SIDLEY

SIDLEY GLOBAL INSURANCE REVIEW

APRIL 2022

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SIDLEY GLOBAL INSURANCE REVIEW

April 2022

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

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

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

We hope you find the 2022 edition of the *Sidley Global Insurance Review* to be a valuable tool in navigating the insurance market.

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I. The Global Mergers and Acquisitions Market

A. THE NORTH AMERICAN MARKET

1. Introduction

The resurgence in insurance mergers and acquisitions ("**M&A**") that characterized the last two quarters of 2020 continued in earnest throughout 2021; there appeared to be few, if any, lingering effects from the COVID-19 pandemic that had suppressed deal activity in early 2020. Last year saw the consummation of 180 U.S. insurance mergers and acquisitions, the highest total since 2015.[1] Insurance M&A activity was turbocharged by a number of "megadeals," primarily in the life, health, and annuity sectors, and the statistics would have been even more impressive had the US$30 billion Aon plc ("**Aon**") and Willis Towers Watson ("**WTW**") megamerger described below not been blocked by the U.S. Department of Justice. Consistent with recent years, announced deal activity in the property and casualty ("**P&C**") space was comparatively light, although interest in brokerage transactions remained keen.

The resurgence in insurance mergers and acquisitions ("M&A") that characterized the last two quarters of 2020 continued in earnest throughout 2021; there appeared to be few, if any, lingering effects from the COVID-19 pandemic …

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

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While a comprehensive discussion of the insurance M&A transactions announced or closed in 2021 is beyond the scope of this publication, we consider below some of the more noteworthy transactions and developments in insurance M&A in the past year.

2. Life and Health

Deal activity in the life and health sector in 2021 was very strong, driven in large part by a number of large transactions and continued enthusiasm on the part of private equity-backed buyers for assets in the space including, as has consistently been the case in recent years, variable annuity business. Among the leading transactions announced or closed in 2021 were Blackstone's acquisition of Allstate Life Insurance Company for US$2.8 billion (with total deal proceeds amounting to US$4 billion); Apollo Global Management's stock-for-stock merger with Athene Holding Ltd. ("**Athene**") in a transaction that implied a total equity value of approximately US$11 billion for Athene; the acquisition of Prudential Financial's full-service retirement business by Empower Retirement, a subsidiary of Great-West Lifeco Inc. for US$3.5 billion; MassMutual's US$3.5 billion acquisition of Great American Life Insurance Company; and the pending acquisition by Fortitude Re, a private equity-backed Bermuda reinsurer, of a US$31 billion block of legacy variable annuity business from Prudential Financial for a total transaction value of US$2.2 billion. Several of the notable transactions were effected through block reinsurance, including the cession by Equitable Holdings, Inc. to Venerable Holdings of US$12 billion of variable annuity liabilities (which closed in June), and a pending reinsurance transaction announced on December 3, 2021, through which Talcott Resolution ("**Talcott**") and Resolution Life agreed to reinsure approximately US$35 billion of fixed indexed annuity liabilities from Allianz Life. US$20 billion of these liabilities will be placed with Talcott and one of its Bermuda affiliates, and US$15 billion will be placed with Resolution Life.

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3. P&C

Consistent with recent years, deal activity in the P&C space, relative to the life and health space, was comparatively muted in terms of both the number of transactions and aggregate deal value. However, a number of large P&C deals closed early in 2021, and the statistics would have been quite different had Chubb's bid to acquire The Hartford been accepted. Notable exceptions to the more limited deal activity in the P&C sector were MetLife's April 2021 sale of its auto and home business to Farmers Group, Inc. ("**Farmers**") for US$3.94 billion, and Allstate's US$4 billion acquisition of National General Holdings Corp. in January 2021, followed six months later by Allstate's agreement to acquire SafeAuto

1 *Global Insurance M&A Rises in 2021, Despite Pandemic Pressures: Clyde & Co. Report*, Insurance Journal (February 15, 2022).

… the burgeoning interest in broker (including managing general agency) transactions evidenced in recent years continued in 2021. In fact, 2021 was a record year for insurance brokerage transactions …

… COVID-19 does not appear to be inhibiting the willingness of parties to transact at pre-pandemic levels of activity; the rollout of vaccines and the concomitant reduction in the severity and frequency of infections helped to reduce whatever trepidation dealmakers may still have had going into 2021.

The stream of transactions featuring private equity-backed and other financial buyers into the insurance space continued in 2021.

for US$300 million. The August 2021 acquisition by TowerBrook of ProSight Global, a specialty P&C insurer, was further proof that the sector is not without appeal to financial buyers seeking opportunities in growth markets.

Despite the relatively subdued market for P&C transactions involving carriers, the burgeoning interest in broker (including managing general agency) transactions evidenced in recent years continued in 2021. In fact, 2021 was a record year for insurance brokerage transactions, as the total number of deals increased by 30% from the prior year to a total of more than 1,000 consummated transactions.[2]

2022 is off to a strong start in the P&C space; as this publication went to press, Berkshire Hathaway announced its agreement to acquire the New York-based P&C insurer Alleghany Corp. for US$11.6 billion in cash.

4. COVID-19

While the future course of the pandemic, including the possible emergence of new variants, is of course difficult to predict, COVID-19 does not appear to be inhibiting the willingness of parties to transact at pre-pandemic levels of activity; the rollout of vaccines and the concomitant reduction in the severity and frequency of infections helped to reduce whatever trepidation dealmakers may still have had going into 2021.

From a practitioner's standpoint, the negotiation of COVID-related provisions in acquisition agreements — including allocation of pandemic risk through the negotiation of interim operating covenants (and related "ordinary course" exceptions) and material adverse effect carve-outs — has by and large become less contentious; the formulations have become fairly standardized, and buyers and sellers have a better grasp on the attendant risks.

5. Private Equity

In recent years, it has become a truism that the participation of private equity and other financial buyers in the insurance space has been a key driver of insurance M&A activity. 2021 was no exception. Among the most prominent of the 2021 deals driven by private equity were the acquisition of Allstate Life Insurance Company and related subsidiaries by entities managed by Blackstone for total proceeds of US$4 billion, Talcott's reinsurance (together with Resolution Life) of a US$35 billion block of annuity liabilities from Allianz, and Fortitude Re's pending US$2.2 billion acquisition, announced September 15, 2021, of a portion of Prudential Financial's in-force legacy variable annuity business.

In January 2022, Apollo Global Management completed its merger with Athene, creating a company with an implied market capitalization of approximately US$43 billion. The in-house presence of the annuities provider will enable the combined company to scale asset and liability origination, and broaden distribution channels. Another approach employed by some of the other private equity players is making the insurance sector investment through a managed investment fund or co-investment vehicle, rather than investing through their own balance sheet.

The stream of transactions featuring private equity-backed and other financial buyers into the insurance space continued in 2021. Notable examples included Brookfield Asset Management Reinsurance Partners' August 2021 agreement to acquire American National Group in a transaction valued at US$5.1 billion; and Sixth Street's July 2021 acquisition of Talcott from an investor group led by Cornell Capital LLC, Atlas Merchant Capital LLC, TRB Advisors LP, Global Atlantic Financial Group, Pine Brook, J. Safra Group, and The Hartford. Sixth Street's growing presence in the insurance space was underlined when it announced early in 2022 a transaction providing for the reinsurance by a non-U.S. affiliate of Talcott of approximately US$25 billion of retail fixed annuity and secondary guarantee universal life insurance liabilities from Principal Financial Group. The transaction — the fourth transaction involving Talcott since its acquisition by Sixth Street — is expected to close in the second quarter of 2022.

We see no reason why the involvement of financial buyers in insurance M&A transactions will not continue apace, although one potential headwind may have arrived in the form of the Macroprudential (E) Working Group of the National Association of Insurance Commissioners ("**NAIC**"). This topic is discussed more fully elsewhere in this publication, but we note the Working Group's recent focus on

2 *Broker M&A deals top 1,000 in 2021*, Business Insurance (February 1, 2022).

issues relating to the ownership and operation of insurance companies by private equity, including in particular the terms of investment management agreements with affiliates. It remains to be seen whether, and to what extent, this focus will result in new regulations or affect the Form A approval process for private equity buyers.

6. Strategic/Traditional Insurers

Despite their prominence in insurance M&A in 2021, financial buyers did not have the field to themselves, as traditional insurers successfully found opportunities to expand their product offerings, geographic markets, and customer bases. For example, MassMutual's US$3.5 billion acquisition of Great American Life Insurance Company from American Financial Group, announced in January and completed in May of 2021, was motivated at least in part by MassMutual's strategy to broaden and diversify its product and distribution capabilities. In a similar vein, the acquisition of Prudential Financial's full-service retirement business by Great-West Lifeco Inc. broadens Great-West's U.S. customer base and unlocks expanded product offerings and new capabilities from Prudential Financial. Geographic expansion was one of the motivations for Chubb's pending acquisition of Cigna's life, accident, and supplemental benefits businesses in seven countries, primarily in the Asia Pacific region, for US$5.75 billion, announced on October 7, 2021.

Despite their prominence in insurance M&A in 2021, financial buyers did not have the field to themselves, as traditional insurers successfully found opportunities ...

A recurring theme that was evidenced once again in 2021 was the strategic decision by some large multiline insurers to divest non-core assets and business lines in order to focus on core businesses. The most prominent examples included Allstate's sale of Allstate Life Insurance Company, discussed above, and the US$3.94 billion sale by MetLife of Metropolitan Property and Casualty Insurance Company and certain of its wholly owned subsidiaries to Farmers, completed in April 2021, which was undertaken by MetLife in large part to allow the company to focus on core strengths, simplify the company operationally, and further differentiate its product offerings in the employee benefits space. Farmers, on the other hand, saw the transaction as an opportunity to expand its nationwide presence and to access new distribution channels. American International Group (AIG) also announced that it planned to sell part of its life insurance and retirement business to Blackstone.

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7. Insurtech

Insurance company investment in insurtech now appears to be a permanent feature of the insurance transactional landscape, with traditional insurers investing in or acquiring insurtech businesses in order to leverage the efficiencies offered by new technologies, and insurtech firms partnering with carriers with a view to expanding the reach of their platforms. Traditional insurers continued to see in the insurtech market the opportunity to expand markets and access to customers, provide a more compelling user experience, automate processes, and enhance (and monetize) data analytics.

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Traditional insurers continued to acquire technology-based enterprises that they had initially backed as startups. A recent example is the acquisition by American Family Insurance of Bold Penguin, an insurtech firm focused on providing cover to small businesses through its digital exchange and in which American Family had been a minority investor.

Traditional insurers continued to acquire technology-based enterprises that they had initially backed as startups.

Perhaps the most high-profile insurtech deal announced in 2021 was the November agreement for Lemonade, the newly listed digital insurer, to acquire Metromile, a California-based pay-per-mile auto insurance startup, in a US$500 million all-stock transaction. The acquisition of Metromile (and its 49 state licenses) would provide Lemonade with a national auto insurance presence, as well as Metromile's in-force auto insurance premium and experience using big data and artificial intelligence ("**AI**") for car insurance.

8. The Growth and Initial Utilization of Statutory Divisions and Insurance Business Transfers

As discussed in last year's edition of this publication, the insurance industry has seen a more widespread adoption of division and insurance business transfer ("**IBT**") statutes, which have now been enacted in Arkansas, Connecticut, Georgia, Illinois, Iowa, Michigan, Nebraska, Oklahoma, Pennsylvania, Rhode Island, and Vermont. These statutes may present an increasingly viable option for insurance companies seeking to separate blocks of business or specified policies, bifurcate business lines, and create increased flexibility in the pursuit of future transactions.

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A recent high-profile division transaction was completed in April 2021, when Allstate divided Michigan auto insurance policies supported by more than US$5 billion of reserves into a separate newly formed Illinois-based insurance company. The Allstate transaction may have been a good test case, as it involved policies in a single state, and the division transaction was not coupled with the sale of the divided company. It remains to be seen whether other insurers will view the successful completion of the Allstate division as support for a decision to proceed with a similar transaction, especially in light of the regulatory scrutiny more complex transactions may receive (for further discussion on this topic, see Section V.A.6).

9. Representation and Warranty Insurance

… the use of representation and warranty insurance ("RWI") has become increasingly common in insurance M&A transactions, and this remained true in 2021 …

As we have discussed in previous editions of the *Sidley Global Insurance Review*, the use of representation and warranty insurance ("**RWI**") has become increasingly common in insurance M&A transactions, and this remained true in 2021; however, our anecdotal observation is that it was more difficult to obtain RWI for insurance deals in 2021 than in prior years. Reasons for this may include: stretched bandwidth and underwriting capacity resulting from an overheated market; the disfavoring of insurance M&A deals relative to deals in other industries because of a perception that aspects of insurance M&A pose unique underwriting challenges; and the limited number of insurers willing or able to underwrite insurance deals, making it especially difficult to secure RWI for large deals in which the underwriting risks might otherwise have been syndicated in a "tower."

While the popularity of RWI has grown dramatically in recent years, there are factors that may make it a less attractive solution in some circumstances and for particular parties. These factors include concerns as to confidentiality — in particular, the risk of alerting RWI carriers who are competitors to a pending deal — the increase in premiums, and the prevalence of insurance M&A-specific exclusions.

10. Outlook Ahead

There is reason to be optimistic that the insurance M&A market will continue on its robust trajectory. The deployment of assets by private equity and other financial buyers into the insurance industry have continued to buoy transactional activity in the insurance space, and general economic conditions (including interest rates that remain relatively low from a historical perspective) do not seem unfavorable.

There is reason to be optimistic that the insurance M&A market will continue on its robust trajectory. The deployment of assets by private equity and other financial buyers into the insurance industry have continued to buoy transactional activity in the insurance space, and general economic conditions (including interest rates that remain relatively low from a historical perspective) do not seem unfavorable. However, the impact on borrowing rates of mounting inflationary pressures, and the knock-on effects on the financing and viability of transactions, bear watching in 2022. So too will the potential effects on the U.S. and global economy of the Russian invasion of Ukraine and the resulting sanctions regime.

B. EUROPEAN AND ASIAN MARKETS

1. Introduction

Despite the global COVID-19 pandemic persisting through 2021, insurance M&A activity in the UK and Europe remained relatively robust.

Despite the global COVID-19 pandemic persisting through 2021, insurance M&A activity in the UK and Europe remained relatively robust. The trends across 2021 broadly mirrored those of recent years, including private equity interest in the UK broker market and continued interest in the insurtech sector. More recently, in response to the difficulties faced in the current market, there has been renewed interest in Lloyd's of London ("**Lloyd's**") legacy deals.

2. Lloyd's and the Legacy Market

… with the emergence of alternative methods for making new investments at Lloyd's (see further below), the principal Lloyd's M&A focus in 2021 was on the legacy market.

Historically, the long lead time and associated costs of establishing a Lloyd's platform organically via a turnkey operation has meant that M&A has, for many, been a preferable route to market entry, and has added some level of "market access" premium to the valuations of Lloyd's entities. However, with the emergence of alternative methods for making new investments at Lloyd's (see further below), the principal Lloyd's M&A focus in 2021 was on the legacy market.

Another noteworthy trend at Lloyd's has been that the size of some portfolios being marketed to the legacy market are larger than in the past.

The focus on legacy has in part been driven by the continued focus of Lloyd's on improving underwriting performance. The legacy market has also been supported by consumer demands for digital products, rate hardening, and uncertainty caused by the COVID-19 pandemic, as organizations have looked to optimize portfolios and how they deal with or carve out legacy reserves, with (re)insurers increasingly seeking to restructure their portfolios, either to release solvency capital via back-year transactions, or to put underperforming units into run-off. Another noteworthy trend at Lloyd's has been that the size of some portfolios being marketed to the legacy market are larger than in the past.

Among the more significant Lloyd's legacy deals of 2021, Brit Ltd. ("**Brit**") announced the completion of a loss portfolio transfer with run-off specialist RiverStone International, effective from October 1, 2021. The transaction relates predominantly to legacy years of account on certain classes of business underwritten by Brit Syndicate 2987. RiverStone's Syndicate 3500 agreed to indemnify Brit against potential adverse development, in respect of net liabilities, with an approximate value of US$380 million.

The Lloyd's prospectus, since expanded upon in both Blueprint One — the Future At Lloyd's ("**Blueprint One**") and Lloyd's Blueprint Two ("**Blueprint Two**"), envisages simplified methods for enabling third parties to deploy capital in Lloyd's. One such solution was the "syndicate in a box." Similar to 2020, Lloyd's approved a number of syndicates in a box in 2021, including Beazley's environmental, social, and governance ("**ESG**") underwriting consortium, which will sit under Syndicate 4321, and the Oman Insurance Company's Syndicate 2880 on the Lloyd's DIFC Platform, approved in September 2021. It appears that this trend is set to continue into 2022 with the approval of Greenlight Re's insurtech-focused syndicate in a box, Syndicate 3456, in February 2022.

Another way in which Lloyd's is hoping to carry out its Blueprint One and Blueprint Two development strategies is through the implementation of a new multi-arrangement insurance special purpose vehicle, London Bridge Risk PCC Ltd. ("**London Bridge Risk**"). London Bridge Risk received regulatory approval on January 14, 2021 and is intended to provide an easier and more efficient way for capital at Lloyd's to be deployed and managed. In November 2021, Ontario Teachers' Pension Plan became the first investor to provide capital at Lloyd's via London Bridge Risk. It has also since provided a second tranche of capital to cover more underwriting in 2022. In addition, in December 2021, Nephila Capital launched its new specialty lines-focused Syndicate 2358 at Lloyd's, using London Bridge Risk to bring capital into the market to support its launch.

3. Broker M&A

Consolidation in the broker market continued to be a significant trend in 2021. Following the U.S. Department of Justice's block of the US$30 billion Aon-WTW merger, WTW agreed to sell the reinsurance brokerage arm of its business to Arthur J. Gallagher & Co. ("**AJG**"). The deal, for an initial consideration of US$3.25 billion, allows AJG to expand its global reinsurance business with increased product breadth and expertise in this space, as the combined business will trade as Gallagher Re across more than 70 offices in 31 countries. The bulk of the transaction closed on December 1, 2021, with some deferred elements due to close in 2022.

Consolidation in the broker market continued to be a significant trend in 2021.

In a significant UK broker deal announced on October 18, 2021, Howden Group agreed to acquire Aston Lark from Goldman Sachs Asset Management and Bowmark Capital. Under this deal, Aston Lark will join A-Plan Group and Howden UK. The UK business created from this transaction is expected to manage over £6 billion of gross written premiums for more than 1.7 million policyholders.

The Ardonagh Group, which secured significant new investment in December 2021 from its existing private equity shareholders, Madison Dearborn Partners and HPS Investment Partners, has also continued to be active in the broker M&A market. On November 1, 2021, it announced completion of its US$500 million acquisition of BGC Partners Inc.'s insurance operations and subsequently announced its planned acquisition of MDS Group on December 23, 2021.

Given that many UK brokerage firms are now backed by private equity, this will likely drive further broker M&A (and possibly initial public offerings) over the course of 2022, as private equity owners look to maximize and realize returns from their investment.

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4. Insurance Company Transactions

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On December 8, 2021, Finnish financial services firm Sampo plc signed an agreement with Rand Merchant Investment Holdings Limited ("**RMI**") to acquire the latter's remaining shares in UK car insurer Hastings Group ("**Hastings**"). For an initial consideration of £685 million, Sampo will acquire a further 30% interest in Hastings and the option held by RMI to acquire a further 10% of Hastings' share capital from Sampo by May 2022. This deal follows Sampo's initial acquisition of a 70% stake in Hastings, completed in November 2020, thus potentially taking Sampo's ownership to 100%.

On June 1, 2021, Tryg A/S and Regent Bidco, a wholly owned subsidiary of Intact Financial Corporation ("**Intact**"), completed their acquisition of RSA Insurance Group plc (now RSA Insurance Group Limited) ("**RSA**") in a £7.2 billion break-up deal, with Tryg A/S accounting for £4.2 billion of the purchase price, and Intact accounting for £3 billion. As a result of the acquisition, Tryg A/S retains RSA's Swedish and Norwegian operations while Intact retains RSA's Canadian, UK, and international entities. Tryg A/S and Intact co-own RSA's Danish business.

In February 2022, AXA UK and Ireland agreed to acquire the renewal rights to Ageas UK's commercial business, though the back book will remain with Ageas UK. AXA UK and Ireland indicated that the deal will support its effort to strengthen its growth strategy and partnerships with commercial business customers and brokers. The initial consideration for the deal will be £47.5 million, and renewal rights are due to transfer to AXA Commercial in July 2022.

Insurers are increasingly seeking partners whose global reach and expertise extend beyond capital. Technology, in the form of insurtech, has also been a key driver, as purchasers have sought potential efficiencies …

5. Insurtech

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

Traditional (re)insurance companies have demonstrated a growing interest in investing their capital into insurtech, given the advantages of using digital products …

Notable recent UK insurtech transactions include the further expansion of the reverse auction marketplace first launched by Honcho Markets Limited ("**Honcho**") in 2019 to enable insurers to bid against each other in real time. Honcho's partnership with Admiral, announced in March 2021, brought Admiral's multi-car insurance product to the Honcho platform. Honcho is one of a number of players in the insurtech auction space, which also includes Tremor Technologies Inc. and Akinova Limited.

FloodFlash, a London-based insurtech company and coverholder at Lloyd's, announced on February 10, 2022 that it has raised US$15 million of funding in a Series A round. This capital injection follows the company's announcement of a new insurance capacity partnership with Munich Re. FloodFlash's business focuses on writing natural catastrophe parametric insurance and includes a cloud platform for brokers and agents.

Another key area of insurtech growth is, perhaps unsurprisingly, cyber.

Another key area of insurtech growth is, perhaps unsurprisingly, cyber. Corvus Insurance announced on January 4, 2022 that it has acquired the underwriting platform Tarian Underwriting Limited from Beat Capital in a move to expand globally. With this deal, Corvus is said to have become the first cyber insurtech to acquire a London underwriting platform, with a view to providing the business with global underwriting capabilities and access to Lloyd's.

II. The Global Alternative Risk Transfer Market

A. P&C MARKET

1. Catastrophe Bonds

After a record-breaking 2020, the catastrophe bond market saw another record-breaking year for new catastrophe bond issuances in 2021, with estimates generally ranging around US$12-13 billion (excluding mortgage insurance-linked securities ("**ILS**") deals). The year 2021 saw many first-time entrants into the market, and we expect this trend to continue into 2022. Analysts generally expect another strong year, predicting new issuances in 2022 ranging in the US$10-11 billion range.

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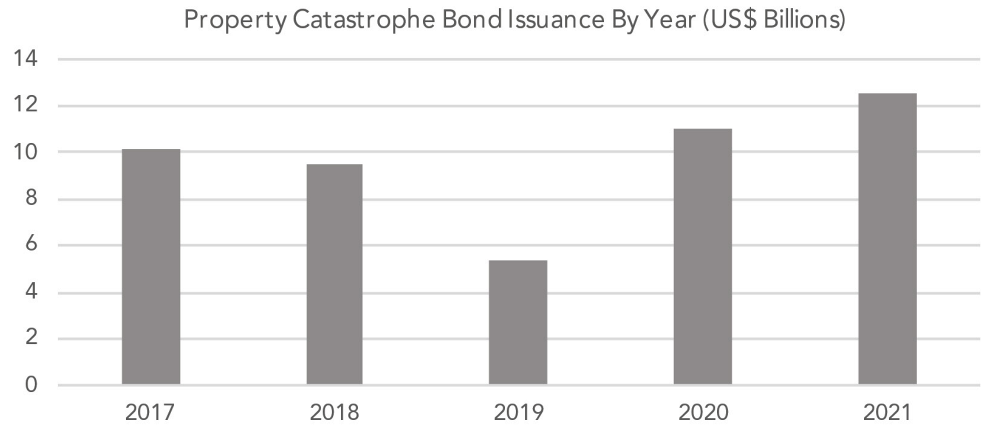

Source: *Insurance-Linked Securities: Aon Securities Q4 2021 Update*, Aon (February 2022).

The market continued to exercise caution around multi-peril aggregate indemnity triggers, with the concern that high-frequency secondary perils such as severe thunderstorm and wildfire could accumulate and result in losses to aggregate layers. Accordingly, for many aggregate structures, an event deductible replaced the franchise deductible that was historically used in aggregate structures. A franchise deductible allows all loss from an event to apply toward a total loss calculation once a particular loss threshold is met, as opposed to an event deductible in which the losses up to that threshold are excluded from the total loss amount.

The market continued to exercise caution around multi-peril aggregate indemnity triggers, with the concern that high-frequency secondary perils such as severe thunderstorm and wildfire could accumulate and result in losses to aggregate layers.

Investor appetite for catastrophe bonds has remained high despite the losses seen in recent years and the uncertainty caused by global climate change and the COVID-19 pandemic, as the more risk-remote nature of the catastrophe bond market allowed it to continue to perform more in line with expectations than other ILS asset classes, such as collateralized reinsurance.

Investor appetite for catastrophe bonds has remained high despite the losses seen in recent years and the uncertainty caused by global climate change and the COVID-19 pandemic …

2. Market Response to Recent Catastrophe Losses

Global insured catastrophe losses in 2021 are estimated to be approximately US$130 billion.[3] The estimated total is well above the 21st century annual average (US$74 billion) and median (US$66 billion) and 18% higher than in 2020.[4] This is the fourth time in five years that such losses have surpassed US$100 billion. Nearly all insured natural disaster losses resulted from weather- or climate-related disasters. Tropical cyclone was the costliest peril for the insurance industry, with US$39 billion in insured losses. Hurricane Ida became the sixth costliest global tropical cyclone ever recorded, resulting in at least US$30-32 billion in estimated insured losses.[5] The second costliest peril in 2021 was severe weather, with US$37 billion in insured losses. Of the insured losses, 71% stemmed from events that occurred in the U.S.[6]

3 *2021 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2022).

4 *Id.*

5 *Global insured catastrophe losses rise to USD 112 billion in 2021, the fourth highest on record, Swiss Re Institute estimates*, Swiss Re (December 14, 2021).

6 *2021 Weather, Climate & Catastrophe Insight*, Aon Benfield (January 2022).

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

… catastrophe bond and other ILS issuances, including mortgage ILS deals, set a new annual record in 2021 at just under US$20.3 billion.

The relative stability of the ILS market throughout this period, compared to that of other asset classes, further illustrated the value of the ILS asset class …

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

Nevertheless, catastrophe bond and other ILS issuances, including mortgage ILS deals, set a new annual record in 2021 at just under US$20.3 billion.[7] The year 2021 also saw a record number of catastrophe bond transactions (84). The first half of 2021 proved to be busy with 50 transactions, and 34 followed in the second half.[8] In the first six months of 2021, catastrophe bonds and other ILS issuances reached US$9.5 billion. ILS fund managers continue to actively pursue new inflows of capital, and managers are attracting additional capital from a combination of new investors and existing investors topping up their positions. All of these factors signal a favorable catastrophe bond market environment.

A number of notable transactions occurred in 2021. A second-time sponsor, China Re, came to the market with a US$30 million issuance, the first catastrophe bond to use Hong Kong as a domicile. Zenkyoren issued its largest catastrophe bond, a US$775 million Nakama Re transaction utilizing the Singapore government grant scheme. The World Bank on behalf of the Government of Jamaica issued a US$185 million IBRD CAR 130 catastrophe bond. Arch Capital, a first-time 144A sponsor, issued a US$150 million global peak perils catastrophe bond.

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

3. Sidecars and ILS Funds

Similar to recent years, the sidecar market continued to decrease in capacity. In comparison to 2021, the market in 2022 is estimated to be down 20% to 50% in capacity, according to market sources. Some sources suggest that withdrawals are occurring across the board, not just by typical ILS sidecar investors, such as Stone Ridge and Credit Suisse. These sources claim that mutual funds, rated insurers that have historically participated in such transactions, and direct pension funds are also among those withdrawing. Other market sources suggest that the outlook is not as bleak, and that the market is shrinking only slightly. S&P Global Ratings suggested that interest in sidecars in comparison to catastrophe bonds suffered this past year because sidecars are typically prone to losses that occur at a higher frequency and have gradually taken on more exposure to unnamed perils and commercial risks over the years.[9] In contrast, Guy Carpenter reported an increase in the sidecar and quota share market, noting that "the increased allocation has come mainly through direct bilateral arrangements with foundational investors rather than through syndicated placements with dedicated insurance-linked securities funds."[10] Losses have played a significant part in investors' decisions on which vehicles to allocate their funds. For 2021, average annual returns for sidecars were reported mostly in the range of a 5% loss to a 5% gain, a fairly significant range in performance. As a result, renewal conversations for 2022 were slower to move ahead.

Looking back at 2021, the sidecar market saw a number of transactions. In January 2021, MS Amlin sponsored Phoenix 1 Re in a US$42 million deal, a first of its kind, in Singapore. Phoenix 1 Re provides remote-risk coverage for MS Amlin's Asian Pacific clients across more than 10 territories. MS Amlin then launched a second Phoenix sidecar, Phoenix 2 Re, in two tranches amounting to US$37.5 million. The Class A tranche was sized at US$9.4 million and the Class B tranche was sized at US$28.1 million. Peak Re raised US$107 million for its third Lion Rock Re vehicle. In September 2021, Randall & Quilter raised US$300 million for run-off sidecar Gibson Re. In December, Munich Re renewed the first US$42.1 million portion of its Eden Re sidecar for 2022 and listed a further US$147.9 million of Eden Re sidecar notes on the Bermuda Stock Exchange, taking the 2022 total fundraise to US$190 million. Swedish pension

7 *Insurance-Linked Securities Market Insights Volume XXXVI, February 2022,* Swiss Re (February 2022); *Reinsurance Market Outlook*, Aon Benfield (November 2021).

8 *Q4 2021 Catastrophe Bond & ILS Market Report*, Artemis.bm (January 2022).

9 *Reinsurers' Use of Insurance-Linked Securities Is Set to Increase amid Rising Catastrophe Losses*, S&P Global Ratings (October 27, 2021).

10 *Capital Resilient Despite Major Loss Activity*, Guy Carpenter (September 2021).

fund Alecta has allocated US$200 million to Scor's Atlas Gotland Worldwide Catastrophe sidecar in a multi-year agreement. The vehicle is a segregated account of newly created Bermudian special purpose reinsurer Atlas Re.

Overall, sidecars continue to prove to be an efficient and attractive investment for longer term investors with an appetite for diversifying risks. In the shorter term, however, the market is not expected to see many new entrants, and attracting investors may prove difficult, especially with cedants feeling pressure to negotiate ceding commissions and other key terms, as claimed by market sources.

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4. Global ILS Initiatives

The Monetary Authority of Singapore (the "**MAS**") extended its ILS grant scheme to approximately US$1.5 million per issuance through the end of 2022. The MAS also aims to enhance rules surrounding ILS and catastrophe bond issuance structures to reduce any friction between sponsors and other participants in transactions. The MAS has been running a consultation process seeking feedback on two proposals to its framework. The first proposal is to exclude special purpose reinsurance vehicles ("**SPRVs**") from requirements related to certain investment-related requirements for insurance and reinsurance companies registered in Singapore. The second change proposes to exclude SPRVs from certain public disclosure requirements of an insurance or reinsurance business domiciled in Singapore. These proposals aim to bring Singapore's ILS regulatory regime more in line with other domiciles where issuers are not subject to such detailed reporting requirements.

The MAS also aims to enhance rules surrounding ILS and catastrophe bond issuance structures to reduce any friction between sponsors and other participants in transactions.

Similar to Singapore's grant scheme, the Hong Kong government approved a two-year pilot ILS grant scheme of up to US$1.6 million per issuance and will have similar qualifying requirements, such as requiring a minimum of 20% of the issuance costs to be billed locally and a minimum investment size of US$250,000. The Hong Kong Insurance Authority's licensing process is expected to take anywhere from six weeks to two months. In July 2022, Hong Kong passed legislation enabling the issuance of ILS by special purpose insurers. The Insurance (Special Purpose Business ("**SPB**")) Rules ("**SPB Rules**"), passed in July 2020, came into effect on March 29, 2021. Since then, the Hong Kong Insurance Authority has published a guideline ("**GL-33**") authorizing special purpose insurers to carry on SPB in or from Hong Kong. The GL-33 provides further guidelines that became effective on June 30, 2021. GL-33 also highlights Rule 3(1) and Rule 3(4) of the SPB Rules, limiting the scope of persons to whom ILS may be offered or sold. The addition of Hong Kong as a domicile in the ILS market will be pivotal to ILS growth in that region.

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5. M&A Activity

In 2021, M&A continued to be an important driver behind the continued convergence of traditional insurance and reinsurance with the ILS market. In March 2021, Aon announced a proposed business combination with WTW in a US$30 billion merger. In July 2021, both parties agreed to terminate the merger due to opposition from the U.S. Department of Justice and other regulators. Aon announced that it would pay WTW a US$1 billion termination fee. Many in the industry speculated on the impact this termination would have on other parties involved in the transaction, such as AJG. As part of the larger transaction, AJG was to purchase Willis Re and certain other WTW assets for US$3.6 billion, which was intended to ease regulators' concerns over the Aon/WTW merger. Although the originally planned acquisition by AJG was not completed, in August 2021 AJG agreed to acquire Willis Re for US$3.25 billion and completed the transaction on December 1, 2021. Post-closing, the new reinsurance operation became known as Gallagher Re, led by Willis Re's CEO, who serves as the global reinsurance CEO. Gallagher Re became the third-largest reinsurance broker in a highly consolidated area.

In 2021, M&A continued to be an important driver behind the continued convergence of traditional insurance and reinsurance with the ILS market.

6. Outlook Ahead

"Resilience bonds" have been gaining attention recently, with high-profile individuals advocating on their behalf. Although resilience bonds are not a new concept (a framework for them was first launched in 2015), with rising climate volatility many are shining light on their potential benefits. Resilience bonds are a variation of conventional catastrophe bonds with an incentive to invest in infrastructure by offering premium rebates. According to a 2017 report by the RE:bound program (a partnership among RE:focus partners Risk Management Solutions (RMS), Swiss Re, and The Rockefeller Foundation), "the aim is to

"Resilience bonds" have been gaining attention recently, with high-profile individuals advocating on their behalf.

Whether resilience bonds gain more traction in the future is not yet certain, but the ILS market may be able to participate in addressing growing concerns over damaged infrastructure due to climate volatility.

… whether ILS investments can qualify as ESG assets remains an open question. Many different standards exist for qualifying an asset as an ESG asset.

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

Traditional insurers and reinsurers will continue to explore new ways to use third-party capital to their benefit, with cyber risk being one potential opportunity for growth.

link insurance and resilience projects to monetize avoided losses."[11] Samantha Medlock, senior counsel on the U.S. House Select Committee on the Climate Crisis, told the BBC that "resilience bonds are, in [her] view, the next exciting and innovative frontier in infrastructure and resilience finance."[12] Despite the potential benefits, these bonds have failed to take off, largely in part due to problems in modeling and timing. Some critics think that such bonds could work only on a local scale. Others suggest that standard catastrophe bond or ILS structures could be used to achieve similar goals, by having the sponsoring entity use a payout for reinvestment rather than to pay insurance claims. They point to several catastrophe bonds issued on behalf of countries by the World Bank as well as sovereign catastrophe risk pools for the Caribbean (CCRIF-SPC), Africa (ARC), and the Pacific (PCRIC) that support government rebuilding efforts.[13] Whether resilience bonds gain more traction in the future is not yet certain, but the ILS market may be able to participate in addressing growing concerns over damaged infrastructure due to climate volatility.

The year 2021 saw ESG assets become a significant consideration for both ILS sponsors and investors alike. Bloomberg forecasts that ESG-based assets could exceed US$53 trillion globally by 2025, a third of all assets under management.[14] However, whether ILS investments can qualify as ESG assets remains an open question. Many different standards exist for qualifying an asset as an ESG asset. Some organizations look to ratings agencies for a framework, while others look to the United Nations' Sustainable Development Goals framework.[15] ILS investments may not satisfy transparency and disclosure requirements applicable to ESG-qualifying assets. Even some sovereign catastrophe bonds, which provide coverage for disaster relief, may not meet certain ESG requirements. Nonetheless, ESG/socially responsible investing catastrophe bond collateral components have emerged, most recently in the Lion III Re catastrophe bond transaction. Assicurazioni Generali S.p.A. ("**Generali**") returned to the catastrophe bond market in June 2021 for its third Lion III Re transaction, the first of its kind to have specific "green" features incorporated, to match the initiatives of Generali. In addition, in September 2021, the Guernsey International Insurance Association awarded its first ESG accreditation to an insurance entity, Dunant Re IC Limited incorporated cell of Replexus ICC (Guernsey) Limited, a Red Cross-sponsored issuer of a catastrophe bond covering risk from volcanic eruption. We expect to see these types of transactions in the future and to hear more from sponsors, investors, and regulators alike on this topic.

We also expect that the use of alternative risk transfer mechanisms in the P&C market, including in the casualty and specialty sectors, will continue to grow in the year ahead, and the insurance risk asset class as a whole will continue to attract new participants and new capital, despite the losses experienced in recent years. Corporate sponsors may become more significant participants in the catastrophe bond market. Following Alphabet's entry to the market in 2020, other new corporate sponsors entered in 2021, including logistics firm Prologis, as well as a Blackstone entity.

Traditional insurers and reinsurers will continue to explore new ways to use third-party capital to their benefit, with cyber risk being one potential opportunity for growth. Some predict that cyber risk will overtake property catastrophe reinsurance before 2040.[16] Overall, the ILS market will continue to look for new and innovative ways to meet the needs of cedents and investors.

B. PRUDENTIAL REGULATION AUTHORITY'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, which set out the tax legislative structure. In addition, the Prudential Regulation Authority ("**PRA**") published the final version of an amended PRA

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11 *A Guide for Public-Sector Resilience Bond Sponsorship*, RE:bound - Re:Focus Partners (2017).

12 *'Resilience bonds': A secret weapon against catastrophe*, BBC (2017).

13 *A Guide for Public-Sector Resilience Bond Sponsorship*, RE:bound - Re:Focus Partners (2017).

14 *ESG assets may hit $53 trillion by 2025, a third of global AUM*, Bloomberg (February 2021).

15 *ESG – A New Lens for Investors and Insurers*, Foster, Grant (Aon 2021).

16 *CY-FI: the Future of Cyber Reinsurance*, Gallager Re (2022).

Rulebook — including new rules to incorporate the ILS regime — as well as a Supervisory Statement[17] ("**SS8/17**") setting out its guidance on the new rules and regulations, and the Financial Conduct Authority ("**FCA**") published its final statement on authorizing and supervising special purpose vehicles for ILS.

Since the regime has come into force, the UK regulators have already approved a number of ILS structures. With the experience gained from this, the PRA committed as part of its 2019/2020 Business Plan to further refine the ILS framework. As part of this commitment, the PRA consulted on updates to the authorization and supervision of UK ILS vehicles, with a focus on updating the rules around funding arrangements for ILS vehicles (including clarity on how a UK ILS vehicle may be able to benefit from "roll-over" techniques), the documentation required, and risk transfer requirements.[18] The final rules and guidance on this were published and came into effect on May 26, 2020 and have been the applicable rules and guidance since then.[19, 20]

In an additional bid to keep the UK ILS regime attractive to potential issuers and investors, the UK government's HM Revenue and Customs ("**HMRC**") released a consultation paper in March 2021[21] (the "**Securitization Company Consultation**") which sought feedback on, among other matters, potential clarification of or amendments to the "loan capital exemption" from Stamp Duty and Stamp Duty Reserve Tax (together "**UK Stamp Taxes**") in the context of securitization and ILS arrangements. Based, at least in part, on responses received to the relevant questions in the Securitization Company Consultation, legislation has since been introduced which more explicitly exempts transfers of certain notes issued as part of ILS arrangements from UK Stamp Taxes. Further detail is set out below.

1. Background to the Proposed UK Stamp Tax Changes for ILS Vehicles

In the UK, transfers of certain securities may be subject to UK Stamp Taxes. These taxes will, broadly, apply to transfers of UK securities, either by way of Stamp Duty, which is technically a charge on documents or instruments effecting a relevant transfer, or by way of Stamp Duty Reserve Tax, which is a charge on agreements to transfer relevant securities, including transfers which are given effect on a paperless basis. UK Stamp Taxes, whether Stamp Duty or Stamp Duty Reserve Tax, will generally be charged at 0.5% of the consideration given for the transferred securities.

Certain securities are exempt from the requirement to pay UK Stamp Taxes on their transfer, and this includes transfers of "exempt loan capital." This exemption will not, however, apply where the relevant securities have certain prohibited equity features (for example, they carry a return linked to the profits of an underlying business).

In a typical ILS transaction, investors will be issued a loan note in exchange for capital to cover the transferred insurance risk. Certain features of the loan notes that are typically issued under an ILS transaction can create uncertainty around the application of the "exempt loan capital" exemption from UK Stamp Taxes. In the past, this has led to more complex structuring for certain ILS issuers, to avoid the inherent uncertainties in the "loan capital exemption."

This residual risk of UK Stamp Taxes may also have been a factor in why ILS transactions were still largely being implemented outside the UK rather than utilizing the UK regime.

This residual risk of UK Stamp Taxes may also have been a factor in why ILS transactions were still largely being implemented outside the UK rather than utilizing the UK regime.

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

18 Consultation Paper CP 19/19 *Insurance Special Purpose Vehicles: Updates to authorisation and supervision*.

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

20 See the 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.

21 *Consultation on reform of taxation of securitisation companies*, HMRC and HM Treasury (March 23, 2021).

2. Proposed Legislative Changes

Following completion of the Securitization Company Consultation, on November 30, 2021 a new statutory instrument was issued in draft form: The Securitisation Companies and Qualifying Transformer Vehicles (Exemption from Stamp Duties) Regulations 2022 (the "**Exemption Regulations**"), which provide 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. Some notes could still remain within the scope of UK Stamp Taxes upon transfer (e.g., if they carry rights to convert into or acquire UK shares), but the Exemption Regulations are generally expected to provide greater certainty to ILS issuers, which should eliminate the need for more complex structuring and associated costs.

The Exemption Regulations are due to come into force in the spring of 2022, as part of the Finance Bill 2021-2022. This bill was debated by UK Members of Parliament in early January 2022, and the Exemption Regulations garnered broad cross-party support, with no material amendments proposed. The Exemption Regulations are therefore expected to become law in due course in the spring of 2022.

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Accordingly, this is a positive step forward for the UK ILS market in becoming a more attractive market for prospective ILS issuers and investors, and it is hoped that it will encourage additional activity in the UK ILS market.

3. UK ILS Outlook

Although the UK government is committed to making the UK ILS market a more attractive market, and encouraging steps have been made with respect to updates to the regulatory regime and the new UK Stamp Taxes exemption, this has not yet led to an increase in the volume of new UK-based ILS transactions.

However, there was a notable ILS transaction that was approved under the UK's ILS regime in 2021. Lloyd's announced that it received regulatory approval on January 14, 2021 for its new multi-arrangement insurance special purpose vehicle, London Bridge Risk. This was a significant step for the UK's ILS regime, as it was the first PRA-approved ILS structure designed for use for multiple, market-wide transactions for Lloyd's members, and reflects the UK regulators' support for using the UK's ILS regime to create more innovative products and transactions. It is also a key step forward for Lloyd's in carrying out its Future at Lloyd's strategy, as it is intended that London Bridge Risk will provide an easier and more efficient way for capital at Lloyd's to be deployed and managed. As London Bridge Risk is largely being pitched as an efficient way for new investors to enter the Lloyd's market to provide capital to members at Lloyd's, it is not being viewed by some market participants as a traditional collateralized reinsurance transformer vehicle.

It remains to be seen whether the steps taken by the UK government and regulators over recent years will increase interest in the UK as an ILS jurisdiction over the medium term.

Looking ahead to the remainder of 2022, Pool Reinsurance Company has announced that it will be exploring whether there is appetite among its ILS investors to cover catastrophic terrorism risk, with the imminent renewal of its three-year Baltic PCC Ltd. catastrophe bond, which was launched in February 2019 using the UK's ILS regime. However, in terms of transaction volumes, the UK ILS regime continues significantly to lag behind established ILS markets, such as Bermuda. It remains to be seen whether the steps taken by the UK government and regulators over recent years will increase interest in the UK as an ILS jurisdiction over the medium term. In addition, now that the UK has withdrawn from the EU, there is 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 insurance special purpose vehicles, in particular that such vehicles should remain fully funded at all times. Changes in this respect would bring the UK more in line with other key ILS markets.

III. The Global Longevity Market

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

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

A. TRANSACTION STRUCTURES

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

1. Buyouts

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

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2. Buy-Ins

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

Under a pension buy-in, there is no direct contractual link between the insurer and the individual scheme members. Instead, the pension scheme trustees hold the buy-in policy in their name as an investment of the scheme, and the scheme continues to deal with the payment and administration of benefits.

3. Longevity Swaps

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

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

Whereas buy-ins and buyouts involve a transfer of inflation, interest rate, investment, and longevity risk, longevity swaps offer a purer hedge against the risk of scheme members living longer than is actuarially predicted; and the fact that there is no upfront payment of a lump sum premium means that the investment, interest rate, and inflation risk remain with the trustees. Accordingly, longevity swaps are typically a less expensive alternative to buy-ins and buyouts, albeit more complex to structure and negotiate. Longevity swaps almost invariably require the two-way posting of collateral to protect against

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In 2021, the pension de-risking market in the U.S. experienced the highest sales levels since 2012, when the GM and Verizon deals led to a record-breaking year.

Given the recent growth of the market, many new participants have either entered the market or are seeking entry into the market as direct insurers or as reinsurers of direct writers. Insurers in this space are increasingly seeking to work with reinsurers to transfer pension liability risk, either by packaging reinsurance as part of a pension de-risking deal or by obtaining reinsurance for its liabilities after the fact.

the possibility of early termination by reason of the other party's default or insolvency. The collateral is typically based upon the present value of the covered benefits and will also include a fee element payable to the insurer/bank in the event of termination arising by virtue of trustee default.

4. Index-Based Trades

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

B. U.S. MARKET

Consistent with recent years, the pension de-risking market in the U.S. continued to experience significant growth in 2021. While during the rise of the market one or two direct writers dominated, in recent years a number of other group annuity writers, including an abundance of new entrants into the market, have become more active. In 2021, the pension de-risking market in the U.S. experienced the highest sales levels since 2012, when the GM and Verizon deals led to a record-breaking year. According to LIMRA Secure Retirement Institute ("**LIMRA**"), the single premium buy-out sales totaled US$34.2 billion in 2021, up 37% from 2020 sales, led by remarkably strong third quarter sales. During the same time, the single premium buy-in sales reached a record US$3.9 billion, which is more than double the sales made in 2020.

Sales for the full calendar year of 2021 were approximately US$38.1 billion, up significantly for the same period in 2020, and include the following transactions[22]:

- In March 2021, J.C. Penney Corp. Inc., a retail and clothing company, transferred to Athene approximately US$2.8 billion in pension obligations affecting approximately 30,000 participants.
- In August 2021, Lockheed Martin Co., a defense company, transferred US$4.9 billion in U.S. pension plan liabilities representing 18,000 retirees and beneficiaries.
- Additionally, in September 2021, HP Inc. announced it had entered into a deal with Prudential Financial pursuant to which it will transfer approximately US$5.2 billion in pension obligations affecting approximately 41,000 retirees.

Other notable pension de-risking transactions include (i) telecommunications company Lumen Technologies, Inc. transferring US$1.4 billion in U.S. pension plan liabilities affecting approximately 22,600 participants and (ii) Arconic Corp., an industrial company, transferring approximately US$1 billion in U.S. pension plan assets and liabilities to MassMutual affecting approximately 8,400 retirees.

Given the recent growth of the market, many new participants have either entered the market or are seeking entry into the market as direct insurers or as reinsurers of direct writers. Insurers in this space are increasingly seeking to work with reinsurers to transfer pension liability risk, either by packaging reinsurance as part of a pension de-risking deal or by obtaining reinsurance for its liabilities after the fact. As additional participants enter the market, new strategies will likely continue to develop that further increase the competitiveness in the market. According to LIMRA, in 2022 strong performance in this space is expected to continue, as the number of plan sponsors interested in performing a pension de-risking transaction increases.

C. UK/EUROPEAN MARKETS

Industry commentary on the UK de-risking market indicates that in 2021 there were approximately £40 billion of bulk annuity and longevity transactions executed, with a trend toward larger and more full-scheme transactions. Despite a slower-than-anticipated start to the year, increased reinsurance capacity

22 Special Edition – US and UK PRT market overview, Legal & General Retirement America, Pension Risk Transfer Monitor (February 2022), https://www.lgra.com/docs/librariesprovider3/lgra--knowledge-center/us-and-uk-joint-prt-monitor---feb-2022.pdf?sfvrsn=31bb07d9_16. Statistics and data with respect to the performance of the pension risk transfer market in 2021 in this paragraph are from market data collected, and projections made, by Legal & General Retirement America.

and favorable pricing in the bulk annuity and longevity swap markets contributed to a sustained level of transaction activity from the prior year, and reflected attractive pricing attributable to increased allocations to illiquid assets in insurers' investment strategies, and improved longevity reinsurance costs.

With respect to longevity swap transactions, total publicly announced UK deal volumes reached approximately £15 billion, although some reporting suggests that a significant amount of private deal-flow may bring the figure to £20 billion in terms of transactions as a whole.

In the bulk annuity market, industry commentary indicates that total UK transaction volumes reached £30 billion for 2021, a level similar to the £31.8 billion total in 2020. Overall, market analysis indicates that the volume of transactions in the de-risking market hit pre-pandemic predictions despite the challenges of COVID-19. While the publicly available figures for 2021 indicate that the total value of deals may not have reached the heights of 2019, it will likely become the second busiest year on record in longevity swap market history.

In 2021 fewer than half of the publicly announced bulk annuity transactions exceeded the £1 billion threshold. This shift represents an opening of the market to smaller and mid-sized pension schemes, allowing them to participate in a market with which they previously struggled to gain traction. This change was driven in part by small and mid-sized schemes' ability to more easily and efficiently execute streamlined transactions.

Industry forecasts predict that 2022 will be another year of high buy-in, buyout, and longevity swap activity, with some total estimates ranging between £60-65 billion — comprised of £40 billion of buy-ins and buyouts and £20-25 billion of longevity swaps. In light of the predicted high levels of market activity, it is anticipated that (re)insurance capacity may be more limited. In addition, market commentary indicates that reinsurance capital availability may be reduced as some global reinsurance firms look to deploy their capital into hardening P&C markets.

According to industry research, around a third of UK pension schemes are looking to de-risk their liabilities in the next three years, with forecasts suggesting that 2022 is expected to be a peak year because of competition among (re)insurance firms, competitive pricing, and bottled up demand from the pandemic. This may limit capacity in the market. As a result, some pension schemes may look to alternative sources of capacity to support their pension risk transfer and longevity risk transfer arrangements, which could provide an opportunity for ILS funds.

The largest publicly announced transaction in the bulk annuities market in 2021 was the £2.2 billion buyout between Metal Box Pension Scheme and Pension Insurance Corporation ("**PIC**") for 10,300 pensioners and 2,200 non-pensioner members. Under the transaction, each member will become a PIC policyholder, and the scheme's liabilities will be removed from the balance sheet of the scheme sponsor, Crown Packaging Manufacturing UK Ltd. In addition, the Trustee of the IMI plc's 2014 Deferred Fund has completed a partial buy-in deal with PIC, which covers £250 million in liabilities for approximately 1,200 fund members. The transaction is the fifth buy-in by this pension scheme since 2016, and takes liabilities sponsored by IMI which have been insured by PIC to £800 million. Lastly, the Northern Bank Pension Scheme has completed two buy-in transactions with Aviva Life & Pensions UK Ltd. ("**Aviva Life**") — the first worth £227 million and a second worth £30 million. Under the terms of the agreement, Aviva Life will insure the defined benefit pension liabilities of 800 members.

Regarding intermediated transactions, a longevity swap and reinsurance agreement was executed in March 2021 between Prudential Financial and Zurich Assurance Ltd. ("**Zurich**") in respect of approximately £6 billion of pensioner liabilities for an undisclosed UK pension scheme. Other notable deals were executed at the close of 2021, such as the December 2021 longevity swap involving Zurich and a U.S. reinsurer, covering £2.5 billion of pensioner liabilities. The transfer of longevity risk for the UK pension scheme was completed through an intermediated longevity swap and reinsurance agreement, with Zurich acting as fronting insurer. There continued to be strong levels of life reinsurance activity in the more traditional market. Among the largest publicly announced deals last year was a longevity reinsurance agreement in December 2021 between Reinsurance Group of America and Aegon N.V. in respect of approximately £7 billion of pensioners' liabilities. The transaction includes deferred pensioners, as well as in-payment policies of pensioners and dependents.

... increased reinsurance capacity and favorable pricing in the bulk annuity and longevity swap markets contributed to a sustained level of transaction activity from the prior year, and reflected attractive pricing attributable to increased allocations to illiquid assets in insurers' investment strategies, and improved longevity reinsurance costs.

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One further significant development came in November 2021 when pensions consolidator Clara-Pensions became the first UK superfund to pass the Pensions Regulator's assessment process, deeming it to have good governance, fit and proper management, and adequate capital. A superfund is designed to manage a number of pension schemes and thereby create economies of scale. The model is comparable to the system in the Netherlands, where company pension schemes have been brought together. The efficacy of the system has, however, been questioned by insurance companies providing bulk annuities, which consider that superfunds will provide less protection than that provided to insurance company policyholders. Whether this part of the market develops more broadly will depend on the extent to which it holds up to scrutiny by advisers to company pension schemes. Clara-Pensions' model is intended to act as a "bridge" to schemes brought into the superfund being passed on to a life insurer via a buyout. This model is consistent with the PRA's past comments about superfunds being used as an interim step, given its concerns about the financial strength of such funds. The current main competitor to Clara-Pensions, The Pension SuperFund, has a model that focuses on running a scheme to extinction. Superfunds have been seeking to become established for a number of years and now seem to be getting some traction, although it remains to be seen the extent to which they develop to become a significant part of the market.

IV. Select Tax Issues Affecting Insurance Companies and Products

A. U.S. TAX ISSUES

1. Final and Proposed Regulations Relating to CFCs

a. Final Regulations on the Treatment of Domestic Partnerships Owning Shares in a CFC

On January 24, 2022, the U.S. Internal Revenue Service ("**IRS**") released final regulations ("**Final Regulations**") under section 958 of the U.S. Internal Revenue Code of 1986 ("**Code**"). Section 958 of the Code provides rules for determining stock ownership in "controlled foreign corporations" ("**CFCs**"), and the Final Regulations address ownership through domestic partnerships (and S corporations).

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In general, a "U.S. shareholder" of a CFC must include in its gross income, as ordinary income, a pro rata share of the CFC's "subpart F income." A U.S. shareholder for this purpose generally means any U.S. person owning (directly, indirectly, or constructively) 10% or more of a foreign corporation, by vote or value, and a foreign corporation is a CFC if it is more than 50% owned (directly, indirectly, or constructively) by U.S. shareholders, also by vote or value. However, for purposes of including subpart F income that is "insurance income," a foreign corporation is a CFC if it is more than 25% owned (directly, indirectly, or constructively) by U.S. shareholders, by vote or value.

With respect to a domestic partnership owning stock in a CFC, the Final Regulations adopt an "aggregate approach" (rather than an "entity approach"). An aggregate approach generally treats a domestic partnership as an aggregate of its partners for purposes of determining subpart F inclusions. In other words, a domestic partnership is not treated as a U.S. shareholder for purposes of determining subpart F inclusions, and the partners will have subpart F inclusions only if they themselves qualify as U.S. shareholders with respect to the CFC. Under the Final Regulations, however, a domestic partnership is still treated as a U.S. shareholder (provided that it otherwise qualifies as such) for purposes of determining whether a foreign corporation is a CFC.

b. Proposed Regulations on the Determination and Inclusion of RPII

Also on January 24, 2022, the IRS published proposed regulations ("**Proposed Regulations**") on the determination and inclusion of related person insurance income ("**RPII**") under the subpart F regime. These Proposed Regulations would generally become effective for taxable years of foreign corporations beginning on or after the date final regulations are published.

Also on January 24, 2022, the IRS published proposed regulations ("Proposed Regulations") on the determination and inclusion of related person insurance income ("RPII") under the subpart F regime. These Proposed Regulations would generally become effective for taxable years of foreign corporations beginning on or after the date final regulations are published.

As noted above, U.S. shareholders of a CFC generally must include in their gross income, as ordinary income, their pro rata share of the CFC's subpart F income. Included in subpart F income is "insurance income," as defined in section 953 of the Code. Under section 953(a)(1) of the Code, a CFC's insurance income generally includes income (i) that is attributable to issuing or reinsuring insurance or annuity contracts, and (ii) that would be taxed under subchapter L of the Code if the income were earned by a domestic insurance company.

Special rules in section 953(c) apply with respect to RPII. Under section 953(c), RPII generally includes any insurance income attributable to a policy of insurance or reinsurance that directly or indirectly insures a U.S. shareholder of the CFC, or a person related to such U.S. shareholder. For purposes of taking RPII into account, a "U.S. shareholder" is a U.S. person that owns any shares of the foreign corporation's stock ("**RPII U.S. shareholder**"), and the special rules for including RPII are applicable if such RPII U.S. shareholders own (directly, indirectly, or constructively) 25% or more of the stock by vote or value (a CFC meeting such test, a "**RPII CFC**").

The IRS proposed regulations in 1991 providing general definitions and rules for determining RPII. These regulations would have defined RPII as premium and investment income attributable to a policy of insurance or reinsurance or an annuity contract that provides insurance coverage to a "related insured" on risks located outside the RPII CFC's country of incorporation. A "related insured" under the proposed regulations was defined in a manner generally consistent with the statute: any RPII U.S. shareholder or any person related thereto. The 1991 proposed regulations also proposed an anti-abuse rule targeting "cross-insurance arrangements," which is discussed further below. The 1991 proposed regulations were never finalized.

The Proposed Regulations are modeled in part after the 1991 proposed regulations, but also contain new guidance on a number of issues relevant to insurance companies with international activities.

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i. Aggregate Treatment of Domestic Partnerships

Consistent with the aggregate approach taken in the Final Regulations (discussed above), the Proposed Regulations provide that a domestic partnership owning shares in a RPII CFC is not treated as a RPII U.S. shareholder for purposes of determining RPII inclusions. Rather, the determination of a RPII U.S. shareholder status is made at the partner level. A domestic partnership would still, however, be treated as a RPII U.S. shareholder for purposes of determining whether a foreign corporation is a RPII CFC.

ii. Expanded Scope of Relationships Giving Rise to RPII

The definition of RPII in the Proposed Regulations is generally consistent with the definition in the 1991 proposed regulations: premium and investment income attributable to an annuity contract or policy of insurance or reinsurance that directly or indirectly insures a "related insured." However, the Proposed Regulations would expand the definition of a "related insured" beyond the scope of the 1991 proposed regulations, and arguably beyond the scope of the statutory language.

The definition of RPII in the Proposed Regulations is generally consistent with the definition in the 1991 proposed regulations: premium and investment income attributable to an annuity contract or policy of insurance or reinsurance that directly or indirectly insures a "related insured." However, the Proposed Regulations would expand the definition of a "related insured" beyond the scope of the 1991 proposed regulations, and arguably beyond the scope of the statutory language.

Under the Proposed Regulations, the term "related insured" includes any partnership (or S corporation) owning shares in a CFC if a related insured is a partner in the partnership. This rule applies to foreign and domestic partnerships. Thus, if a RPII U.S. shareholder (or other person that would qualify as a related insured) owns shares of a RPII CFC indirectly through a partnership, the partnership is treated as a related insured.

In addition, the Proposed Regulations would treat as a related insured any entity that is more than 50% owned (directly, indirectly, or constructively) by RPII U.S. shareholders, with an exception for publicly traded corporations and publicly traded partnerships. Accordingly, a corporation (other than one that is "publicly traded") would be treated as a related insured if it were majority owned by RPII U.S. shareholders. The IRS describes this rule, in the preamble to the Proposed Regulations, as intended to prevent avoidance of RPII. But the rule could significantly expand the scope of relationships giving rise to RPII. For example, this rule could treat a subsidiary of a RPII CFC, that would not otherwise be considered a related insured under current law, as a related insured on account of its indirect ownership (through the RPII CFC) by RPII U.S. shareholders.

iii. Anti-Abuse Rule of Cross-Insurance Rule

The Proposed Regulations also contain an anti-abuse rule, first proposed in different form in the 1991 proposed regulations, targeting "cross-insurance arrangements." A "cross-insurance arrangement," generally, is an arrangement in which a RPII CFC insures a person that is not a related insured, but as part of the same arrangement, another person insures a person that would be a related insured if insured by the RPII CFC. Under this anti-abuse rule, the Proposed Regulations would treat as RPII any income that is attributable to an arrangement in which a RPII CFC insures a person that is not a related insured and, as part of the same arrangement, another person insures a related insured of the RPII CFC.

The Proposed Regulations also contain an anti-abuse rule, first proposed in different form in the 1991 proposed regulations, targeting "cross-insurance arrangements."

iv. Overall Analysis of the Proposed RPII Rules

Among the proposed regulations in this package, the rules expanding the relationships that give rise to RPII stand apart as a very taxpayer-unfriendly expansion of the statutory scheme. The rules in the Proposed Regulations on aggregate treatment of partnerships are largely consistent with other recent regulatory efforts of the IRS and are generally taxpayer-friendly. The anti-abuse rules similarly reflect a familiar and reasonable concern of the IRS. By contrast, the rules expanding the scope of "related insureds" to any person that is more than 50% owned by RPII shareholders represents a dramatic expansion of the statute that is not well supported by policy or the text of the statute. The IRS has asked for comments in reaction to these proposed regulations, and we expect many taxpayers will express concerns over the approach adopted in this regulatory package.

2. Proposed Regulations on Ownership of PFICs through a Domestic Partnership

The Proposed Regulations discussed above also address the treatment of domestic partnerships (and S corporations) that own shares in "passive foreign investment companies" ("**PFICs**"). In general, a foreign corporation is a PFIC if 75% or more of its gross income consists of "passive income" or if 50% or more of its assets are held for the production of such income. Under section 1291 of the Code, U.S. persons owning shares of a PFIC are generally subject to burdensome "excess distribution" rules, unless an election is made to treat the PFIC as a qualified electing fund ("**QEF**"). If a QEF election is made, the U.S. person generally must include its pro rata share of the ordinary earnings and net capital gain generated by the QEF on a current basis (such amounts, "**QEF inclusions**").

Under current law, while a domestic partnership is not treated as the PFIC shareholder for purposes of the excess distribution rules — such rules generally apply at the partner level — domestic partnerships are treated as the PFIC shareholder for purposes of the QEF rules. Thus, QEF elections (if applicable) are made by the domestic partnership, and QEF inclusions are recognized at the partnership level, with each U.S. person owning an interest in the partnership recognizing its pro rata share of such inclusions. Moreover, domestic partnerships (and not the partners) are also generally responsible under current law for annually filing Forms 8621 ("Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund").

The Proposed Regulations would change this. As stated in the preamble, and generally in line with the approach taken elsewhere in the Proposed Regulations and the Final Regulations, the IRS has determined that an "aggregate approach" should apply. Thus, under the Proposed Regulations, domestic partnerships (and S corporations) are not considered PFIC shareholders for purposes of making QEF elections (or certain other elections), recognizing QEF inclusions, or filing Forms 8621. Rather, any U.S. person that is a partner would be responsible for such matters.

... generally in line with the approach taken elsewhere in the Proposed Regulations and the Final Regulations, the IRS has determined that an "aggregate approach" should apply.

The preamble notes that commenters have expressed "administrability concerns" with respect to the shifting of these responsibilities from domestic partnerships to their partners, and seeks comment on, among other things, whether final regulations should permit domestic partnerships to make the QEF election on behalf of its partners, despite the general rule that the election would be made by the partners.

3. Private Letter Ruling 202109001: Assumption Reinsurance Transactions and the BEAT

Section 59A of the Code, known as the base erosion and anti-abuse tax ("**BEAT**") generally imposes a 10% minimum tax on large U.S. corporations with average annual revenue of at least US$500 million. The BEAT is intended to limit the amount of payments U.S. corporations make to foreign affiliates. The related-party payments covered by the BEAT are referred to as "base erosion" payments, and they include amounts paid to a foreign person for reinsurance. Sections 59(c)(4) and (e)(1)(C) of the Code provide that the BEAT applies only if U.S. corporations make base erosion payments that equal or exceed 3% of the total deduction claimed by the U.S. corporation.

Private Letter Ruling 202109001 ("**Letter Ruling**"), issued by the IRS on March 5, 2021, addresses a taxpayer's request to determine whether agreements entered into with two foreign insurance companies resulted in a base erosion payment. The taxpayer, a domestic corporation, had previously reinsured risks under certain insurance policies and ceded the risk to two related foreign reinsurance companies (("**FC1**") and ("**FC2**")). FC2 then entered into a retrocession agreement with FC1 with respect to its share of the risk.

Private Letter Ruling 202109001 ("Letter Ruling"), issued by the IRS on March 5, 2021, addresses a taxpayer's request to determine whether agreements entered into with two foreign insurance companies resulted in a base erosion payment.

To reduce operational complexity and administrative burden the taxpayer, FC1, and FC2 proposed an agreement ("**Agreement**") that would result in FC1 becoming the direct reinsurer of the risk that had been initially ceded by the taxpayer to FC2. The Agreement would restructure and replace the existing reinsurance agreements between the taxpayer and FC1 and FC2, respectively, with a single reinsurance agreement between the taxpayer and FC1. No new consideration would be paid by the taxpayer, the payments to be made by the taxpayer would not change, and FC1 would assume all liabilities as if it was the original reinsurer.

These facts raised the question whether the substitution of FC1 for FC2 would result in a deemed base erosion payment by the taxpayer in connection with the transaction. A modification of an insurance or reinsurance contract can result in a deemed sale or exchange of the contract. For example, Revenue Ruling 90-109 deals with the exercise of an option in an insurance contract to replace the insured with a

These facts raised the question whether the substitution of FC1 for FC2 would result in a deemed base erosion payment by the taxpayer in connection with the transaction.

The IRS analyzed the proposed agreement as a sale by FC1 to FC2. Accordingly, any amounts paid or accrued with respect to the Agreement were between FC1 and FC2. The IRS did not give detailed reasoning or analysis. But it recognized that a "change in the counterparty […] does not always result in a deemed termination of the contract in regards to the taxpayer," …

Brexit has resulted in the exclusion of the UK from the EU directives that previously, in qualifying circumstances, eliminated taxation by EU member states with respect to certain payments made to the UK, such as the elimination of certain withholding taxes pursuant to the Parent-Subsidiary Directive or the Interest and Royalties Directive.

Companies should also monitor the effect of Brexit on their value-added tax ("VAT") positions. As a result of the Brexit final terms, the UK is now treated as a "third country" from the perspective of EU member states for VAT purposes.

new person. The IRS held in that ruling that this constituted a "material change" to the contract, and thus resulted in a deemed exchange of the insurance contract for the new, modified insurance contract. This principle is generally consistent with authorities in the context of modifications to debt instruments.

Applying this principle to the facts in the Letter Ruling, one could argue that replacing FC2 with FC1 constituted a material change, resulting in a deemed sale or exchange of the new or existing reinsurance contract. If that were the case, and if the taxpayer recognized a loss in such deemed sale or exchange, then the taxpayer could be said to have made a base erosion payment in the transaction (despite the fact that no new consideration was paid by the taxpayer under the Agreement).

The IRS analyzed the proposed agreement as a sale by FC1 to FC2. Accordingly, any amounts paid or accrued with respect to the Agreement were between FC1 and FC2. The IRS did not give detailed reasoning or analysis. But it recognized that a "change in the counterparty […] does not always result in a deemed termination of the contract in regards to the taxpayer," citing authorities in the context of modifications of debt instruments. In that context, a replacement of the obligor may not be considered a material change resulting in a deemed sale or exchange if the change does not result in a change in payment expectations. Thus, the Letter Ruling possibly suggests that a similar analysis may be appropriate with respect to insurance and reinsurance contracts.

B. UK/EU TAX DEVELOPMENTS

1. Brexit and Tax

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

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

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

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

2. EU Blacklist and New Substance Laws

On December 5, 2017, the EU published its list of 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 5, 2021, such that the current list includes only American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the U.S. Virgin Islands, and Vanuatu. Importantly, 47 jurisdictions were originally placed on the so-called "greylist," representing those countries that avoided the EU Blacklist due to commitments to (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 5, 2021, such that it now includes 15 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 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," …

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

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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3. The EU Anti-Tax Avoidance Directives

On January 28, 2016, the EU presented its proposal for an Anti-Tax Avoidance Directive ("**ATAD**"). On May 29, 2017, the EU amended ATAD with Directive (EU) 2017/952 ("**ATAD 2**"). ATAD and ATAD 2 contain various measures that could have an effect on insurance companies. Of particular note to insurance companies are (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

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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.

On November 5, 2020, HMRC published a consultation paper on measures to improve the operation of, and prevent certain types of avoidance and evasion of, UK insurance premium tax ("IPT").

The UK government has enabled the introduction of a new "Asset Holding Company" ("AHC") regime, intended to offer a more comprehensive tax framework for UK tax resident AHCs to make and hold investments in equities, debt, real estate, and other asset classes.

The net effect of this new 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.

day-to-day operations and decision-making on significant functions and receive mobile and/or passive income, such as interest, dividends, and royalty income, may be caught by these rules. It is currently planned that implementation will be required by EU member states by June 30, 2023.

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

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

On November 5, 2020, HMRC published a consultation paper on measures to improve the operation of, and prevent certain types of avoidance and evasion of, UK insurance premium tax ("**IPT**"). The aim of the consultation was to identify measures that may improve the operation of IPT, and make it easier for both the industry and HMRC to administer IPT. The consultation did not, however, consider the rates of IPT or the exemptions to IPT. A summary of the responses to this consultation was published on November 30, 2021. Broadly, HMRC has concluded from the responses that no legislation should be implemented at this time to tackle tax avoidance structures and that no changes should be made to the content or process of IPT returns. However, HMRC has stated that it will consider taking forward its proposal of a "Code of Conduct" for the UK insurance broker industry. This will likely include a register of insurers who are registered for IPT and provide brokers with the ability to report insurers not so registered (although participation by brokers would be voluntary). At this stage, HMRC will engage stakeholders in the brokerage and insurance industries to explore these possibilities and no draft legislation has been published at this time.

5. The UK's New "Asset Holding Company" Regime

The UK government has enabled the introduction of a new "Asset Holding Company" ("**AHC**") regime, intended to offer a more comprehensive tax framework for UK tax resident AHCs to make and hold investments in equities, debt, real estate, and other asset classes. The legislation is now in final form, and the AHC regime will come into effect on April 1, 2022.

Under the new 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.
- 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 new 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 new 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 new 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 once the regime comes into force.

6. 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 insurance-linked securities 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). In November 2021, the UK government published draft legislation, expected to become law in Spring of 2022, which provides 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.

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V. Global Regulatory and Litigation Developments

Throughout 2021, regulators and industry members around the world continued to implement changes addressing international group supervision and group capital standards, innovation and technology, data privacy, reinsurance, and many other areas. Regulators have also been considering the changing global social and economic landscape with respect to, among other areas, cybersecurity, the use of big data, race, and insurance. While responding to the impact of COVID-19 continued to be a priority in 2021, regulators were also looking ahead to emerging issues related to private equity ownership of insurers, innovative restructuring mechanisms, and ESG.

A. U.S. NAIC AND STATE ACTIVITY

1. Changes to the Insurance Holding Company System Regulatory Act and Model Regulation

a. NAIC Adopts Revisions to Model Holding Company Act to Add Group Capital Calculation and Liquidity Stress Test as Updates to the Accreditation Standards

In December 2020, the NAIC adopted revisions to the Insurance Holding Company System Regulatory Act (#440) (the "**Holding Company Model Act**") 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 (the "**Covered Agreements**"), which require that states have a "worldwide group capital calculation" in place by November 7, 2022. If this deadline is not met for adoption by any state, a U.S. insurance group that has operations in the EU or UK and for which such state acts as the group-wide supervisor could be subject to the imposition of Solvency II (Directive 2009/138/EC) requirements by such group's supervisors in the EU or UK.

The NAIC has exposed, for a one-year public comment period ending 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 is able to seek an exemption from further filings, as exposed the significant elements for the GCC accreditation standard were modified to allow state regulators to grant exemptions to groups meeting the qualifications set forth in the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450) (the "**Holding Company Model Regulation**") without the requirement to file a GCC at least once.

The proposed effective date of the updates to the accreditation standard is January 1, 2026; however, the NAIC has encouraged all states with a group affected by the Covered Agreements to adopt the GCC revisions to the Holding Company Model Act and the Holding Company Model Regulation by November 7, 2022, 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.

b. NAIC Adopts Revisions to Holding Company Model Act to Ensure Continuity of Essential Services and Functions for Insurers in Receivership

During the NAIC's Summer 2021 National Meeting (the "**Summer 2021 National Meeting**"), the Executive (EX) and Plenary Committee adopted amendments to the Holding Company Model Act and the Holding Company Model Regulation (such amendments, the "**Receivership Revisions**"), which were previously adopted by the Financial Condition (E) Committee on July 8, 2021. The Receivership Revisions are intended to address the continuation of essential services provided through affiliated intercompany agreements in the event of an insurer's receivership.

The Receivership Revisions address new minimum standards for affiliated cost-sharing services and management services agreements. Such standards will now include, among other matters, the following requirements:

- The books and records of the insurer be defined to specifically include data of the insurer and that such data and records be identifiable and capable of segregation.

Throughout 2021, regulators and industry members around the world continued to implement changes addressing international group supervision and group capital standards, innovation and technology, data privacy, reinsurance, and many other areas.

While responding to the impact of COVID-19 continued to be a priority in 2021, regulators were also looking ahead to emerging issues related to private equity ownership of insurers, innovative restructuring mechanisms, and ESG.

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The Receivership Revisions are intended to address the continuation of essential services provided through affiliated intercompany agreements in the event of an insurer's receivership.

- The insurer be indemnified for any actions by the affiliate that violate the Holding Company Model Regulation's requirements with regard to provision of services to the insurer when in receivership.

- With regard to an insurer in receivership, supervision, or conservatorship, (i) the rights of such insurer will extend to the receiver or guaranty fund, (ii) the affiliate service provider will make available essential personnel, (iii) the affiliate service provider will continue the services for a minimum period of time as specified in the agreement with timely payment for post-receivership work, and (iv) the affiliate service provider will maintain necessary systems and make them available to the receiver for as long as the affiliate service provider receives timely post-receivership payment, unless released by the receiver.

The Receivership Revisions also provide that if regulators deem an insurer to be in a statutorily defined hazardous financial condition, affiliate service providers may be required to post a bond or deposit not to exceed the value of the relevant services agreement in any one year.

The Receivership Revisions also provide that if regulators deem an insurer to be in a statutorily defined hazardous financial condition, affiliate service providers may be required to post a bond or deposit not to exceed the value of the relevant services agreement in any one year. In determining whether a bond or deposit is required, regulators will consider whether there are concerns about such affiliated party's ability to fulfill the contract in the event of the insurer's liquidation.

The Receiver's Handbook (E) Subgroup is developing guidance related to the Receivership Revisions as part of its ongoing charge to update the Receiver's Handbook. Re-drafted versions of Chapters 1 and 2 of the Receiver's Handbook were exposed by the Subgroup in November 2021 for a 30-day public comment period ending December 20, 2021.

In December 2021, the Receivership and Insolvency (E) Task Force referred the Receivership Revisions to the Financial Regulation Standards and Accreditation (F) Committee, recommending that the Receivership Revisions be "Acceptable, but Not Required" to be adopted by states.

c. NAIC Proposes Guidance Regarding Examiner Review of Affiliate Service Agreements

In October 2021, the Risk-Focused Surveillance (E) Working Group exposed proposed revisions to the NAIC Financial Analysis Handbook and Financial Condition Examiners Handbook that would provide enhanced guidance related to the review of affiliated service agreements.

The proposed changes were made as a result of a referral received from the Chief Financial Regulator Forum in late 2020 to address concerns regarding an increase in the number of Form D Prior Notice of a Transaction filings (or Form D filings) submitted with financial regulators for approval with respect to affiliated service agreements with more complex, market-based expense allocations.

In a Form D filing, the insurer is required to provide a statement regarding the cost allocation methods that specifies whether proposed charges are based on "cost or market." While market-based expense allocations are not prohibited, the Form D must include the rationale for using market- instead of cost-based charges ...

In a Form D filing, the insurer is required to provide a statement regarding the cost allocation methods that specifies whether proposed charges are based on "cost or market." While market-based expense allocations are not prohibited, the Form D must include the rationale for using market- instead of cost-based charges, including justification for the insurer's determination that amounts are fair and reasonable. The Financial Analysis Handbook and Financial Condition Examiners Handbook currently provide guidance regarding the review of affiliate service agreements, noting that "compensation based on other than actual cost should be closely evaluated" and providing for the review and evaluation of the appropriateness of affiliated service agreements. However, under the proposed guidance, the review of affiliate service agreements that utilize a market-based cost allocation would be heightened. The proposed guidance states that prior Form D approvals may need to be reevaluated as "the examination team may be in a better position to assess the fairness and reasonableness of expense allocations after the agreement has been in place for a period of time."

During discussions by the Risk-Focused Surveillance (E) Working Group in November 2021 on the exposure, interested parties emphasized that the examiner's review should be focused on the verification that a service agreement utilizing mark-based cost allocation has been implemented and is functioning as approved, rather than providing an opportunity to reevaluate prior Form D approvals.

Following feedback received on the initial exposure, the Risk-Focused Surveillance (E) Working Group and NAIC staff plan to revisit the draft guidance and plan to continue to work on this project in 2022.

Following feedback received on the initial exposure, the Risk-Focused Surveillance (E) Working Group and NAIC staff plan to revisit the draft guidance and plan to continue to work on this project in 2022.

2. NAIC Reviews Considerations Relating to Private Equity Ownership of Insurers

In December 2021, the Financial Stability (E) Task Force exposed a draft list of "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity ("**PE**") Owned Insurers" (the "**List of PE Considerations**") and confirmed that the Macroprudential (E) Working Group will serve as the coordinator of considerations related to PE owners of insurers to streamline regulatory review of such considerations within the NAIC.

The topic of PE ownership of insurers has recently garnered renewed interest at both the state and federal levels in the U.S., as well as by regulators internationally, as a result of a noted increase in PE acquisitions of insurers and the recent release of several reports regarding PE ownership of insurers, including the report issued by the NAIC Capital Markets Bureau as of year-end 2020. The Financial Stability (E) Task Force noted that recent concerns are focused on the increase in complex group structures and affiliate agreements, which may not be appropriately captured by the existing holding company regulatory framework. Superintendent Eric Cioppa (Maine), who serves as the state insurance commissioner representative on the Financial Stability Oversight Council, specifically noted that the Federal Insurance Office ("**FIO**") and others at the federal level have raised questions about the PE business model related to insurance entities, including affiliated transactions, investment transparency, and fee structures, and reiterated support for oversight enhancements at the NAIC.

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In February 2022, the Macroprudential (E) Working Group adopted a revised List of PE Considerations, which will be sent to the Financial Stability (E) Task Force and Financial Condition (E) Committee for further adoption. The List of PE Considerations includes 13 areas noted for further review by the NAIC to assess whether additional work is needed to address concerns. The list includes, among others:

In February 2022, the Macroprudential (E) Working Group adopted a revised List of PE Considerations …

- Structuring contractual agreements in a manner to avoid regulatory disclosures and requirements;
- Control considerations that may exist with less than 10% ownership (such as control through contractual arrangements);
- Material terms of investment management agreements and whether they are at arm's length;
- Operational, governance, and market conduct practices affected by the different priorities and level of insurance experience of PE firms;
- Material increases in privately structured securities (by both affiliated and nonaffiliated asset managers); and
- Use of offshore reinsurers and complex affiliated sidecar vehicles.

Once fully adopted, the Macroprudential (E) Working Group will start addressing each of the concerns and evaluating whether additional NAIC action is required and, if so, by which NAIC committee. For all work that is ongoing, the Macroprudential (E) Working Group's staff will maintain status information and provide oversight of such activities.

3. NAIC Adopts FAQ Document to Facilitate Uniformity in State Adoption of Revised Suitability in Annuity Transactions Model Regulation

The NAIC adopted a frequently asked question ("**FAQ**") document to address issues that are likely to arise as states adopt the 2020 revisions to the Suitability in Annuity Transactions Model Regulation ("**SAT**"). The revised SAT, which the NAIC adopted in February 2020, incorporates a requirement for producers to act in the "best interest" of a retail customer when making a recommendation of an annuity. To meet this standard, a producer must not place his or her own financial interest ahead of the consumer's, and the producer must also satisfy the four key obligations of care, disclosure, conflict of interest, and documentation.

The revised SAT, which the NAIC adopted in February 2020, incorporates a requirement for producers to act in the "best interest" of a retail customer when making a recommendation of an annuity.

As adopted, the FAQ document addresses topics such as general background on the development of the revised SAT, the intersection of state insurance regulation and federal regulation, how to satisfy the best interest standard of conduct (including guidance regarding the care obligation, the disclosure obligation, and the conflict of interest obligation), and insurer supervision and producer training requirements. The FAQ document is intended to facilitate uniformity in state adoption and implementation of the revisions

As of January 25, 2022, the revised SAT had been adopted in approximately 19 jurisdictions, with legislation pending in another six jurisdictions and with two jurisdictions (including New York) having adopted similar provisions regulating annuity transactions.

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4. NAIC Evaluates the Applicability of Nonforfeiture Benefits to Index-Linked Variable Annuities

The Index-Linked Variable Annuity (A) Subgroup ("**ILVA Subgroup**") exposed for comment a new Actuarial Guideline ("**Actuarial Guideline ILVA**") to prescribe conditions under which index-linked variable annuities ("**ILVAs**") can be considered variable annuities exempt from the scope of the Standard Nonforfeiture Law for Individual Deferred Annuities (#805) (the "**Standard Nonforfeiture Law**").

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

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

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

Through the proposed Actuarial Guideline ILVA, the ILVA Subgroup intends to clarify the application of the Standard Nonforfeiture Law and the VA Model Regulation to these hybrid products.

Through the proposed Actuarial Guideline ILVA, the ILVA Subgroup intends to clarify the application of the Standard Nonforfeiture Law and the VA Model Regulation to these hybrid products. The proposed guideline is based on certain principles, including that the products should provide equity to contract holders with reference to a hypothetical portfolio containing fixed-income assets and derivatives designed to perfectly hedge the benefit guarantees at the end of the contract term.

In February 2022, the ILVA Subgroup met to discuss comments received on the exposure draft of Actuarial Guideline ILVA. The American Council of Life Insurers ("**ACLI**") and the Committee of Annuity Insurers ("**CAI**") submitted an alternative version of Actuarial Guideline ILVA (the "**ACLI and CAI Proposal**") and requested that the ILVA Subgroup expose the ACLI and CAI Proposal for public comment. In relevant part, the ACLI and CAI Proposal describes two methods that are currently used in the marketplace to determine interim values on ILVAs. Under the ACLI and CAI Proposal, calculating interim values on ILVAs pursuant to one of these two methods would provide a safe harbor for compliance with applicable regulatory requirements. It is expected that the ACLI and the CAI will provide additional information to the ILVA Subgroup regarding the two methods in order for the ILVA Subgroup to assess whether to expose the ACLI and CAI Proposal for public comment and/or incorporate elements of the ACLI and CAI Proposal in the next draft of the Actuarial Guideline ILVA.

5. NAIC Disbands Annuity Disclosure (A) Working Group

The NAIC decided to terminate efforts to revise the Annuity Disclosure Model Regulation (#245) to impose additional restrictions on indices used in annuity illustrations.

The NAIC decided to terminate efforts to revise the Annuity Disclosure Model Regulation (#245) to impose additional restrictions on indices used in annuity illustrations. Accordingly, the Annuity Disclosure (A) Working Group ("**ADWG**"), which was charged with drafting such revisions, was disbanded.

The Annuity Disclosure Model Regulation prohibits annuity issuers from illustrating the performance of an index that is less than 10 years old. Based on industry proposals, in June 2018 the ADWG exposed for comment draft revisions to the Annuity Disclosure Model Regulation that would permit illustrations of indexed returns for an index that has not been in existence for 10 calendar years, subject to certain conditions. In response to concerns raised by the Center for Economic Justice, in March 2019 the ADWG proposed revisions to the Annuity Disclosure Model Regulation that would prohibit annuity issuers from illustrating the performance of an index that is less than 20 years old unless certain criteria are met. In July 2019, in response to industry concerns, the ADWG proposed a "compromise" version of the revisions to the Annuity Disclosure Model Regulation, which would prohibit annuity issuers from illustrating the performance of an index that is less than 15 years old unless certain criteria are met.

Ultimately, the ADWG was unable to reach consensus on these proposed revisions to the Annuity Disclosure Model Regulation, and the NAIC determined to cease efforts on such revisions. Accordingly, any additional restrictions on indices used in annuity illustrations will be determined by individual states to the extent that they decide to amend existing state law to address the issue.

6. NAIC Activities Involving IBTs and Corporate Divisions

In October 2021, the Restructuring Mechanisms (E) Working Group exposed for comment a draft Restructuring Mechanisms white paper ("**Restructuring White Paper**"). The Restructuring White Paper discusses new statutory processes that certain states have adopted to govern IBT and corporate division ("**CD**") transactions. The Restructuring White Paper includes a survey of U.S. restructuring statutes and regulations (including a summary of transactions completed to date) and a summary of the significant legal issues related to IBT and CD laws (including guaranty association issues).

The Restructuring White Paper concludes by making the following recommendations:

- The Restructuring Mechanisms (E) Subgroup will continue its work to develop financial best practices to be used in considering the approval of proposed restructuring transactions.
- The Guaranty Association Model Act should be amended to address issues related to guaranty association coverage following IBT and CD transactions.
- IBT and CD transactions should be subject to a robust regulatory process, which may require the application of certain statutory minimums (e.g., court approval, independent expert, notice to stakeholders) in some transactions, but not others.
- The NAIC should consider developing licensing standards for insurers formed for the purpose of effectuating restructuring mechanisms.

The Restructuring White Paper does not establish an official position by the NAIC regarding IBTs or CDs.

Ten comment letters were submitted during the exposure period. The Restructuring Mechanisms Working Group will continue reviewing comments and working on the Restructuring White Paper in 2022.

7. NAIC Activities Related to Long-Term Care Insurance

During the NAIC's Fall 2021 National Meeting (the "**Fall 2021 National Meeting**"), the Long-Term Care Insurance ("**LTCI**") (EX) Task Force ("**LTCI Task Force**") adopted the Long-Term Care Insurance Multistate Rate Review Framework ("**LTCI MSA Framework**") as well as a checklist for premium increase communications. In addition, the Long-Term Care Insurance Model Update (B) Subgroup ("**LTCI Model Update Subgroup**") continued its review of the Long-Term Care Insurance Model Act (#640) and Long-Term Care Insurance Model Regulation (#641) (the "**LTCI Model Regulation**" and, together, the "**LTCI Model Laws**") to determine whether the models remain compatible with the evolving delivery of long-term care services in the changing LTCI marketplace.

a. NAIC LTCI Task Force Adopts LTCI MSA Framework

During the Fall 2021 National Meeting, the LTCI Task Force adopted the LTCI MSA Framework, which is intended to provide a consistent national approach for reviewing current long-term care insurance rates that results in actuarially appropriate increases being granted by the states in a timely manner and eliminates cross-state rate subsidization.

Industry comments with respect to the adoption reflected continued concern with a perceived lack of transparency and consistency, specifically with respect to the methodology used to calculate increases recommended by the Multi-State Actuarial Team under the LTCI MSA Framework. However, the comments recognized that such questions would be addressed over time as regulatory and industry experience with the LTCI MSA Framework evolves.

The LTCI MSA Framework is expected to be considered by the Executive (EX) Committee and Plenary at the NAIC's Spring 2022 National Meeting, in advance of becoming fully operational by September 2022.

During the Fall 2021 National Meeting, the LTCI Task Force adopted the LTCI MSA Framework, which is intended to provide a consistent national approach for reviewing current long-term care insurance rates that results in actuarially appropriate increases being granted by the states in a timely manner and eliminates cross-state rate subsidization.

The checklist is intended to establish a consistent approach to drafting and reviewing LTCI reduced-benefit-options policyholder communications.

While the LTCI Task Force recommended that state regulators adopt the checklist and adapt it to local needs, it noted that the checklist is to be used as guidance and does not carry the weight of law or impose any legal liability.

b. NAIC Adopts Checklist for Premium Increase Communications

On November 19, 2021, the LTCI Reduced Benefit Options (EX) Subgroup adopted a checklist for premium increase communications, which was subsequently adopted by the LTCI Task Force at the Fall 2021 National Meeting. The checklist is intended to establish a consistent approach to drafting and reviewing LTCI reduced-benefit-options policyholder communications. Specifically, use of the checklist by insurers and state regulators is intended to ensure that consumer communications (i) are written in a clear, logical, not overly complex manner, (ii) present options fairly, and (iii) include appropriate referrals to external resources, definitions, disclosures, and visualization tools.

While the LTCI Task Force recommended that state regulators adopt the checklist and adapt it to local needs, it noted that the checklist is to be used as guidance and does not carry the weight of law or impose any legal liability.

c. NAIC Reviews LTCI Model Laws

The LTCI Model Update Subgroup continued its review of the LTCI Model Laws to determine whether the models remain compatible with the evolving delivery of long-term care services in the changing LTCI marketplace, specifically focusing on Sections 7–19 of the LTCI Model Regulation during its November and December 2021 meetings. These sections relate to, among other things, requirements to offer inflation protections, reporting requirements, and prohibitions against post-claims underwriting. The LTCI Model Update Subgroup's review of the models began in May 2021 and remains ongoing. The LTCI Model Laws have not been fully reviewed since 2010 and were most recently updated in 2016. To the extent that the LTCI Model Update Subgroup determines that an update to the models is necessary, it will report such determination to the Senior Issues (B) Task Force, which would then begin drafting revisions.

8. NAIC Fails to Adopt Pharmacy Benefit Manager Licensure and Regulation Model Act

The proposed Pharmacy Benefit Manager Licensure and Regulation Model Act (the "**PBM Model Act**") failed to receive the required two-thirds majority vote for adoption by the Executive (EX) Committee and Plenary at the Summer 2021 National Meeting. Twenty states abstained from voting, and another 12 states voted against adoption of the PBM Model Act.

The Pharmacy Benefit Manager Regulatory Issues (B) Subgroup ("**PBM Subgroup**") began developing the PBM Model Act in 2019 to provide state insurance departments with direct authority to regulate pharmacy benefit managers ("**PBMs**") rather than to regulate indirectly through the insurer. The PBM Model Act would have established standards and criteria for the licensing and regulation of PBMs providing claims-processing services or other prescription drug or device services for health benefit plans. However, in the course of developing the PBM Model Act, members of the PBM Subgroup could not come to a consensus on a number of matters, including whether the model would focus only on PBM licensing and registration provisions or include substantive provisions addressing certain PBM business practices.

During the vote, several states abstained on the grounds that their state had already passed legislation regarding the licensure and registration of PBMs. In that regard, a majority of states introduced separate bills regulating PBMs following the December 10, 2020, unanimous decision by the Supreme Court in *Rutledge vs. Pharmaceutical Care Management Association* that backed an Arkansas state law that regulates PBMs and paved the way for state regulation of PBMs.

Following the failed vote on the PBM Model Act, the PBM Subgroup will continue work in 2022 on a white paper that will:

- Analyze and assess the roles of PBMs, pharmacy services administrative organizations, and other supply chain entities in the provision of prescription drug benefits;
- Identify, examine, and describe current and emerging state regulatory approaches to PBM business practices, such as price transparency and reporting requirements, rebating, and spread pricing, including the implications of the *Rutledge* decision on such business practices; and
- Discuss any challenges states have encountered in implementing such laws and/or regulations.

Based on issues identified in the white paper once finalized, the PBM Subgroup is also charged with considering the (i) development of a new NAIC model to establish a licensing or registration process for PBMs and (ii) inclusion of provisions on PBM prescription drug pricing and cost transparency in such new NAIC model.

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

Since the early months of the COVID-19 pandemic, policyholders have filed lawsuits against property insurers, asserting that they are entitled to recover lost income they sustained when their businesses were fully or partially closed under government shutdown orders. To date, over 2200 such business interruption cases have been filed. Policyholders in the restaurant industry account for approximately 725 of the cases. Medical, surgical, and dental practices account for another 250.[23] Litigation has been complicated and expensive as insurers have worked through the tidal wave of cases. But insurers have succeeded in winning early dismissal in the vast majority of these actions.

Under the policies at issue, income loss is generally covered only when "direct physical loss of" or "direct physical damage to" insured property causes a suspension of operations. Policyholders have been unsuccessful in these lawsuits because they cannot identify physical loss of or physical damage to insured property. The courts have largely concluded that no physical loss or damage occurs when a state or local government issues a closure order.

In seeking a route to coverage, policyholders have argued, among other things, that direct physical loss or damage occurs (i) when they lose the use of property for its intended purposes, (ii) when the property becomes contaminated or potentially contaminated by the virus, which they argue is analogous to the kinds of gas or asbestos contamination that some courts have held triggers coverage, and (iii) when they make alterations required to keep a business open, such as the installation of plexiglass or the rearrangement of floor space and furniture to ensure that people are distanced from one another. Policyholders have also argued that under basic rules of policy interpretation, they should prevail as long as they can advance any reasonable interpretation that favors coverage — even if it is not the most reasonable interpretation.

Although courts have applied this policy interpretation rule, they have largely rejected each of the policyholders' substantive coverage theories for the following reasons: (a) the term "loss of use" does not appear in the coverage provisions and is in fact often the subject of a policy exclusion; (b) because a property that is potentially contaminated by the virus can be easily cleaned, the COVID-19 situation is not analogous to contamination with asbestos or other substances that require extensive property remediation; and (c) alterations required to keep a business open are distinct from physical loss or damage that causes a business to suspend operations.

Insurers have also raised policy exclusions in many cases. When courts review these exclusions, they have generally held that the exclusions unambiguously preclude coverage. The exclusion courts address most often is the virus exclusion, which typically provides that the insurer will not pay for any loss or damage caused by a virus. Courts have also held that "loss of use" and "ordinance or law" exclusions foreclose coverage.

Federal district courts have issued rulings in approximately 600 cases, and have dismissed roughly 95% of them. State trial courts have issued rulings in approximately 180 cases, and have dismissed roughly 78% of them.

At the appellate level, the news has been uniformly positive for insurers to date: they have prevailed in every case. This includes rulings from all but two federal Circuit Courts of Appeal (the First and the Third), as well as state intermediate appellate courts in California, Indiana, Michigan, and Ohio.

Although the overwhelming weight of authority has favored insurers, the policy interpretation questions involve the application of state law. Thus, policyholders continue to litigate these questions in state court, hoping to reverse the current trend. In several states, including Massachusetts and Washington, supreme courts have accepted direct review of cases, bypassing the intermediate appellate courts. The First

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

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Circuit, which is presiding over an appeal involving Massachusetts law, has stayed appellate proceedings pending the outcome of COVID-19 coverage litigation in Massachusetts' highest court. The Ninth Circuit has done the same in one case involving Washington law. Without a turnaround from state supreme courts, however, the wave of business interruption litigation is likely to recede rapidly.

10. NAIC Continues Implementation of Revisions to Model Credit for Reinsurance Law and Regulation

In 2021, the NAIC continued to move forward on its implementation of aspects of the 2019 revisions to the Credit for Reinsurance Model Law and Regulation (together, the "**Revised CFR Model Laws**"). The Revised CFR Model Laws eliminate reinsurance collateral requirements for certain reinsurers and limit the worldwide application of prudential group insurance measures on insurance groups that are domiciled in a "reciprocal jurisdiction." Reciprocal jurisdictions include (i) accredited U.S. jurisdictions, (ii) non-U.S. jurisdictions that have entered into a covered agreement with the U.S. (such as the EU and the UK), and (iii) "qualified jurisdictions" that meet certain additional requirements consistent with the terms and conditions of the covered agreements, including that the jurisdiction "recognizes the U.S. state regulatory approach to group supervision and group capital." To date, Bermuda, Japan, and Switzerland have been approved as reciprocal jurisdictions.

To be eligible for passporting, a reinsurer must first seek recognition as a reciprocal jurisdiction reinsurer from an initial state for certification, referred to as the "Lead State," which will coordinate with ReFAWG on the review of the application to analyze the criteria required for certification and eligibility for the reinsurer to apply for passporting into other states.

The NAIC previously adopted the Process for Evaluating Qualified and Reciprocal Jurisdictions to specify how qualified jurisdictions that meet the requirements under the Revised CFR Model Laws are recognized as reciprocal jurisdictions. In December 2021, the NAIC Executive (EX) Committee and Plenary adopted the Reinsurance Financial Analysis (E) Working Group ("**ReFAWG**") Review Process for Passporting Certified and Reciprocal Jurisdiction Reinsurers for reciprocal jurisdictions, under which a state may defer to another state's determination with respect to the requirements for reciprocal jurisdiction reinsurers. To be eligible for passporting, a reinsurer must first seek recognition as a reciprocal jurisdiction reinsurer from an initial state for certification, referred to as the "Lead State," which will coordinate with ReFAWG on the review of the application to analyze the criteria required for certification and eligibility for the reinsurer to apply for passporting into other states.

Also in December 2021, the NAIC Executive (EX) Committee and Plenary adopted the Process for Evaluating Jurisdictions that Recognize and Accept the GCC (referred to as "Recognize and Accept" Jurisdictions), which process will be similar to the Process for Evaluating Qualified and Reciprocal Jurisdictions. Under the 2020 revisions to the Holding Company Model Act relating to the GCC, a non-U.S. jurisdiction may meet the standards for its insurance groups to be exempt from the GCC (i) if the jurisdiction has been determined to be a "reciprocal jurisdiction," which already includes a requirement that the jurisdiction "recognizes the U.S. state regulatory approach to group supervision and group capital," or (ii) if the jurisdiction has otherwise been determined to "recognize and accept" the GCC through the adopted Process for Evaluating Jurisdictions that Recognize and Accept the GCC. Through this process, the Mutual Recognition of Jurisdictions (E) Working Group will evaluate non-U.S. jurisdictions, and a list of "Recognize and Accept" Jurisdictions will be published through the NAIC committee process.

As of February 3, 2022, 47 U.S. jurisdictions had adopted the 2019 revisions to the Credit for Reinsurance Model Law, while six jurisdictions had action under consideration.

As of February 3, 2022, 47 U.S. jurisdictions had adopted the 2019 revisions to the Credit for Reinsurance Model Law, while six jurisdictions had action under consideration. In addition, 31 U.S. jurisdictions had adopted the revisions to the Credit for Reinsurance Model Regulation, and nine jurisdictions had action under consideration. The Revised CFR Model Laws must be adopted by the states prior to September 1, 2022, the date at which the FIO must complete its federal preemption reviews under the Covered Agreements. The NAIC is encouraging all states and jurisdictions to adopt the Revised CFR Model Laws as soon as possible and no later than July 1, 2022, to give the FIO time to complete its federal preemption analysis.

11. NAIC Activities Relating to International Insurance Activities

Over the last year, the NAIC and its representatives at the International Association of Insurance Supervisors (the "**IAIS**") have been actively participating in the implementation process of various initiatives designed to enable effective cross-border supervision of internationally active insurance groups and contribute to global financial stability.

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

The IAIS has continued to make progress on the insurance capital standards (the "**ICS**") applicable to internationally active insurance groups ("**IAIG**") under the Common Framework for the Supervision of Internationally Active Insurance Groups ("**ComFrame**"). The ICS aims to provide a globally comparable risk-based measure of capital adequacy of IAIGs. The ICS was approved in November 2019 along with ComFrame and will be implemented in two phases, starting with a five-year monitoring period that runs through 2024, after which the ICS will be implemented as a group-wide prescribed capital requirement ("**PCR**"). In connection with such work, the IAIS is also continuing to assess whether the Aggregation Method ("**AM**"), which is intended to be an alternative to the ICS developed by the NAIC in the U.S. along with other interested jurisdictions, provides comparable outcomes to the ICS. The AM will be similar to the GCC and calculated in a similar but "jurisdictionally agnostic" manner. Work on the draft comparability criteria was delayed in 2021, but the IAIS plans to issue a public consultation on the draft comparability criteria in the first half of 2022. The IAIS still intends to determine by the end of 2024 whether the AM will be considered "outcome equivalent" to the ICS. If the IAIS determines that the AM does provide comparable outcomes to the ICS, the AM will be considered an outcome-equivalent approach for implementation of the ICS as a PCR for IAIGs.

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b. NAIC Continues Implementation of ComFrame

At the NAIC, the Group Solvency Issues (E) Working Group has been continuing its work to incorporate ComFrame elements deemed appropriate for incorporation into the U.S. system of solvency regulation into the Financial Analysis Handbook. Applicable revisions to the Financial Analysis Handbook were initially exposed in May 2021, and additional work on such revisions will continue on in 2022. In addition, the ComFrame Examination Drafting Group and ComFrame Own Risk and Solvency Assessment ("**ORSA**") Drafting Group have been drafting proposed revisions to incorporate ComFrame elements into the Financial Condition Examiners Handbook and the ORSA Guidance Manual. These revisions are expected to be exposed for public comment during the first quarter of 2022.

c. IAIS Publishes First Public Report on the Global Monitoring Exercise

In 2021, the IAIS also published its first public report on the annual Global Monitoring Exercise, which is being undertaken as part of the IAIS's holistic framework for the assessment and mitigation of systemic risk in the insurance sector (the "**Holistic Framework**"). The Holistic Framework was published by the IAIS in 2018 and was created to assess and mitigate systemic risk in the insurance sector, with implementation beginning in 2020. The Holistic Framework recognizes that systemic risk can arise both from sector-wide trends with regard to specific activities and exposures, as well as from a concentration of these activities and exposures in individual insurers. The Holistic Framework consists of (i) an enhanced set of supervisory policy measures and powers of intervention, (ii) an annual global monitoring exercise ("**GME**") designed to assess global insurance market trends and developments, and detect the possible build-up of systemic risk in the global insurance sector, and (iii) an assessment of the consistent implementation of enhanced supervisory policy measures and powers of intervention. In 2020, the GME was adapted to focus on assessing the impact of COVID-19 on the global insurance sector. The GME public report draws on data from approximately 60 of the largest international insurance groups and close to 40 insurance supervisors, covering more than 90% of global gross written premiums.

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d. IAIS Publishes Issue Paper on Insurer Culture

In addition, the IAIS has also identified insurer culture as a key topic that will affect the IAIS's mission in upcoming years. In November 2021, the IAIS approved for publication an Issues Paper on Insurer Culture, which explores the role of insurer culture as a point of intersection for managing prudential and conduct risks. The paper focuses on understanding the various elements that make up an insurer's culture that inform decisions, behaviors, and practices across an insurer's business. The IAIS believes that understanding an insurer's culture is critical in helping supervisors identify and address prudential and conduct issues in a timely and effective manner and could potentially reduce the occurrence of widespread misconduct and possible financial and consumer harm. The paper also provides illustrations of selected cultural drivers using jurisdictional examples.

12. NAIC Takes Action Regarding Various Investment Monitoring Activities

a. NAIC Adopts Revised Risk-Based Capital Bond Factors for Life Insurers

It is anticipated that the revised bond factors may cause certain life insurers to reevaluate their investment portfolios to assess whether any adjustments should be made to maintain or improve their RBC levels.

The NAIC adopted revised risk-based capital ("**RBC**") factors for bond investments of life insurers, otherwise known as C1 RBC charges, which apply commencing with year-end 2021 financial statements and accompanying RBC schedules. It is anticipated that the revised bond factors may cause certain life insurers to reevaluate their investment portfolios to assess whether any adjustments should be made to maintain or improve their RBC levels.

Moody's Analytics, in collaboration with the ACLI, developed the revised bond factors, which are based on more recent historical data, as the data on which the prior factors were based was approximately 30 years old. Among other matters, the revised bond factors establish a more granular rating analysis by expanding the number of bond designation categories from the previous six categories to 20 categories.

As reported in the July 2021 NAIC Life Risk-Based Capital Newsletter, the expanded categories from a technical perspective include "factors on the Bonds page (LR002), Asset Concentration page (LR010), Hedged Asset Bond Schedule (LR014), Off Balance Sheet Collateral page (LR017), and Calculation of Tax Effect (LR030). In addition to the base factors on LR002, the bond size adjustment factors were modified."[24]

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

The report must provide an analytical review of the privately issued security that mirrors the work product that a CRP would produce for a similar publicly rated security, including an explanation of the transaction structure, methodology relied on, and, as appropriate, analysis of the credit, legal, and operational risks and mitigants supporting the assigned CRP rating.

The NAIC is concerned that private credit rating provider ("**CRP**") ratings may not adequately represent the risks of privately issued securities purchased by insurers, which can affect an insurer's RBC calculation, resulting in a lower RBC charge for higher-risk investments. The Valuation of Securities (E) Task Force ("**VOS Task Force**") previously adopted an amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* ("**P&P Manual**") requiring the submission of private rating letter rationale reports with certain private rating letters filed with the NAIC Securities Valuation Office ("**SVO**"). As of January 2022, insurers are required to file such reports with the SVO to provide additional details regarding the private letter ratings obtained with respect to their ownership of privately issued securities. The report must provide an analytical review of the privately issued security that mirrors the work product that a CRP would produce for a similar publicly rated security, including an explanation of the transaction structure, methodology relied on, and, as appropriate, analysis of the credit, legal, and operational risks and mitigants supporting the assigned CRP rating.

Additionally, on November 9, 2021, the SVO issued a memorandum to the VOS Task Force expressing concern regarding the NAIC's extensive reliance on CRP ratings to assess investment risk for regulatory purposes and proposing changes to the SVO's "filing exempt" process, which grants an exemption from filing with the SVO for bonds and preferred stock that have been assigned a current, monitored rating by a nationally recognized statistical rating organization ("**NRSRO**"). The memorandum noted that the SVO staff conducted an in-depth review of a sample of 43 privately rated securities and found material differences between the private ratings and the SVO staff's estimates, with the private ratings being three to six or more notches higher than the SVO staff's estimates. The memorandum suggested four alternatives that the NAIC should consider in 2022 to begin the process of actively managing and overseeing its use of CRP ratings, which alternatives may be considered independently or may be combined or phased in over different time periods. The proposed alternatives include:

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24 *Life Risk-Based Capital Newsletter, Volume 27*, NAIC (July, 2021), https://content.naic.org/sites/default/files/inline-files/2021%20Life%20Newsletter.pdf.

- Requiring at least two CRP ratings for every security and using the lowest rating to determine the NAIC designation; if a security has only one rating, then requiring it to be reviewed by the SVO to determine whether the SVO deems the rating reasonable (i) pursuant to its own analysis, (ii) when benchmarked to NRSRO peers and methodology, or (iii) compared to a spread implied rating, and, if not, to determine whether a full filing and SVO analysis would be appropriate;
- Conducting an in-depth study of the NAIC's use of CRP ratings and SVO-assigned NAIC designations as to their consistency and comparability for regulatory purposes, specifically the determination of RBC factors;
- Offering NRSROs the opportunity to respond to a request for qualifications ("**RFQ**"), with the NAIC contracting only with those CRPs that adequately meet the RFQ criteria; and
- Having the SVO remove any rating agency from the CRP list at any time upon the request of the VOS Task Force.

The VOS Task Force indicated that the memorandum provides a starting point to evaluate the rating process, and the VOS Task Force expects to form a subgroup charged with conducting such evaluation, which would include participation by CRPs, insurers, and other stakeholders.

c. NAIC Removes Residual Tranches From Receiving NAIC Designation

The VOS Task Force adopted an amendment to the P&P Manual to remove residual tranches and interests from receiving an NAIC designation. Specifically, the amendment provides that securities that are residual tranches or interests, as defined in *Statement of Statutory Accounting Principles No. 43R–Loan Backed and Structured Securities*, must be reported on Schedule BA (Other Long-Term Invested Assets) without an NAIC designation and are not eligible to be assigned an NAIC 5GI or NAIC 6* Designation. Residual tranches or interests generally refer to securitization tranches, beneficial interests, and other structures that reflect loss layers without any contractual payments, whether principal, interest, or both. Payments to investors in residual tranches or interests (i) occur after contractual interest and principal payments have been made to other tranches and interests and (ii) are based on any remaining available funds. For 2021 year-end reporting only, residual tranches or interests previously reported on Schedule D-1 (Long-Term Bonds) may be reported on Schedule D-1 with an NAIC 6* Designation but not an NAIC 5GI Designation.

d. NAIC Considers Amendment to Definition of Principal Protected Securities

The VOS Task Force is considering an amendment to the definition of principal protected securities ("**PPS**") in the P&P Manual to address alternate securities with "performance assets" that do not fit within the current PPS definition but nevertheless should be categorized as PPS. The draft amendment was exposed for comments that were due by February 11, 2022.

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

The impetus for the more recently proposed amendment to address alternate securities with "performance assets" was the SVO's receipt of a proposed security that had many of the same risks as PPS but was structured in a way that did not fit squarely within the PPS definition in the P&P Manual as adopted in May 2020. The proposed security was not issued by a special purpose vehicle holding both the bond and the performance asset; rather, the security was the direct obligation of a large financial institution that was obligated to pay principal at maturity and any additional return based on the performance of certain referenced indices of equities, fixed-income instruments, futures, and other financial assets. Although the financial institution issuing the security was the sole obligor under the security, such that there were no underlying bonds or performance assets, the structure posed the

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… unlike a PPS transaction with an underlying bond and performance asset, the likelihood of payment of any performance asset return was linked directly to the creditworthiness of the issuing financial institution.

same risk of exposure to a performance asset because the amount of the issuing financial institution's payment obligation depended directly on the performance of the referenced indices. Additionally, unlike a PPS transaction with an underlying bond and performance asset, the likelihood of payment of any performance asset return was linked directly to the creditworthiness of the issuing financial institution. The proposed amendment to the PPS definition is intended to address such alternate structures that pose similar risks, so that such structures would be covered under the PPS definition and ineligible for the SVO's "filing exempt" process.

e. NAIC Adopts Instructions for Review of Funds

In August 2021, the VOS Task Force adopted an amendment to the P&P Manual to add instructions for the review of funds on the NAIC's Fixed Income-Like SEC Registered Funds List.

The amendment adopted by the VOS Task Force is intended to provide greater clarity and predictability to fund sponsors and investors regarding the acceptable use of derivatives in funds and permit some funds to have greater flexibility in their use of derivatives.

The P&P Manual currently grants the SVO discretion when determining whether a fund's use of derivatives is consistent with a fixed income-like security (i.e., whether it will generate predictable and periodic cash flows and is, therefore, eligible for an NAIC designation). The amendment adopted by the VOS Task Force is intended to provide greater clarity and predictability to fund sponsors and investors regarding the acceptable use of derivatives in funds and permit some funds to have greater flexibility in their use of derivatives. The amendment is consistent with Rule 18f-4 under the U.S. Securities and Exchange Commission ("**SEC**") Investment Company Act of 1940 related to the use of derivatives by registered investment companies, including funds, which the SEC adopted in October 2020.

… one difference between the P&P Manual amendment and the SEC rule is that the P&P Manual's methodology requires a look-through assessment of all funds which, in turn, includes a requirement that a fund "predominantly hold" bonds or preferred stock, as applicable.

However, one difference between the P&P Manual amendment and the SEC rule is that the P&P Manual's methodology requires a look-through assessment of all funds which, in turn, includes a requirement that a fund "predominantly hold" bonds or preferred stock, as applicable. As defined in the P&P Manual, "predominantly hold" means that a fund holds at least 80% of its assets in bonds or preferred stock, depending on the type of fund, in normal market conditions.

Pursuant to the P&P Manual amendment, a fund's exposure to the following is limited to 10% of the fund's net assets in normal market conditions:

- Derivatives under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payments or otherwise;
- Short sale borrowings; and
- Reverse repurchase agreements or similar financing.

Exposure is calculated based on the gross notional amounts of derivatives, the value of assets sold short for short sale borrowings, and the proceeds received by the fund but not repaid for reverse repurchase agreements.

Consistent with the SEC rule, under the P&P Manual amendment, interest rate derivatives and option contracts exposures are calculated with other defined methods consistent with market practice.

Consistent with the SEC rule, under the P&P Manual amendment, interest rate derivatives and option contracts exposures are calculated with other defined methods consistent with market practice. In addition, certain currency and interest rate derivatives that hedge currency or interest rate risk associated with one or more specific equity or fixed-income investments of the fund are excluded from the 10% exposure calculation.

f. NAIC Forms New RBC Investment Risk and Evaluation (E) Working Group

… the RBC Investment R&E Working Group is charged with performing a comprehensive review of the RBC investment framework for all business types …

At the Fall 2021 National Meeting, the Capital Adequacy (E) Task Force established a new RBC Investment Risk and Evaluation (E) Working Group ("**RBC Investment R&E Working Group**"), which is expected to coordinate with other NAIC groups in an effort to achieve a more holistic evaluation of investment-related proposals and their RBC impact. Specifically, the RBC Investment R&E Working Group is charged with performing a comprehensive review of the RBC investment framework for all business types, which could include:

- Identifying and acknowledging uses that extend beyond the purpose of the NAIC Risk-Based Capital for Insurers Model Act;

- Assessing the impact and effectiveness of potential changes in contributing to the identification of weakly capitalized companies at RBC action level; and

- Documenting the modifications made over time to the RBC formulas, including an analysis of the costs in study and development, implementation (internal and external), assimilation, verification, analysis, and review of the desired changes to the RBC formulas and facilitating the appropriate allocation of resources.

In advance of its introductory meeting on February 28, 2022, the RBC Investment R&E Working Group issued a request for comment to solicit feedback regarding the review of RBC treatment of asset-backed securities ("**ABS**"), including collateralized loan obligations, collateralized fund obligations, and other similar securities carrying similar types of tail risk. Feedback was specifically requested regarding the following topics:

- Methodologies for capturing the risk, including tail risk, that exists with such assets, including ratings-determined bond factors, a modeling process akin to the current commercial mortgage-backed securities/residential mortgage-backed securities approach or other proposals;

- How the NAIC could use a consultant or consulting actuary to determine the appropriate charge based upon certain data;

- The need for review of RBC for health and P&C insurers in addition to RBC for life insurers;

- Whether residual tranches in ABS structures can be evaluated in conjunction with and under similar methodologies as the debt tranches; and

- Specific proposals for addressing RBC treatment of residual tranches to reduce arbitrage incentives.

13. NAIC Revisions to Statements of Statutory Accounting Principles

a. Identification of Related Parties and Affiliates

In March 2021, the Statutory Accounting Principles (E) Working Group ("**SAPWG**") voted to adopt revisions to SSAP No. 25—Affiliates and Other Related Parties that incorporate new disclosures regarding the identification of related parties and affiliates. The revisions to SSAP No. 25 were originally exposed at the NAIC's Fall 2019 National Meeting and are largely aimed at aligning related party and affiliate reporting under statutory accounting principles ("**SAP**") with SEC reporting requirements, the latter of which focus on beneficial ownership and do not include the concept of a disclaimer of control or affiliation ("**Disclaimer**"). The revisions were subsequently adopted at the NAIC's Spring 2021 National Meeting (the "**Spring 2021 National Meeting**") by the Financial Condition (E) Committee and the Executive (EX) Committee and Plenary through the Financial Condition (E) Committee's technical changes report process.

The revisions make the following clarifications:

- Any related party identified under U.S. generally accepted accounting principles or SEC reporting requirements will be considered a related party under statutory accounting principles.

- Noncontrolling ownership over 10% results in a "related party" classification regardless of any Disclaimer.

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

The SAPWG made minor modifications to the proposed revisions to SSAP No. 25 to clarify that "ownership," as referenced in SSAP No. 25, includes both direct and indirect ownership. In addition, the Blanks (E) Working Group adopted a new Schedule Y, Part 3, to reflect the new disclosure required by

SSAP No. 25 as adopted by the SAPWG and to capture data items, such as owners with more than 10% and identification of an insurer's ultimate controlling party. Reporting on the new Schedule Y, Part 3, will be required commencing with the filing of the 2021 annual statement.

b. "Substantive" and "Nonsubstantive" Terminology

The NAIC adopted revisions to the NAIC Policy Statement on Maintenance of Statutory Accounting Principles to modify the historical use of the terms "substantive" and "nonsubstantive" to classify proposed modifications to the NAIC Accounting Practices and Procedures Manual. Such revisions provide that, effective January 1, 2022, substantive modifications will be identified as a "new SAP concept," while nonsubstantive modifications will be identified as a "SAP clarification." The SAPWG also exposed for comment editorial revisions to statutory accounting guidance to reflect the revised terminology.

Historically, the procedural requirements for adopting modifications to statutory accounting guidance were different depending on whether such modifications were classified as "substantive" or "nonsubstantive."

Historically, the procedural requirements for adopting modifications to statutory accounting guidance were different depending on whether such modifications were classified as "substantive" or "nonsubstantive." The use of the historical terminology became controversial in the context of the NAIC's recent revisions to SSAP No. 71—Policy Acquisition Costs and Commissions (as further described below). The NAIC elected to maintain the distinction in the terminology and the related procedural requirements, notwithstanding the fact that some industry commentators suggested that the more robust procedural requirements should apply regardless of which classification a proposed modification receives.

c. Levelized and Persistency Commission Arrangements

In August 2021, the NAIC voted to adopt changes to SSAP No. 71—Policy Acquisition Costs and Commissions that will accelerate the timing for many insurers to recognize liabilities for initial sales commission owed to third parties. The changes became effective on December 31, 2021.

The revisions, which were classified as "nonsubstantive" by the SAPWG, clarify that (i) a levelized commission arrangement (whether linked to traditional or nontraditional elements) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party, such as a funding agent, at the time the policy is issued, and (ii) persistency commissions must be accrued proportionately over the policy period to which the commissions relate and cannot be deferred until fully earned. While not typically required for "nonsubstantive" changes, due to the nature of the revisions and the continued debate by industry and members, the revisions to SSAP No. 71 ultimately required approval by the NAIC Executive (EX) Committee and Plenary, which voted to adopt the revisions during the Summer 2021 National Meeting.

In addition, in connection with the discussions on the revisions, industry members and other regulators voiced concerns over the classification of the revisions as "nonsubstantive," noting that the revisions, as applied, would result in substantial changes for companies that have historically used levelized commission arrangements in reliance on existing guidance.

d. Issue Paper Regarding Loan-Backed and Structured Securities

On August 26, 2021, the SAPWG met to discuss comments received on the May 20, 2021, exposure of a proposed principles-based bond definition in connection with the SAPWG's continuing review of proposed revisions to SSAP No. 43R—Loan-Backed and Structured Securities. During that meeting, the SAPWG directed NAIC staff to use the principles-based bond definition to move forward with drafting an issue paper and revisions to SSAP No. 26R–Bonds and SSAP No. 43R, which will be undertaken by a 43R study group. The earliest effective date for proposed SSAP revisions is expected to be January 1, 2024.

The exposure was the result of several meetings since October 2020 between regulators from the Iowa Insurance Division, NAIC staff, and a small subset of interested parties who met regularly to draft the exposed bond definition to be used for all securities in determining whether they qualify for reporting on Schedule D-1. The exposure draft also included appendices setting forth several examples of securities that do, or do not, meet the definition of a "bond" under the proposed definition. The proposed definition reflects principles-based concepts for consideration as to whether a structure qualifies as either (i) an asset-backed security or (ii) an issuer credit obligation prior to reporting as a bond, with a focus on substance over form.

The bond definition concepts are not considered final, as further discussion and deliberation will occur during the remainder of this project. As a result, although the proposed bond definition has not been formally exposed, interested parties can submit comments or questions on it for consideration by the 43R study group during the issue paper development process.

e. Statutory Accounting Treatment for Cryptocurrencies

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

The SAPWG addressed inquiries regarding the statutory accounting treatment for cryptocurrencies. Specifically, the SAPWG determined that, because cryptocurrencies are not expressly identified as an admitted asset in the Accounting Practices and Procedures Manual, cryptocurrencies are nonadmitted assets.

14. NAIC and States Prioritize ESG Issues

a. NAIC Special Committee on Race and Insurance Continues its Diversity, Equity, and Inclusion Efforts in the Insurance Sector

The NAIC Special (EX) Committee on Race and Insurance ("**Special Committee**"), which was established in July 2020, continues its mission to identify issues related to (i) race, diversity, and inclusion within the insurance sector, (ii) race, diversity, and inclusion in access to the insurance sector and insurance products, and (iii) practices within the insurance sector that potentially disadvantage people of color and/or historically underrepresented groups.

The Special Committee includes five workstreams in the areas of diversity in (i) the insurance industry workforce, (ii) the NAIC and regulatory community, (iii) P&C insurance (the "**P/C Insurance Workstream**"), (iv) life insurance and annuities, and (v) health insurance (the "**Health Insurance Workstream**"). Current activities of interest related to the P/C Insurance Workstream and the Health Insurance Workstream are described below.

Among other charges, specific to the P/C Insurance Workstream, the Special Committee is to (i) conduct research and analysis of insurance, legal, and regulatory approaches to address unfair discrimination, disparate impact, disparate treatment, and proxy discrimination and (ii) make recommendations for statutory or regulatory changes, including developing analytical and regulatory tools to assist state insurance regulators in defining, identifying, and addressing unfair discrimination in P&C insurance. Pursuant to this workstream, the Special Committee is in the process of drafting a white paper to define the terms "unfair discrimination," "disparate impact," "disparate treatment," and "proxy discrimination."

Additionally, the Health Insurance Workstream has completed a draft "Principles for Data Collection" document, which provides high-level guiding principles for the collection and treatment of data on race, ethnicity, and other demographic characteristics in health insurance for consideration by the Special Committee. The Health Insurance Workstream observed that robust data collection is critical to both quantifying existing disparities and evaluating the effectiveness of initiatives to address those disparities. The Health Insurance Workstream is also in the process of finalizing an outline for a white paper regarding provider networks, provider directories, and cultural competency of providers.

b. Climate Change

i. NYDFS Issues Final Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change

On November 15, 2021, the New York Department of Financial Services ("**NYDFS**") issued final guidance for New York domestic insurers on managing the financial risks from climate change. The initial purpose of the guidance is to support insurers in managing climate risks and to serve as a basis for supervisory dialogue.

On November 15, 2021, the New York Department of Financial Services ("NYDFS") issued final guidance for New York domestic insurers on managing the financial risks from climate change. The initial purpose of the guidance is to support insurers in managing climate risks and to serve as a basis for supervisory dialogue.

As outlined in the new guidance, the NYDFS expects insurers to take a strategic approach to managing climate risks that considers both current and forward-looking risks. Specifically, the NYDFS expects that insurers will, among other things, (i) integrate the consideration of climate risks into governance structures at the group or insurer entity level, (ii) incorporate climate risks into existing financial risk management, (iii) use scenario analysis to inform business strategies and risk assessment and identification, and (iv) disclose climate risks.

Over time, the NYDFS expects to shift its approach from supporting insurers' implementation of the expectations set forth in the new guidance to actively supervising against such expectations.

ii. NAIC Climate and Resiliency (EX) Task Force

In 2021, climate-related risk and resiliency issues were areas of interest at the NAIC, which formed the Climate and Resiliency (EX) Task Force in July 2020.

In 2021, climate-related risk and resiliency issues were areas of interest at the NAIC, which formed the Climate and Resiliency (EX) Task Force in July 2020. During its first full year of operation, the task force coordinated discussion and engagement in the following areas: (a) consideration of appropriate climate risk disclosures with the insurance sector; (b) evaluation of financial regulatory approaches to climate risk and resiliency; (c) consideration of innovative insurer solutions to climate risk and resiliency; (d) identification of sustainability, resilience, and mitigation issues and solutions related to the insurance industry; (e) consideration of pre-disaster mitigation and resiliency and the role of state insurance regulators in resiliency.

Among the task force's goals for 2022 is the adoption of a redesigned NAIC Climate Risk Disclosure Survey, which is intended to enhance transparency about how insurers manage climate risks and opportunities and provide a baseline supervisory tool to assess how climate-related risks may affect the insurance industry.

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

a. NAIC Forms New Innovation, Cybersecurity and Technology Committee

The NAIC established a new Innovation, Cybersecurity and Technology (H) Committee ("(H) Committee") to address the insurance implications of cybersecurity and emerging technologies, including big data, AI, and e-commerce.

The NAIC established a new Innovation, Cybersecurity and Technology (H) Committee ("**(H) Committee**") to address the insurance implications of cybersecurity and emerging technologies, including big data, AI, and e-commerce. The (H) Committee is the first new letter committee to be formed since 2004 and, among other matters, will assume the activities of the Innovation and Technology (EX) Task Force, which held its final meeting at the Fall 2021 National Meeting.

The objectives of the (H) Committee are to:

- Provide a forum for state insurance regulators to learn and have discussions regarding cybersecurity, innovation, data security and privacy protections, and emerging technology issues;
- Monitor developments in such areas that affect the state insurance regulatory framework;
- Maintain an understanding of evolving practices and use of innovation technologies by insurers and producers in various lines of business;
- Coordinate NAIC efforts regarding innovation, cybersecurity and privacy, and technology across other committees; and
- Make recommendations and develop regulatory, statutory, or guidance updates.

The (H) Committee will also oversee the activities of the Big Data and Artificial Intelligence (H) Working Group, Speed to Market (H) Working Group, E-Commerce (H) Working Group, and Cybersecurity (H) Working Group.

b. NAIC Adopts Regulatory Review of Predictive Models White Paper

The Predictive Models White Paper identifies best practices for state insurance regulators in their review of predictive models and analytics filed by insurers to justify rates and provides state guidance for the review of rate filings based on predictive models.

The Executive (EX) Committee and Plenary adopted the *Regulatory Review of Predictive Models* white paper (the "**Predictive Models White Paper**") at the Spring 2021 National Meeting. The Predictive Models White Paper identifies best practices for state insurance regulators in their review of predictive models and analytics filed by insurers to justify rates and provides state guidance for the review of rate filings based on predictive models. A "predictive model" in the insurance sector is a model chosen to estimate the probability or expected value of an outcome given a set amount of input data, such as frequency of loss, severity of loss, or pure premium. The four best practices for regulatory review described in the Predictive Models White Paper are to:

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

The Predictive Models White Paper also provides guidance for regulators' review of rate filings based on predictive models by identifying specific "information elements" a regulator may need to consider. The "information elements" are set forth in Appendix B of the Predictive Models White Paper and organized in three categories: (i) selecting model input, (ii) building the model, and (iii) the filed rating plan. Although Appendix B focuses on generalized linear models ("**GLMs**") for personal automobile and home insurance, the Predictive Models White Paper notes that many of the "information elements" may be transferable to other types of models, other lines of business, and other applications beyond rating. The Casualty Actuarial and Statistical (C) Task Force currently is considering a modification of Appendix B from GLMs to random forest models, including a proposed glossary of random forest model terminology.

Notably, confidentiality of predictive models is an area of industry concern, and the Predictive Models White Paper merely provides that whether rate filings, including any predictive models and supplemental information furnished to a regulator, are accorded confidential treatment is determined by state confidentiality laws.

c. NAIC Adopts Amendments to Model Unfair Trade Practices Act

At the Spring 2021 National Meeting, the Executive (EX) and Plenary Committee adopted amendments to the anti-rebating provisions in the Model Unfair Trade Practices Act (#880) that address concerns raised by interested parties that perceive the existing anti-rebating laws to be an obstacle to innovative insurance solutions. The Executive (EX) Committee had adopted these amendments at the 2020 Fall National Meeting.

At the Spring 2021 National Meeting, the Executive (EX) and Plenary Committee adopted amendments to the anti-rebating provisions in the Model Unfair Trade Practices Act (#880) …

The amendments permit insurers and insurance producers to provide "value added" products and services to policyholders at no or reduced cost. Value-added products and services include those designed to reduce claim costs, reduce risk, or induce behavioral changes that will reduce risk. Additionally, the amendments include a broad "de minimis" exception permitting insurers and insurance producers to offer or give noncash gifts, items, or services in connection with the marketing, sale, purchase, or retention of contracts of insurance as long as the cost does not exceed an amount determined to be reasonable by the commissioner and as long as the customer is not required to purchase, continue to purchase, or renew a policy in exchange for the gift, item, or service.

The amendments permit insurers and insurance producers to provide "value added" products and services to policyholders at no or reduced cost.

At the Executive (EX) and Plenary Committee meeting, Kentucky, Louisiana, Mississippi, Nevada, New York, and Washington voted against the amendments, citing concerns that, as amended, the anti-rebating provisions would be ambiguous and increase the opportunity for consumer abuse; in addition, California abstained. Nonetheless, a supermajority of the committee voted in favor of the amendments.

d. NAIC Establishes Working Group to Examine E-Commerce Laws and Regulations

During the Spring 2021 National Meeting, the Innovation and Technology (EX) Task Force announced the formation of what would become the E-Commerce (H) Working Group. The E-Commerce Working Group's 2022 charge is to examine e-commerce laws and regulations, survey states regarding U.S. federal Uniform Electronic Transactions Act exceptions, and work toward recommendations on any laws and

During the Spring 2021 National Meeting, the Innovation and Technology (EX) Task Force announced the formation of what would become the E-Commerce (H) Working Group.

regulations that may need to be changed in connection with any issues identified. The E-Commerce Working Group will also examine whether a model bulletin would be appropriate for addressing some of the identified issues where legislation changes are not needed and will draft a proposed bulletin if determined appropriate.

The E-Commerce Working Group was formed in response to industry comments related to a request for information on continuing "regulatory accommodations" offered by states related to the COVID-19 pandemic. Comments focused on continuing a move toward e-commerce, including allowing for e-signatures, e-delivery of documentation and information, e-notary, and changing the paradigm from what is primarily an "opt-in" basis today to an "opt-out," where receiving and exchanging information electronically or digitally would be the default, with consumers having the ability to opt out of that option.

The report was intended to provide recommendations with respect to the minimum consumer privacy protections that are appropriate for the business of insurance and to review the consumer privacy protections that already exist under applicable state and federal laws.

16. Privacy and Cybersecurity

a. NAIC Finalizes Report on Consumer Data Privacy Protections

During the Fall 2021 National Meeting, the Privacy Protections (D) Working Group finalized its Report on Consumer Data Privacy Protections, which the Market Regulation and Consumer Affairs (D) Committee received at the same meeting. The report was intended to provide recommendations with respect to the minimum consumer privacy protections that are appropriate for the business of insurance and to review the consumer privacy protections that already exist under applicable state and federal laws.

Specifically, the report provided summaries of consumer privacy protections provided by (i) NAIC models, including the Health Information Privacy Model Act (#55), the Insurance Information and Privacy Protection Model Act (#670) (the "**Privacy Model Act**"), and the Privacy of Consumer Financial and Health Information Regulation (#672) (the "**Privacy Model Regulation**"), and (ii) the General Data Protection Regulation and recently adopted state consumer privacy protection laws. The Privacy Protections (D) Working Group ultimately recommended that the Privacy Model Act and Privacy Model Regulation be revised to modernize their applicability to the current technology-based insurance market.

These new state laws will significantly expand individual privacy rights and privacy program compliance obligations.

The Privacy Protections (D) Working Group's 2022 charges include developing recommended revisions, as needed, to the Privacy Model Act and Privacy Model Regulation. Further direction from the Executive (EX) Committee, however, may result in this charge being moved to the new (H) Committee.

b. State Innovation in Comprehensive Privacy Legislation

Preparations continue for the effective date of three new privacy laws that will take effect in January 2023: the California Privacy Rights Act ("**CPRA**"), which was approved by California voters on November 3, 2020 to expand the requirements of the existing California Consumer Protection Act ("**CCPA**"), as well as the Colorado Privacy Act and the Virginia Consumer Data Protection Act. These new state laws will significantly expand individual privacy rights and privacy program compliance obligations. But with less than a year to go, there is still uncertainty of exactly how the obligations will need to be implemented. The new California Privacy Protection Agency ("**CalPPA**") is only recently constituted and has yet to issue draft regulations. There are also reports that the Virginia and Colorado legislatures are considering amendments.

Regardless of regulations or amendments, however, it is important that all three states include notable exemptions for data covered by the Health Insurance Portability and Accountability Act (HIPAA) and Gramm-Leach-Bliley Act (GLBA) that mitigate compliance burdens for large portions of insurance company operations.

Regardless of regulations or amendments, however, it is important that all three states include notable exemptions for data covered by the Health Insurance Portability and Accountability Act (HIPAA) and Gramm-Leach-Bliley Act (GLBA) that mitigate compliance burdens for large portions of insurance company operations. Indeed, Virginia and Colorado provide entity-based exemptions that greatly mitigate compliance challenges, leaving insurance companies focused on California and the potentially still significant impacts from the law. Such impacts are most particularly focused on website operations, online advertising, and, potentially, employee data. Moreover, more than a dozen states are seriously considering bills inspired by or heavily influenced by the California law's innovations.

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

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

Unlike the CCPA's current "sale" opt-out, the CPRA's opt-out gives consumers the additional right to opt-out of the sharing of personal information with a third party even where there is no exchange of consideration between the parties. This includes sharing for the purpose of targeted advertisements. In practice, this means consumers can prevent businesses from using technologies such as cookies and pixels to track them across other websites, apps, or services and then share that information (e.g., websites visited or products viewed) with ad networks to deliver targeted advertisements to them. The CPRA's opt-out also gives consumers opt-out rights with respect to businesses' use of "automated decision-making technology," which includes profiling consumers based on their "performance at work, economic situation, health, personal preferences, interests, reliability, behavior, location or movements." § 1798.185(a)(16). In addition, consumers will be able to require a business to disclose "meaningful information about the logic involved in such decision-making processes, as well as a description of the likely outcome of the process with respect to the consumer."

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

The CPRA incorporates the principle of data minimization, requiring that a business's collection and use of a consumer's data be reasonably necessary and proportionate to the purposes for which it was collected and to refrain from using personal data incompatible with the disclosed purposes for which it was collected.

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

Not all states, however, will be following the California model. Considering the serious risk of fragmentation that could arise from dozens of distinct privacy statutes, the Uniform Law Commission has proposed a model bill — the Uniform Personal Data Protection Act ("**UPDPA**"). The Uniform Law Commission's model bills, such as the Uniform Commercial Code, are often influential in the development of state laws. The UPDPA will be available for states' 2022 legislative sessions, with a bill having already been introduced in the District of Columbia. If adopted, the UPDPA offers a more business-friendly framework than many of the existing and proposed state privacy laws.

c. NYDFS Guidance Concerning Cyber Insurance

On February 4, 2021, the NYDFS issued Insurance Circular Letter No. 2, setting forth a new Cyber Insurance Risk Framework (the "**Cyber Framework**"). This outlined industry best practices for New York-regulated P&C insurers that write cyber insurance to effectively manage their cyber insurance risk. The Cyber Framework is the first of such guidance by a U.S. regulator on cyber insurance.

The Cyber Framework is the first of such guidance by a U.S. regulator on cyber insurance.

The Cyber Framework was developed out of concerns regarding the need to address the increased risk and cost associated with cybercrime and the recent increase in ransomware attacks, which creates new challenges for insurers managing such risks. While the Cyber Framework does not establish new legal requirements or have the force of law, it does set forth the NYDFS's interpretation of the requirements of existing laws and regulations, including the NYDFS's cybersecurity regulation (23 NYCRR 500).

The Cyber Framework describes seven best practices that authorized property/casualty insurers should use to manage their cyber insurance risk:

The Cyber Framework describes seven best practices that authorized property/casualty insurers should use to manage their cyber insurance risk ...

- **Establish a Formal Cyber Insurance Risk Strategy**. Insurers that offer cyber insurance should have a formal strategy for measuring cyber insurance risk that is directed and approved by the entity's governing body and that includes clear quantitative and qualitative goals for risk.

- **Manage and Eliminate Exposure to Silent Cyber Insurance Risk**. All insurers should determine their exposure to silent or non-affirmative cyber insurance risk (i.e., risk that the insurer must cover a loss from a cyber incident under a policy that does not explicitly mention cyber). Silent risk can be found in a variety of combined coverage policies and stand-alone non-cyber policies, including errors and omissions, burglary and theft, general liability, and product liability insurance. Insurers should make it clear in any policy that could be subject to a cyber claim whether that policy provides or excludes coverage for cyber-related losses.

- **Evaluate Systemic Risk**. Insurers that offer cyber insurance should regularly evaluate systemic risk and plan for potential losses. Systemic risk has risen as a result of insurers increasingly relying on third-party vendors that are highly concentrated in the areas of cloud storage and managed services providers. Insurers should model the effect of a catastrophic cyber event on such critical third parties that may cause simultaneous losses to many of their insureds.

- **Rigorously Measure Insured Risk**. Insurers that offer cyber insurance should have a data-driven and comprehensive plan for assessing the cyber risk of each insured and potential insured and make a rigorous assessment of potential gaps and vulnerabilities in the insured's cybersecurity.

- **Educate Insureds and Insurance Producers.** Insurers that offer cyber insurance should strive to offer comprehensive information about the value of cybersecurity measures. Insurers should also facilitate the adoption of those measures and incentivize the adoption of better cybersecurity measures by pricing policies based on the effectiveness of each insured's cybersecurity program.

- **Obtain Cybersecurity Expertise**. Insurers that offer cyber insurance should recruit employees with cybersecurity experience and skills and commit to their training and development, supplemented as necessary with consultants or vendors.

- **Require Notice to Law Enforcement**. Cyber insurance policies should include a requirement that victims notify law enforcement, as law enforcement often has valuable information that may not be available to private sources and can help victims of a cyber incident, including recovering data and funds that were lost.

In addition to these best practices, the NYDFS also stated that it recommends against making ransom payments as doing so both incentivizes and provides funding for future attacks and does not provide a guarantee that an organization will regain access to all of its data or that such data will not be released.

In addition to these best practices, the NYDFS also stated that it recommends against making ransom payments as doing so both incentivizes and provides funding for future attacks and does not provide a guarantee that an organization will regain access to all of its data or that such data will not be released.

d. New York Cybersecurity Enforcement Activity

The NYDFS is actively enforcing its cybersecurity regulation, which requires all banks, insurance companies, and other financial services institutions and licensees regulated by the NYDFS to establish and maintain a cybersecurity program.

The NYDFS is actively enforcing its cybersecurity regulation, which requires all banks, insurance companies, and other financial services institutions and licensees regulated by the NYDFS to establish and maintain a cybersecurity program. The NYDFS cybersecurity regulation includes specific technical safeguards as well as requirements regarding governance, incident planning, training, data management, system testing, and regulator notification in the event of certain cybersecurity events. Portions of the regulation became effective in March 2017, and the regulation become fully effective in March 2019.

To date, the NYDFS has settled actions to enforce the cybersecurity regulation against four companies:

- In April 2020, the NYDFS announced its settlement with National Securities Corporation, imposing a penalty in the amount of US$3 million.

- In March 2021, the NYDFS announced its settlement with Residential Mortgage Services, Inc., imposing a penalty in the amount of US$1.5 million.

- In May 2021, the NYDFS announced its settlement with First Unum Life Insurance Company and Paul Revere Life Insurance Company (subsidiaries of the Unum Group), imposing a penalty in the amount of US$1.8 million.

All of the alleged violations were tied to a data breach each individual company experienced. In each of these actions, and in its public statements, the NYDFS appears to be particularly focused on the requirement to implement multi-factor authentication ("**MFA**"). In two of the actions (National Securities and First Unum/Paul Revere), the NYDFS alleged that companies failed to implement MFA as required. As a result, the NYDFS also contended that those companies' certifications of compliance with the cybersecurity regulation were false.

With the NYDFS's focus on MFA, it would be prudent for insurance companies and their affiliates to closely examine and develop a position regarding whether their cybersecurity programs comply with the cybersecurity regulation's MFA requirements.

In addition to imposing monetary penalties, each of the consent orders required the companies to implement specific remedial measures, such as:

- Implementing a cybersecurity risk assessment system;
- Adopting procedures for better training and monitoring of authorized user activity;
- Having a third-party audit conducted of MFA controls in various environments; and
- Implementing a cybersecurity incident response plan.

Companies should consider implementing such measures as best practices to proactively defend against potential NYDFS enforcement actions.

B. U.S. FEDERAL ACTIVITY

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

In 2021, the Department of Labor ("**DOL**") further delayed enforcement of certain claims against investment advice fiduciaries and provided additional transition relief for compliance with the conditions of the fiduciary investment advice prohibited transaction exemption issued at the end of 2020. The DOL also released proposed guidance in 2021 to change the rules enacted under the prior administration relating to the consideration of ESG factors, and proxy voting, in managing assets subject to the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**").

In 2021, the Department of Labor ("DOL") further delayed enforcement of certain claims against investment advice fiduciaries and provided additional transition relief for compliance with the conditions of the fiduciary investment advice prohibited transaction exemption issued at the end of 2020.

a. Delay of Enforcement of Claims Against Investment Advice Fiduciaries

On October 25, 2021, the DOL issued a Field Assistance Bulletin (the "**FAB**") that announced a temporary enforcement policy relating to Prohibited Transaction Class Exemption 2020-02 ("**PTCE 2020-02**"), which provides relief for certain investment advice prohibited transactions. PTCE 2020-02 allows an investment advice fiduciary to receive compensation for providing fiduciary investment advice that otherwise would be restricted under the prohibited transaction rules of ERISA. There are several conditions that must be satisfied in order for PTCE 2020-02 to apply, including that the investment fiduciary (i) complies with impartial conduct standards described in the exemption, (ii) provides appropriate disclosures to retirement investors, including an acknowledgement of fiduciary status, (iii) prior to recommending a rollover from a plan or individual retirement account ("**IRA**") to another plan or IRA, documents the specific reasons for the rollover recommendation, (iv) maintains adequate policies and procedures to ensure compliance with the impartial conduct standards, and (v) conducts a retrospective review, at least annually, to detect any violations of the impartial conduct standards or the policies and procedures referenced above. The FAB states that, for the period beginning on the effective date of PTCE 2020-02 and ending January 31, 2022, the DOL will not pursue prohibited transaction claims against investment advice fiduciaries who have worked diligently and in good faith to comply with impartial conduct standards of the exemption. In addition, the FAB states that the DOL will not enforce the documentation requirements of PTCE 2020-02 relating to rollover recommendations through June 30, 2022 but stated that all other requirements of PTCE 2020-02 will be subject to full enforcement effective as of February 1, 2022.

… the DOL, on October 13, 2021, released a proposed rule (the "DOL Proposal") that would amend the DOL's investment duties regulation with respect to the consideration of ESG factors in the selection of investments for retirement plans that are subject to ERISA.

b. Proposed Guidance Relating to ESG Factors

In 2020, under the prior administration, the DOL issued a final regulation, which became effective on January 12, 2021, to set forth strict rules requiring plan fiduciaries to consider only pecuniary factors in making investment decisions. By executive order, President Biden directed the DOL to review this regulation. In response to that executive order, the DOL, on October 13, 2021, released a proposed rule (the "**DOL Proposal**") that would amend the DOL's investment duties regulation with respect to the consideration of ESG factors in the selection of investments for retirement plans that are subject to ERISA. The DOL Proposal eliminates the pecuniary factors concept set forth in the existing regulation and states that "a prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis." In addition, the DOL Proposal includes the following ESG factors as examples of the facts and circumstances that can be considered if material to the risk-return analysis:

- Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change;
- Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and
- Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention.

According to the DOL, the purpose of this change is to make it clear that in appropriate situations, ESG factors are risk-return factors that fiduciaries should consider in making investment decisions. However, the DOL Proposal is clear that "a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives" and may not sacrifice economic returns to promote ancillary goals.

c. Proposed Guidance Relating to Proxy Voting Under ERISA

The DOL Proposal also would amend the proxy voting rules under ERISA issued under the prior administration.

The DOL Proposal also would amend the proxy voting rules under ERISA issued under the prior administration. The existing regulation issued by the prior administration states that the fiduciary duty to vote proxies or otherwise manage shareholder rights does not require the voting of every proxy or the exercise of every shareholder right. The DOL Proposal removes that statement and explains that this removal doesn't mean that every proxy must be voted, but noted that the DOL's longstanding view is that proxies generally should be voted unless a fiduciary determines that the attendant costs would outweigh the benefits.

The DOL Proposal removes the two "safe harbor" proxy voting policies that plan fiduciaries can use under the existing regulation. The DOL explained that it does not believe those two safe harbor policies are necessary or helpful and requested comments on those provisions. The two safe harbor proxy voting policies contained in the existing regulation are: (i) a policy that limits voting to proposals that are substantially related to the issuer's business or are expected to materially affect the value of the investment; and (ii) a policy that the fiduciary will refrain from voting when the plan's ownership of a single issuer of stock is relatively small, relative to the plan's total assets, so that voting on a particular matter is not expected to materially affect the investment performance of the plan's portfolio (or the portion of a plan's portfolio managed by an investment manager).

The DOL Proposal also removes the current rule's requirement that a plan fiduciary must monitor a third-party proxy voting service to which voting has been delegated. The DOL noted that the intent of this change is not to reflect a change in the DOL's view that a fiduciary must monitor its delegates, but to signal that there is nothing special about monitoring proxy voting services.

Last, the DOL Proposal eliminates the requirement for plan fiduciaries to maintain records on proxy voting and other exercises of shareholder rights. The DOL stated that it proposed this change to remove any misperception that heightened fiduciary standards, and corresponding liability, apply to proxy voting and other exercises of shareholder rights.

2. Derivative Transactions

a. Initial Margin Requirement Final Phase-In Period

The final phase-in date for the initial margin requirements (the "**IM Rules**"), which are part of the margin regulatory requirements adopted by the Commodity Futures Trading Commission (CFTC) and the SEC collectively by the Treasury, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency, will occur on September 1, 2022.

The compliance date for phase 6 of the IM Rules was originally extended from September 1, 2021 to September 1, 2022 due to COVID-19; however, no further extensions are expected. Financial end users who have an aggregate average notional amount ("**AANA**") of US$8 billion or more during the relevant test period will be captured by this last phase of the IM Rules and will need to plan well in advance of the September 1, 2022 compliance date in order to be able to execute new trades after that date. Compliance with the IM Rules will generally require that existing trading documentation be amended to incorporate new initial margin ("**IM**") compliant documentation. Further, compliance with the IM Rules will also generally require that the parties establish custody relationships with a third-party custodian as well as implementation of methods to monitor relevant threshold calculations on an ongoing basis, as required under the IM Rules. However, for financial end users who trade relevant products that result in their IM being significantly below the US$50 million threshold for posting IM, it may be possible, with the consent of the relevant dealer counterparties, to defer the required amendments to their trading documentation to comply with the IM Rules and the implementation of the third-party custodial relationship until such time as the relevant IM gets closer to the US$50 million threshold.

In order to determine whether a financial end user is subject to phase 6 of the IM Rules, a series of calculations are required with respect to the average gross notional amount of all in-scope derivatives contracts in effect on the last business day of each of March, April, and May 2022 for each financial end user, including all relevant affiliated group members. If those calculations result in an AANA of US$8 billion or more, then the relevant financial end users will be in scope and subject to the IM Rules as of September 1, 2022.

In order to determine whether a financial end user is subject to phase 6 of the IM Rules, a series of calculations are required with respect to the average gross notional amount of all in-scope derivatives contracts in effect on the last business day of each of March, April, and May 2022 for each financial end user, including all relevant affiliated group members.

b. IM Rules Requirements

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

3. U.S. Transition from U.S. Dollar LIBOR

The transition from U.S. Dollar ("**USD**") LIBOR in the U.S. saw a number of material developments during 2021.

The transition from U.S. Dollar ("USD") LIBOR in the U.S. saw a number of material developments during 2021.

First, on January 25, 2021 the IBOR Fallbacks Protocol and Supplement 70 to the ISDA 2006 Definitions ("**IBOR Supplement**") became effective. The IBOR Supplement provides robust fallbacks for all swap transactions entered into on or after January 25, 2021 that reference the ISDA 2006 Definitions, whereas the IBOR Fallbacks Protocol allows parties to amend pre-existing transactions to incorporate the same fallbacks that are provided for in the IBOR Supplement. As a result of these changes, when a USD LIBOR termination trigger event occurs, the USD LIBOR rates in relevant swap transactions will automatically adjust to a compounded Secured Overnight Financing Rate ("**SOFR**") in arrears, with such other conforming changes as may be necessary to the swaps to allow the new SOFR rate to be calculated in arrears.

Second, on March 5, 2021 the LIBOR administrator, ICE Benchmark Administration (IBA), announced that it would discontinue the publication of the one-week and two-month USD LIBOR tenors effective as of December 31, 2021 and all of the other USD LIBOR tenors effective as of June 30, 2023.

Third, in April 2021 New York adopted legislation that allows certain New York law-governed agreements to automatically fall back to a SOFR-based alternate rate upon the permanent discontinuation of USD

LIBOR. Specifically, this legislation allows agreements that would otherwise have no functional fallback to fall back to SOFR if the parties are not otherwise able to amend the agreements to address the LIBOR discontinuation. This New York legislation will be helpful for agreements that would otherwise be difficult to amend, such as securitizations and publicly held bonds and notes, among others. There is also currently pending similar legislation at the federal level that would provide similar relief for all covered agreements (versus just New York law-governed agreements); however, that legislation is still pending in Congress as of this writing.

Fourth, in August 2021 CME Group Inc. ("**CME**") began publishing a term SOFR index which provides a forward-looking term SOFR rate ("**CME Term SOFR**"). Use of the CME Term SOFR rate requires a license from CME, which restricts the use of the CME Term SOFR rate to finance-related transactions and certain hedges related thereto. In addition to CME Term SOFR, other indices that have developed as alternatives to SOFR include the Bloomberg Short-term Bank Yield Index published by Bloomberg and the Ameribor Index published by the American Financial Exchange.

Fifth, in late October 2021 the Federal Deposit Insurance Corporation, in conjunction with several other bank regulatory agencies, issued a joint statement indicating that, absent certain narrow exceptions, they would consider it a "safety and soundness" issue for regulated financial institutions to enter into new USD LIBOR agreements after December 31, 2021, notwithstanding the continued publication of the USD LIBOR primary tenors until June 30, 2023. As a result, financial institutions started to migrate new transactions to non-LIBOR-based indices towards the end of 2021.

As a result of these and other market developments, the financing and derivatives markets have migrated to non-USD LIBOR interest rates, although, at this time, there is no single uniform replacement that the market has broadly accepted.

As a result of these and other market developments, the financing and derivatives markets have migrated to non-USD LIBOR interest rates, although, at this time, there is no single uniform replacement that the market has broadly accepted. Instead, the financing markets are using different variations of SOFR, including term SOFR, daily simple SOFR, and compounded SOFR, whereas the derivatives markets are using compounded SOFR in arrears. Because of these differences, it is important for market participants to fully understand the specific rates (including the relevant fallbacks that will be used) being used for the products they hold and the potential economic, financial, and regulatory implications of any differences between those rates and/or fallbacks.

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

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

a. Trade and Cooperation Agreement

The UK and EU published declarations alongside the Trade and Cooperation Agreement agreeing to establish a structured regulatory cooperation on financial services. In March 2021, the UK and EU agreed on a memorandum of understanding ("MoU") which sets out the framework for this further cooperation.

The UK officially exited the EU on January 31, 2020 ("**Exit Day**"), commencing the transition period that ran until December 31, 2020 (the "**Transitional Period**"). During the Transitional Period, "passporting" rights continued to be available.

On December 24, 2020, the EU and the UK concluded an agreement on their future economic relationship ("**Trade and Cooperation Agreement**"). The Trade and Cooperation Agreement did not provide for a continuation of passporting as between the UK and EU, and it contained very few specific provisions relating to insurance and financial services. The UK and EU published declarations alongside the Trade and Cooperation Agreement agreeing to establish a structured regulatory cooperation on financial services. In March 2021, the UK and EU agreed on a memorandum of understanding ("**MoU**") which sets out the framework for this further cooperation. The MoU lays out the groundwork for future cooperation between the two sides, but it does not address regulatory equivalence. The EU financial services commissioner has stated that the process of granting full regulatory equivalence to the UK would depend on the UK aligning to the EU's regulations. The MoU establishes the Joint UK-EU Financial Regulatory Forum, which provides a platform between the European government and the UK government to facilitate dialogue on financial services issues.

b. Passporting

In addition to the creation of new EU platforms, Brexit meant that many UK-based insurers looked to restructure their current operating models by way of portfolio transfers, known as "Part VII transfers" in the UK (a court-sanctioned method to transfer books of insurance policies from one legal entity to another).

In addition to the creation of new EU platforms, Brexit meant that many UK-based insurers looked to restructure their current operating models by way of portfolio transfers, known as "Part VII transfers" in the UK (a court-sanctioned method to transfer books of insurance policies from one legal entity to another). Such transfers were designed to ensure that in-force EU business was transferred to an EU entity that is able to continue to perform regulated activities in respect of that business, such as paying claims, now that the UK has left the single market. In 2021, the PRA and the FCA ran consultations on Part VII transfers regarding proposed changes on the criteria for approval of a transfer (see Section V.C.3.a).

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

The aim of the TPR is to allow firms that wish to continue carrying out regulated activities in the UK in the longer term to do so while they seek authorization from the UK regulators. The deemed permission covers those activities that the firm was permitted to carry on in the UK via passporting immediately before the end of the Transitional Period. More recently, the FCA cancelled the temporary permissions of four European firms, as they did not respond to mandatory information requests. The TPR is currently set to last until the end of 2023. This period is, however, subject to a review and possible extension. Once the TPR comes to an end, deemed authorization will fall away.

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

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

c. Equivalence

Under Solvency II, the European Commission is able to grant regulatory equivalence to a "third country" in three areas: (i) Reinsurance (Article 172, Solvency II); (ii) Group Supervision (Article 260, Solvency II); and/or (iii) Group Solvency (Article 227, Solvency II).

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

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

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

For UK-headquartered insurance groups with EU subsidiaries, if group supervision equivalence is not found, the EU could look to apply Solvency II from the EU perspective (from which the UK may diverge over time) to the top of the UK group, and levy an additional capital charge on the EU subsidiary in respect of group risk. Such UK insurance groups may also come under the purview of the EU for group supervision purposes. The Solvency II (Group Supervision) (Amendment) Regulations 2021, which was published on December 10, 2021, came into force on January 24, 2022. The amendment regulations provide that if a third country is equivalent for group supervision purposes, as determined in accordance with Solvency II Regulations 2015, then the PRA (where it is group supervisor of an insurance group with a parent in an equivalent third country) can, in some situations, defer to the supervisory authority in the relevant third country. The UK government believes that this may be advantageous for UK insurance groups with a parent in a third country, as it can reduce duplicative supervisory work.

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

d. UK Regulatory Response

The FCA, Bank of England, and PRA have all issued standstill prudential directions, the final texts of which were published in December 2020, meaning that firms are required to comply with the pre-Brexit version of such requirements until March 31, 2022. It was made clear in the PRA's and FCA's Brexit Policy Statements[25] (published in February 2019) that the regulators intended to use these powers broadly.

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

e. Legislation and Solvency II Directive

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

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

Further to a ministerial statement made by Lord Frost to the House of Lords on December 9, 2021, the government is currently reviewing retained EU law with a review to replacing, amending, or repealing any retained EU law which is "not right" for the UK. The reviews will examine the substance of retained EU law and the legal status of retained EU law. The UK government is aiming to issue its proposals in the spring of 2022.

f. U.S.-UK Covered Agreement

In December 2018, in anticipation of the UK's exit from the EU, the U.S. Department of Treasury and the Office of the U.S. Trade Representative announced their intent to enter into a "Bilateral Agreement between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance" (the "**U.S.-UK Covered Agreement**") with a view to maintaining regulatory certainty

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

and market continuity on insurance matters. The U.S.-UK Covered Agreement addresses three areas of regulation: (i) group supervision, (ii) reinsurance, and (iii) exchange of information between supervisory authorities. The U.S.-UK Covered Agreement is based on similar provisions to the U.S.-EU Covered Agreement which was previously entered into between the U.S. and the EU. This means that little has changed in the regulatory insurance relationship between the U.S. and the UK in a post-Brexit landscape.

At the end of the Transitional Period both countries exchanged notices, bringing the U.S.-UK Covered Agreement into force as of December 31, 2020. A Joint Committee was established under the U.S.-UK Covered Agreement, which held its first meeting on March 25, 2021 and which affirmed the participants' commitment to the U.S.-UK Covered Agreement, as well as discussing the progress made toward timely implementation of the agreement. Both sides to the agreement continue to encourage the relevant authorities to refrain from taking any measures that are inconsistent with the provisions of the agreement.

2. Lloyd's Update

a. Blueprint Two

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

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

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

Blueprint Two is targeting significant cost savings for market participants …

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

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b. Project Rio

In 2021, Lloyd's launched Project Rio, which made fundamental changes to the Lloyd's Oversight Framework. Most notably, Lloyd's is moving away from a prescriptive rules-based approach to a more outcomes-based approach.

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

The Principles will replace the minimum standards and articulate the fundamental responsibilities expected of all managing agents in order to support the market's overall performance, capital strength, and financial and reputational creditability. Underpinning the Principles are sub-principles and technical level guidance, which is expressed in terms of outcomes, capabilities, and processes but is not prescriptive.

The Syndicate Categorization is the process of allocating syndicates to one of five categories: outperforming, good, moderate, underperforming, and acceptable. The assessment is a qualitative and quantitative review across the Principles, and creates a consistent approach to syndicate and agent categorization. Firms should bear in mind that the overall category can only be as high as the lowest of the fundamental Principles (i.e., underwriting profitability, reserving, governance, risk management and reporting, and culture).

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

The switch is taking place gradually, allowing time for market participants to familiarize themselves with the new Principles and Framework. Managing agents will be expected to comply with the minimum standards until a full transition to the Principles from Q3 2022. By the end of April 2022, managing agents must complete a best-efforts self-assessment against the new Principles. Lloyd's expects the self-assessment to be discussed with the board of the relevant managing agent to ensure it maintains a view on performance and how to address any gaps identified.

Conducting the self-assessment in an outcomes-based regime requires a different mindset than a prescriptive, rules-based oversight approach. While offering greater flexibility, the principles-based oversight will result in intensified reliance on managing agents to interpret and apply the rules.

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

c. Lloyd's 2022 Market Oversight Plan

The Lloyd's Market Oversight Plan 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 risk profile of managing agents is used to determine the level at which each managing agent is exposed to key risks and issues, and to inform the managing agent's individual oversight plan.

Over the past two years, the market oversight activity of Lloyd's was primarily focused on the COVID-19 pandemic and improving underwriting performance. Due to the greater certainty around COVID-19 loss estimates, Lloyd's was able to incorporate loss monitoring into their core oversight returns and activities. Improving underwriting performance will continue to be a core focus for the London market in 2022 to ensure sustained profitability.

The complete list of topics for 2022 Market Oversight Plan includes: (i) conduct – fair value, (ii) culture, (iii) ESG, (iv) cyber underwriting, (v) underwriting performance, (vi) non-natural catastrophes, (vii) outwards reinsurance, (viii) operational resilience, (ix) governance and risk management, (x) investments, (xi) liquidity, (xii) reserve deterioration, and (xiii) financial crime. It is important for firms to understand the key issues and risks in the context of their business model and ensure they are proactively and appropriately managed.

d. ESG

In December 2020, Lloyd's published its first ESG report and strategy which set out their ambition to become a truly sustainable marketplace and to support the global transition towards net zero.

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

Broadly, expectations on managing agents for 2022 relate to improving data collection and identifying clear ESG strategies across the market. Managing agents can expect engagement across four key areas: (i) climate transition measurement approach; (ii) embedding an ESG framework; (iii) developing a sustainable underwriting approach; and (iv) setting a responsible investment policy (see Section V.C.7).

e. Lloyd's Brussels

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

In 2021, the Belgian regulators (the Financial Services and Markets Authority and the National Bank of Belgium) raised concerns at the possibility that some of the services performed by managing agents could be held to constitute insurance distribution, as defined under the Insurance Distribution Directive ("**IDD**"). As a result, Lloyd's Brussels revisited its operating model with a view to moving IDD activities from the current outsourced model to an approach where impacted IDD-related activities will be under the direct control and oversight of Lloyd's Brussels.

There were four operational solutions discussed with Belgian regulators and the market, with the two most popular solutions being the secondment model ("**Solution 1.2**") and a service company model ("**Solution 4**"). Under Solution 1.2, the seconded underwriters will remain employed by the managing agents, located in the UK, and would be seconded to the UK branch of Lloyd's Brussels. Under Solution 4, a managing agent would establish a service company in the EEA. The EEA service company would write business as an appointed Coverholder of Lloyd's Brussels.

It is important to note that Lloyd's Brussels has planned post-bind monitoring on the operational model over 2022 and therefore it remains to be seen whether further changes to the operational model will be made.

3. Regulatory Updates in the UK Insurance Sector

Businesses in the UK insurance sector are regulated by either the FCA (if they are insurance intermediaries), or both the PRA and the FCA (if they are insurers or reinsurers). The PRA is responsible for the prudential regulation of these businesses and the FCA is responsible for regulating their conduct. In addition, those businesses that have an underwriting platform in the Lloyd's insurance market are also regulated by Lloyd's, which in turn is regulated by the FCA and the PRA.

a. Updates to the Rules and Guidance on Part VII Transfers

Following Brexit, a number of amendments were made to the Financial Services and Markets Act 2000 ("**FSMA**"), including to the statutory roles of the PRA and FCA in insurance business transfers ("**IBT**") under Part VII of FSMA, known as Part VII transfers. A Part VII transfer is a court sanctioned, statutory novation of books of (re)insurance business in the UK, which allows applicants to avoid the need to obtain individual consent from policyholders.

Given the proposed legislative changes brought about by Brexit, in July 2021 both the PRA and FCA released consultation papers, with proposals to update the detailed guidance notes that both regulators have already prepared, which outline the criteria that they expect applicants to meet when considering a Part VII transfer (the "**Guidance Notes**"). The consultation periods closed on August 31, 2021 (with respect to the FCA's consultation) and October 28, 2021 (with respect to the PRA's consultation). Both regulators have been considering the feedback received from the industry, with the PRA releasing its policy statement and updated Guidance Notes on January 12, 2022, reflecting its final rules and guidance. On February 15, 2022, the FCA also published its finalized guidance on its approach to the review of Part VII transfers ("**Finalized Guidance**" or "**FG22/1**").

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i. Key Changes to the PRA's Statement of Policy on the PRA's Approach to IBTs

- **Guidance for Independence Experts**. Part of the PRA's assessment of a proposed scheme includes reviewing and approving the form of the scheme report prepared by the Independent Expert ("**IE**") to ensure it is fit for its intended purpose. The PRA has amended the PRA's Statement of Policy on the PRA's Approach to Insurance Business Transfers (the "**SoP**") to provide

In addition to the additional guidance on the scheme report itself, the PRA has also clarified its guidance with respect to the role of the IE and the ways in which they can ensure that they are exhibiting an appropriate level of independence, which they need to be continually assessing throughout the Part VII process.

clearer guidance of its expectations with respect to scheme reports, such as ensuring that it covers in sufficient detail all the issues that appear to the PRA to be relevant, and incorporates appropriate reasoning for this assessment. In addition, the PRA has provided further information to IEs as to the areas it expects the scheme report to cover. For example, IEs should consider (i) the likely effects of the scheme at both a firm and policyholder level, (ii) that the transferee and transferor have the requisite ability to measure, monitor, and manage risk and conduct in their business prudently, (iii) any risks that may not fall within the regulatory capital regime applied, and (iv) ensuring the transferee's existing capital model remains appropriate following the scheme. In addition to the additional guidance on the scheme report itself, the PRA has also clarified its guidance with respect to the role of the IE and the ways in which they can ensure that they are exhibiting an appropriate level of independence, which they need to be continually assessing throughout the Part VII process.

- **Transfers Involving Transferees in Run-Off**. The PRA has noted that schemes involving the transfer of books of business in run-off may pose certain risks to its statutory objectives. Accordingly, the PRA has made the following two key changes to the SoP to mitigate this risk:
  - For schemes that trigger particular criteria (including a scheme involving non-life insurance business in run-off with gross technical provisions of more than £100 million and where the scheme would increase the transferee's technical provisions by more than 10%), the PRA intends to utilize its powers under s. 166 of FSMA[26] so that it can assess the operational readiness of the transferee to accept the scheme. Given the potential operational and financial burden imposed by a s. 166 review on the business, this proposal was met with some hesitation by the market. The PRA has since clarified that it will only use these powers in circumstances where it is not able to complete this assessment by other means (e.g., there has been a recent s. 166 assessment in the same area or an equivalent assessment by an independent body or regulator). The PRA also notes that this assessment would take place prior to the appointment of the IE.
  - For schemes where the transferee is in run-off (or is in the business of acquiring books of business in run-off), such transferee should make clear that it has considered both its existing risks and the risks it is acquiring over the time horizon of the run-off firm's obligations to its policyholders (including obligations relating to business agreed to be assumed following the relevant reference date), until those risk are fully run-off.

ii. Key Changes to the FCA's Finalized Guidance on the FCA's Approach to the Review of Part VII IBTs

… if a proposed IE intends to work on two interacting projects concurrently or consecutively, it must be able to demonstrate that it can act independently with respect to both.

- **Independence of the IE**. The Finalized Guidance asserts that if a proposed IE intends to work on two interacting projects concurrently or consecutively, it must be able to demonstrate that it can act independently with respect to both. The FCA may not agree with nominations where it is not satisfied that the IE will be able to manage those conflicts effectively. In assessing the independence of the IE, the FCA will consider any potential or actual conflicts of interest from other matters the IE or its employer has been involved in. In addition, the FCA has noted that it will not only consider the independence of the IE but also any proposed peer reviewer. If an IE's employer is unable to identify an internal peer reviewer with sufficient experience and who is suitably independent, it might consider nominating a peer reviewer from a different firm. With respect to having sufficient skills and experience, the FCA has also clarified that it expects all members of the IE's core support team to be able to demonstrate this, including the peer reviewer.

The Finalized Guidance includes a new set of "general expectations" which the FCA expects applicants and IEs to abide by when considering FG22/1 and the provisions contained therein.

- **General Expectations**. The Finalized Guidance includes a new set of "general expectations" which the FCA expects applicants and IEs to abide by when considering FG22/1 and the provisions contained therein. In particular, the FCA expects applicants and IEs to act in accordance with the provisions of FG22/1 and, where there are any situations where a judgment call has been made or an applicant or IE may deviate from the expectations in FG22/1, these should be proactively raised with the FCA in good time. This includes material conduct issues

26 Such powers include the right to require a firm commission skilled person reports into any aspect of a firm's business.

where a judgment call is made on a matter that is not straightforward or where there may be scope for affected policyholders to raise concerns. In addition, if there are any issues arising in relation to a scheme that the FCA is likely to want to consider (e.g., material conduct issues), these should be raised with the FCA in good time. In summary, the FCA will require applicants and IEs to be proactive in engaging with the FCA on the application and any issues or considerations arising from that.

- **Changes Affecting Policyholders**. The FCA expects applicants and the IE to demonstrate that they have adequately considered and analyzed what changes may be occurring and to what extent there may be an adverse or positive impact on policyholders. These include (i) any changes to claims philosophy or plans to accelerate run-off, (ii) the impact of the scheme on any vulnerable policyholders, (iii) appropriate proposals to mitigate, and appropriately protect, against possible adverse impacts on policyholders, including, where relevant, compensation, and (iv) the extent to which previous statements made by the applicant (e.g., through their website or other communications) could give policyholders a reason to object to the scheme. Applicants and IEs should be able to demonstrate that they have considered these issues (as well as those previously included in FG18/4). The FCA will consider whether the description of the scheme is clear and fair, contains enough detail, and is sufficiently prominent.

The FCA will consider whether the description of the scheme is clear and fair, contains enough detail, and is sufficiently prominent.

- **Objections from Policyholders and Other Interested Parties**. The FCA has provided additional clarity around how applicants should deal with and respond to any objections from policyholders. Any objections should be responded to in a timely manner and all staff dealing with them should have appropriate training in order to know when to escalate particularly complex cases. If there are any concerns regarding inconsistency with previous statements, applicants should address these with sufficient detail in order to abate any further confusion. In addition, all objections should receive proper consideration of the substance of the issue, to assess whether any proposals under the scheme will need to change or, if not, why this would not be necessary to ensure there is no material adverse impact. IEs will play a crucial role in this and should consider all objections from the perspective of policyholders and whether the applicant has done enough to respond to any concerns raised. Notably, the FCA may take a different view to the applicants or the IEs, depending on whether the objectors' concerns have been adequately addressed.

Any objections should be responded to in a timely manner and all staff dealing with them should have appropriate training in order to know when to escalate particularly complex cases.

- **Use of Digital Communications**. The FCA has acknowledged the advancement of digital communication across the industry and notes that the traditional postal methods of communication may no longer be appropriate. When considering the use of digital communication, the FCA will want firms to demonstrate that they have considered a number of factors, including if (i) the policyholder's preferred method of communication is digital (rather than post), (ii) it is customary to communicate digitally with this party, (iii) all digital contact information is up to date, (iv) the proposed method is reliable and appropriate, (v) there is a plan in place to manage any failed deliveries, and (vi) the subject matter of the communication is sufficiently striking to allow the recipient to know that it contains important information.

The FCA has acknowledged the advancement of digital communication across the industry and notes that the traditional postal methods of communication may no longer be appropriate.

b. FCA Consultation on the Appointed Representative Regime

On December 3, 2021, the FCA published a consultation paper ("**CP21/34**")[27] with a view to improving the Appointed Representatives ("**AR**") regime. CP21/34 focuses on two key areas of change to target more effective supervisory interventions. First, the FCA is consulting on requiring additional information and notification requirements from principals in order to better assess whether the principal has the expertise, systems, and controls to effectively oversee its ARs. The second main area of change is the proposal to enhance and clarify the FCA's expectations of principals and their responsibilities.

On December 3, 2021, the FCA published a consultation paper ("CP21/34") with a view to improving the Appointed Representatives ("AR") regime. CP21/34 focuses on two key areas of change to target more effective supervisory interventions.

Additionally, HM Treasury is calling for evidence on the AR regime as part of an information gathering exercise on how market participants use the regime and how effectively it works in practice. The UK government will use the evidence, along with the FCA's proposals, to decide whether legislative reform is necessary, and has identified several areas where legislative changes could be required.

The first change would be to the overall scope of the section 39 FSMA exemption, including the regulated activities that ARs are permitted to carry on. The scope of the section 39 exemption could be

27 Consultation Paper CP21/34 on Improving the Appointed Representatives Regime.

It is also possible that more regulatory obligations will be imposed on ARs to incentivize compliance with regulatory rules which serve to protect consumers and markets …

The PRA's consultation paper 17/21,[28] which was published in September 2021, sets out the PRA's proposed approach to interpreting the definition of "insurance holding company" in the context of Group Supervision.

An "insurance holding company" is currently defined in both legislation and the PRA Rulebook as a parent whose "main business" is to acquire and hold participations in subsidiaries, where those subsidiaries are "exclusively or mainly" insurers or reinsurers.

Notably, the PRA's proposed amended definition of "insurance holding company" includes ancillary insurance services undertakings …

altered by specifying new conditions to be met for the exemption to apply, for example, a specified limit for the maximum size of an AR's business. Further, the government could consider prohibiting ARs from carrying on certain activities where there was strong evidence to suggest that activity was generating an unacceptable level of risk for consumers or market integrity.

Another proposal is to enhance the FCA's role within the AR regime so that it may accurately scrutinize the principal's capabilities, such as requiring authorized firms to gain a specific permission from the FCA before appointing ARs. It is also possible that more regulatory obligations will be imposed on ARs to incentivize compliance with regulatory rules which serve to protect consumers and markets, for example, by extending the Senior Managers and Certification Regime, which currently applies to authorized firms, to cover ARs.

If HM Treasury concludes that reform is needed, it will consult on proposals. The FCA intends to publish a policy statement and final rules in H1 2022.

c. Updates to the Definition of Insurance Holding Company

The PRA's consultation paper 17/21,[28] which was published in September 2021, sets out the PRA's proposed approach to interpreting the definition of "insurance holding company" in the context of Group Supervision. The issue is a significant one because the designation of an entity's parent as an "insurance holding company" brings that group within the scope of a full group solvency calculation. As a consequence, such a group would be required either to calculate a group solvency capital requirement, which is the total amount of funds that insurance and reinsurance companies in the EU are required to hold, on an accounting consolidation basis at the level of the parent. Or, where that is not deemed appropriate by the group supervisor in consultation with the group itself and other relevant supervisory authorities, it shall apply the alternative method (the deduction and aggregation method), or a combination of the two methods. In either case, the solvency calculation is undertaken by reference to the group as a whole. By contrast, if the holding company was not considered to be an "insurance holding company," the solvency calculation would be performed at a lower level, and wider group supervision would be limited to a much lighter touch regime.

An "insurance holding company" is currently defined in both legislation and the PRA Rulebook as a parent whose "main business" is to acquire and hold participations in subsidiaries, where those subsidiaries are "exclusively or mainly" insurers or reinsurers. What is meant in this context by "mainly" is not defined in Solvency II, the PRA Rulebook, or any other related guidance. Following a report by the EIOPA in 2018, it became clear that different methods are used in different EU member states to interpret the definition of "insurance holding company" and therefore, the treatment in one member state may be more favorable than another.

In the consultation paper 17/21 the PRA proposes to:

- Amend the definition of "insurance holding company" to interpret the term "mainly" by reference to the proportion of a group's assets, revenues, or capital requirements that are derived from insurance or reinsurance subsidiaries; and

- Require ancillary insurance service undertakings be brought within the relevant calculation.

It is further proposed that a holding company's subsidiaries would be considered as "mainly" insurance or reinsurance subsidiaries and consequently defined as an "insurance holding company" in cases where at least two of the three measures noted above (the group's assets, revenues, or capital requirements) exceed the 50% threshold.

Notably, the PRA's proposed amended definition of "insurance holding company" includes ancillary insurance services undertakings, so as to stop parent companies from avoiding full group solvency calculation by using service companies to be treated as "mixed-activity insurance holding company." The inclusion of this additional layer of protection also suggests a divergence from the EU's Solvency II regime, which currently does not prohibit this in explicit terms.

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

The changes proposed are not intended to be retrospective and will apply to future determinations of whether or not a parent company will be deemed an "insurance holding company" as opposed to a "mixed-activity insurance holding company." The consultation period on the consultation paper 17/21 closed on December 6, 2021.

d. FCA Consultation on New Consumer Duty

On December 7, 2021, the FCA published a second consultation paper CP21/36 ("**CP21/36**") on a new consumer duty, which now includes feedback from the FCA's first consultation paper in May 2021.

On December 7, 2021, the FCA published a second consultation paper CP21/36 ("CP21/36") on a new consumer duty, which now includes feedback from the FCA's first consultation paper in May 2021.

The proposed new consumer duty will consist of a new consumer Principle that would replace Customers' interests (Principle 6) and Communications with clients (Principle 7) for retail business and require firms to act to deliver good outcomes for retail customers. Principles 6 and 7 would continue to apply to firms dealing with wholesale or retail customers outside the scope of consumer duty. The scope of the consumer duty for insurance entities will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS). The duty would also apply to firms dealing with high-net-worth individuals, unless that status takes conduct outside of the regulatory parameter of the FCA.

The consumer duty also would apply to prospective customers and unregulated activities that are ancillary to regulated activities. Described by the FCA as the cross-cutting rules, these set out how firms should act to deliver good outcomes by requiring firms to act in good faith, avoid foreseeable harm, and enable and support retail customers to pursue their financial objectives. Further, the FCA sets out the four outcomes that it wants to see under the consumer duty. The outcomes relate to the quality of products and services, the price and value of products and services, consumer understanding, and consumer support. Appendix 2 to the consultation paper sets out draft non-handbook guidance for firms on the consumer duty, which is issued under section 139A of FSMA. The guidance sets out the scope of the consumer duty and further explains what the cross-cutting rules mean for firms, and discusses the FCA's views of how firms should comply with their obligations under the new consumer duty, as set out in the new Principle 12.

The response period for the consultation paper CP21/36 closed on February 15, 2022, and the FCA intends to publish a policy statement with final rules by July 31, 2022. The FCA proposes that firms should have until April 30, 2023 to fully implement the consumer duty.

e. Updates to Solvency II

i. European Updates

On September 22, 2021, the European Commission (the "**Commission**") adopted its proposals (2021/0295(COD)) for amendments to Solvency II. The overarching aims of the proposals are to enable insurance companies to drive long-term productive and green finance in Europe's COVID-19 recovery and strengthen the (re)insurance sector's resilience to better protect policyholders. The proposals relate to proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, and group and cross-border supervision. In relation to group supervision, changes proposed relate to the application of the regime to insurance holding companies and mixed financial holding companies, and the use of enforcement powers in relation to group companies. The Commission also proposes notifications to EIOPA on authorization refusals and monitoring of compliance with fit and proper requirements for members of reinsurers' management bodies. Further, the Commission looks to improve cross-border supervision between EU supervisory authorities in respect of information-sharing and proposes giving national supervisory authorities macro-prudential tools to prevent the materialization of financial stability risks in insurance markets.

The overarching aims of the proposals are to enable insurance companies to drive long-term productive and green finance in Europe's COVID-19 recovery and strengthen the (re) insurance sector's resilience to better protect policyholders

There are also proposals for lighter touch reporting requirements for low-risk profile undertakings, and a new category of low risk profile reinsurers which would benefit from lighter and more proportionate rules. In a bid to promote green finance, it is also suggested that insurers may be required to identify material exposure to climate change risks.

In the next step of this review of Solvency II, the European Parliament and the member states will negotiate the final legislative texts on the basis of the Commission's review.

The UK government's review of Solvency II aims to ensure that it is properly tailored to account for the UK's post-Brexit structural features in delivering a more efficient regime which supports long-term productive and green finance, and policyholder protection.

ii. UK Updates

The UK government's review of Solvency II aims to ensure that it is properly tailored to account for the UK's post-Brexit structural features in delivering a more efficient regime which supports long-term productive and green finance, and policyholder protection. Following HM Treasury's Call for Evidence in October 2020, the PRA undertook a two-part information gathering exercise, comprising of a quantitative impact study and a qualitative questionnaire. The data provided will allow the PRA to assess different combinations of policy options. Following this, the next stage is to develop policy proposals and inform its discussions with HM Treasury.

In a December 2021 speech, the Governor of the Bank of England highlighted the two material items of the regime currently under review. Notably, there may be a case for reducing the risk margin as the current calibration is too sensitive to interest rates. Second, there is a concern that Solvency II has created risks to the PRA's primary objectives in relation to the Fundamental Spread, which is used by insurers to calculate the risk-free curve for liabilities within a matching adjustment portfolio.

On December 17, 2021, PRA published a policy statement on Phase 1 of its review of reporting requirements under the Solvency II regime, which amends its earlier July 2021 proposals. The impact of these changes will be to bring forward the implementation date of the technical standards instrument and the PRA Rulebook instrument, and reduce reporting requirements. The objective was to enhance the clarity of the PRA's approach, in alignment with the feedback received from the July 2021 consultation paper.

Phase 2 of the review will cover a more in-depth review of all of the components that make up the UK reporting and disclosure framework, and will take into account reform proposals in other areas of HM Treasury's review of the Solvency II regime. The PRA intends to consult on additional proposals in 2022.

4. Competition Law Update in Europe

a. EU Level Enforcement by the EU Courts

i. Opinion on Key Aspects of Directive 2002/83 Regarding Life Assurance

The questions concerned unit-linked life insurance contracts where the underlying assets of the fund are derivatives (or structured financial instruments with embedded derivatives).

As discussed in the 2021 edition of the *Sidley Global Insurance Review*, in March 2020 the Warsaw District Court referred a number of questions to the Court of Justice of the European Union ("**CJEU**") regarding the interpretation of key aspects of Directive 2002/83 regarding life assurance (the "**Life Assurance Directive**"). The questions concerned unit-linked life insurance contracts where the underlying assets of the fund are derivatives (or structured financial instruments with embedded derivatives).

Advocate General Bobek delivered his Opinion in September 2021 (Advocate General opinions serve as advice to the Court and tend to be followed). He considered that at least the information listed in Annex III(A) to the Life Assurance Directive needs to be communicated to purchasers of such contracts, prior to the conclusion of the contracts. This information disclosure obligation includes the definition of the units to which the benefits under the assurance policy are linked, and an indication of the nature of the assets underlying the unit-linked policy. Assuming the Court follows the Advocate General's Opinion in its judgment later this year, failure to provide sufficient information as set out in the Life Assurance Directive would be confirmed as constituting a misleading commercial practice.

b. EU Level Enforcement by the European Commission

i. European Commission Launches Public Consultation on Marketability of Short Term Export-Credit Insurance

In March 2020, at the beginning of the COVID-19 pandemic, the Commission decided to remove all countries from the list of "marketable risk" countries for short term export-credit insurance. The Commission took this decision because the insurance market faced significant global contraction.

In March 2020, at the beginning of the COVID-19 pandemic, the Commission decided to remove all countries from the list of "marketable risk" countries for short term export-credit insurance. The Commission took this decision because the insurance market faced significant global contraction. As a result, short term export-credit insurance to countries for which the risk was previously seen as insurable by private insurers has also been eligible for state or state supported insurance.

In September 2021, the Commission launched a public consultation on the extension of this decision. In the consultation, the Commission sought all relevant stakeholders' views as to any changes in the capacity of private insurers to cover short term export-credit insurance. The consultation made clear that the private insurance market had become more stable, which led the Commission to include the EU member states and nine Organization for Economic Co-operation and Development member states in the list of "marketable risk" countries again. The updated list is effective from March 31, 2022.

ii. European Commission Investigates Exclusionary Practices on Insurance Ireland's Data-Sharing Platform

In June 2021, the Commission issued a Statement of Objections ("**SO**") accusing Insurance Ireland, an Irish industry association, of unlawfully denying certain insurers access to its data-sharing platform. According to the SO, the limited access for certain motor vehicle insurers resulted in reduced choice, reduced quality of offers, and higher prices, since it put insurers that could not become members of the association at a competitive disadvantage. The SO does not prejudge the outcome of the ongoing investigation but is a formal step to inform Insurance Ireland of the objections raised. There are likely to be further case updates through 2022.

c. National Level Enforcement in the UK

i. FCA Publishes Final Report of its General Insurance Pricing Practices Market Study

In May 2021, the FCA published the feedback it had received on its consultation paper in relation to general insurance pricing practices. The FCA's market study had found that the UK's home and motor insurance markets were not working well for all consumers. The remedy imposed by the FCA consists of (i) a price-parity obligation for new and renewing customers, (ii) facilitating discontinuation of auto-renewals for customers, and (iii) transparency improvements.

Insurers had until January 1, 2022 to implement new pricing and auto-renewal remedies as well as comply with additional reporting requirements.

ii. Damages Claim Filed Against ComparetheMarket on Behalf of 20 Million UK Consumers of Home Insurance

In November 2021, Home Insurance Consumer Action filed an opt-out collective claim on behalf of over 20 million UK consumers of home insurance against the companies behind comparison website comparethemarket.com.

The claim follows the Competition and Markets Authority's finding last year that ComparetheMarket breached competition law in relation to its contracts with certain insurers that listed on its website and is based on an allegation that ComparetheMarket's conduct led to higher home insurance prices for all UK consumers.

d. National Level Enforcement in Bulgaria

In May 2021, Bulgaria's Commission for Protection of Competition fined insurance broker SDI Group for conducting a false advertising campaign. SDI Group offered a so-called discount, whereas the "standard price" was a price it had never offered. The fine amounted to approximately US$180,000.

e. National Level Enforcement in Estonia

In September 2021, in response to an investigation by the Estonian Competition Authority, the Estonian insurance broker IIZI agreed to remove parity clauses it used in agreements with insurers. The clauses obliged insurers to offer their products to IIZI at least on the same conditions and at the same prices as through other sales channels.

f. National Level Enforcement in Greece

In September 2021, the Hellenic Competition Commission ("**HCC"**) launched a consumer survey on the use of fintech in Greece. The survey aims to map the use of several fintech services, including insurtech. Based on this exercise, the HCC will conclude if any competitive concerns exist in fintech services (including insurtech) and may undertake initiatives to improve competition.

g. National Level Enforcement in Ireland

In August 2021, the Irish Competition and Consumer Protection Commission ("**CCPC**") accepted commitments by six players in the motor insurance sector. The CCPC had previously found anti-competitive price signaling in a preliminary investigation, concluded in September 2020. By means of public statements, these players had issued forecast future prices, which allowed them to coordinate. A seventh party, the brokers association Brokers Ireland, did not agree to the commitments. It is unclear if the CCPC will undertake any further steps against Brokers Ireland.

h. National Level Enforcement in Italy

In May 2021, the Italian competition authority ("**AGCM**") opened an investigation against a subset of companies active in the price comparison and insurance sectors. The AGCM is trying to ascertain whether companies have restricted competition by exchanging sensitive information related to the economic conditions for the direct sale of motor vehicle liability policies.

i. National Level Enforcement in Lithuania

In October 2021, the Lithuanian Competition Council cleared INVL's acquisition of Mandatum Life, one of Finland's largest life insurance companies, which also operates in the Baltics through branch operations across Lithuania, Latvia, and Estonia respectively. Mandatum Life has nearly 30,000 customers across the Baltic countries and total revenue in 2020 was €7.8 million with €22 million of premiums written.

j. National Level Enforcement in the Netherlands

In April 2020, the Dutch Authority for Consumers and Markets ("**ACM**") allowed health insurers to make collective arrangements to provide financial support to healthcare providers during the COVID-19 crisis.

In July 2021, the ACM outlined its ongoing approval for a smaller scale version of the initiative for health insurers and hospitals in order to prevent far-reaching consequences of the COVID-19 pandemic. As noted by the ACM, without any collective distribution scheme, there was a risk that the continuity of healthcare could have been jeopardized.

k. National Level Enforcement in Poland

In May 2021, The Office for Protection of Competition and Consumers ("**OPCC**") launched an investigation into agency agreements entered into by PZU Zycie, one of Poland's largest insurance companies.

The OPCC opened the investigation following a complaint by Invest-Pol, a company specializing in financial and insurance advice services. The OPCC is investigating whether some clauses such as its policies for group life insurance for employees, including an obligation to obtain the consent of employees in order to terminate the agreement despite their not being the parties to the agreement, might constitute an abuse of PZU Zycie's alleged dominant position.

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**").

... the conditions for processing special category personal data (most notably health data) and personal data relating to criminal convictions and offenses, can differ across the EEA. This is of particular relevance for the (re)insurance industry in the context of the provision of health, life, and motor insurance.

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

As for the time being, the UK GDPR is largely aligned with the EU GDPR, and for 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.

The initial aim of the GDPR was to create a harmonized approach to data privacy compliance across the EEA. However, as national laws, guidance, and case law continue to develop, it has become obvious that this is not the case. In particular, the conditions for processing special category personal data (most notably health data) and personal data relating to criminal convictions and offenses, can differ across the EEA. This is of particular relevance for the (re)insurance industry in the context of the provision of health, life, and motor insurance.

We set out below some further considerations for the (re)insurance industry from a data protection perspective in 2022.

a. GDPR Enforcement and Fines

We saw a year of record-breaking fines under the GDPR in 2021. Sources indicate that GDPR fines went from totaling just €436,000 in 2018 (the year the GDPR came into force), to over €1 billion in 2021. Two of the largest fines issued in 2021 were against multinational technology companies for breaches in relation to the transparency and consent requirements under the GDPR. For example, one of these decisions has suggested that privacy notices should be much more granular than is the current market approach. Of note, for the (re)insurance industry particularly, where personal data is processed to meet legal and regulatory obligations, the decision suggests that all key legislation relied upon to process personal data are listed. This could impose a heavy burden on heavily regulated companies, like those in the (re) insurance industry. However, this decision is subject to appeal in the Irish High Court.

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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 are not relevant, given that the transparency and consent requirements at issue are almost universally applicable to companies, including those in (re)insurance, which rely on consent and will often have multiple privacy notices in place. Nonetheless, GDPR enforcement actions specific to the (re)insurance industry in 2021 include, for example, a €135,000 fine against an unnamed insurance company for failing to document and notify a personal data breach. The fine was also imposed for insufficient security measures. This is of particular relevance in the UK given the PRA's recent focus on information security indicated by its Supervisory Statement (the "**Statement**") that is due to come into force from March 31, 2022 (but which impacts agreements entered into after March 31, 2021). It requires outsourcing agreements entered into by (re)insurers to 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 to data security (see Chapter 7), network security, and security monitoring processes; and operational and security incident handling procedures, including escalation and reporting."

Although these fines have not been issued against companies in the (re)insurance industry, it does not mean that the issues raised are not relevant, given that the transparency and consent requirements at issue are almost universally applicable to companies, including those in (re)insurance ...

b. International Transfers and Schrems II

2021 was as a significant year in terms of 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. There are certain exemptions under the GDPR from this data transfer prohibition, including where certain data protection safeguards have been adopted (such as the data exporter in the EEA and the data importer outside the EEA entering into EU Standard Contractual Clauses ("**SCCs**" or "**EU SCCs**")).

2021 was as a significant year in terms of continued developments regarding the international transfer of personal data.

However, following a case by the CJEU in 2020 ("**Schrems II**"), further obligations were imposed on organizations relying on SCCs, including a requirement 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. In light of the decision, the European Data Protection Board ("**EDPB**") published two sets of recommendations to provide further guidance on how companies can meet the requirements set out in the Schrems II decision, including a six-step approach to assess and protect international data flows and its recommendations on how to implement supplementary measures.

Following the Schrems II decision, the European Commission published new EU SCCs which were adopted on June 4, 2021 ("**New EU SCCs**"). The New EU SCCs applied to new contracts from September 27, 2021 and companies have until December 27, 2022 to update existing contracts. The New EU SCCs adopt a modular approach and broaden the scope of the EU SCCs from addressing controller-controller and controller-processor transfers to now also covering processor-processor and processor-controller transfers. They are also intended to address Article 28 data processing provisions, where relevant.

Following the Schrems II decision, the European Commission published new EU SCCs which were adopted on June 4, 2021 ("New EU SCCs").

However, the Commission's implementing decision of the New EU SCCs also noted that the New EU SCCs can only be used to legitimize transfers to a data importer who is not itself directly subject to the GDPR. This resulted in some ambiguity as to which SCCs should be put in place where there is a transfer of personal data to a data importer who is subject to the GDPR (by virtue of the extra-territorial scope of the GDPR under Article 3). On November 19, 2021 the EDPB released draft guidelines to clarify the interplay between Article 3 of the GDPR on the territorial scope of the GDPR, and the provisions on international transfers in Chapter V of the GDPR. These clarified a number of issues including the concept of a "transfer" and, helpfully, that a transfer directly from an individual is not a restricted transfer. The draft guidelines confirmed that where an EEA-based exporter, subject to the GDPR, is transferring personal data to an ex-EEA-based importer also subject to the GDPR then the New EU SCCs cannot be used. The Commission intends to issue a new set of SCCs ("**Recital 7 SCCs**") to deal with this scenario. In the meantime, businesses will have to decide whether to (i) continue using the New EU SCCs as is while awaiting the new Recital 7 SCCs, or (ii) prepare their own set of ad hoc SCCs in line with the EDPB's limited guidance.

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

(Re)insurers transferring personal data outside of the EEA will need to take into account both the Schrems II decision and the new EU SCCs when transferring personal data. This process should include: (i) carrying out a data mapping exercise of their data transfers to get a clear overview of each data transfer from the EEA; (ii) verifying whether the recipient jurisdiction has obtained an adequacy decision (e.g., Switzerland or Japan) and if not, determining which GDPR data transfer mechanism, such as SCCs, can be used; (iii) assessing the third country's legal order (e.g., the U.S., Bermuda, India, etc.) to determine to what extent it impinges on the effectiveness of the GDPR's safeguards; (iv) implementing supplementary protection measures, if needed based on the outcome in (iii); (v) complying with all procedural formalities to implement the safeguards; and, finally, (vi) ensuring the reevaluation of the situation at appropriate intervals, especially in relation to the potential further SCCs to be released. In terms of specific guidance to assist (re)insurance companies with these assessments, the Lloyd's Market Association ("**LMA**") and other relevant industry bodies have to date provided more limited market guidance beyond responses to the public consultations with respect to the EU SCCs and the Schrems II decision, and therefore companies should consider recent guidance on international transfers from the EDPB and the UK Information Commissioner's Office ("**ICO**").

Following Brexit, the EU SCCs do not automatically apply in the UK.

… after March 21, 2024, all contracts must have transitioned to the new UK IDTA or the Addendum. (Re)insurers with operations in the UK should review their data transfers from the UK and update them in line with the IDTA or the Addendum.

Following Brexit, the EU SCCs do not automatically apply in the UK. In turn, the UK government and ICO have developed a UK equivalent to the EU SCCs: the UK International Data Transfer Agreement ("**IDTA**"). However, they have also published a new UK addendum which can be used with the New EU SCCs (the "**Addendum**"). Both the Addendum and the IDTA were laid before the UK Parliament on January 28, 2022. If no objections are raised by the UK Parliament, the IDTA and Addendum will come into force on March 21, 2022. Alongside these documents, we are also expecting final guidance from the ICO and the final version of the UK Transfer Risk Assessment tool, which companies can use to assess whether the level of data protection in a country is "essentially equivalent" to the UK, akin to the Schrems II Privacy Impact Assessment. The ICO has confirmed that companies may continue to enter into new contracts on the basis of the old EU SCCs (not the New EU SCCs) until September 21, 2022. However, after March 21, 2024, all contracts must have transitioned to the new UK IDTA or the Addendum. (Re)insurers with operations in the UK should review their data transfers from the UK and update them in line with the IDTA or the Addendum.

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 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 (i) is necessary to enter into or perform a contract, (ii) has been authorized by an EU member state (or UK) law, or (iii) is conducted with the individual's explicit consent, and appropriate safeguards are implemented.

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

AI is an area that has undergone significant changes in recent years with further developments expected in 2022. For example, in April 2021, the European Commission published a draft Artificial Intelligence Act ("**AI Act**") centralizing EU member state obligations when designing and deploying AI. The AI Act is part of a broader package of legislation on AI, with the ultimate goal being to strengthen Europe's potential to compete in AI at a global level. The AI Act takes a risk-based approach categorizing all AI into: (i) unacceptable risk — activities which are prohibited under the AI Act such as those relating to social scoring; (ii) high-risk activities, e.g., those relating to medical devices and consumer creditworthiness; and (iii) low-risk activities like chatbots. The relevant legal obligations imposed by the AI Act reduce as the perceived risk level posed by the AI system reduces. Activities not mentioned in the AI Act are deemed to be of "minimal risk" and are not regulated.

The AI Act is notable for its wide scope of application with the Act, among other things, applying where the output of the system is in the EU, even if an organization has no commercial presence within the EU. This continues to be a controversial point for organizations that will not always know where the output of their AI technologies will be used. The AI Act is also significant because of its proposed fines for non-compliance of €30 million or up to 6% of worldwide turnover, whichever is higher. The AI Act has not been finalized yet and it is not yet clear when the AI Act will finally be adopted and come into force. However, (re)insurers should note that the Commission is particularly cautious when it comes to using AI in areas like insurance, noting that "underwriting and claims assessment[s]….if not duly designed, developed and used, can lead to serious consequences for people's life, including financial exclusion and discrimination."

Many Data Protection Authorities ("**DPAs**") list AI as a top priority for 2022, with Spain becoming the first EU country to establish a Supervisory Agency specifically relating to AI in January 2022. Similarly, the ICO has stated a need to balance digital development against appropriate regulations. The form of that regulation is still to be determined in a forthcoming AI Whitepaper ("**AI Whitepaper**"), as was stated in the UK government's National AI Strategy. In particular, the AI Whitepaper must determine whether AI regulation should be centralized to cover all industries, such as with the proposed EU's AI Act, or de-centralized with regulation of AI and other emerging technologies being dealt with at an industry level. The ICO have also produced a draft AI toolkit ("**Toolkit**") which explains how to develop and deploy AI in a way that is data law compliant, which (re)insurers will find useful in designing any AI-based compliance regime. (Re)insurers should now consider how the developments in the regulation of AI may impact them, including identifying what and how AI is used within the business, and consider making use of the ICO's Toolkit.

d. Cybersecurity and 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, and by damages awarded in favor of individuals and organizations affected by a personal data breach.

Cybersecurity and data breach reporting requirements have remained priority issues for both companies and regulators throughout 2021 and into 2022. Ransomware and distributed denial-of-service ("**DDoS**") attacks are, according to the European Council, on the rise. The European Council noted that the average ransom fee demanded doubled between April 2020 and July 2021, while there have been more than 10 million DDoS attacks in the same period.[29] COVID-19 has also made the threat of cyberattacks more acute, with the European Council reporting an increase in healthcare data breaches and COVID-19-related phishing attacks dominating email threat campaigns. In addition, a recently

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

… (re)insurance and financial services businesses are vulnerable to attack because of their access to personal data relating to credentials (e.g., usernames and passwords). The report notes that credentials remain one of the most sought after types of data for hackers.

(Re)insurers should, in turn, seek to be proactive in maintaining strong, state-of-the-art security systems, particularly in light of the PRA's Statement in relation to the inclusion of appropriate security measures in outsourcing agreements …

The line between pseudonymized and anonymized data is a fine one, and so the UK government's proposal to clarify this is welcome — especially for (re) insurers who will regularly have to consider whether personal data relating to, for example policyholders, is sufficiently pseudonymized …

published Verizon report[30] states that (re)insurance and financial services businesses are vulnerable to attack because of their access to personal data relating to credentials (e.g., usernames and passwords). The report notes that credentials remain one of the most sought after types of data for hackers.

In turn, efforts are being made by regulators to respond to this increasing threat, with EU countries agreeing to strengthen cybersecurity measures across a range of industries through the EU's draft Cybersecurity Directive and a proposal for a Cybersecurity Resilience Act. The EDPB also published guidelines on examples regarding data breach notification in 2021. The examples provide practical guidance as to how companies should react when faced with a data breach. The ICO has also reported that cybersecurity is a key priority for them in 2022, with a particular focus on more "sophisticated" attacks.

(Re)insurers should, in turn, seek to be proactive in maintaining strong, state-of-the-art security systems, particularly in light of the PRA's Statement in relation to the inclusion of appropriate security measures in outsourcing agreements (see above). Measures that (re)insurers should consider will vary depending on the circumstances, but should include (i) pseudo-anonymization (this is especially important so individuals, e.g., policyholders, cannot be identified when personal data is being used, for example for 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 Post-Brexit

In addition to some of the UK divergences we have noted throughout this section, while the UK has implemented much of the EU GDPR into its own domestic laws, 2021 saw the UK take advantage of its post-Brexit independence from a data protection perspective and propose far-reaching reforms to its data protection regime in its public consultation entitled: "Data: A new direction" (the "**Consultation**"). The aim of the Consultation is to drive economic growth and innovation through a new strategy and approach to data protection, and depending on its actual implementation. The proposals included in the Consultation could result in significant divergences within the UK's data protection regime.

Important potential changes by the Consultation which could be particularly relevant to the (re)insurance industry include:

- A proposed clarification as to the meaning of "anonymized" and "pseudonymized" data. The distinction between the two concepts is important as only pseudonymized data falls within the scope of the GDPR. Pseudonymized data is personal data which has been processed such that it cannot be used to identify an individual without additional information; anonymized data is where a person is no longer identifiable at all. The line between pseudonymized and anonymized data is a fine one, and so the UK government's proposal to clarify this is welcome — especially for (re)insurers who will regularly have to consider whether personal data relating to, for example policyholders, is sufficiently pseudonymized (or whether it may in fact be considered anonymized and therefore outside the scope of the UK GDPR). The UK government will either place text from Recital 26 of the UK GDPR into legislation or adopt a statutory test based on the explanatory report accompanying the Council of Europe's modernized Convention 108.

- The proposed removal of the so-called legitimate interests "balancing test" under the UK GDPR. Currently, the UK GDPR requires controllers to identify a lawful ground before processing personal data. These grounds include processing that is necessary for the legitimate interest of the controller (Article 6(1)(f), UK GDPR). However, this can only be relied on to the extent the organization's interests are not outweighed by the interests of the individual (i.e., the "balancing test"). The UK government seeks to address this by removing the balancing test for a limited list of legitimate interests to be specified by the UK in future legislation. It remains to be seen whether that list would include processing activities relevant to those in the (re)insurance industry.

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

- A proposal to remove the 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 also be noted that the Consultation focuses on the insurance industry when providing examples of potential bias in AI systems (e.g., "insurers predicting someone's fitness levels from their purchasing habits" or "red lining poorer neighborhoods within the insurance industry," i.e., the refusal to approve products based on geographical location).

- A recognition by the UK of the difficulties with a perceived overreporting of personal data breaches, with the Consultation considering a need to report only "material" breaches.

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f. Cookies

Cookies are small text files that are downloaded onto "terminal equipment" like a computer or smartphone when the user accesses a website. In addition to any personal data processed in the context of cookies, which is governed by the GDPR, (re)insurers will also have additional obligations under the ePrivacy Directive and/or PECR. The ePrivacy Directive and PECR require (re)insurers utilizing cookies to (i) inform users that cookies are there, (ii) explain what cookies are doing and why, (iii) explain the potential consequences of not accepting cookies, and (iv) get a user's consent for non-essential cookies.

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Various DPAs (e.g., the ICO, the French Commission Nationale de l'informatique et des Libertés ("**CNIL**") and Italy's Garante) have published additional guidance on how organizations should implement these requirements, which has led to some divergence in approach when organizations look to update their cookies policy and cookie banner to obtain user consent, particularly if they have multinational operations. In turn, this is also an area of increased regulatory activity. For example, various DPAs have conducted audits into cookie compliance of company websites, and the French CNIL issued a €150 million fine against Google on December 31, 2021. The fine was for unlawful methods of refusing cookies on its Google and YouTube websites.

The ICO, among other commentators, have suggested that considerable change is needed regarding cookie laws, suggesting that the current method of accepting, rejecting, or tailoring cookies in the form of pop-ups on every website is causing "cookie fatigue," i.e., where individuals "consent" to cookie use without considering their data protection rights or wishes. Instead, the ICO has indicated that it may move towards an approach of integrating cookie compliance into the design of websites so that repeated consent is not requested of individuals. (Re)insurers should take note of any updated guidance in respect of cookies and monitor their existing cookie compliance to ensure it aligns with existing guidance.

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g. Contractual Provisions

While many areas of data protection compliance have been subject to major developments in recent years, it may come as a relief to note that there is a fairly developed market practice in regard to contractual provisions in the (re)insurance industry which provides some certainty for (re)insurers in 2022. For example: (i) the updates to the model Terms of Business Agreement by the LMA, the International Underwriting Association and the London & International Insurance Brokers Association in 2018, which incorporate controller-controller data sharing provisions; and (ii) in terms of policyholder notices, the LMA published its template privacy notice in 2018, which continues to be used by the industry. Nonetheless, this position should be read in conjunction with the updates that are required in respect of any international transfers related to such agreements and the ongoing enforcement action, particularly in the context of transparency requirements (see above).

h. Final Thoughts

The GDPR continues to have a significant impact on the way in which the (re)insurance industry processes personal data, as the EDPB, the ICO, and other national bodies continue to develop guidance and introduce new obligations on (re)insurers — most notably in the form of the New EU SCCs last year. Companies need to continue to be agile and adapt to the various developments imposed by case law, decisions, and guidance. Given recent enforcement action and regulatory attention towards areas relevant to the (re)insurance industry, for example how big data sets are used for pricing and underwriting, the (re)insurance industry will need to continue its efforts in this area of compliance. The (re)

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insurance industry should also consider how to align with privacy and cybersecurity compliance efforts in the U.S., Asia, and elsewhere which are also developing at pace. The sector should also be wary of how it uses emerging technologies like AI given the new EU AI Act and pending UK AI Whitepaper. Further, (re)insurers with international transfers in and out of Europe should continue to prioritize their Schrems II projects and determining how they will implement the EU SCCs, each of which will require an analysis of data flows from the EU to group companies or third-party vendors and others outside of the EEA. (Re)insurers with a UK presence must also consider whether they will move to the new UK IDTA or continue using EU SCCs with the UK Addendum. Failure to keep up with these legal obligations can result in significant sanctions and liabilities.

6. UK Cyber and Operational Resilience Update

Cyberattacks have surged in frequency over the past two years, leaving brokers inundated with claims from large-scale ransomware attacks.

Though restrictions were eased, the ongoing COVID-19 pandemic over the course of 2021 caused businesses to be subjected to continuing necessary digitization. Adaptation to restrictions came easier to businesses which had already made progress in digitizing customer interactions, moving their assets to the cloud, and enabling access to key organizational services for employees remotely. However, these efforts have meant a broader attack surface for cybercrime, thus increasing the likelihood of a major cyber breach. Cyberattacks have surged in frequency over the past two years, leaving brokers inundated with claims from large-scale ransomware attacks. The rise in cybercrime activity shows cyber criminals to be aware of this increased opportunity for extortion, theft, and sabotage. Ransomware has remained a persistent cyber risk with legal challenges. GDPR notification obligations are not the only considerations for compliance. Companies must also consider anti-terrorism, anti-money laundering laws, and sanctions and internal compliance. Some insurers are changing their policies to reduce the cover they offer for organizations with problematically low cyber controls. For example, AIG announced that it would tighten its cyber insurance terms, including a stricter underwriting process. There would be a series of additional questions for its customers questioning the security measures that they have in place. Where clients do not meet the required control level, their ransomware limit will be reduced by a specified level, suggesting that customers will be expected to bear losses in excess of the reduced limit under the policy. Another measure insurance companies are increasingly taking to mitigate a cyber threat is to provide financial compensation and emergency support services. These emergency support services are aimed at allowing insurance brokers to mitigate the damage caused when a cybersecurity risk is identified, and potentially avoid the cost of paying out.

Another way in which increased remote work may be shown to correlate to increased risk of cyberattack is seen when considering the impact of remote work on employees. According to business support data, UK workers have increased their working week by nearly 25%, while working remotely. A survey conducted by software company Tessian found that 52% of participants stated that the increased stress caused them to make more mistakes. Relatedly, 47% of participants admitted to having clicked on a phishing link. Thus, there is also a danger in employees' reduced capacity to remain diligent to a cyber threat.

While complete cybersecurity is not realistic, there are core cyber risk management controls that organizations may consider in order to reduce the likelihood that they will be victimized by a cyber breach. Technical mitigations may be put into place, such as multifactor authentication, secure backups, privilege access management, and training and awareness raising.

While complete cybersecurity is not realistic, there are core cyber risk management controls that organizations may consider in order to reduce the likelihood that they will be victimized by a cyber breach. Technical mitigations may be put into place, such as multifactor authentication, secure backups, privilege access management, and 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 key. The importance of resilience preparation and continuity planning is not lost on investors, shareholders, or regulators.

An organization should have a well-defined, stress-tested plan in place to ensure that effective decisions can be made, should a cyber event occur.

a. Cyber Insurance Market

With the rise of cybercrime activity over the past few years, the relevance of cyber insurance is vastly growing.

With the rise of cybercrime activity over the past few years, the relevance of cyber insurance is vastly growing. The difficulty is that, however, due to the unique nature of each organization's cyber risk profile and information assets, there is no market standard cyber insurance coverage. Further, some policies were not drawn up to take into account that some employees might be working remotely using their own personal devices, such as a personal computer. It is still to be seen how this point, as well as the issue of slower remote connection than that which is in the office, may affect existing policies.

With the rise in cyberattacks since the breakout of COVID-19 leading to a rise in insurance claims, unsurprisingly the rates for buying cyber insurance are soaring. According to a report from cyber insurance broker Howden, cyber insurance premiums have increased by nearly a third during the course of 2021, and this was due to a steep rise in ransomware strikes. Furthermore, some insurers are now changing their policies to reduce the cover that they offer, with the organization's own mitigation controls being used to measure the appropriateness of the cover given. This means that as ransoms grow and policies get stricter, preventative digital protection is particularly pressing.

Hence, there are greater risks of financial losses resulting from data breaches. Another notable effect of the increase in cyberattacks and premiums that we see is that organizations are increasingly resorting to setting up their own captive insurance companies as a result of the continuing hard market. The growth of captive insurance was a trend seen in 2020, which continued into 2021. However, it seems that companies which form captives still buy insurance in the traditional market, but do so in a more strategic and cost-effective manner. Captives can be a key part of an organization's risk management strategy as they can enable these organizations to understand and manage their risks better. Looking ahead, it seems that organizations which struggle to find coverages within their intended coverage and price points may increasingly adopt captive structures.

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

i. PRA

In August 2021, the PRA published a Dear CEO letter addressed to the CEOs of the largest regulated life and general insurance firms. The letter explained that the PRA will be asking these firms to carry out the next concurrent insurance stress test in 2022, as set out in its previous June 2020 letter. The letter sets out the timelines and scope of the 2022 stress test exercise, and looks to support these firms' planning.

The PRA notes that stress-testing is an important tool which allows supervisors and firms to understand the impact that real-world scenarios have on their balance sheets. It also gives the PRA insight into firms' and the market's financial resilience. This informs the PRA's view of a firm's management systems and allows it to better assess sector resilience and response to the potential occurrence of any similar scenario.

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The scope of the stress testing exercise for life insurers will primarily focus on economic stresses. Meanwhile, for general insurers, the stress-testing will focus on natural catastrophe perils and cyber underwriting risk. The insurance stress test is scheduled to launch in mid-May 2022, with firm submission set for mid-September, and feedback to the industry due to take place in December 2022.

ii. FCA and PRA

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

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

The FCA and PRA published their final Policy Statements on March 29, 2021 which announces the new Operational Resilience Requirements that come into force on March 31, 2022.

The FCA and PRA published their final Policy Statements on March 29, 2021 which announces the new Operational Resilience Requirements that come into force on March 31, 2022. The requirements apply to insurers, banks, building societies, designated investment firms, and e-money and payment services firms.

The new Operational Resilience Requirements state that before March 31, 2022, firms must (i) identify their important business services, (ii) set impact tolerances, meaning the firm's maximum tolerable disruption, (iii) carry out mapping and testing to a level of sophistication necessary to identify the above as well as to identify any vulnerabilities in its operational resilience, (iv) conduct lessons learned from exercises to identify, prioritize, and invest in their ability to respond to and recover from disruptions as effectively as possible, (v) develop internal and external communications plans for when important business services are disrupted, and (vi) prepare self-assessment documentation.

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

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

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

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

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

Firms should anticipate the likelihood of increased supervisory scrutiny on compliance with Operational Resilience Requirements from their home state and foreign regulators.

Firms should anticipate the likelihood of increased supervisory scrutiny on compliance with Operational Resilience Requirements from their home state and foreign regulators. For example, the PRA's Dear CEO Letter from January 2022 on Insurance Supervision confirms that operational resilience of the financial sector remains a strategic priority area and the regulator intends to review firms' programs and implementation. In addition, the Lloyd's Market Oversight Plan for 2022 confirms that Lloyd's will address any gaps in managing agent readiness with the new Operational Resilience Requirements as identified in the 2021 Operational Resilience Survey (see Section V.C.2.c).

It would do firms well to also bear in mind cyber reporting requirements, as set out by the FCA, PRA, and Lloyd's. Principle 11 of the FCA's Principal for Businesses and Lloyd's Minimum Standard 11 Cyber Resilience and Data Management assert that notification may be required for any Material Operational Incident, also known as a Material Cyber Incident. A cyber/operational incident may be "material" if it: results in significant loss of data, or the availability or control of IT systems, affects a large number of customers, or results in unauthorized access to, or malicious software present on, information and communication systems. Such incidents would need to be reported to the FCA and PRA immediately upon awareness and, in any event, within 72 hours to Lloyd's.

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

iii. EIOPA

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

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

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

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

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

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iv. European Commission

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

In 2021, the European Commission announced its plans to launch a Joint Cyber Unit which will act as a platform to ensure an EU-coordinated response to large-scale cyber incidents and crises.

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

The European Commission aims for the Joint Cyber Unit to move to the operational phase by June 30, 2022 and be fully established by June 30, 2023. The European Union Agency for Cybersecurity (ENISA) will serve as secretariat for the preparatory phase.

7. ESG Update

Initiatives relating to ESG have increasingly become a priority in the (re)insurance sector. 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 new 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.

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a. ESG in the Insurance Market

The past year saw companies increasingly taking action to evidence their commitment to ESG priorities.

The past year saw companies increasingly taking action to evidence their commitment to ESG priorities. The UN-convened Net-Zero Insurance Alliance, formed in July 2021, consists of the world's leading insurers and reinsurers who play a part in accelerating the transition to net zero emissions economies. The participants commit to individually transition their underwriting portfolios to net zero greenhouse gas emissions by 2050, in line with the 1.5 degrees Celsius target of the Paris Agreement, which came into force on November 4, 2016. The Net-Zero Insurance Alliance will work under the auspices of the UN Principles for Sustainable Insurance. The Alliance will be chaired by AXA, and other founding members include Allianz, Aviva, Generali, Munich Re, SCOR, Swiss Re, and Zurich.

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

b. Solvency II and ESG

The European Commission published its proposal to amend Solvency II on September 22, 2021. It highlighted that its review of Solvency II was an opportunity to ensure that the regulatory framework promotes long-term investment by the insurance sector and that the sector should play a role in financing the post-COVID-19 economic recovery.

The European Commission published its proposal to amend Solvency II on September 22, 2021. It highlighted that its review of Solvency II was an opportunity to ensure that the regulatory framework promotes long-term investment by the insurance sector and that the sector should play a role in financing the post-COVID-19 economic recovery. The Commission also considered whether the insurance sector could contribute to the EU's political priorities, including climate and environmental targets under the European Green Deal.

The proposal states that COVID-19 has caused concerning socio-economic damage whereby the EU economy is in need of a sustainable, inclusive, and fair recovery. This has made the objectives of the European Green Deal even more urgent. The European Green Deal is the EU's new growth strategy, which aims to transform the EU into a modern, resource-efficient, and competitive economy with no net emissions of greenhouse gases by 2050. The insurance and reinsurance sector can support these objectives by providing private sources of financing to European businesses and supplying protection against a wide range of risks to make the economy more resilient. The proposal pushes for some amendments to the European Green Deal. Under a new Article 45a, the proposal introduces a new take on climate scenario analysis. Insurers will have to identify any material exposure to climate change risks, and assess the impact of long-term climate change scenarios on their business, where relevant. Insurers classified as low-risk profile undertakings are exempted from scenario analyses. The amendments provide two mandates to EIOPA relating to sustainability risks where, by 2023, it may explore a dedicated prudential treatment of asset or activity exposures which relate substantially with environmental and/or social objectives, including a regular review of the scope of the standard formula relating to natural catastrophe risk.

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Additionally, the Commission takes the view that the prudential framework should be adjusted to better take into account the long-term nature of the insurance business. In particular, this could be done when the relevant insurer is calculating its regulatory capital requirement, which are standardized regulations that determine how much liquid capital must be held vis-à-vis a certain level of their assets. This could be done by facilitating the use of a more favorable standard parameter for equity investments, which are held with a long-term perspective, which the Commission considers should not undermine policyholder protection and financial stability. This view comes after the Commission made a commitment to integrate the management of climate and environmental risks better into the EU's prudential framework in its Communication of December 11, 2019 on the European Green Deal. In its Communication of July 6, 2021 on a Strategy for Financing the Transition to a Sustainable Economy, the Commission committed to propose amendments to Solvency II to consistently integrate sustainability risks in risk management of insurers. Fitch Ratings suggests that while life insurers are well-placed to invest in longer-term assets, such as environmentally sustainable infrastructure and renewable energy projects, given their long-term investment horizon, they are constrained by somewhat unduly high capital requirements. Such high capital requirements may be set to change through reforms to reduce the risk margin provision that insurers must hold against certain long-term business and to lower the capital charges for equities that are treated as "long-term." The benefit of this for insurers and their policyholders may come in higher returns that may be available on longer-term, though often illiquid, assets. The change is expected to be gradual as investors will need time to source the investments that they consider to be suitable. Some insurers may initially use the capital that is freed up by the reforms to purchase more readily available shorter or medium-term assets, to invest internally, or to support shareholder distributions.

c. Lloyd's and ESG

Announced in its October 2021 release, Lloyd's has mandated that managing agents must create an ESG framework and strategy in 2022, for sign-off in the 2023 business planning cycle. Lloyd's has consulted extensively with regulatory authorities, governments, NGOs, the market, and other key stakeholders with a view to further develop its ESG strategy. This is following its first ESG report, published in December 2020, which sets out its plans for enabling a more sustainable insurance and reinsurance marketplace. On this, Chief Risk Officer, David Sansom, noted "this approach will need to be supported with a concerted effort by all market participants in putting their own ESG strategy in place which considers the wider responsibilities we have collectively and individually to fulfil our social purpose." It is the intent of Lloyd's to align its ESG strategy and activities with government policy in achieving its goal net zero greenhouse gas emissions by 2050. As well as committing to achieve net zero by 2050, Lloyd's has also committed to transparently report on its progress towards achieving this goal.

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In support of its goal of achieving net zero, Lloyd's will develop a climate transition measurement framework, through the SMI Insurance Task Force. This framework will allow Lloyd's to track and measure the market's progress in transitioning towards a net zero underwriting position by 2050. Lloyd's expects to implement a "Sustainability Transparency and Reporting" regime from 2023 onwards to get the first market-wide aggregate baseline view of the carbon contribution of underwriting portfolios to track and report against.

In support of its goal of achieving net zero, Lloyd's will develop a climate transition measurement framework, through the SMI Insurance Task Force.

The 2021 Lloyd's ESG report acknowledges that continuing to provide reinsurance for carbon-intensive businesses will increasingly become unsustainable, as climate risks intensify. However, the report does note that there would be detriment to the competitiveness of Lloyd's, to risk becoming a market of last resort for carbon-intensive industries where business models will become increasingly unviable. Regardless, Lloyd's commits to continuing to support sectors where there is a credible climate transition plan in place, which can be measured or tracked in the years ahead.

The drive within Lloyd's on ESG is further illustrated by the fact that the CEO of Lloyd's urges the insurance and reinsurance marketplace to see the transition as an opportunity, rather than a threat, as new products which support sustainable energy as a part of the ESG agenda of Lloyd's will be launched this year.

In establishing a successful ESG framework, two key priorities for managing agents will be satisfying the relevant regulations and requirements, and identifying how they can achieve internal ESG credentials. Another consideration will be the speed of the transition to establish a successful ESG framework, ahead of the 2023 business planning cycle. The transition is likely to have internal cultural impacts. Managing agents who are too small to have dedicated ESG functions may consider measures to drive ESG governance, such as board-level task forces and steering groups.

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Further highlighting the Lloyd's market's focus on ESG, specialty insurer Beazley announced the launch of its ESG-focused Lloyd's syndicate, Syndicate 4321, with effect from January 1, 2022. Syndicate 4321, serving as the first ESG-focused syndicate of Lloyd's, concentrates on offering additional capacity to businesses which perform well against ESG metrics. Beazley has partnered with rating agencies to provide ESG data, and will use the rating agencies' scoring categorizations to determine which clients are eligible. The premiums received by Syndicate 4321 will be invested in line with the company's Responsible Investment Strategy.

d. FCA Consultation on Climate-Related ESG Disclosures

On December 17, 2021, the FCA published its policy statement on enhancing climate-related disclosures by life insurers, FCA-regulated pension providers, and asset managers. In the policy statement, the FCA clarified its intended scope of firms and products. It also made some changes to the rules and guidance it previously consulted on in June 2021, which proposed mandatory annual disclosures at entity and product level. The policy statement aims to increase transparency on climate-related risks

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and opportunities, and to enable clients and consumers to make considered choices. It summarizes the feedback received to its earlier consultation and confirms the FCA's final policy position. The rules take effect through a new ESG sourcebook in the FCA handbook and came into effect on January 1, 2022 for the largest in-scope firms, and from January 1, 2023 for smaller firms above the £5 billion exemption threshold. The first public disclosures must be made by June 30, 2023.

The new rules introduce entity level and product level disclosures relating to sustainability risks which are aligned with the TCFD recommendations. For insurance companies, TCFD in-scope business covers the provision of insurance based investment products ("**IBIPs**"), operating a personal pension scheme or stakeholder pension scheme, and operating a SIPP (that contains an IBIP). Only disclosures of core metrics using Task Force on Climate-related Financial Disclosures are mandated by the FCA. Meanwhile, additional metrics will only need to be disclosed as far as reasonably practicable.

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

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

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

The UK government is set on extending the scope of non-financial reporting over the next two to five years. This includes UK Green Taxonomy alignment reporting and disclosure of net zero transition plans.

The current regime under the UK Companies Act 2006 implements the requirements of the Non-Financial Reporting Directive, and requires a large UK company with over 500 employees to include a non-financial information statement in their strategic report with an obligation to disclose information about the company's development, performance and position, and the impact of its activity in relation to environmental matters, among others. The disclosures required in the strategic report will be extended in April 2022 to mandatory TCFD-aligned disclosures. In addition, a director's report, as outlined in the UK Companies Act 2006, must disclose a company's energy consumption and greenhouse gas emissions, if that company consumes more than 40,000 kWh of energy. The UK government is set on extending the scope of non-financial reporting over the next two to five years. This includes UK Green Taxonomy alignment reporting and disclosure of net zero transition plans.

The EU Non-Financial Reporting Directive (2014/95/EU) ("**NFRD**") amends the EU Accounting Directive (2013/34/EU) and requires a large public-interest entity (e.g., listed companies, insurance undertakings) with more than 500 employees to make disclosures on the company's development, performance, position, and impact of its activity in relation to environmental, social, employee, human rights, and anti-corruption matters. The NFRD's disclosures involve the concept of double-materiality (i.e., disclosures on the impact the company has as well as the impact of external factors on the company). As an EU directive, the NFRD applies to in-scope member states' entities in accordance with its implementation under member states' local law. The EU's proposal for a Corporate Sustainability Reporting Directive ("**CSRD**") seeks to widen the scope and extent of disclosures required by the NFRD with further amendments to the Accounting Directive. The CSRD would apply to all large companies; all companies with securities listed on EU regulated markets (regardless of size); credit institutions; and insurance companies. Such entities would be required to provide far more extensive disclosures than is required under the NFRD in relation to their impact on sustainability matters, as well as information on how sustainability matters affect the company's development, performance, and position, including with specific reference to principal adverse impacts. The proposed CSRD would apply from January 1, 2023. 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.

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