# NAIC 2022 Fall National Meeting Highlights

**December 21, 2022**

The National Association of Insurance Commissioners (the "NAIC") held its 2022 Fall National Meeting (the "Meeting") from December 12 to 16, 2022, in Tampa, Florida. We attended many of the conference sessions, and in this update we highlight meeting developments of particular interest to our insurance industry clients, colleagues and friends.

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## Private Equity in Insurance

### Private Equity Regulatory Considerations Update

As we reported in our NAIC 2022 Summer National Meeting Highlights, the NAIC's **Executive (EX) Committee and Plenary** formally adopted the "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers" (the "Regulatory Considerations") in August 2022. The NAIC, through referrals to several of its working groups and task forces, continues to make progress in addressing the Regulatory Considerations, with ramifications for private equity actors and others in the insurance space.

To address concerns that acquirors of insurers are using complex holding company structures to avoid regulatory disclosure requirements, the **Group Solvency Issues (E) Working Group** is developing a proposal to request more information from Form A applicants, including information regarding the acquiror's economic goals, dividend expectations and ability to provide additional capital support in the future. They also discussed possible modifications to the Form A reporting template to contemplate private equity-like structures that have been encountered by regulators in the past. In September 2022, the NAIC conducted advanced regulatory training in Kansas City about emerging private-equity holding company structures. During the Meeting, the Working Group supported an initiative to provide more comprehensive and regular regulatory training sessions on this matter.

The **Group Solvency Issues (E) Working Group** also formed a drafting group tasked with identifying scenarios in which owners (directly or indirectly) of under 10% of the voting securities of an insurer may be deemed to have "control." Regulators are concerned that transactions are being structured around the definition of control in the Model Holding Company Act (which provides for a presumption of control at an ownership level of 10% or more of voting securities), thereby allowing investors to exert control without submitting to reporting or monitoring activities and regulator approval or non-disapproval requirements. The proposed drafting group is designed to help regulators more easily identify types of arrangements—such as board representations, non-customary minority shareholder rights, restrictive investment management agreements or excessive control or discretion over investment strategies—that could create controlling influences.

In an effort to address the Regulatory Consideration regarding the use of increasingly complex asset classes to support pension risk transfer ("PRT") business, in 2021, modifications to PRT reporting requirements went into effect, requiring entities to use disaggregated product identifiers. However, the **Statutory Accounting Principles (E) Working Group** conducted a review of these 2021 PRT disclosures and found that

entities are still broadly grouping their PRT activities. In addition, the NAIC staff is in continuing discussions with the Department of Labor to review the applicability of labor protections to pension beneficiaries in PRT transactions.

In addition, to address the Regulatory Consideration regarding the increasing use of offshore reinsurance and sidecar vehicles by insurers, the **Macroprudential (E) Working Group** has been holding ongoing confidential discussions with foreign regulators and industry members to gather information on the increasing use of these structures and regulation thereof in other jurisdictions. The Working Group expects these discussions to conclude in early 2023 and thereafter to develop a template for use in the review and monitoring of these reinsurance transactions.

The Regulatory Considerations also address a concern that new entrants into the insurance sector may have misaligned priorities or a lack of insurance experience that could negatively affect an insurer's operational, governance or market conduct practices. While no specific actions on this Regulatory Consideration have yet been advanced, the **Macroprudential (E) Working Group** indicated that it plans to develop more specific suggestions and thereafter refer this matter to the **Risk-Focused Surveillance (E) Working Group**.

Several changes made earlier this year related to the Regulatory Conditions are already effective as of 2022 year-end reporting. For example, the **Statutory Accounting Principles (E) Working Group** adopted revisions to Statement of Statutory Accounting Principles ("SSAP") 25 (Affiliates and Other Related Parties) to clarify related-party and affiliate investment disclosures, and the **Blanks (E) Working Group** added six related-party reporting codes. These adoptions build upon Schedule Y, Part 3, a new financial statement schedule that became effective for 2021 year-end reporting and requires the identification of all investors with holdings in the applicable insurer or insurance group in excess of 10% of its equity interests, regardless of any disclaimers of control or affiliation. Additionally, the **Life Actuarial (A) Task Force** adopted revisions to Actuarial Guideline 53 that enhanced adequacy testing requirements for certain "complex" life insurer investments.

## Statutory Accounting

### Negative Interest Maintenance Reserve

The **Statutory Accounting Principles (E) Working Group** acknowledged that revisions to SSAP 7 (Asset Valuation Reserve and Interest Maintenance Reserve) are urgently needed to address the rising interest rate environment that has created an increased likelihood that reporting entities move to a net negative interest maintenance

reserve ("IMR") position from the sale of fixed income instruments. Under current statutory accounting principles, negative IMR is not an admitted asset, and so, net negative IMR-positioned insurers must record a non-admitted asset, thus lowering the insurer's surplus and RBC.

In particular, the **Statutory Accounting Principles (E) Working Group** was concerned with and is urgently soliciting feedback on whether some guardrails are necessary to prevent admitting negative IMR from incentivizing companies to undertake short-term non-economic activity that is not in the best interest of long-term financial health, like selling down bonds. The American Council of Life Insurers ("ACLI") submitted a comment letter in late October asking for urgent attention to be given to this issue, with a request that a negative IMR position be permitted as an admitted asset. Otherwise, the treatment could negatively impact ratings and consumer confidence and could result in double-counting of losses in asset adequacy testing (although this point has since been addressed by the **Life Actuarial (A) Task Force**). Some suggestions for resolving this issue raised at the Meeting included: (i) treating net negative IMR as part of a "special surplus" not taken into account for purposes of determining the amount of dividends permitted; (ii) limiting the amortization schedule of net negative IMR; and (iii) limiting the amount of net negative IMR to a percentage of admitted assets of the applicable insurer. Until additional guidance is adopted with respect to negative IMR, an insurer is left to rely on its domestic regulators approving a permitted practice for admitting negative IMR as an asset, after considering the insurer's specific situation.

## Related Party Investments

The **Statutory Accounting Principles (E) Working Group** exposed revisions to SSAP 25 (Affiliates and Other Related Parties), with respect to the definition of affiliated investments, as well as income disclosures, revised so that reported interest income due and accrued includes interest from gross, non-admitted and admitted amounts. Notably, the SSAP amendments add a new reporting obligation for any investment with a related party as sponsor, originator or other similar transaction party, regardless of whether the investment is otherwise captured on the affiliate reporting line. The revisions to SSAP 25 have a comment period ending on February 10, 2023.

The **Valuation of Securities (E) Task Force** also adopted amendments to the NAIC's Purposes & Procedures Manual (the "P&P Manual") that update the instructions for Related Party and Subsidiary, Controlled and Affiliated ("SCA") Investments to clarify that SCA and Related Party Filing Exempt Investments will be defined to mean any investment (i) issued by an affiliate or related party special purpose entity that itself is not an obligor or ultimate source of the investment repayment or (ii) issued as part of a structure in which the originator, sponsor, manager, servicer, or other influential transaction party is an affiliate or related party of the reporting insurance company.

Related Party Bond and Preferred Stock Investments will not be filing exempt, except that certain SCA and Related Party investments might be filing exempt if the investment does not have underlying affiliated or related party credit exposure (*e.g.*, a related party investment with a related party originator, sponsor, manager or servicer, but not a related party issuer/entity to which the insurance company investor has credit exposure).

### Principles-Based Bond Definition, Treatment of Structured Securities

The **Statutory Accounting Principles (E) Working Group** exposed revisions to the draft issue paper providing guidance on applying the principles-based bond definition reflected in proposed amendments to SSAP 26R (Issuer Credit Obligations) (f/k/a Bonds) and SSAP 43R (Asset Backed Securities) (f/k/a Loan-Backed and Structured Securities). Both the revised Issue Paper and the SSAP amendments have been exposed for a comment period ending on February 10, 2023.

In addition to the work of the Statutory Accounting Principles (E) Working Group to revise the SSAPs for the principle-based bond definition, other NAIC working groups have discussed and exposed proposals that may impact the resulting Risk-Based Capital ("RBC") treatment of structured securities, including: (1) the **Risk-Based Capital Investment Risk and Evaluation (E) Working Group** and its consideration of RBC charges for Collateral Loan Obligations ("CLO" or "CLOs"); (2) the Capital Adequacy (E) Task Force and Valuation of Securities (E) Task Force evaluation of procedures for modeling of CLOs; and (3) the Valuation of Securities (E) Task Force proposed amendments to the P&P Manual to remove the filing exemption for "structured equity and funds," which have been exposed for a comment period ending on February 13, 2023.

The principles-based bond proposal and resulting revisions to SSAP 23R (Issuer Credit Obligations) and SSAP 43R (Asset Backed Securities) suggest that both rated feeder vehicles and Collateralized Fund Obligations ("CFO" or "CFOs"), if properly structured to meet the bond principles, will continue to be eligible to have their debt tranches qualify as bonds reportable on Schedule D-1. Structures where the collateral assets backing the structure reflect equity investments, such as CFOs, will need to overcome the rebuttable presumption that equity-like structures do not inherently possess the characteristics to be considered bonds and will require reporting documentation to support the conclusion that the underlying equity interests lend themselves to the production of predicable cash flows and that the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Residual tranches of bonds will be required to be reported on Schedule BA – Other Long-Term Assets beginning December 31, 2022. Investments that were reported as a bond on Schedule D-1 as of December 31, 2024 that do not qualify under the principles-based bond concepts

shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025.

The analysis for whether certain asset backed securities qualify as bonds reportable on Schedule D-1 is left to the reporting insurance company. In particular, the revised issue paper exposed by the **Statutory Accounting Principles (E) Working Group** highlights that the assessment and compliance with bond definition concepts such as "meaningful cash flows" and "substantive credit enhancement" are the responsibility of the reporting insurance company, along with providing appropriate documentation for these assessments for regulator review when requested.

Subsequent discussion at the NAIC has highlighted an RBC issue for equity or residual tranches of asset backed securities that is being considered by the **Capital Adequacy (E) Task Force** and the **Risk-Based Capital Investment Risk and Evaluation (E) Working Group** separate from the statutory accounting changes proposed by the **Statutory Accounting Principles (E) Working Group** to implement the principles-based bond definition.

The **Valuation of Securities (E) Task Force** exposed proposed amendments to the P&P Manual to add instructions for "structured equity and funds" having the effect of removing the "filing exempt" status. The effect is that investments that are wholly dependent, directly or indirectly, upon payments or distributions from one or more underlying equity or fund investment(s) (such as in a CFO or feeder fund structure) will no longer be filing exempt with an NAIC designation automatically assigned based on a rating from a credit rating provider. Rather, CFOs and rated feeder structures would need to be filed with the NAIC's Securities Valuation Office ("SVO") for obtaining an NAIC Designation with the RBC treatment based on the NAIC designation assigned by the SVO after performing a credit quality assessment of the investment. The **Valuation of Securities (E) Task Force** recognized that the SVO does not have a methodology for all types of structured investments that may be captured by the proposed amendments and accordingly, the SVO will continue to use nationally recognized statistical ratings organization ("NRSRO") ratings as data points for its evaluation of structured investments for which it does not have a methodology, with additional validation procedures to aid in its review. The **Valuation of Securities (E) Task Force** exposed the proposed amendments to the P&P Manual for a 60-day comment period ending on February 13, 2023 and made an informational referral to **Capital Adequacy (E) Task Force** for coordination on the proposal.

In addition, the **Valuation of Securities (E) Task Force** proposed to add CLOs as a financial modeled security, and it will re-expose that proposal for a brief 15-day comment period once the Task Force updates the proposal with comments from the

ACLI. The Task Force is soliciting feedback on the assumptions in their model from interested parties during a 60-day comment period ending on February 13, 2023.

The **Risk-Based Capital Investment Risk and Evaluation (E) Working Group** heard a presentation from the American Academy of Actuaries concerning its analysis of CLOs and the RBC bond factors applicable to CLOs. The American Academy of Actuaries concluded that from an actuarial perspective, the RBC bond factors are not appropriate for CLOs, and that an equity RBC factor of 30% is not the right factor, but there is no quantitative analysis to justify 75% or 100% proposed by the NAIC either. The **RBC Investment Risk and Evaluation Working Group** noted that determining new RBC factors for residual tranches of CLOs is intended to be an interim solution for evaluating CLO risk until a more robust RBC methodology for CLOs can be developed. The American Academy of Actuaries' CLO presentation was exposed for comment for a 45-day comment period ending on January 27, 2023.

In general, the key theme underlying the exposures and adoptions at the Meeting is the increased scrutiny of complex structured securities like CLOs, CFOs and rated feeders. The proposals and amendments exposed at the meetings are generally intended to facilitate substantive review by the SVO (rather than reliance on NRSRO ratings by regulators) for the accounting and capital treatment by reporting insurance companies of such investments. These proposals have the potential to change the application of RBC charges applied to these investments.

## Life and Annuity Insurance

### Product Illustrations

Consumer advocates continue to push back against the proposed revisions to Actuarial Guideline XLIX-A ("AG49") regarding illustrations for Indexed Universal Life products. The opposition warns that AG49, by allowing "backtesting," will not prevent the issuance of illustrations that mislead consumers about a product's risks and returns. The **Life Insurance and Annuities (A) Committee** commented that the proposed revisions to AG49 are just a first step and that it expects to make additional changes governing such illustrations in the future.

### Annuity Stability

In 2020, revisions to the Suitability in Annuity Transactions Model Regulation (#275) were adopted. This model regulation is gaining traction; at the time of the Meeting, 29 jurisdictions had adopted the revised model regulation, and adoption was pending in an additional six jurisdictions.

## Property & Casualty Insurance

### Guaranty Funds

The **Receivership and Insolvency (E) Task Force** adopted a request to amend the Property and Casualty Insurance Guaranty Association Model Act (#540) in order to clarify that cybersecurity is covered by this model act. This request was in turn adopted by the **Financial Condition (E) Committee**. The **Receivership and Insolvency (E) Task Force** is also considering further revisions to the Model Act to reflect the possibility of corporate divisions and insurance business transfers.

## International Insurance

As part of the implementation of the holistic framework that the **International Association of Insurance Supervisors** (the "IAIS") began in 2019, a draft report of the IAIS's Targeted Jurisdictional Assessment ("TJA") is scheduled to be available in February, with a public version of the report expected in June. Preliminary results from the TJA indicate that the United States, as compared to other jurisdictions, scored relatively well. The areas flagged as needing improvement in the United States generally were problems in most jurisdictions worldwide, including crisis management. Additionally, the state-specific regulatory structure of the U.S. insurance industry was a point of confusion for European colleagues, and a coordinated effort between the **Receivership and Insolvency (E) Task Force** and the **Group Solvency Issues (E) Working Group** is planned to put together tools for use in discussions with international counterparts on resolution planning.

As we covered in our review of the NAIC 2022 Summer National Meeting, the Financial Stability Board ("FSB") suspended its annual designation of global systemically important insurers ("GSIIs"). In early December, 2022, the FSB formally adopted the holistic framework, replacing its former GSII entity-based focus with an activity-based analysis. Additionally, the IAIS executive committee last year designated the insurance working group as dormant for 2022, and now has decided to disband it entirely because there are no projects assigned to it next year or planned for the future. To the extent that future groupwide supervision issues emerge, IAIS tentatively plans for them to be folded into the mandate of the supervisory forum, and the charges of the group have been updated to reflect this.

The IAIS also completed this year's global monitoring exercise and held its annual discussion on the results in September. The **Macroprudential (E) Working Group** reported that the key topics of discussion were private equity ownership of insurers,

climate risk, and inflation. On climate risk, IAIS will look at the role that the insurance sector can play in building natural disaster resilience. There is active consultation on an issue paper to this effect, with comments due by January 6, 2023. In addition, IAIS is looking at a limited number of changes for Insurance Core Principles (ICP) guidance, starting with a series of consultations in early 2023.

Finally, the IAIS postponed approval of its comparability criteria to March 2023 to further consider scenarios and sensitivity analysis for the assessment process.

## Data, Privacy and Artificial Intelligence

Data, privacy and the use of artificial intelligence in the insurance industry was one of the major themes of the Meeting. A number of groups at the NAIC are concerned about implicit bias in artificial intelligence, which is increasingly being used by insurance companies for underwriting and other purposes, as well as big data and consumer privacy protections.

### Model Law Development and State and Federal Legislation

The **Privacy Protections (H) Working Group** is proposing replacing the Insurance Information and Privacy Protection Model Act (#670) and the Privacy of Consumer Financial Health and Information Regulation (#672) with a new model law (to be numbered #674). The **Privacy Protections (H) Working Group** has issued a reference document to this effect and expects to expose a draft of the new model law for a 60-day comment period once available.

Privacy protection is also gaining attention in state legislatures nationwide. There are now five states with laws generally applicable to data privacy (in California, Colorado, Connecticut and Utah, with a new law going into effect in Virginia on January 1, 2023). In addition, a pending data privacy bill in Michigan has been referred out of committee.

At the federal level, the American Data Privacy and Protection Act (“ADPPA”) is still awaiting a full vote of the U.S. House of Representatives. If passed by Congress, the ADPPA would preempt most state privacy regulation and create a private right of action for violations of the ADPPA or a regulation promulgated thereunder that would be available starting two years after the ADPPA’s effective date. The ADPPA as currently constructed would limit lawsuits to federal courts.

## Artificial Intelligence and Big Data

The general consensus of the **Innovation, Cybersecurity and Technology (H) Committee** was the need for the NAIC to adopt a regulatory framework governing the use of artificial intelligence by insurance companies as soon as possible. The Committee is currently working on a principles-based model bulletin that will articulate regulatory standards at a high level. The bulletin is expected to focus on governance requirements and the establishment of artificial intelligence use protocols that rely on objective standards, as well as guidance around methods of validating artificial intelligence outputs.

In addition, the bulletin will address the use of third-party data in artificial intelligence models, with the onus on the applicable insurer to conduct appropriate diligence on the third-party data it elects to use, rather than insurance regulators regulating these third-party vendors directly. The model bulletin is also expected to include background, a definition section, information about general regulatory expectations about the use of artificial intelligence in the insurance industry and regulatory oversight and examination standards that would address market conduct, financial filings and the like.

The **Big Data and Artificial Intelligence (H) Working Group** shared the results of its survey on the use of artificial intelligence and machine learning in the private passenger line, with 90% of respondents indicating that they use artificial intelligence or machine learning in some capacity. The highest proportion of respondents uses these technologies in claims (70%), while the smallest proportion uses them in loss management (2%). The **Big Data and Artificial Intelligence (H) Working Group** is currently developing similar surveys for home insurance and life insurance. Review of the home insurance survey is currently in process, after responses were due December 15, 2022.

The development of the life insurance survey is currently underway. A formal data call letter will be issued to 192 life insurance companies, six of which are "InsurTechs," and life insurers will be selected on the basis of whether they wrote at least $250 million in direct written premium in 2021, or, in the case of a term writer, if they wrote policies in respect of more than 10,000 lives. The draft life insurance survey was exposed on November 10, 2022 for a 30-day comment period, and those comments are currently being incorporated. An informational letter to companies that will be subject to the call is expected to be circulated in January 2023, with the formal letter expected to be circulated in early February. Companies will then have 30 days to respond. The ACLI expressed concerns over these data calls, primarily due to the sheer volume of information required and questioning the ability of the regulators to effectively use such detailed information.

The **Big Data and Artificial Intelligence (H) Working Group** also exposed for a 62-day comment period, ending February 13, 2023, its draft document outlining data regulatory questions for regulators to ask their subject insurers about the data and models that they use, whether internally or externally obtained. Similar to the ACLI's feedback on the life survey, the American Property Casualty Insurance Association noted that the proposed survey questions, consisting of nine pages, are too detailed and would exhaust insurers' response resources. A consumer advocate also suggested that the **Big Data and Artificial Intelligence (H) Working Group** inquire into the nature of third-party vendors and their status as licensed advisory organizations. In addition, he warned about the potential for third-party vendors to engage in anticompetitive data collection and processing practices, for example, if all vendors are using the same model.

The **Accelerated Underwriting (A) Working Group** plans to expose its draft regulatory guidance document early in 2023; however, the content of this document was not yet available for discussion at the Meeting.

## Other Developments

### Macroprudential Risk

Shortly following the Meeting, the **Macroprudential (E) Working Group** is expected to release its Macroprudential Risk Assessment (not yet released as of this writing). Based on discussion at the Meeting, as a signal of future regulatory interest, the Macroprudential Risk Assessment is expected to highlight concerns around inflation and interest rates, structural changes in investment strategies, catastrophic losses and cybersecurity risks. The Macroprudential Risk Assessment is also expected to recommend that regulators seek additional data and analysis concerning the use of and investments in Funding Agreement-Backed Notes.

### Liquidity Stress Test

The **Macroprudential (E) Working Group** adopted its 2022 Liquidity Stress Testing Framework. Additionally, they discussed the results of the 2021 liquidity stress test. From a review of 22 submissions in response to the 2021 liquidity stress test, the **Macroprudential (E) Working Group** found that the largest asset sale categories were investment grade corporates and treasuries, with no material impacts to the market for insurers as a result of these sales. To validate the results against this year's interest rate increases, the Working Group notes that lead state regulators may follow up with insurers domiciled in their respective jurisdictions on the liquidity stress test interest rate spike scenarios.

## Electronic Document Submission

The **Group Solvency Issues (E) Working Group** discussed its ongoing Uniform Certification Authority Application ("UCAA") Project, which involves updates to the forms and processes used to review Form A applications. Notably, the NAIC is in the process of making electronic submission available for all UCAA primary applications and corporate amendments, Form A applications and biographical affidavits. Electronic submission may also become available for Form E applications. Ultimately, the NAIC is seeking to maintain a database onto which biographical affidavits and third-party vendor reports can be uploaded and updated.

States are expected to receive a survey on the electronic submission process in summer 2023 that will ask about state-specific electronic submission requirements (including confidentiality requirements).

Please do not hesitate to contact us with any questions.

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