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CLIENT ALERT

NAIC Report: 2023 Fall National Meeting

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The 2023 Fall National Meeting (the "Fall National Meeting") of the National Association of Insurance Commissioners (the "NAIC") was held from November 30 to December 4, 2023 in Orlando, Florida with attendees participating virtually or in person.

Welcoming a record number of attendees since the COVID-19 pandemic, NAIC President and Director of the Missouri Department of Commerce and Insurance Chlora Lindley-Myers opened the Fall National Meeting by noting that, "As state insurance regulators, we do not travel much in the world of predictability….The predictability of unpredictability leads us to work hard to make sure consumers are covered, prepared and supported for whatever may come their way." In the face of the unexpected, she praised the NAIC for upholding its mission to address challenges and opportunities facing insurance supervisors, consumers and industry, including climate risk, cybersecurity concerns, reinsurance costs and inflationary pressures.

Highlights from the Fall National Meeting include:

- Bond Project: At the 2023 Summer National Meeting of the NAIC (the "Summer National Meeting"), the NAIC adopted its new, principles-based bond definition aimed in part at ensuring that collateralized loan obligations and rated notes are not automatically reported as "bonds" without regard to their underlying structures. It is now nearing the final stages of additional amendments to implement this definition throughout statutory accounting reporting requirements.

- Framework for Insurer Investment Regulation: The Financial Condition (E) Committee (the "(E) Committee") received initial public comments on the proposed *Framework for Regulation of Insurer Investments – A Holistic Review* (the "Insurer Investment Framework").

- Negative IMR Accounting Treatment: Following the adoption of INT 23-01T at the Summer National Meeting, SAPWG voted to establish a long-term initiative aimed at capturing accounting guidance for asset valuation reserve ("AVR") and interest maintenance reserve ("IMR") in SSAP No. 7 – *Asset Valuation Reserve and Interest Maintenance Reserve*.

- SVO Review of CRP Ratings: The Valuation of Securities (E) Task Force exposed a revised version of the amendment to the *Purposes and Procedures Manual* of the NAIC Investment Analysis Office (the "P&P Manual") that permits the SVO Senior Credit Committee ("SVO SCC") to place "under review" a filing-exempt security with an NAIC Designation determined by a credit rating provider ("CRP") rating that appears to be an unreasonable assessment of risk.

- NAIC Adopts Accreditation Standard for the Group Capital Calculation: The Executive and Plenary adopted the accreditation standard for the NAIC's 2020 amendments to the Holding Company Models, which implement the annual filing requirements for the Group Capital Calculation and Liquidity Stress Test. This standard becomes effective on January 1, 2026.

- Artificial Intelligence ("AI") Bulletin: The Executive and Plenary adopted the *Model Bulletin on the Use of Artificial Intelligence Systems by Insurers* (the "AI Bulletin").

- Climate Resiliency Strategy for Insurance: The Climate and Resiliency (EX) Task Force adopted the NAIC's Climate Resiliency Strategy for Insurance (the "Climate Strategy"), which formalizes the actions the NAIC will take, both pre- and post-disaster, to strengthen climate resilience.

NAIC members also elected the following officers for 2024:

- President: Connecticut Insurance Commissioner Andrew N. Mais
- President-Elect: North Dakota Insurance Commissioner Jon Godfread
- Vice President: Virginia Commissioner of Insurance Scott A. White
- Secretary-Treasurer: Rhode Island Department of Business Regulation Director Elizabeth (Beth) Kelleher Dwyer.

The NAIC membership also recognized Louisiana Commissioner of Insurance James J. Donelon, who will be retiring at the end of 2023 after more than 40 years in public service.

The report below further summarizes key activities at the Fall National Meeting, certain interim conference calls, and other developments leading up to the Fall National Meeting, that may be of interest to our clients in the insurance industry.

NAIC Report: 2023 Fall National Meeting

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GLOSSARY

"AG 53" means *Actuarial Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves*.

"AI/ML" means artificial intelligence and machine learning.

"Bond Project" means the NAIC's principles-based bond project, which aims to clarify what should be considered and reported as a bond on Schedule D-1 (Long-Term Bonds) of an insurance company's statutory financial statements and to improve accounting and reporting.

"Certified Reinsurer" means a reinsurer that is domiciled in a "Qualified Jurisdiction" (meaning a non-U.S. jurisdiction listed on the NAIC list of "Qualified Jurisdictions" established pursuant to the *NAIC Process for Evaluating Qualified and Reciprocal Jurisdictions*) that is eligible to qualify for reduced reinsurance collateral pursuant to the 2019 amendments to the Credit for Reinsurance Models.

"Code" means the Internal Revenue Code of 1986, as amended.

"Considerations" means the *Regulatory Considerations Applicable (But Not Exclusive) to Private Equity Owned Insurers*.

"Covered Agreements" means the U.S./EU Covered Agreement and the U.S./UK Covered Agreement, both as defined below.

"Credit for Reinsurance Models" means the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786).

"Dodd-Frank" means the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

"ERISA" means the Employee Retirement Income Security Act of 1974.

"Executive and Plenary" means all of the U.S. state insurance commissioners in plenary session along with the NAIC's Executive (EX) Committee.

"Federal Reserve" refers to the Board of Governors of the Federal Reserve System.

"FSOC" means the U.S. Department of the Treasury's Financial Stability Oversight Council.

"GCC" means the group capital calculation that was developed by the Group Capital Calculation (E) Working Group and adopted by the NAIC in December 2020. It is a tool that uses an RBC aggregation methodology for all entities within the insurance holding company system, including non-U.S. entities.

"Holding Company Models" means the NAIC's Insurance *Holding Company System Model Act* (#440) and the *Insurance Holding Company System Model Regulation with Reporting Forms* (#450).

"LST" refers to the Liquidity Stress Test, an annual filing by a life insurance company that satisfies the test's scope criteria pursuant to the relevant state's insurance holding company laws. The LST filing provides an insurance regulator with quantitative and qualitative insights for macroprudential surveillance.

"Reciprocal Jurisdiction Reinsurer" or "RJR" means a reinsurer that is domiciled in a "Reciprocal Jurisdiction" (meaning a non-U.S. jurisdiction listed on the NAIC list of "Reciprocal Jurisdictions" established pursuant to the NAIC *Process for Evaluating Qualified and Reciprocal Jurisdictions*) that is eligible to qualify for zero reinsurance collateral pursuant to the 2019 amendments to the Credit for Reinsurance Models.

"SEC" means U.S. Securities and Exchange Commission.

"SIFI" means a systematically important financial institution designated by FSOC.

"SSAP" means Statement of Statutory Accounting Principles.

"U.S./EU Covered Agreement" means the *Bilateral Agreement Between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance* entered into by such parties on September 22, 2017.

"U.S./UK Covered Agreement" means the *Bilateral Agreement Between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance* entered into by such parties on December 11, 2018.

I. Financial Condition Regulation

A. Work Continues on the Proposed Framework for Insurer Investment Regulation

At the Summer National Meeting, the (E) Committee voted to expose the Insurer Investment Framework, available **here**. The Insurer Investment Framework's primary objective is to highlight areas where the insurance regulatory framework could be enhanced in order to strengthen oversight of insurers' investments in complex assets, taking into account feedback on the NAIC's current workstreams related to insurer investments and the limited resources of state regulators. The document proposes specific regulatory changes to the NAIC's Securities Valuation Office, such as: (i) reducing/eliminating "blind" reliance on CRPs, while retaining some utilization of CRPs, coupled with the implementation of a due diligence framework; (ii) bolstering the SVO's capabilities in regard to portfolio risk analysis by investing in a risk analytics tool and additional personnel; and (iii) potentially establishing an investment working group under the (E) Committee that would serve in an advisory role for several investment processes, such as reviewing bond reporting analysis under the principles-based bond definition and challenging individual designations provided by CRPs, as previously reported **here**.

The proposed Insurer Investment Framework remains in its early stages of development, with the (E) Committee receiving initial public comments from various parties at the Fall National Meeting, including insurance companies, trade group representatives and interested regulators. Set forth below is a summary of the parties' general comments:

- Interested parties recognize that investment portfolios in the insurance industry have changed in recent years, with large increases in allocations to complex securities. As a result, there is strong support for the (E) Committee's initiative because it is necessary to conduct a comprehensive review of the NAIC's investment-related initiatives that are currently underway.
  - The American Investment Council expressed concern that certain NAIC initiatives are proceeding at a pace that is too fast and inconsistent with the principles set forth in the Insurer Investment Framework. For example, the SVO's modeling of collateralized loan obligations ("CLOs") that will begin in 2024 and the increase in the risk-based capital ("RBC") factor for structured security residual tranches for year-end 2024 RBC filings are significant changes that warrant additional time and consideration before implementation.
- Several commenters emphasized that the (E) Committee's process should be transparent given the complex nature of structured investments.
- One interested party stated that the (E) Committee should prioritize the study of how developing technology can improve the way that insurance regulators quantify the risk of individual securities.

- Several commenters expressed support for retaining an outside consultant, as set forth in the draft document, citing the challenges in addressing accounting, risk assessment and capital adequacy issues.
- The Nebraska Department of Insurance voiced support for the formation of an investment working group as a way to promote collaboration and ensure that regulatory guardrails are appropriate for financial statement reporting, risk assessment and the implementation of RBC charges.

The (E) Committee plans to address specific comments on the proposed Insurer Investment Framework in early 2024.

B. Valuation of Securities

1. *NAIC Designations*

The Valuation of Securities (E) Task Force ("VOSTF") continues to consider an amendment to the definition of "NAIC Designation" in the P&P Manual aimed to refine this definition. Currently, the term is separately defined in different parts of the P&P Manual, depending on whether an NAIC Designation is (i) assigned by the SVO, with respect to securities required to be filed with the SVO for assessment, or (ii) directly translated from a CRP rating, for securities that are "filing exempt." NAIC Designations are used as an indication of risk in a number of NAIC processes, including credit quality assessment of investments by the SVO, assignment of RBC factors, statutory accounting valuation, state investment regulations that incorporate NAIC guidance and determining eligibility of reinsurance collateral.

At the Summer National Meeting, VOSTF discussed a proposed amendment to the definition that included language stating that:

> *An NAIC Designation shall reflect the likelihood of timely and full payment of principal and scheduled periodic interest, as appropriate and the probability of principal and interest payment default. It will also reflect consideration of potential "tail risks" (e.g., the probability that a security's payment default will be more than three standard deviations from the mean is greater than what is shown by a normal distribution).*

The proposal also provided guidance on the use of the "Subscript S Symbol," which the SVO is directed to assign as part of an NAIC Designation to securities that reflect "other non-payment risks," such as where governing agreements permit irregular or conditional payments. Interested parties raised concerns in August that this proposal would expand the scope of the SVO's authority by adding additional risks or factors to the NAIC Designation process and allowing it to apply the Subscript S concept to CRP ratings (essentially removing investments with "other non-payment risks" from the filing exemption).

At the Fall National Meeting, NAIC staff presented a revised version of the proposed amendment that includes a "more concise definition" of an NAIC Designation. Among other changes, the revised version has removed the language noted above, replacing it with more limited guidance that "[w]here appropriate for a given investment, NAIC Designations shall reflect 'tail risk' and/or loss given default" and that "NAIC Designations and Designations Categories shall reflect… other non-payment risks or non-payment mitigants." Additionally, the revised version removes application of the Subscript S concept for other non-payment risks. The updated amendment is exposed for comment until January 26, 2024.

2. *Rating Agency Matters*

VOSTF continues to refine a proposed amendment to the P&P Manual to address concerns with the existing reliance on CRP ratings in the filing exemption process. This initiative dovetails with the NAIC's broader private equity initiative (as discussed in Section II.A.1 below). During 2023, VOSTF's approach has shifted from a proposal that would have sought to make "structured equity and funds" investments ineligible for filing based on CRP ratings, towards a more nuanced "yellow light" approach that would provide a process for the SVO to review and potentially challenge a CRP rating for a specific filing-exempt investment.

Following an initial exposure in May 2023, VOSTF received comments at the Summer National Meeting that included criticism of the lack of transparency in the proposed process, potential inconsistent treatment of insurers and securities and market uncertainty that the proposed process could introduce. NAIC and SVO staff defended the proposal in August, but indicated that comments would be reviewed "in good faith" with an eye towards increased transparency. A further revised draft of the amendment (available **here**) was discussed at the Fall National Meeting.

The amendment continues to provide a process by which the SVO can "challenge" a security's filing-exempt status based on a CRP rating, but it incorporates feedback from interested parties. In short, the amendment permits the SVO SCC to place "under review" a filing-exempt security with an NAIC Designation determined by a CRP rating that appears to be an unreasonable assessment of risk. If a security is placed "under review," SVO SCC will gather information from insurers that hold the security and will perform a full analysis. If SVO SCC determines that the NAIC Designation assigned through the filing exemption process is three or more notches different from its post-analysis opinion, the CRP rating for that security will be removed from the filing exemption. These determinations would be subject to oversight by a sub-group of VOSTF, as well as an appeal process permitting insurers to appeal to the VOSTF chair (if P&P Manual procedures were not followed) or to request a third-party blind review of the security, which could override SVO SCC's determination.

This revised amendment to the P&P Manual is exposed for comment until January 26, 2024.

3. *CLO Modeling Update*

In February 2023, VOSTF adopted revisions to the P&P Manual to give SVO the responsibility for modeling CLO investments. This modeling is intended to facilitate the assignment of appropriate NAIC designations to CLO tranches and to reduce reliance on CRP ratings. The CLO Ad Hoc Working Group (formed by VOSTF to develop the technical specifications for the modeling process) has been working throughout 2023 with regulators and industry representatives through regular calls. At the Fall National Meeting, NAIC staff reported that the CLO Ad Hoc Working Group is “proceeding with haste” in developing a modeling methodology. The SVO is expected to begin CLO modeling with year-end 2024 financial reporting, with the potential to extend to 2025 if work is delayed.

C. RBC Matters

1. *Residual Tranches*

At the Summer National Meeting, the NAIC implemented an interim RBC factor for structured security residual tranches of 30% for year-end 2023 RBC filings, which is scheduled to rise to 45% for year-end 2024 RBC filings (pending any further action by the NAIC’s Risk-Based Capital Investment Risk and Evaluation (E) Working Group (the “RBCIRE WG”) to amend the factor). Also in August, SAPWG exposed proposed revisions to SSAP No. 48 – *Joint Ventures, Partnerships and Limited Liability Companies* to clarify that investment structures within the scope of the SSAP that represent residual interests or predominantly hold residual interests should be reported on the dedicated residual reporting line on Schedule BA. SAPWG voted to adopt these revisions with minor changes during an interim meeting on September 21, 2023. Investments captured as residual interests will be subject to the interim 30% RBC factor at year-end 2023.

D. Statutory Accounting

1. *IMR Matters*

In July 2023, SAPWG adopted INT 23-01T as a limited-time, optional interpretation of statutory accounting principles that permits reporting entities to admit net negative IMR up to 10% of their adjusted general account capital and surplus, subject to certain restrictions as well as reporting and disclosure requirements. These restrictions and requirements, along with further background on the NAIC’s process, are described in detail in our Client Alert available **here** and in a disclosure memo published by the Blanks (E) Working Group, available **here**. INT 23-01T is in effect for insurers’ 2023 year-end reporting and will remain effective until December 31, 2025 (automatically expiring on January 1, 2026), unless adjusted by SAPWG.

With INT 23-01T in place as an interim solution, SAPWG is focused on developing a long-term solution for the treatment of net negative IMR, as well as formalizing IMR/AVR guidance within the SSAPs. At the Fall National Meeting, SAPWG voted to establish a long-term project dedicated to this initiative (Agenda Item #2023-14) that will develop accounting guidance for AVR and IMR in SSAP No. 7 – *Asset Valuation Reserve and Interest Maintenance Reserve*. This agenda item identifies a number of IMR/AVR-related discussion areas for consideration by SAPWG (including guidance for treatment of net negative IMR), and proposes that a corresponding issue paper ultimately be produced to detail revisions stemming from the project. SAPWG also adopted a separate proposal (Agenda Item #2023-15) to correct guidance in the annual statement instructions that appear to direct entities to allocate non-interest-related losses to IMR rather than to AVR.

To support the broader IMR project, SAPWG has formed an IMR Ad Hoc Group that includes members of SAPWG, as well as actuarial and investment industry representatives. The group currently meets weekly to discuss IMR-related topics, such as the ultimate purpose of IMR in the statutory accounting framework, with the goal of making future recommendations to SAPWG.

2. *Bond Project*

The NAIC's Bond Project is intended to clarify which securities should be reported as a bond on Schedule D-1 (Long-Term Bonds) to an insurance company's statutory financial statements, and to improve accounting and reporting of these investments. The Bond Project grew out of concerns that certain structured securities were potentially being inappropriately reported as bonds on Schedule D-1 and receiving more favorable accounting treatment as debt. SAPWG has developed a new, principles-based bond definition, which at a high level defines a "bond" as "any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security." In August, SAPWG adopted revisions to SSAP No. 26R and SSAP No. 43R to incorporate this definition, with such changes becoming effective on January 1, 2025.

SAPWG is developing other statutory accounting revisions related to the Bond Project. At the Fall National Meeting, SAPWG discussed proposed changes to SSAP No. 21R – *Other Admitted Assets* to provide guidance for debt securities that do not qualify as bonds and to detail the accounting for residual tranches, as well as to reflect recent changes to SSAP No. 48 on the definition of residual tranches.

In Orlando, SAPWG voted to expose this updated draft of SSAP No. 21R for further public comment until January 22, 2024. This item has a shortened exposure period to ensure that SAPWG has sufficient time to adopt any revisions before the Blanks (E) Working Group adopts changes to Schedule BA related to the Bond Project. As consideration of this SSAP remains ongoing, SAPWG also directed NAIC staff to continue to update the draft Bond Project issue paper (available **here**) to reflect further discussions.

3. *INT 23-04T*

In response to inquiries received from industry and regulators in the context of the ongoing liquidation of Scottish Re (US), NAIC staff have prepared a draft temporary interpretation (INT 23-04T – *Scottish Re Life Insurance Liquidation Questions*) addressing the accounting and reporting of reinsurance recoverables from that entity. The initial draft of this interpretation was exposed for comment after an October 23, 2023 SAPWG meeting. That draft, which was originally framed to apply generically to any life insurer in liquidation, has now been limited to apply specifically to Scottish Re and to reflect comments from regulators and interested parties regarding admissibility of recoverables. This revised draft was discussed by SAPWG at the Fall National Meeting, and subsequently exposed for a shortened comment period ending December 29, 2023, with further discussions planned to follow in January.

II. Macroprudential Risk and Insurance Industry

A. Macroprudential Initiatives at the NAIC

1. *Status of Private Equity Considerations Work Plan*

The Macroprudential (E) Working Group (the "MWG") provided a brief update on certain Considerations since a detailed status report was recently given at the Summer National Meeting, as previously reported **here**, and noted that there will be more progress to report in the spring of 2024. A summary of the current status of the thirteen Considerations is set forth below:

- Consideration One (*Structuring Contracts in a Holding Company System*): Regulators may not be obtaining a clear picture of risk due to holding companies structuring contractual agreements in a manner to avoid regulatory disclosures and requirements. Related party agreements, which impact an insurer's risks, may also be structured to avoid disclosure (for example, by not including the insurer as a party to the agreement).

- Consideration Two (*Control*): Control is presumed to exist where ownership is greater than or equal to 10% of an insurer's voting securities, but control and conflict of interest considerations may exist with less than 10% ownership. For example, a party may exercise a controlling influence over an insurer through board and management representation or contractual arrangements, including non-customary minority shareholder rights or covenants, investment management agreement ("IMA") provisions, such as onerous or costly IMA termination provisions, or excessive control or discretion given over the insurer's investment strategy and its implementation.

    - **Status of Considerations One and Two**: The MWG has referred these Considerations to the Group Solvency Issues (E) Working Group, which has discussed enhancing regulator training and best practices surrounding insurance company acquisition transactions and "control" determinations. A drafting group is developing "best practices" for regulatory review in this area. After such best practices are developed, the drafting group will consider whether any should be proposed for inclusion in NAIC handbooks, or if other actions should be considered.

- Consideration Three (*IMAs*): The material terms of an IMA and whether they are arm's length or include conflicts of interest—such as the amount and types of investment management fees paid by the insurer, the termination provisions (how difficult or costly it would be for the insurer to terminate the IMA) and the investment manager's degree of discretion or control over investment guidelines, allocation and decisions.

    - **Status of Consideration Three**: This Consideration has been referred to the Risk-Focused Surveillance (E) Working Group (the "RFSWG"), which is turning from its project to update guidance in the Financial Analysis Handbook and Financial Condition Examiners Handbook regarding affiliate service agreements to work on more targeted guidance related to affiliated IMAs. At the Summer National Meeting, the RFSWG formed a drafting group of regulators to develop guidance for NAIC handbooks regarding affiliated IMAs.

- Consideration Four (*Asset-Liability Matching*): Owners of insurers, regardless of type and structure, may be focused on short-term results that may not be in alignment with the long-term nature of liabilities in life insurance products.

    - **Status of Consideration Four**: This Consideration is addressed by AG 53, developed in 2022, which requires additional disclosures related to private equity and complex assets supporting annuities, pension risk transfers and other life insurance products.

      The Valuation Analysis (E) Working Group formed a sub-group with actuarial, investment and financial expertise (the "Review Group") to review the initial set of AG 53 filings submitted by 246 in-scope life insurers. A targeted review was used to identify high priority issues in the filings, such as outlier high net yield assumptions for investment returns. The cause for regulatory concern is that if an insurer assumes unreasonably high investment returns, it may not have enough assets set aside for reserves, which could impact its ability to pay future claims. For life insurers in this category, the Review Group met with their domiciliary regulators in an effort to decrease the highest net yield assumptions.

      Due to increased activity in non-traditional reinsurance, the Review Group was also focused on reinsurance collectability, in particular: (i) whether the relevant reinsurer had enough assets to pay reinsurance claims in moderately adverse conditions, and (ii) whether significant reinsurance risks were appropriately addressed in the ceding insurer's asset adequacy analysis projections.

      The Review Group will continue to engage with life insurers and their domiciliary regulators to address high priority issues identified in the filings.

      The MWG also referred Consideration Four to the Risk-Focused Surveillance (E) Working Group for review, such as suggesting guidance for appropriate entities to provide capital maintenance agreements.

- Consideration Five (*Operational Oversight*): Operational, governance and market conduct practices may be effected by the different priorities and level of insurance experience possessed by entrants into the insurance market without prior insurance experience, including, but not limited to, private equity ("PE") owners.

- **Status of Consideration Five**: At the Summer National Meeting, the MWG Chair Bob Kasinow (NY) reported that the MWG can now turn its attention to this Consideration because it has completed the reinsurance worksheet with respect to Consideration Thirteen (see below).

- Consideration Six (*PE Definition*): There is no uniform or widely accepted definition of PE; there are challenges in maintaining a complete list of insurers' material relationships with PE firms.

  - **Status of Consideration Six**: No action will be taken on this Consideration since regulators agree the focus should be on activities and not specific types of owners.

- Consideration Seven (*Related Party Investments*): The lack of identification of related party-originated investments (including structured securities). This may create potential conflicts of interests and excessive and/or hidden fees in the portfolio structure, as assets created and managed by affiliates may include fees at different levels of the value chain—for example, a CLO, which is managed or structured by a related party.

  - **Status of Consideration Seven**: This Consideration is addressed by the financial statement related party transaction reporting requirements effective for year-end 2022 as reported **here**.

- Consideration Eight (*Affiliate Investments within Structured Securities*): Although the NAIC's Annual and Quarterly Statement blanks include affiliate investment disclosures, it is not easy to identify underlying affiliate investments and/or collateral within structured security investments. Also, transactions may be excluded from affiliate reporting due to nuanced technicalities. Regulatory disclosures may be required to identify underlying related party and subsidiary, controlled and affiliated investments and/or collateral within structured security investments (e.g., loans in a CLO issued by a corporation owned by a related party).

  - **Status of Consideration Eight**: The approach to this Consideration overlaps with Consideration Seven (related party reporting requirements) and Consideration Ten (privately structured securities).

- Consideration Nine (*Disclaimers of Affiliation*): Broader considerations exist around asset manager affiliates (not just PE owners) and disclaimers of affiliation avoiding current affiliate investment disclosures.

  - **Status of Consideration Nine**: This Consideration is addressed by the Schedule Y, Part 3 reporting requirement, which went into effect for year-end 2021, to identify all entities with a greater than 10% ownership regardless of whether a disclaimer is in place. SAPWG's ongoing Bond Project further addresses this Consideration.

- Consideration Ten (*Increased Risk from Certain Investments*): The material increases in privately structured securities (both by affiliated and nonaffiliated asset managers), which introduce other sources of risk or increase traditional credit risk, such as complexity risk and illiquidity risk and involve a lack of transparency.

    - **Status of Consideration Ten**: As described under Consideration Four above, this is addressed by AG 53, since it includes disclosure requirements for the referenced risks. The MWG also referred this Consideration to VOSTF, which (along with related NAIC groups) has been working on a project to determine appropriate RBC charges for CLOs held by insurers. For more information, see **Section I.A**, "Work Continues on the Proposed Framework for Insurer Investment Regulation" above.

- Consideration Eleven (*Reliance on Ratings*): The level of reliance on rating agency ratings and their appropriateness for regulatory purposes (e.g., accuracy, consistency, comparability, applicability, interchangeability and transparency).

    - **Status of Consideration Eleven**: Since referral by the MWG of this Consideration, VOSTF has been actively engaged on this topic. For more information, see **Section I.B.2**, "Rating Agency Matters", above.

- Consideration Twelve (*Pension Risk Transfer Risks*): The trend of life insurers engaging in pension risk transfer ("PRT") business and supporting such business with the more complex investments outlined above.

    - **Status of Consideration Twelve**: This Consideration is addressed by certain prior NAIC actions, including (i) AG 53 (see Consideration Four, above); (ii) the new charge added to the 2021 Life Risk-Based Capital Formula related to longevity risk transfer business, which regulators will monitor; and (iii) modifications to the reporting of PRT transactions adopted by SAPWG in May 2021.

      The Life Actuarial (A) Task Force is also considering the development of PRT/longevity risk mortality factors but there have been no updates on such projects. In addition, NAIC staff is holding discussions with U.S. Department of Labor ("DOL") representatives and industry groups. In August, MWG Chair Bob Kasinow (NY) highlighted the DOL's work to update its Interpretive Bulletin 95-1, related to fiduciary standards under ERISA with respect to annuity providers, as a developing area for insurance regulators and interested parties to follow.

- Consideration Thirteen (*Offshore Reinsurers*): Insurers' use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency, reduce reserves, increase investment risk and introduce complexities into the group structure.

    - **Status of Consideration Thirteen**: At the Summer National Meeting, the (E) Committee adopted a "reinsurance comparison worksheet," which was developed by the MWG. The worksheet is an "optional tool" that is intended to help state regulators assess cross-border reinsurance treaties involving different regulatory systems and to enhance regulators' ability to monitor these activities by understanding the impacts of a reinsurance transaction. It was designed with life reinsurance transactions as the initial focus; it is not limited to life transactions.

At the Fall National Meeting, the MWG Chair Bob Kasinow (NY) noted that states which have used the worksheet report that it has been very helpful when assessing complex reinsurance transactions.

B. FSOC Adopts Significant Changes to the SIFI Designation Process

In early November, FSOC approved two guidance documents following a public comment period earlier in the year: (i) the *Analytic Framework for Financial Stability Risk Identification, Assessment, and Response* (the "**Analytic Framework**"), effective on November 14, 2023; and (ii) *Guidance for Nonbank Financial Company Determinations* (the "**2023 Guidance**"), effective January 16, 2024.

Under Dodd-Frank, FSOC is authorized to designate a non-bank financial entity as a SIFI if (i) the entity's financial distress could pose a systemic risk to the financial system, or (ii) the nature, scale, concentration or interconnectedness of its activities could pose a threat to U.S. financial stability. Once designated, the entity is subject to enhanced prudential standards under the Federal Reserve's supervision. FSOC's designation authority, which Superintendent Elizabeth Dwyer (RI), the NAIC's member representative on FSOC (as a non-voting member), previously referred to as "a potent tool" in its toolbox, applies to a broad range of financial companies, including insurers, hedge funds, asset managers and mortgage servicers.

The 2023 Guidance, which creates a two-stage designation process, contains important changes to FSOC's existing process that was last modified in December 2019. The 2023 Guidance eliminates the requirement that FSOC must "exhaust all available alternatives by prioritizing an 'activities-based approach'" before considering the designation of a company. FSOC is also no longer required to conduct a cost-benefit analysis or assess the likelihood of a company's material financial distress before a determination is made. A SIFI designation requires a two-thirds vote of FSOC's voting members and must be reevaluated at least annually.

Certain asset managers have expressed criticism that FSOC's move away from an activities-based approach "lacks justification" and will make the SIFI designation process easier. At the Fall National Meeting, Superintendent Dwyer noted that it is not clear what actions FSOC will take next.

III. Innovation, Cybersecurity and Technology, and Privacy Developments

Notable updates from the Innovation, Cybersecurity, and Technology (H) Committee (the "(H) Committee") include the adoption of the AI Bulletin (available **here**), and the formation of the Third-Party Data and Models (H) Task Force that will focus on creating a framework for the oversight of regulated entities' use of third-party data and models.

A. AI Model Bulletin Adopted

Following the Summer National Meeting, the (H) Committee exposed a revised draft of the AI Bulletin, notably removing the defined term "Bias" in response to concerns from interested parties that the concept of bias was unrelated to the statutory framework upon which the AI Bulletin relies, particularly the *Unfair Trade Practices Model Act* (#880) and the *Unfair Claims Settlement Practices Model Act* (#900) (as we reported **here**). In Orlando, interested parties urged the (H) Committee to remove the undefined term "bias" from the AI Bulletin as well, citing further concern that the term is untethered to any statutory framework, thereby making it vague.[1] Over this objection, the (H) Committee adopted the AI Bulletin at the Fall National Meeting, with one minor correction in Section 4.3 with respect to contractual audits and with the undefined term "bias" retained in a number of locations.

The AI Bulletin outlines how state departments of insurance that adopt the bulletin will exercise their existing statutory authority to govern the development, acquisition and use of AI technologies, as well as the types of information and documentation that departments may request during an investigation or examination of an insurer in relation to AI systems. The AI Bulletin requires insurers to develop, implement and maintain a written governance program to ensure that use of AI does not violate a state's unfair trade practices laws by resulting in unfair discrimination. In addition, insurers are required to document risk mitigation and management frameworks and controls for AI through all stages of adoption and use. Notably, the AI Bulletin provides examples of the types of information and documentation relating to an insurer's use of AI that may cause regulators to make specific inquiries during an investigation or market conduct examination. The responsibility for third-party data and AI systems' compliance lies with the insurer, including, where appropriate and available, ensuring the inclusion of certain contract provisions with third-party providers that confer audit rights and require third-party cooperation with regulatory inquiries.

Each state's insurance regulator will now decide whether to issue the AI Bulletin, which would serve as non-binding guidance for licensed insurers in the relevant state and set forth the regulator's "expectations" as to how such insurers should oversee their use of AI systems.

While the AI Bulletin provides some guidance on insurers' use of third-party data and models, the (H) Committee will form the Third-Party Data and Models (H) Task Force in 2024 that is charged with developing a framework for the oversight of

[1] It is also notable that recent AI-related regulations that have recently been adopted and exposed by the Colorado Division of Insurance do not use the term "bias," only referencing "unfair discrimination," a statutorily defined term.

insurers' use of such data and models. Commissioner Kathleen Birrane (MD), Chair of the (H) Committee, previewed that the (H) Committee intends to take a "deeper dive" on the impact of AI on consumer protections with additional consideration of enforcement mechanisms or best practices around the use of AI while taking into account the need for consistency among the states and across product lines.

B. Results of Life AI/ML Survey

At the Big Data and Artificial Intelligence (H) Working Group meeting, Co-Vice Chair Commissioner Kevin Gaffney (VT) summarized the results of the *2023 Life Artificial Intelligence/Machine Learning Survey* (the "Life AI/ML Survey") (available **here**), which was conducted in 14 states in the second quarter of 2023 and completed by (i) life insurers with at least $250 million in premiums and covering at least 10,000 lives and (ii) InsurTech companies.

Commissioner Gaffney reported that fifty-eight percent (58%) of the reporting companies currently use, plan to use, or plan to explore using AI/ML in their operations. Interestingly, this percentage was lower than that reported in the *Private Passenger Artificial Intelligence/Machine Learning Survey*, in which 88% of auto insurers reported use of AI/ML, and the *2022–2023 Home Artificial Intelligence/Machine Learning Survey*, in which 70% of home insurers reported use of AI/ML. The life insurers' operational use of AI/ML was primarily in marketing (36%), underwriting (34%), pricing (18%) and risk management (11%). More than half of the life insurers reported that they have implemented governance programs that align with the *NAIC Principles on Artificial Intelligence*, while many others use other recognized standards as part of their governance program.

The Life AI/ML Survey results show that more than half of the data and models utilized by the life insurers for marketing, pricing and underwriting were developed by third parties. (H) Committee members focused on this result when they highlighted the importance of forming the Third-Party Data and Models (H) Task Force that will create a regulatory framework for the oversight of insurers' use of third-party data and models.

C. New Work Plan for Proposed Insurance Consumer Privacy Protections Model Law

The (H) Committee granted the Privacy Protections (H) Working Group ("PPWG") an extension until December 31, 2024 to develop the new *Insurance Consumer Privacy Protections Model Law* (#674). PPWG needs additional time to develop the model law due to the large number of comments received this year, as we previously reported **here**. The third exposure draft is expected to be released in early 2024.

IV. Reinsurance Matters

The Reinsurance (E) Task Force met virtually on November 16, 2023, in lieu of the Fall National Meeting.

A. Update on Reinsurance Collateral Reduction Applications

The Reinsurance Financial Analysis (E) Working Group ("ReFAWG") continues to assist states with reviewing reinsurance collateral reduction applications to determine whether an applicant meets the requirements to be recognized as a Certified Reinsurer and/or a Reciprocal Jurisdiction Reinsurer. As of November 16, 2023, ReFAWG had approved 70 Reciprocal Jurisdiction Reinsurers and 42 Certified Reinsurers, and 47 states had "passported" at least one Reciprocal Jurisdiction Reinsurer, which is the process that gives states discretion to defer to the collateral reduction status of a reinsurer in another state. Although not required by law, the Reinsurance (E) Task Force continues to recommend submission of reinsurance collateral reduction applications to ReFAWG in order to ensure uniformity in the review process, which can better equip ReFAWG to answer questions from governments, foreign jurisdictions or other interested parties. The NAIC's complete list of Certified Reinsurers and Reciprocal Jurisdiction Reinsurers is available **here**.

B. Qualified and Reciprocal Jurisdictions

At its November 1st meeting, the Mutual Recognition of Jurisdictions (E) Working Group (formerly the Qualified Jurisdictions (E) Working Group) (the "MRJ Working Group") re-approved the status of seven existing jurisdictions (Bermuda, France, Germany, Ireland, Japan, Switzerland and the United Kingdom) on the *NAIC List of Qualified Jurisdictions*. While most of the current Reciprocal Jurisdictions included on the *NAIC List of Reciprocal Jurisdictions* are afforded automatic Reciprocal Jurisdiction status by virtue of the Covered Agreements, the MRJ Working Group also determined that Bermuda, Japan and Switzerland (which are not parties to the Covered Agreements) will maintain their existing status on that list.

C. Adoption of the Draft Revisions to the Uniform Checklist for Reciprocal Jurisdiction Reinsurers

The Reinsurance (E) Task Force adopted draft revisions to the *Uniform Checklist for Reciprocal Jurisdiction Reinsurers* (the "RJR Checklist"), which included, among other changes, the addition of an alien number and instructional guidance to assist Reciprocal Jurisdiction Reinsurer applicants and regulators with the filing requirements for "Passporting State" applications. The Reinsurance Association of America ("RAA") provided one comment letter with additional suggestions about how the review of RJR applications by states and ReFAWG could be improved. NAIC staff and ReFAWG were directed to review the comment letter from RAA and consider changes to the RJR Checklist.

D. Referral to the Property and Casualty Risk-Based Capital (E) Working Group

The Reinsurance (E) Task Force referred to the Property and Casualty Risk-Based Capital (E) Working Group a proposal to add additional disclosures to the PR027 Catastrophe Risk Interrogatories included in the RBC Blank. Given the recent catastrophe-related insolvencies and the increasing cost of CAT reinsurance coverage, state insurance regulators have identified a need to collect additional detail from insurers on the structure of their catastrophe reinsurance programs on an annual basis. As such information could be viewed as confidential and proprietary, and as it is closely related to the existing PR027 RCAT charge in Property/Casualty RBC, the collection of additional information on an insurer's catastrophe reinsurance program is being proposed through a series of additional interrogatories.

V. Other Topics of General Interest

A. NAIC Adopts Accreditation Standard for the GCC and LST Framework

The proposed accreditation standard for the NAIC's 2020 amendments to the Holding Company Models, which implement the annual filing requirements for the GCC and LST, was approved by the Executive and Plenary during the Fall National Meeting. States must adopt the significant elements of the amendments by January 1, 2026 in order to maintain their accredited status with the NAIC. As of November 27, 2023, 28 states had adopted the amendments. For more information, see our 2021 Summer National Meeting Report, available **here**.

B. NAIC Response to the Fiduciary Rule Proposal by the U.S. Department of Labor

On October 31, 2023, the Biden-Harris administration released a press **statement** regarding the U.S. Department of Labor's proposed rule which describes the circumstances in which an advisor or other financial professional would be considered a "fiduciary" under ERISA and/or the Code when such professional provides investment recommendations to defined "retirement investors" (the "Fiduciary Rule Proposal"), described in detail in our Client Alert available **here**. Notably, the Fiduciary Rule Proposal would expand the existing fiduciary standard that commonly covers advice over purchasing certain securities, such as mutual funds, to include certain types of non-securities, such as fixed index annuities. The fiduciary standard would also apply to advice provided to employers and plan fiduciaries and one-time advice for transactions such as 401(k) rollovers. The press statement noted that advice to purchase certain insurance products like fixed index annuities "is governed by state law, which often varies state by state."

In response to the Fiduciary Rule Proposal, the NAIC released the following **statement** on November 1, 2023, expressing its disagreement: *"We fundamentally disagree with the White House's characterization of state consumer protections for annuity products. The White House press statement that oversight of these products 'varies state by state' and provides 'inadequate protections and misaligned incentives' suggests either ignorance of, or willful disregard for, the hard work of the 40 states and counting that have worked diligently to enhance protections for consumers by adopting the NAIC's Suitability in Annuity Transactions Model Regulation."*

The NAIC's response points to the power granted to the states by Congress to regulate all insurance transactions, including states' regulatory responsibility over annuities. It also notes that 40 states have adopted the February 2020 updates to the *Suitability in Annuity Transactions Model Regulation* (#275) (the "Suitability in Annuity Model"), which revised the annuity standards to establish best interest requirements similar to those adopted by the Securities and Exchange Commission for securities dealers in 2019. States that have adopted the updated Suitability in Annuity Model require that all recommendations by agents and insurers must be in the best interest of the consumer, and that agents and carriers may not place their financial interest ahead of the consumer's interest in making a recommendation.

At the Life Insurance and Annuities (A) Committee meeting, industry representatives provided support for the NAIC's position and voiced concerns about the expansive definition of fiduciary under the Fiduciary Rule Proposal and the widespread impact of the Fiduciary Rule Proposal on the life insurance industry. Birny Birnbaum of the Center for Economic Justice, on the other hand, expressed full support of the Fiduciary Rule Proposal as being beneficial to consumers.

C. Climate-Related Initiatives

1. *Adoption of the NAIC's Climate Resiliency Strategy for Insurance*

At the Fall National Meeting, the Climate and Resiliency (EX) Task Force adopted the Climate Strategy, which formalizes the actions the NAIC will take, both pre- and post-disaster, to strengthen climate resilience. The multi-year Climate Strategy incorporates data from existing NAIC efforts and will bring together the products of the Task Force's Solvency, Technology and Innovation, Climate Risk Disclosure and Pre-Disaster Mitigation workstreams. The Climate Strategy includes five key "resiliency actions": (1) identifying and coordinating measurement of protection gaps across states; (2) creating a blueprint for the future of flood insurance that coordinates regulator approaches to strategies on products, risk assessment tools, communication and mitigation programs that can help to close protection gaps for flood insurance; (3) utilizing the Catastrophe Modeling Center of Excellence to improve understanding of how coverages are changing within and across jurisdictions; (4) creating and coordinating new resilience tools to assist regulators with developing state level mitigation grant programs and expanding incentives for pre-disaster mitigation; and (5) expanding regulators' leadership on new solvency tools.

Certain regulators and industry representatives raised concerns that there had not been an opportunity for public review and comment on the Climate Strategy. Although the Task Force views the Climate Strategy as an internal strategy document of the NAIC, representatives noted that, due to its public nature, both regulators and industry members may be held accountable to its wording. The Task Force voted to adopt the Climate Strategy as written, but welcomed comments from interested parties before presenting it for adoption by the NAIC membership.

2. *Climate-Related Work of the MWG*

NAIC staff have developed a preliminary climate risk dashboard that includes physical and transition risk indicators and a coverage section with protection gap measures. They intend to work with the Climate and Resiliency (EX) Task Force to develop additional metrics, with the goal of presenting an updated dashboard to the MWG in early 2024 for further discussion.

In other climate-related work, the MWG plans to update the Macroprudential Risk Assessment dashboard in 2024 to incorporate climate risk metrics. The Financial Stability (E) Task Force and the MWG jointly adopted the Macroprudential Risk Assessment in 2022 to allow insurance regulators to proactively identify and monitor risks that could impact the insurance industry and U.S. financial stability.

D. Service of Process Issues for Surplus Lines Insurers Arising from *Mallory v. Norfolk Southern Railway Co.*

The Surplus Lines (C) Task Force discussed issues relating to service of process for surplus lines insurers (particularly, but not exclusively, alien insurers) arising out of the recent United States Supreme Court decision in *Mallory v. Norfolk Southern Railway Co.* In *Mallory*, the Supreme Court held that any company that consents to service of process through a state's Secretary of State or Insurance Commissioner is subject to suit in that state for any cause of action, regardless of the action's relation to matters arising under the company's contracts in the state. The heightened standard is particularly concerning to surplus lines insurers, who could be exposed to any possible cause of action in a state where they are not admitted merely because they provide insurance through surplus lines brokers in that state. The broad language of the *Uniform Certificate of Authority Application Form 12* ("Form 12"), which was drafted for use by admitted insurers, has broad language that could subject surplus lines insurers executing it to general jurisdiction. Form 12, or state specific forms with similar language, are used in several states for surplus lines eligibility. Interested parties noted that the current language of the *Unauthorized Insurers Process Act* (#850) and the *Nonadmitted Insurance Model Act* (#870) does not require such broad language and that specific forms for surplus lines insurers and non-United States insurers have been drafted and used by the NAIC in other contexts.

The Surplus Lines (C) Task Force is forming a voluntary drafting group, led by Louisiana, to consider the issues, including potentially drafting a new service of process form for use by surplus lines insurers. The group will meet prior to the 2024 NAIC Spring National Meeting, at which time, the Surplus Lines (C) Task Force will review the drafting group's considerations.

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