim Report, the Greek health insurance sector enjoys, overall, a healthy degree of competition. The main concerns identified in the Interim Report were (i) the vertical integration between the health industry and the health insurance industry; and (ii) the lack of an appropriate framework for the collection of, and access to, health-related data.

In July 2023, the Hellenic Competition Commission ("HCC") published an Interim Report related to its sector inquiry into the provision of private health services and related insurance services.

f. National Level Enforcement in Luxembourg

In August 2023, Luxembourg's Ministry of the Economy proposed legislation establishing a merger control regime in Luxembourg (Bill of Law No. 8296). The new regime will be based on turnover thresholds but will foresee derogation procedures for transactions involving (re)insurance companies, and captive insurance/reinsurance companies will be excluded from its scope. The Bill is expected to be adopted in the first quarter of 2024 and will enter into force four months following its publication in Luxembourg's Official Journal.

In August 2023, Luxembourg's Ministry of the Economy proposed legislation establishing a merger control regime in Luxembourg (Bill of Law No. 8296).

g. National Level Enforcement in Malta

In September 2023, the Malta Competition and Consumer Affairs Industry reportedly sent questions to several participants in the car insurance market. The authority is looking into allegations that some individuals in Malta, including taxi drivers, who intend to purchase Y-plate vehicles (for coaches and (light) passenger transport vehicles), were required to transfer their personal car insurance to Argus Group Holdings Limited, a *de facto* monopolist in the provision of car insurance for Y-plate vehicles.

In September 2023, the Malta Competition and Consumer Affairs Industry reportedly sent questions to several participants in the car insurance market.

h. National Level Enforcement in the Netherlands

In November 2023, the chair of the Authority for Consumers & Markets ("**ACM**"), noted that domestic merger control rules should be amended to provide the ACM with the power to "call in" roll-up deals where consolidation strategies are being adopted in markets with low concentration, including within the insurance sector.

In July 2023, the ACM launched a consultation on draft guidelines which would define the limits of the role of trade associations in relation to competition rules in individual healthcare contract negotiations. The draft guidelines intend to ensure that healthcare providers and health insurers negotiate individually and freely. To that end, the draft guidelines state that trade associations should not provide advice to their members about commercial aspects of contracts such as prices, volumes, and cost reimbursements.

i. National Level Enforcement in Portugal

In April 2023, the Tribunal da Concorrência, Regulação e Supervisão de Santarém ("TdC") annulled €54 million in fines that the Portuguese Competition Authority (Autoridade da Concorrência) had imposed on Lusitania, Companhia de Seguros, S.A ("Lusitania") and Zurich Insurance Group Ltd ("Zurich") in August 2019.

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j. National Level Enforcement in Romania

At the end of 2023, an investigation of the Romanian Consiliul Concurentei ("**RCC**"), opened in May 2022, into the motor insurance software provider Audatex Services S.R.L. ("**Audatex**"), remained ongoing. The investigation concerns Audatex's alleged abuse of dominance in the market for specialized software services for the assessment and administration of damage to cars, and for subsequent repair and maintenance work.

k. National Level Enforcement in Spain

In June 2023, the Spanish Comisión Nacional de los Mercados y la Competencia ("CNMC") closed its investigation into several domestic banks regarding alleged involvement in taking advantage of consumer access to COVID-19 government-backed loans by demanding consumers take on additional bank products, specifically life insurance and other insurance products.

In June 2023, the Spanish Comisión Nacional de los Mercados y la Competencia ("**CNMC**") closed its investigation into several domestic banks (including CaixaBank, S.A., Banco Santander, S.A., and Banco de Sabadell, S.A.) regarding alleged involvement in taking advantage of consumer access to COVID-19 government-backed loans by demanding consumers take on additional bank products, specifically life insurance and other insurance products.

In May 2023, the CNMC launched a market-wide study focused on healthcare insurance. The study aims to analyze competition dynamics and barriers to entry, including: (i) the relationship between insurance companies and healthcare providers; and (ii) consumer information asymmetries. The purpose of the study is to make recommendations to improve the quality and levels of competition in the provision of healthcare insurance in Spain.

In April 2023, the European Commission, following a complaint brought by four separate Spanish associations for car repair services, asked the CNMC to investigate potential anti-competitive practices by car insurers in Spain (e.g., potential tacit collusion between car insurers and the tying of insurance policies to specific car repair workshops). It is unclear whether the CNMC has opened an investigation.

In February 2023, the CNMC closed its investigation into DKV Seguros Y Reaseguros, S.A ("**DKV**") by accepting commitments from DKV. During the COVID-19 pandemic, certain self-employed workers were forced to cease their activity and the legislator asked insurers to refund paid-but-not-used premiums related to temporary disability coverage. The CNMC was investigating DKV for conditioning such refunds on the taking out of insurance for hospitalization. DKV committed to compensate customers that were harmed by its conduct.

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 EU 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.D.5.e. below for how the UK data protection regime is developing 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 2024.

a. GDPR Enforcement and Fines

Over the last year, European Data Protection Authorities ("**DPAs**") issued landmark fines for GDPR breaches, with the Irish DPA issuing the highest ever administrative fine under GDPR of €1.2 billion against a multinational technology company in May 2023. The fine related to the international transfer of personal data to the U.S. Fines of €10 million and up were seen in France (€40 million against a targeted advertising company for various GDPR breaches, including a failure to demonstrate valid consent and to respect the right of access) and the UK (£12.7 million against a multinational technology company in April 2023 in relation to its use of children's data). Following similar trends to the prior year, the most common violations to incur fines in 2023 included: (i) insufficient legal basis for data processing, (ii) non-compliance with processing principles, and (iii) insufficient technical and organizational security measures. Enforcement trends in 2023 also included a focus on cookie banner compliance and international data transfers.

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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 2023, the total number of fines, since the GDPR came into effect, is now €43 million in the Finance, Insurance, and Consulting sector (an increase of approximately €14 million from 2022).[36]

The largest fine issued this year in the insurance sector, amounting to €3 million, regarded insufficient cybersecurity in Sweden. In this case, documents containing sensitive customer data became available to a public user of the company's website without requiring authentication. Although the breach affected a limited number of data subjects (202 people), the data was allegedly available between October 2018 and February 2021, and the high corresponding fine highlights a particular focus and concern of the Swedish regulator with regard to appropriate technical and organizational measures to ensure a level of security appropriate to the risk of processing. In the UK, the PRA's Supervisory Statement (the "**Statement**") came into force on March 31, 2022 requiring 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." It is also of note given the series of comprehensive cybersecurity regulations that have either recently come in force or are on the horizon for the year ahead (see section V.D.5.d. below for further detail).

On November 21, 2023, the UK Information Commissioner's Office ("**ICO**") published a statement[37] outlining its upcoming enforcement priority regarding cookie banner compliance. In particular, the ICO noted that organizations must give users a choice to "reject all" advertising cookies, a feature which they noted was missing from many cookie banners currently in use. Insurance companies should ensure they review their approach to cookie compliance, including cookie banners, to ensure this standard is satisfied.

On November 21, 2023, the UK Information Commissioner's Office ("ICO") published a statement outlining its upcoming enforcement priority regarding cookie banner compliance.

After a year of record fines and active enforcement discussed above, and corresponding high-profile appeals, the European Court of Justice ("**CJEU**") issued an important ruling on the circumstances in which national DPAs are entitled to impose fines under the GDPR. This CJEU ruling has the potential to impact not only how these fines are calculated but, most importantly, when fines can be imposed.

The decision specified that wrongful conduct, either intentional or negligent, is a necessary condition for a DPA to impose an administrative fine. The CJEU's interpretation led it to reject a strict liability approach to GDPR enforcement. This ruling presents a major change in data protection law enforcement, but it is

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36 *GDPR Enforcement Tracker Report*, CMS (December 2023).

37 https://ico.org.uk/about-the-ico/media-centre/news-and-blogs/2023/11/commissioner-warns-uk-s-top-websites-to-make-cookie-changes.

2023 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.

In terms of specific guidance to assist (re)insurance companies with these assessments, the Lloyd's Market Association 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.

important to note that in some cases, negligent conduct will be evident from the lack of protections in the organization (e.g., missing GDPR-required documentation). In other cases, with use of investigatory powers, a DPA will be able to discover wrongful conduct where it exists.

b. International Transfers

2023 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 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, the EU-U.S. Privacy Shield ("**Privacy Shield**") was invalidated as a data transfer mechanism and 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.

Following the Schrems II decision, the European Commission ("**Commission**") published new EU SCCs, which were adopted on June 4, 2021 ("**2021 SCCs**"). (Re)insurers transferring personal data outside of the EEA will now be well versed in taking into account both the Schrems II decision and the 2021 SCCs when transferring personal data internationally.

As a reminder, the current TIA process should include: (i) carrying out a data mapping exercise of 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., 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 European Data Protection Board ("**EDPB**")) at present.

Following these initial developments, there have been a number of further significant developments on this topic in 2023, in particular in relation to transfers to the U.S.

On July 10, 2023, the Commission issued its Final Implementing Decision granting the U.S. adequacy ("**Adequacy Decision**") with respect to companies that subscribe to the EU-U.S. Data Privacy Framework ("**DPF**"), which replaces the invalidated Privacy Shield. This decision, coordinated with the U.S. Attorney General's determination that the EU and EEA countries are "qualifying states" under President Biden's Executive Order 14086 on Enhancing Safeguards for U.S. Signals Intelligence ("**EO**"), follows nearly a year and a half of intense collaboration between the EU and U.S. to develop a durable solution to international data transfers between the two jurisdictions.

The DPF's foundation is found in the EO and the EU-U.S. Data Privacy Framework Principles ("**DPF Principles**"). The DPF Principles are set forth in Annex I of the Adequacy Decision, and are substantively the same as the Privacy Shield principles, which were the standard before the Schrems II decision.

As a result of the Adequacy Decision, personal data is able to flow between the EU to companies participating in the DPF without the need for an additional data transfer safeguard (e.g., EU SCCs).

In addition, the finalization of the Adequacy Decision is also important for companies relying on other Article 46 GDPR data transfer mechanisms when transferring personal data to the U.S. (i.e., where an organization cannot or does not want to self-certify to the DPF). Entities relying on the SCCs or binding corporate rules (BCRs) are able to rely on the analysis in the Adequacy Decision as support for their TIAs regarding the assessment of the equivalence of U.S. national security safeguards and redress.

In the UK and following Brexit, the EU SCCs do not automatically apply. 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**"). Since September 21, 2022, any agreements concluded which involve transfers of personal data from the UK to a third country must use the IDTA or Addendum to the June SCCs, and all agreements (whether concluded before that date or after) will need to be updated to address either the IDTA or Addendum by March 21, 2024. The ICO recently updated its guidance on international transfers to assist organizations in understanding the practical application of the IDTA and Addendum, taking a step-by-step approach.

(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 the UK, the UK Extension to the EU-U.S. Data Privacy Framework ("**UK-U.S. Data Bridge**"), which is the UK's equivalent of the Adequacy Decision, took effect on October 12, 2023.

The UK-U.S. Data Bridge enables companies in the UK to lawfully transfer personal data to participating DPF organizations in the U.S. without the need to implement additional safeguards (e.g., the IDTA) or carry out further assessments of the U.S.' equivalence via the TIA. Importantly, as the UK-U.S. Data Bridge is an extension of the DPF, U.S. companies wanting to participate must also self-certify to the DPF.

In November 2022, the ICO published its own guidance on transfer risk assessments, proposing an alternative approach to the EDPB's TIA. The ICO's risk assessment is known as a Transfer Risk Assessment Tool ("**TRA Tool**"). The TRA Tool consists of six questions, with the overriding objective to determine whether the transfer would result in increased risks for data privacy and other human rights, compared to if the data remained in the UK. Importantly, the ICO makes clear that either the EDPB TIA or UK TRA Tool is acceptable to use for transfers subject to the UK GDPR, which is particularly helpful for (re)insurers with operations in both the EU and the UK in avoiding the need to take a bifurcated approach to this assessment. (Re)insurers should consider which approach to take, noting in particular that the TRA Tool provides that if all categories of transferred data are a low harm risk, the transfer can go ahead without the need for further assessment.

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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.

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.

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.

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.

While there are various considerations when undertaking solely automated decision making processes, including profiling under GDPR, of particular note for 2024 are the changes proposed to this compliance obligation by the UK Data Protection and Digital Information Bill ("**Data Reform Bill**"). The Data Reform Bill proposes 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 UK government consultation focused on the insurance industry when providing examples of potential bias

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… (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.

AI is an area which has undergone significant changes in the last few years, and will continue to see increased attention moving into 2024, in particular given the political agreement of the EU's AI Act at the end of 2023.

While the most onerous obligations under the AI Act are imposed on those directly involved in the commercial AI system life cycle (e.g., manufacturers), the AI Act also imposes obligations on AI system users (deployers). It is likely that most (re)insurance companies will fall into the category of a deployer when using AI.

While minimal/no-risk systems are not regulated under the AI Act, it should be noted that they could still be regulated by other legal frameworks (e.g., the GDPR), and voluntary codes of conduct are still encouraged.

(Re)insurers should note that the Commission is particularly cautious when it comes to using AI in industries such as insurance …

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. See section V.D.5.e. below for further detail on the changes to UK data protection law proposed more generally by the Data Reform Bill.

AI is an area which has undergone significant changes in the last few years, and will continue to see increased attention moving into 2024, in particular given the political agreement of the EU's AI Act at the end of 2023.

On December 8, 2023, EU legislators reached political agreement on the world's first standalone law regulating AI: the EU's Artificial Intelligence Act ("**AI Act**"). The ultimate goal of the AI Act being to strengthen Europe's ability to compete in AI at a global level. The AI Act is a horizontal piece of legislation, meaning that it will apply to all sectors and industries, taking a principled, risk-based approach to regulation of AI systems. This differs from the approach taken in other jurisdictions, such as the UK, which instead intends to adopt an industry-specific approach to AI regulation. Once the consolidated text is finalized and published, it is expected that the majority of the AI Act's provisions will apply two years after its entry into force. The AI Act will apply to providers, manufacturers, importers, distributors, and deployers of AI systems. While the most onerous obligations under the AI Act are imposed on those directly involved in the commercial AI system life cycle (e.g., manufacturers), the AI Act also imposes obligations on AI system users (deployers). It is likely that most (re)insurance companies will fall into the category of a deployer when using AI.

The AI Act takes a risk-based approach, categorizing AI into: (i) unacceptable risk – activities which are prohibited under the AI Act such as those relating to social scoring, as they are considered a clear threat to fundamental rights; (ii) high-risk activities (e.g., those relating to medical devices and consumer creditworthiness); (iii) limited-risk activities like chatbots; and (iv) minimal/no-risk systems that do not fall within one of the three risk categories above are considered minimal or no risk and, in turn, are not regulated under the AI Act (e.g., email spam filters). The relevant legal obligations imposed by the AI Act reduce as the perceived risk level posed by the AI system reduces. Under the AI Act, high-risk AI systems must comply with comprehensive and mandatory compliance requirements, including conformity assessments, post-market surveillance, data governance and quality measures, mandatory registration, incident reporting, and fundamental rights impact assessments, among others.

Limited risk AI systems such as chatbots and certain emotion and biometric categorization systems are subject to more limited transparency obligations (i.e., informing a user they are interacting with an AI system and marketing audio, video, text, and image content as artificially generated or manipulated).

While minimal/no-risk systems are not regulated under the AI Act, it should be noted that they could still be regulated by other legal frameworks (e.g., the GDPR), and voluntary codes of conduct are still encouraged.

Non-compliance with the AI Act may result in regulatory fines by national EU member states, structured as follows: (i) €7.5 million or 1.5% of worldwide turnover (whichever is higher) for the supply of incorrect information; (ii) €15 million or 3% of worldwide turnover (whichever is higher) for violations of AI Act obligations; or (iii) €35 million or up to 7% of worldwide turnover (whichever is higher). Enforcement will be carried out through national competent market surveillance authorities. A European AI Office, part of the Commission, will take up administrative and enforcement tasks at an EU level.

The AI Act is notable for its wide scope of application, 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.

(Re)insurers should note that the Commission is particularly cautious when it comes to using AI in industries such as 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."[38]

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38 https://data.consilium.europa.eu/doc/document/ST-14954-2022-INIT/en/pdf.

As noted above, the UK is also developing its approach on the regulation of AI. On March 29, 2023, the UK's Department for Science Innovation and Technology published its long-awaited white paper on "A pro-innovation approach to AI regulation"[39] (the "**White Paper**"), along with a corresponding impact assessment.[40] The White Paper builds on the "proportionate, light touch and forward-looking" approach to AI regulation set out in its AI regulation policy statement published in July 2022. Importantly, the UK has decided to take a different approach to regulating AI compared to the EU, opting for a decentralized sector-specific approach using a principles-based framework for regulators to interpret and apply to AI within their remit, with no new legislation expected at this time. Instead, the UK will regulate AI primarily through sector-specific, principles-based guidance and existing laws, with an emphasis on an agile and innovation-friendly approach.

The proposed framework will be built around four key elements: (i) defining AI based on its unique characteristics to support regulator coordination; (ii) adopting a context-specific approach; (iii) providing a set of cross-sectoral principles to guide regulator responses to AI risks and opportunities – such principles will initially be at the regulator's discretion so priority can be given according to need before eventually introducing a statutory duty; and (iv) delivering new central functions to support regulators to deliver the AI regulatory framework, maximizing the benefits of an iterative approach, and ensuring that the framework is coherent.

Of particular note, the White Paper proposes how a decentralized approach would work in practice with the case study of a fictional insurance company (AI Fairness Insurance Limited).[41] The White Paper specifically calls out insurance offers as having a significant impact on people's lives. In the case study, the insurance company is designing a new AI-driven algorithm to set prices for insurance premiums that accurately reflect a client's risk, but has delayed the deployment of the application because it has been challenging to identify appropriate compliance obligations under the current patchwork of relevant regulatory requirements. To address this issue, the White Paper suggests joint guidance would be issued by the ICO, the Equality and Human Rights Commission, the FCA, and other regulatory authorities to advise organizations on how to satisfy their obligations in the context of insurance and other consumer-facing financial services, using template risk assessments and transparency measures. The White Paper suggests that a focus on practical implementation will create conditions for the responsible deployment of AI.

On October 26, 2023, the PRA and the FCA published the results and corresponding analysis of their discussion paper published in October 2022 on "Artificial intelligence and machine learning" in the finance sector. Themes from the responses included a call for proportionate but coordinated regulation, as well as a fear that over-regulation would stifle innovation in a sector which relies on data analysis and forecasting, and benefits from continued use of AI. Respondents also flagged that a regulatory definition of AI would be helpful, among other feedback.

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.

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Cybersecurity and data breach reporting requirements have remained priority issues for both companies and regulators throughout 2023. According to the European Council, ransomware is one of the biggest cyber threats in the EU,[42] 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 2023 Verizon Report[43] states that ransomware remains the top category of breaches, and noted personal data, being very useful for fraud, remains the "most desired data type stolen."

39 https://www.gov.uk/government/publications/ai-regulation-a-pro-innovation-approach/white-paper.

40 https://assets.publishing.service.gov.uk/media/6424208f3d885d000cdadddf/uk_ai_regulation_impact_assessment.pdf.

41 See Case study 3.7.

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

43 https://www.verizon.com/business/resources/T961/reports/2023-dbir-finance-snapshot.pdf.

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

DORA establishes uniform cybersecurity requirements for information and communication technology ("**ICT**") systems supporting the business processes of financial entities. DORA imposes requirements to certain financial entities and third-party ICT service providers in relation to ICT risk management, incident reporting, digital operational resilience testing, information sharing, and ICT third-party risk management measures.

DORA entered into force on January 17, 2023 and it will be fully enforceable from January 17, 2025 onwards, without there being a need for EU member state implementation – meaning in scope entities have one year left to take the necessary actions to comply.

To manage third-party ICT risk, competent authorities under DORA will have direct regulatory oversight over third-party ICT service providers (including those outside the EU) that are themselves not engaged in regulated activities but deemed to be critical to regulated financial entities. DORA also provides for increased responsibility for individual members of management bodies, and indicates that entities can be faced with fines under DORA and can be individually named in public decisions by the regulator where it finds non-compliance by a financial entity was attributable to the individual. DORA entered into force on January 17, 2023 and it will be fully enforceable from January 17, 2025 onwards, without there being a need for EU member state implementation – meaning in scope entities have one year left to take the necessary actions to comply.

Given DORA will come into force in early 2025, (re)insurers should prepare for compliance with their obligations under the Act.

DORA 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. 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. Member states are required to lay down rules for the imposition of effective, proportionate, and dissuasive fines, but a maximum threshold is not set out in the Act. Given DORA will come into force in early 2025, (re)insurers should prepare for compliance with their obligations under the Act.

Organizations who believe they may be in scope should monitor relevant legislation and take adequate steps in light of the potential enforcement timeline and high possible fines.

NIS2 aims at further harmonizing and establishing a minimum level of cybersecurity standards across the EU. The Directive, which builds on its predecessor, the NIS Directive, modernizes and prescribes in a more detailed manner the minimum level of cybersecurity measures which organizations in scope should adopt, and it also introduces more stringent incident reporting requirements. Importantly, like DORA, it imposes direct obligations and, in the case of NIS2, personal liability on senior management. NIS2 entered into force on January 16, 2023, and member states are required to implement it into national law by October 17, 2024. Organizations who believe they may be in scope should monitor relevant legislation and take adequate steps in light of the potential enforcement timeline and high possible fines (up to €10 million or 2% of global turnover).

On November 30, 2023, the EU reached political agreement on the CRA, the first legislation globally to regulate cybersecurity for digital and connected products that are designed, developed, produced and made available on the EU market.

On November 30, 2023, the EU reached political agreement on the CRA, the first legislation globally to regulate cybersecurity for digital and connected products that are designed, developed, produced and made available on the EU market. Alongside the recently adopted Data Act, DORA, Critical Entities Resilience Act ("**CER**"), NIS2, and Data Governance Act, the CRA builds on the EU Data and Cyber Strategies, and complements upcoming certification schemes, such as the EU Cloud Services Scheme ("**EUCS**") and the EU ICT Products Scheme ("**EUCC**"). It responds to an increase in cyberattacks in the EU over the last few years – in particular the rise in software supply chain attacks, which have tripled over the last year. Enforcement for these cyber laws may involve high fines, with the CRA allowing for fines of up to €15 million or 2.5% of annual global turnover. The maximum fines imposed by the other cyber laws are as follow: for the Data Act, €20 million or 4% of annual global turnover; for DORA, €1 million or 2% of annual global turnover; and for NIS2, €10 million or 2% of annual global turnover. The CER and DGA leave this decision to member states.

It is clear that (re)insurers must seek to be proactive in maintaining strong, state-of-the-art security systems.

It is clear that (re)insurers must seek to be proactive in maintaining strong, state-of-the-art security systems. 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.

e. UK Data Protection Developments

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 UK government introduced the Data Protection and Digital Information Bill into UK Parliament in 2022. A second version of the bill, the Data Protection and Digital Information (No. 2) Bill [Bill 265 2022-23] was introduced in March 2023 and is currently progressing through the House of Lords.

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.

In addition to the discussion around automated decision making and profiling in section V.D.5.b. above, important changes proposed by 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.

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- 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.

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- The Data Reform Bill also proposes the introduction of a Senior Responsible Individual ("**SRI**"). Under the UK GDPR, the role of Data Protection Officer ("**DPO**") is an independent adviser, responsible for monitoring the business' ongoing compliance with applicable data privacy rules. The SRI seeks to replace the role of DPO, and, while a number of the requirements are similar, a key distinction is that the SRI must be a member of senior management and they cannot be externally appointed. In contrast, the DPO cannot be a member of senior management, given the conflict of interest requirements imposed by the UK GDPR. A DPO can also be externally appointed. It remains to be seen how the balance between these requirements will be struck in practice, particularly where companies may be subject to conflicting requirements under the EU GDPR and UK GDPR/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. 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 that 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 became fully applicable on September 24, 2023.

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 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.

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 was adopted on November 27, 2023, and will begin to apply at the end of 2025, 20 months after entry into force.

As part of the broader EU digital finance and data strategy proposed by the Commission, the Financial Data Access Act ("**FIDA**"), proposed by the Commission in June 2023, proposes new rights to customers to port, share, and control access regarding their financial data with an aim to "bring payments and the wider financial sector into the digital age." Organizations across the financial services industry will be impacted, and non-compliance with FIDA could give rise to fines of up to 2% of annual worldwide turnover and a ban of up to 10 years for responsible individuals to exercise managerial functions at a financial information service provider.

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.

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g. Conclusion

The GDPR has been in force for over five years, 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 2024.

The GDPR has been in force for over five years, 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 2024. In particular, (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 large 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 determine whether it is necessary to reassess their approach to international transfers to take account of the Adequacy Decision and the UK-U.S. Data Bridge.

6. UK Cyber and Operational Resilience Update

Cyberattacks have left brokers inundated with claims from large-scale ransomware attacks.

Cyberattacks have left brokers inundated with claims from large-scale ransomware attacks. The rise in cybercrime activity demonstrates the increased opportunity for cyber criminals in relation to extortion, theft, and sabotage.

In response, companies must consider legal challenges such as GDPR notification obligations, anti-terrorism laws, anti-money laundering laws, sanctions, and internal compliance.

In response, companies must consider legal challenges such as GDPR notification obligations, anti-terrorism laws, 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 and technical mitigations 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 to tighten cybersecurity to the fullest extent, 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.

According to market commentary from Lloyd's, cyber insurance is a growing market, forecast to hit between US$13-25 billion in gross written premiums by 2025.

In October 2023, Lloyd's published a systemic risk scenario that models the global economic impact of a hypothetical but plausible cyberattack on major financial services payment systems, resulting in widespread disruption to global business and potential global economic losses of US$3.5 trillion.

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

i. UK

Cyber Practices

Robust cyber practices of firms are of high priority to the PRA and FCA (together "**UK Regulators**"). In October 2023, the Bank of England (the "**Bank**") noted that the threat of cyberattacks has become an increasingly important consideration for maintaining financial stability in the UK. Given that businesses have become more digitized and interconnected at an operational level, this increases the potential for disruption at one firm to lead to system-wide disruption. The Bank's Financial Policy Committee is working to improve and test the financial system's resilience to cyber risks and seeks to identify and monitor the channels through which operational risks could affect financial stability, including those arising from technological developments, such as AI.

A clear understanding of the complex and evolving legal and regulatory environment, and a comprehensive operational resilience program, will be key to ensuring firms manage their cyber risk and avoid hefty fines (such as the approximately £11 million fine issued by the FCA in October 2023 against Equifax Ltd. for failing to manage and monitor the security of UK consumer data that it outsourced to its U.S. parent company).

Firms should also be mindful of their obligations under Principle 11 of the FCA's Principles for Businesses, the PRA's Fundamental Rule 7, and Lloyd's Principles for Doing Business (Regulatory and Financial Crime), and consider whether a notification is required in the event of a cyber incident.

Operational Resilience

The end to the transitional period for compliance with the FCA's policy statement *Building Operational Resilience* ("**PS21/3**")[44] and the PRA's Supervisory Statement *Operational resilience: Impact tolerances for important business services* ("**SS1/21**")[45] is quickly approaching. In particular, in-scope firms, including banks, non-bank payment service providers (including payment institutions and electronic money institutions), building societies, PRA-designated investment firms, insurers, Recognised Investment Exchanges, and Enhanced Scope Senior Managers and Certification Regime firms (together, "**Firms**") will, by no later than March 31, 2025, need to have:

- Performed mapping and scenario testing (including for cyber-related disruptions) of important business services so that they can remain within impact tolerances for each important business service; and

- Made the necessary investments to enable the firm to operate consistently within its impact tolerances.

An important business service is a service provided by a firm, or by another person on behalf of a firm, to one or more clients of a firm which, if disrupted, could: (i) cause intolerable levels of harm to any one or more of a firm's clients; or (ii) pose a risk to the soundness, stability, or resilience of the UK financial system, or the orderly operation of the financial markets. Alongside this, an impact tolerance reflects the first point at which a disruption to an important business service would cause intolerable levels of harm to consumers or risk to market integrity. The UK Regulators also expect Firms to identify a proportionate number of important group business services and respective impact tolerances at the level of the group.

44 https://www.fca.org.uk/publication/policy/ps21-3-operational-resilience.pdf.

45 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2021/ss121-march-22.pdf.

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The cross-functional nature of operational resilience and the interplay with other key programs (such as business continuity and disaster recovery) will require Firms to carefully consider how best to ensure their important business services remain within their defined impact tolerances.

In its Dear CEO letter on 2024 priorities for supervision of UK Deposit Takers, insurers, and international banks, the PRA has stated that operational resilience is a strategic priority for the upcoming year and noted that it "*expects Boards and senior management to actively oversee the delivery of their firm's operational resilience programme.*" The FCA has also made it clear that it is scaling up efforts to deal with Firms who cannot meet the new FCA standards on operational resilience (see the FCA Business Plan 2023-2024). In particular, the individual(s) holding the Chief Operations function ("**SMF 24**") will need to ensure that adequate systems and controls are in place to comply with the operational resilience requirements (including PS21/3 and SS1/21), as failure to comply could result in the issuance of disciplinary measures or sanctions on a firm or individual(s) (such as the SMF 24) by the UK Regulators.

The Lloyd's Market Oversight Plan, published in January 2024, makes clear that Lloyd's has updated Principle 12 (Operational Resilience) to include four maturity levels, and that Lloyd's engagement with managing agents will shift towards oversight and challenge. Lloyd's will also be issuing another Operational Resilience Survey in Q4 of 2024 to focus on the areas of development identified through additional oversight. This will allow Lloyd's to fully understand the overall resilience of managing agents ahead of the March 2025 deadline.

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The regulatory alignment across jurisdictions should alleviate some of the burden of cross-border compliance by driving greater consistency in global standards. The UK Regulators have aligned their policy statements with the European Banking Authority; the Basel Committee for Banking Supervision's proposed Principles for Operational Resilience; the Commission's proposed Digital Operational Resilience Act ("**DORA**"); and the International Organization of Securities Commission's Principles on Outsourcing. Many of the initiatives share a similar approach of asking firms to understand their critically important functions, tolerance for disruption, interdependencies with third parties, and risk appetite. Firms should anticipate the likelihood of increased supervisory scrutiny on compliance with operational resilience requirements from their home state and foreign regulators.

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Critical Third Parties

While the end of the transitional period for PS21/3 and SS1/21 nears, the UK Regulators' recent joint consultation paper, *Operational resilience: Critical third parties to the UK financial sector* ("**CP26/23**"), has sent a strong signal to the financial services industry that operational resilience remains a supervisory priority and that the landscape will continue to expand and evolve. The FSMA 2023 granted the UK Regulators and HMT powers to designate a service provider as a critical third party ("**CTP**") by reference to: (i) the materiality of the service(s) which the third party provides to firms and financial market infrastructures ("**FMIs**"), including payment systems in relation to essential activities, services, or operations; and (ii) the concentration in terms of the number and type of firms and FMIs to which the third party provides its service(s). CP26/23 proposes to broaden the criterion to include whether a failure in, or disruption to, the service(s) that a third party provides to firms and FMIs could threaten the stability of, or confidence in, the UK financial system and market integrity or consumer protection.

CP26/23 is intended to address the systemic risk that CTPs present to firms and FMIs by requiring CTPs that provide essential technology and other services to firms to strengthen their operational resilience framework.

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Under the proposals in CP26/23, CTPs will need to:

- Meet the minimum resilience standards in respect of any material services that they are providing to firms;

- Comply with a set of six "Fundamental Rules" that will apply to all the services a CTP provides, including having effective risk strategies and dealing with the UK Regulators in an open and cooperative way; and
- Comply with eight "Operational Risk and Resilience Requirements" that will apply to a CTP's material services, such as the requirement to appropriately manage incidents that may adversely affect, or may reasonably be expected to adversely affect, the delivery of a material service.

There will also be a new phased approach to notifications in relation to incidents affecting CTP services, such as those that impact the availability, authenticity, integrity, or confidentiality of assets. A CTP will have to provide the following notifications to the relevant firms, FMIs, and regulators: (i) an initial incident notification; (ii) one or more intermediate incident notifications; and (iii) a final incident notification. The first notification must be submitted without undue delay after the CTP is aware that the relevant incident has occurred. The second will need to be provided based on the CTP's reasonable knowledge at the time of submission. Once a relevant incident has been resolved and the CTP has had time to assess its root causes and identify lessons learned, the UK Regulators propose that it must provide the final notification.

In December 2023, the Financial Stability Board published a toolkit for financial institutions and authorities on enhancing third-party risk management and oversight. It will be useful for firms to utilize the toolkit to build upon the existing and upcoming third-party operational resilience standards.

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AI

On October 11, 2022, the UK Regulators 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 UK Regulators sought to encourage a discussion with stakeholders on the challenges associated with the use and regulation of AI in UK financial services. Some of the key points coming out of the feedback statement from October 2023 (FS2/23) include the following: (i) AI capabilities change rapidly, therefore regulators could respond by designing and maintaining "live" regulatory guidance (i.e., periodically updated guidance and examples of best practice); (ii) more coordination and alignment between regulators, domestic and international, would help reduce fragmentation; and (iii) a key focus of regulation and supervision should be on consumer outcomes, especially with respect to ensuring fairness.

In the Lloyd's Market Oversight Plan for 2024, it was stated that Lloyd's plans to conduct an initial review into how managing agents have addressed the risks that AI capability poses from a compliance and financial crime perspective. For further information on AI and its impact on the insurance sector, see section V.D.5.

In the Lloyd's Market Oversight Plan for 2024, it was stated that Lloyd's plans to conduct an initial review into how managing agents have addressed the risks that AI capability poses from a compliance and financial crime perspective.

ii. EU

In September 2023, the European Insurance and Occupational Pensions Authority ("**EIOPA**") published a revised Single Programming Document for 2024-2026 which sets out its operational objectives and planning priorities. EIOPA has stated that it will deliver policy work in relation to several legislative initiatives, including the AI Act and Cyber Security and Information Security Regulations.

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This aligns with the Commission's approach of introducing new cyber legislation which will impact the insurance industry. First, there is the 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 Information and Communications Technology ("**ICT**") risk management framework, report incidents adequately, and allow for periodic testing of their information technology 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 sanctions, criminal penalties, administrative fines, and mandatory implementation of remedial measures.

This aligns with the Commission's approach of introducing new cyber legislation which will impact the insurance industry.

In November 2023, the European Commission ("**Commission**") published two draft delegated acts which supplement DORA by: (i) specifying the criteria for the designation of ICT third-party service providers as critical for financial entities ("**CTPPs**"); and (ii) determining the amount of the oversight fees to be charged by the lead overseer to CTPPs and the way in which those fees are to be paid. The Commission sought feedback on the draft delegated acts (feedback period ended in December 2023) and stated that it will take account of the feedback received when finalizing the acts.

In response to the Commission's call for advice to the European Supervisory Authorities ("**ESAs**") in December 2022 relating to the draft delegated acts under DORA, the ESAs published their technical advice for the Commission in September 2023. In relation to the criticality criteria, the ESAs propose 11 quantitative and qualitative indicators along with the necessary information to build up and interpret such indicators following a two-step approach. The ESAs also put forward minimum relevance thresholds for quantitative indicators, where possible and applicable, to be used as starting points in the assessment process to designate critical third-party providers. Regarding the oversight fees, the ESAs' proposals cover the types of estimated expenditures (for both the ESAs and the competent authorities) that shall be covered by oversight fees. It also covers the basis for the expenditures' calculation, the available information for determining the applicable turnover of the CTPPs (the basis of fee calculation), and the method of fee calculation together with other practical issues regarding the collection of fees. In addition, the advice proposes a financial contribution for voluntary opt-in requests. The Commission intends to adopt the delegated acts by Q2 2024.

In January 2024, the Joint Committee of the ESAs published final reports on the first set of regulatory technical standards and implementing technical standards under DORA.

In January 2024, the Joint Committee of the ESAs published final reports on the first set of regulatory technical standards and implementing technical standards under DORA. The ESAs have also submitted the final draft RTS to the Commission for adoption, following which they will be scrutinized by the European Parliament and the Council of the EU before being published in the *Official Journal of the European Union*. The technical standards are expected to apply on January 17, 2025. For further information on DORA, see section V.D.5.

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 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. A final agreement on the CRA between EU lawmakers was reached on November 30, 2023. A planned vote on the CRA is due to take place in March 2024.

Finally, the Commission has updated its EU Network and Information Systems Security Directive ("**NIS2**"). NIS2 imposes its obligations on "essential" and "important" entities across a range of industries. No explicit reference is included in respect to insurance companies, although 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

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

Initiatives relating to ESG have increasingly become a priority in the (re)insurance sector and companies are continuing to take 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 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. EU and ESG

EU Non-Financial and Sustainability Reporting

2023 saw a number of developments in the area of non-financial and sustainability reporting.

By way of background, the EU framework for non-financial and sustainability reporting by companies has been developing over the last decade by way of a series of directives.

First, the EU Non-Financial Reporting Directive (2014/95/EU) ("**NFRD**") amended the EU Accounting Directive (2013/34/EU), requiring 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 micro-enterprises, 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**")), developed by the European Financial Reporting Advisory Group ("**EFRAG**"). On July 31, 2023, the Commission adopted the first set of final standards as delegated acts. Further, sector-specific ESRS, as well as ESRS to be used by non-EU companies in scope of the CSRD, are expected to be adopted by June 30, 2026. Companies that are already subject to NFRD,[46] 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.

EU Sustainability Due Diligence

On December 14, 2023, the European Parliament and the Council of the EU reached a provisional agreement on the final text of the Corporate Sustainability Due Diligence Directive ("**CS3D**").

Companies in scope of CS3D will be required to carry out due diligence in relation to their own operations, those of their subsidiaries, and those carried out through their chain of operations. The due diligence obligation will require companies to identify, prevent, mitigate, and remediate actual and potential adverse impacts on people and the environment. CS3D also requires in-scope companies to implement a climate transition plan, which aims to ensure, through best efforts, compatibility of the company's business model and strategy with the Paris Agreement goal of a transition to a sustainable economy and limiting of global warming to five degrees Celsius.

CS3D generally applies to EU companies with 500 or more employees a net global turnover of €150 million. Companies in "high risk" sectors (such as textiles and agriculture) are subject to lower thresholds (250 or more employees and net global turnover of €40 million, where at least €20 million is generated from high-risk sectors). CS3D also applies to non-EU companies that have a net turnover in the EU of at

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On December 14, 2023, the European Parliament and the Council of the EU reached a provisional agreement on the final text of the Corporate Sustainability Due Diligence Directive.

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

least €150 million, whether or not they have a place of business in the EU. It also captures non-EU parent companies with a net global turnover of €40 million that have franchising or licensing agreements with EU companies delivering annual royalty payments of more than €7.5 million.

The financial sector was granted a partial carve-out, following pressure from certain EU member states during the legislative process. Accordingly, the financial sector's due diligence obligations will apply only to a financial firm's own operations and its upstream chain of operations ...

The financial sector was granted a partial carve-out, following pressure from certain EU member states during the legislative process. Accordingly, the financial sector's due diligence obligations will apply only to a financial firm's own operations and its upstream chain of operations, i.e., financial firms will not be required to diligence their downstream value chains (including relationships with clients). This carve-out is subject to a review clause. Furthermore, firms in the financial sector will still be subject to the requirement to implement detailed transition plans in the same way as non-financial firms.

The new rules are expected to have a profound impact on the operations and governance of companies that do business both within and outside the EU – due to the direct (and extensive) impact of CS3D on in-scope companies, as well as the indirect impact of those obligations on such companies' global value chains, partners, and customers.

It is expected that the provisional agreement will be formally adopted by the European Parliament and the Council of the EU, likely in Q1 2024.

It is expected that the provisional agreement will be formally adopted by the European Parliament and the Council of the EU, likely in Q1 2024. CS3D will enter into force 20 days after publication. Member states will then have two years to implement CS3D into national law, meaning it is expected to take effect in Q1 2026.

Draft Opinion on Sustainability Claims and Greenwashing

The draft Opinion includes four principles which aim to provide for a more effective and harmonized supervision of sustainability claims across Europe and limit the risk of greenwashing in the insurance and occupational pensions sector.

In December 2023, EIOPA published a public consultation paper ("**Opinion**") (available at https://www.eiopa.europa.eu/consultations/consultation-opinion-sustainability-claims-and-greenwashing-insurance-and-pensions-sectors_en) on its draft Opinion on sustainability claims and greenwashing. The draft Opinion provides guidance to competent authorities on how to identify misleading sustainability claims and monitor greenwashing throughout the insurance and pensions lifecycle. The draft Opinion includes four principles which aim to provide for a more effective and harmonized supervision of sustainability claims across Europe and limit the risk of greenwashing in the insurance and occupational pensions sector. The deadline to respond to the consultation paper is March 12, 2024.

Consultation Paper on the Prudential Treatment of Sustainability Risks

EIOPA has also published a consultation paper (available at https://www.eiopa.europa.eu/system/files/2023-12/Consultation Paper on the Prudential Treatment of Sustainability Risks.pdf) on the prudential treatment of sustainability risks in December 2023. The consultation paper represents the second phase in EIOPA's step-by-step approach concerning the expected mandate under Solvency II, which requires EIOPA to assess whether a dedicated prudential treatment of assets or activities associated substantially with environmental or social objectives, or harm to such objectives, would be justified (see section V.D.8.).

In the consultation, EIOPA considers the following areas related to the potential treatment of sustainability under Solvency II:

- **Market risks of assets and transition risk exposures**. EIOPA considers the potential link between prudential market risks in terms of equity, spread and property risk, and transition risks. Its view is that a risk-based analysis as regards Solvency II's solvency capital requirements in terms of the standard formula would be appropriate. It considers that transition risks can be sufficiently reflected in Solvency II's requirements as regards risk management (Pillar II) and disclosure (Pillar III);

- **Non-life underwriting risks and climate change adaptation**. EIOPA focuses its analysis on the solvency capital requirements, as it considers that risk management and disclosure requirements sufficiently reflect the effects of climate-related risk prevention in the non-life underwriting business. At this stage, it does not recommend changing the prudential treatment of premium risk in context of climate-related adaptation measures; and

- **Social objectives and social risks from a prudential perspective**. EIOPA provides an initial analysis of the Pillar II and III requirements under Solvency II to identify potential areas for further work. It does not recommend changes in Solvency II related to a dedicated Pillar I treatment of social objectives and risks.

The consultation paper closes on March 22, 2024.

EIOPA's Catastrophe Data Hub

In December 2023, EIOPA launched an open-source Catastrophe Data Hub as a key part of its climate change adaptation strategy. The hub brings together data related to natural catastrophe, including exposure and loss data of a sample of EU insurance undertakings. The data is presented in two different views:

- **Insured exposure view**: insured exposure to flood and windstorm of residential and commercial buildings.
- **Insured losses view**: the losses incurred for buildings reported by the insurance undertakings or groups in the sample. It covers three types of events including a flood event, a wildfire, and a windstorm.

EIOPA has stated that the insurance sector can benefit from access to loss data and having a complete view of the market.

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b. UK Rules on Climate-Related ESG Disclosures

FCA Sustainability Disclosure Requirements and Investment Labels

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 Task Force on Climate-Related Financial Disclosures' ("**TCFD**") 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 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[47] alignment reporting and disclosure of net zero transition plans.

FCA SDR

On November 28, 2023, the FCA published its Policy Statement (PS23/16) (the "**Policy Statement**") setting out its final rules on UK Sustainability Disclosure Requirements ("**SDR**") and investment labels.

On November 28, 2023, the FCA published its Policy Statement (PS23/16) setting out its final rules on UK Sustainability Disclosure Requirements ("SDR") and investment labels.

This follows the publication of the FCA's Consultation Paper (CP22/20) on October 25, 2022. In CP22/20, the FCA had proposed a framework for the SDR, encompassing a number of elements, including a new opt-in labeling regime for sustainable investment products, naming and marketing rules, and an anti-greenwashing rule applicable to all authorized firms to reinforce that sustainability-related claims must be fair, clear, and not misleading.

While the rules mostly apply in relation to asset management activities, certain aspects of the SDR are broader in application and capture the activities of FCA-authorized insurance firms. The most notable example is the anti-greenwashing rule, which applies to all FCA-authorized firms. The anti-greenwashing rule will require firms to ensure, when communicating with UK clients or making financial promotions to persons in the UK, that any reference to the sustainability characteristics of a product or service is fair, clear, and not misleading. The FCA also launched a consultation on guidance on the anti-greenwashing rule (GC23/3), which closed on January 26, 2024.

In PS23/16, the FCA confirmed in response to feedback that it would extend the effective date for the anti-greenwashing rule, which will now come into effect on May 31, 2024 (in contrast with the initial proposal in CP22/20 that it would come into effect immediately on publication of the FCA's Policy Statement).

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

As currently proposed, the SDR does not apply to insurance-based investment products ("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.

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International Platform on Sustainable Finance

In February 2021, the UK's HMT published a press release announcing that the UK joined the International Platform on Sustainable Finance (the "**Platform**"), which 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 requiring the 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. In 2023, the Platform focused on three important policy areas: (i) social finance; (ii) transition finance; and (iii) the comparison of taxonomies. Looking ahead to 2024, the Platform has indicated that it "*remains committed to advancing the sustainability agenda, fostering international cooperation, and maintaining its key role in global sustainability efforts.*"

FCA's Insurance Market Priorities 2023-2025

On September 20, 2023, the FCA issued a Dear CEO letter to wholesale insurance firms and life insurance firms. In the letters, the FCA sets out the specific risks of harm that it is most concerned about and what the FCA wants firms to do about them.

On September 20, 2023, the FCA issued a Dear CEO letter to wholesale insurance firms and life insurance firms. In the letters, the FCA sets out the specific risks of harm that it is most concerned about and what the FCA wants firms to do about them. The FCA has indicated that: (i) climate risk; and (ii) governance, culture, and non-financial misconduct are regulatory priorities over the next two years.

Climate Risk

The FCA has indicated that wholesale insurers can have a significant impact in driving the net zero transition and should ensure that their underwriting and investment activities are aligned with any ESG and sustainability-related public commitments that they make.

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For life insurers, the FCA has reminded these firms that any sustainability-related claims must be communicated in a way that is clear, fair, and not misleading. The FCA has proposed a specific rule that reinforces this requirement and directly links it to sustainability claims in its consultation on Sustainability Disclosure Requirements and investment labels published in October 2022.

Governance, Culture, and Non-Financial Misconduct

The FCA has highlighted the following areas for improvement: (i) diversity, equity, and inclusion at all levels; and (ii) preventing and handling non-financial misconduct, including discrimination, harassment, victimization, and bullying.

Over the past year, the FCA has seen an increase in incidents involving non-financial misconduct that have been reported in the wholesale market. The FCA has reminded firms that it must report instances of serious, non-financial misconduct to the FCA promptly and ensure that appropriate systems and controls are in place to deal with such misconduct.

The FCA has indicated that it is ready to use its full range of regulatory tools, including enforcement action, against firms and individuals for non-financial misconduct. Firms should expect to show the FCA how they are making progress in this area.

The FCA has indicated that it is ready to use its full range of regulatory tools, including enforcement action, against firms and individuals for non-financial misconduct. Firms should expect to show the FCA how they are making progress in this area. In particular, the FCA will soon be holding a new round of conversations with non-executive directors on their firms' approach to culture and non-financial misconduct.

PRA and FCA Consultation on Diversity, Equity, and Inclusion

In September 2023, the PRA published a consultation paper (CP18/23) that sets out the PRA's proposed rules and expectations in relation to supporting better firm governance, decision making, and overall culture. This new regulatory framework on diversity and inclusion in the financial sector has been proposed in collaboration with the FCA, who also published their own consultation paper (CP23/20). The final rules are planned to be published in 2024 and are expected to come into effect in 2025.

All firms will be expected to:

- Report the number of employees annually, to help determine diversity statistics and increase transparency;
- Implement a Diversity & Inclusion ("**D&I**") strategy that will set out how the firm will meet their objectives and goals, specifically promoting D&I on the board. There should also be a plan for meeting goals and measuring progress, identifying and managing obstacles, and making sure that staff have an adequate knowledge of the strategy;
- Monitor D&I data internally and take action where necessary;
- Identify and manage non-financial risk within its governance structures. The FCA is planning to introduce guidance to clarify that a lack of D&I is to be considered as non-financial risk and should be treated appropriately within a firm's governance structures; and
- Take into account non-financial misconduct. Firms should account for instances of bullying, and similar non-financial misconduct within the workplace (and private life), in a manner relevant to fitness and propriety assessments.

In addition to the above, the proposed rules require Solvency II firms, firms with 251 or more employees, and Capital Requirement Regulation firms to:

- Set publicly disclosed targets to address underrepresentation;
- Comply with additional reporting obligations by collecting, reporting, and disclosing data against certain characteristics, inclusion metrics, and targets. This data can be used to produce an industry-wide benchmarking report; and
- Make public disclosures on D&I data (the demographic diversity of their firm and the outcome of inclusion surveys) and the targets that firms have set for themselves, to increase transparency and scrutiny.

Discussion Paper on Finance for Positive Sustainable Change

On February 10, 2023, the FCA published DP23/1 with the aim of encouraging an industry-wide dialogue on firms' sustainability-related governance, incentives, and competencies. The FCA is interested in how firms embed a clear purpose, how this relates to sustainability objectives, and the strength of the "tone from the top" on sustainability-related matters. The FCA has indicated that remuneration is a crucial tool to help align corporate outcomes with long-term sustainability aims. The FCA's questions focus on:

- Whether firms have environmental or social objectives and how these are reflected in their policies and strategies;
- How firms design their approaches to governance, remuneration, incentives, training, and competence, to deliver effectively on these objectives;
- Practical challenges, and observed gaps and shortcomings; and
- Whether existing rules and guidance in these areas are appropriate or need to be refined to adapt to the changing role of finance.

The discussion period will end on May 10, 2023. The FCA is considering the feedback received to determine its next steps.

Report on Climate-Related Risks and the Regulatory Capital Frameworks

On March 13, 2023, the Bank of England (the "**Bank**") published a report on climate-related risks and the regulatory capital frameworks. The report includes updates on: (i) capability and regime gaps; (ii) capitalization timelines; and (iii) areas for future research and analysis.

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The Bank has stated that it will undertake further analysis to explore whether changes to the regulatory capital frameworks may be required. In particular, the Bank will progress work to:

- Ensure firms continue to make progress to address capability gaps to improve the identification, measurement, and management of climate risks;
- Build its capabilities and forward-looking tools to judge the resilience of financial systems to climate risks;
- Progress work to understand material regime gaps in the capital frameworks (and consider whether any changes to the macroprudential framework might be appropriate);
- Support initiatives to enhance climate disclosures;
- Promote high quality and consistent accounting for climate risks;
- Supervise against the supervisory statement on "Enhancing banks' and insurers' approaches to managing the financial risks from climate change" ("**SS3/19**"), including whether further guidance or updates to the expectations set out in SS3/19 are warranted over time; and
- Engage in relevant discussions at international forums to inform domestic policymaking.

The Bank has stated that "*substantial further work is needed and there remain many open questions, noting on potential regime gaps to capture systemic risks from climate change and unintended consequences.*" The Bank intends to address these questions as part of its supervision and policymaking.

c. Lloyd's and ESG

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.

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Lloyd's has also imposed ESG-focused outcomes by way of the Principles. 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.

In November 2023, Lloyd's launched a consultation on its three-year roadmap for insuring the transition to net-zero. The aim of the roadmap is to: (i) provide clarity to stakeholders on what Lloyd's ambition to achieve net zero by 2050 means for the market; (ii) set out planned oversight processes and regulatory expectations on climate-related risk management, capital, and reserving, as well as transition planning; and (iii) share key transition-focused toolkits to support the market.

In this consultation, Lloyd's has indicated that it will work with the market to seek to develop a climate litigation scenario, and a key performance indicator for physical climate risk. In addition, it will scope a questionnaire on allowance in capital and reserving which will be collected during 2025. Lloyd's will also continue to engage on, and request, sustainability strategies and responsible investment policies, to ensure that Lloyd's is on track with this strategic priority and better able to support clients as they transition to net zero. The consultation period ends in Q1 2024.

In April 2023, Lloyd's announced the launch of a £250 million fund to invest in sustainability-related assets, which is designed to help London market investors generate risk-adjusted returns on capital and access a broader range of investment opportunities.

The drive within Lloyd's on ESG is further illustrated by the Lloyd's Plan 2024. In its plan, Lloyd's has indicated that managing agents can expect continued regular engagement on culture throughout 2024. A culture survey is expected to be run in Q1 2024 and further development of the Culture Principle will be carried out to include additional levels of maturity (see section V.D.3.).

The impact fund will invest in PE, infrastructure, and natural resources with long-term themes of climate mitigation, climate adaptation, circular economy, and social inclusion.

In April 2023, Lloyd's announced the launch of a £250 million fund to invest in sustainability-related assets, which is designed to help London market investors generate risk-adjusted returns on capital and access a broader range of investment opportunities. The Lloyd's Private Impact Fund, managed by Schroders Solutions, is the first fund to be launched on the Lloyd's Platform and is a key deliverable of the Future at Lloyd's program. The impact fund will invest in PE, infrastructure, and natural resources with long-term themes of climate mitigation, climate adaptation, circular economy, and social inclusion.

8. EU and UK Solvency II Updates

a. European Updates

Improvements to 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. Echoing such proposed changes, the European Parliamentary Research Service published a briefing in January 2023 on a proposal to amend Solvency II, particularly regarding capital requirements and the valuation of insurance liabilities and cross border supervision, as well as clarifications on the proportionality principle.

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On December 13, 2023, the European Council announced that it had reached a provisional political agreement with the European Parliament on the proposed Directive amending Solvency II. The new rules aim to boost the role of the (re)insurance sector in providing long-term private sources of investments to European business, make the sector more resilient, and prepare for future challenges with a view to improving the protection of insurance policyholders. The new review will also make insurance supervision more proportionate and better tailored to the actual risks, by reducing the administrative burden on small insurance companies.

The agreed position includes: (i) reducing the cost-of-capital rate from 6% to 4.75% in order to free up funds that were kept in reserve, allowing the insurance sector to channel more funds into the economic recovery (including the European Green Deal); (ii) increasing cooperation between home and host supervisors of insurers operating in other member states in order to simplify supervision; and (iii) new provisions that require insurers to increase the extent to which they take sustainability-related risks into account and to report more about these risks.

The final compromise texts of the provisional political agreement made in December 2023 were published on January 25, 2024. This texts will be presented to the member states' representatives (via the Committee of Permanent Representatives) and the European Parliament for approval. Once approval is obtained, both the Council and the Parliament will need formally to adopt the texts.

The European Council also assigned new tasks to EIOPA, including technical standards aimed at ensuring a more harmonized implementation of Solvency II in member states. Delegated acts to complement this will follow later, opting for a balanced review of the Solvency II prudential framework in relation to capital requirements.

On December 13, 2023, EIOPA published its consultation paper on the prudential treatment of sustainability risks. The consultation paper assesses whether a dedicated prudential treatment of assets or activities associated substantially with environmental or social objectives, or harm to such objectives, would be justified. EIOPA acknowledges that sustainability risks evolve in a dynamic way, so it is essential that Solvency II evolves alongside this, to tackle any potential future challenges that sustainability risks impose (see section V.D.7.).

b. UK Updates: UK Solvency II Reform

Since the end of the Brexit transition period, the application of Solvency II in the UK has been subject to a major review, with a view to the UK adopting "Solvency UK" following this review. The aim of the Solvency II review is to ensure the UK's competitiveness in the insurance sector, improve protection of policyholders, and to ensure the soundness of UK insurers so that they can provide long-term capital to support the UK's growth objective. 2023 was a significant year for developments in relation to the adaptation of Solvency UK.

The aim of the Solvency II review is to ensure the UK's competitiveness in the insurance sector, improve protection of policyholders, and to ensure the soundness of UK insurers so that they can provide long-term capital to support the UK's growth objective. 2023 was a significant year for developments in relation to the adaptation of Solvency UK.

Solvency UK is a supervisory priority for both Lloyd's and the PRA. In the Lloyd's Market Oversight Plan for 2024, Lloyd's stated that it has engaged with the PRA and HMT throughout this process to advocate for the most proportionate regulatory approach possible and will continue to work with the regulators and engage with the market as the UK implements Solvency UK. Lloyd's is committed to passing on any simplification in requirements to syndicates. Under the same vein, the PRA stated in its insurance supervision priorities for 2024 that they are working on how to implement the changes in the most efficient and proportionate way and will seek to provide more clarity to relevant stakeholders on Solvency UK.

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In June 2023, the FSMA 2023 received royal assent. FSMA 2023 provides a framework for the revocation of retained EU law in financial services and its replacement with corresponding regulators' rules (in the case of Solvency II, mainly in the PRA Rulebook).

In June 2023, the PRA issued a consultation covering reform proposals for insurers ("**CP12/23**"). This consultation paper dealt with the calculation of transitional measures and branch capital, as well as changes to reporting and disclosures. On February 28, 2024, the PRA published a policy statement ("**PS2/24**") containing its near final rules in relation to a number of the proposed reforms in CP12/23.

On September 20, 2023, the Bank of England stated its plans to simplify the operation of the Matching Adjustment ("**MA**"). At the end of September 2023, the PRA published another consultation paper ("**CP19/23**"). The main objectives of the proposed changes to the MA include: (i) facilitating greater investment freedom by insurers to increase their investments in productive finance, from 2024 onwards, and (ii) improving the responsiveness to risk and enhancing firms' responsibility for risk management. The consultation period for CP19/23 ended on January 5, 2024.

The PRA plans to publish final policy and rules on the MA during Q2 2024, with an effective date of June 30, 2024. Implementation of the MA provisions in June 2024 will mean that life insurance firms can take advantage of these investment-related MA reforms in advance of December 31, 2024.

The PRA plans to publish final policy and rules on the MA during Q2 2024, with an effective date of June 30, 2024. Implementation of the MA provisions in June 2024 will mean that life insurance firms can take advantage of these investment-related MA reforms in advance of December 31, 2024. The legislation underpinning the changes to the MA – *the Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023* will take effect on June 30, 2024 (except for Regulation 7 which is the PRA's power to make rules which comes into force on April 1, 2024).

There is a third consultation paper planned to take place in early 2024, which covers all remaining Solvency II requirements to be transferred from retained EU law largely unchanged into the PRA Rulebook and other policy materials. All other changes related to the Solvency II review are scheduled to take effect on December 31, 2024.

Additionally, HMT published draft legislation in June 2023 focusing on changes to the risk margin. CP12/23 sets out the proposals for areas of reform that have been specifically allocated to the PRA.

The RM Regulations are expected to be beneficial for life insurers for several reasons as they: (i) reduce the amount of risk margin insurers need to hold by changing its calculation; (ii) remove some PRA reporting obligations for (re)insurance undertakings; and (iii) change the criteria for the PRA to revoke an approval to apply a transitional deduction to an undertaking's technical provisions.

In relation to the risk margin, the *Insurance and Reinsurance Undertakings (Prudential Requirements) (Risk Margin) Regulations 2023* ("**RM Regulations**"), came into effect on December 31, 2023. The RM Regulations are expected to be beneficial for life insurers for several reasons as they: (i) reduce the amount of risk margin insurers need to hold by changing its calculation; (ii) remove some PRA reporting obligations for (re)insurance undertakings; and (iii) change the criteria for the PRA to revoke an approval to apply a transitional deduction to an undertaking's technical provisions.

9. Bermuda Imposes New Regulatory Approval Process for Block Transactions

In January 2023, the Bermuda Monetary Authority ("**BMA**") began to require that all long-term commercial (re)insurers domiciled in Bermuda obtain prior approval for any new block reinsurance transactions, as well as modifications to existing block transactions, as further described in the BMA's consultation paper titled "Proposed Enhancements to the Regulatory Regime for Commercial Insurers" dated July 28, 2023. (Re)insurers that may be affected by such requirement should consult with Bermuda counsel for further information.

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