

NAIC 2023 Fall National Meeting Highlights

December 15, 2023

The National Association of Insurance Commissioners (the “NAIC”) held its 2023 Fall National Meeting (the “Meeting”) from November 30–December 4, 2023, in Orlando, Florida. Debevoise attorneys attended many of the conference sessions in person or virtually and, in this in-depth update, we highlight meeting developments of particular interest to our insurance industry clients, colleagues and friends.

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Data, Privacy and Artificial Intelligence

The **Big Data and Artificial Intelligence (H) Working Group** received an update regarding the artificial intelligence/machine learning (“AI/ML”) survey of life insurance market participants in 14 states. According to the Working Group, approximately 58% of reporting life insurance companies participating in the survey currently use, plan to use or intended to explore the use of AI/ML. This result follows an approximately 70% positive response rate for home insurers and an 88% positive response rate for auto insurers reported in prior surveys. The survey revealed that life insurers mainly use AI/ML models for marketing, underwriting, pricing and risk management operations. Of the 42% of life insurers that responded that they do not currently use, plan to use or explore using AI/ML, the top reason for nonuse was “no compelling business reason,” followed by “lack of resources & expertise.” The survey found that third parties develop over half of the AI/ML models used by life insurers. Potential next steps for the

Working Group include exploring insurers' use of automated decision-making tools for pricing and risk management tasks, evaluating the regulatory framework around use of third-party models, determining whether to publish additional white papers on AI/ML best practices, researching the use of AI/ML at the product level and developing questions for company discussions in closed regulator-only sessions.

The **Privacy Protections (H) Working Group** provided an update regarding a new draft of the Insurance Consumer Privacy Protection Model Law (#674) for exposure. Notably, the Working Group requested and received a one-year extension to allow for additional comment periods and for the Working Group to consider and incorporate input from stakeholders.

The **Innovation, Cybersecurity and Technology (H) Committee** adopted the Model Bulletin on the Use of Algorithms, Predictive Models and Artificial Intelligence Systems by Insurers. The NAIC exposed the first draft Bulletin at the fall 2022 meeting, which outlines regulatory guidance for the use of AI systems in decision-making processes that impact consumers. Commissioners stated that automated decision-making processes are required to comport with existing statutory guidelines and they expect U.S. regulators to speak on the application of current legal frameworks to AI in the near future. They also emphasized that since AI is fundamentally a methodology, the AI Model Bulletin is a principles-based guide, not a prescriptive one, and it is meant to be flexible enough to be applied by small and large insurers alike.

Twenty-two states participated in the initial drafting process of the AI Model Bulletin and the draft was exposed for public comment in July and then again in October 2023. The revised draft incorporated comments to focus on outcomes and aligning the process with the degree of risk of consumer harm.

Notably, the final draft removed the definition of the word "bias" in section 4.3. Commissioners discussed how to rework the use of the word "bias" and whether to replace it with a more precise definition. One interested party recommended replacing the word with "unfair discrimination," while Colorado's Commissioner suggested that "statistical bias" would be more appropriate and accurate. However, it was noted that "statistical bias" might have a technical, actuarial meaning, making it an unsuitable replacement.

The Committee also received comments from interested parties during the meeting that challenged the assumption that AI technology creates a unique risk or danger to consumers greater than normal insurance evaluation methods. Others recommended that the NAIC develop a risk management framework that takes active regulatory obligations into consideration so that any additional requirements are in line with existing obligations.

The **Special (EX) Committee on Race and Insurance** focused on algorithmic bias in conjunction with the **Property & Casualty Workstream**, the **Life Workstream** and the **Health Workstream**. The Committee's review of algorithmic bias is focused on the use in and impact on marketing, insurance access, fraud detection and underwriting. Additional initiatives stemming from these workstreams include the creation of a resource guide for insurers looking to increase access within underserved communities, as well as building out NAIC Connect as a central repository for information sharing.

Statutory Accounting and Risk-Based Capital

NAIC Designations and SVO Filing Exempt Process

In one of the most significant developments at the Meeting with respect to risk based capital ("RBC"), as part of the ongoing effort to expand Securities Valuation Office (the "SVO") discretion over NAIC designations assigned through the filing exemption ("FE") process, the **Valuation of Securities (E) Task Force** ("VOSTF") exposed an updated Purposes and Procedures Manual (the "P&P Manual") amendment further describing procedures governing its discretion (also until January 26, 2024). The Task Force had previously exposed the amendment in the summer, generating considerable public comment in the process.

While reemphasizing that the SVO's intention is not to supplant or compete with credit rating providers ("CRPs"), the SVO also highlighted that NAIC Designations fall squarely within the purview of regulators and are used solely within the insurance regulatory framework itself, and that the amendment as proposed sets out well-defined processes intended to assist regulators in the fulfillment of their responsibilities. The proposed amendment would authorize the SVO to remove securities from the automated FE process following the determination that the NAIC designation assigned through the FE process "does not provide a reasonable assessment of risk for regulatory purposes," incorporating a step-by-step process for the conduct of this review.

Following public requests for the same in connection with the proposal discussed at the summer National Meeting, the SVO further clarified the appeals process as well (which includes the option to request a blind review). Commenters continued to raise questions regarding the effectiveness and practicality of the appeals process, noting that a blind review would lack even the starting information that the SVO would have access to in the form of the rating agency materials used by the initial CRP. A member of the **Lease-Backed Securities Working Group** also expressed concerns regarding the transparency of a decision-making process that did not conclude with the publication of a report by the SVO. Finally, as at the summer National Meeting, comments from the public questioned the quality of a determination that could be made by the SVO without the

same staffing resources and expertise as CRPs. In any case, public reactions to the proposal promise to be of great interest for those following this SVO initiative.

In tandem with the push to expand SVO discretion over NAIC Designations assigned through the FE process, VOSTF exposed an updated P&P Manual amendment to revise the definition of an NAIC Designation until January 26, 2024 to further clarify the use and purpose of and risks addressed in NAIC Designations. Following discussion of the initial exposure over the summer, the SVO incorporated additional changes to the definition, including revisions intended to reflect credit quality and loss given default and/or tail risk, as appropriate for certain structures, though the proposed exposure did not garner immediate commentary.

RBC Framework for Structured Securities

As a continuation of discussions from its October 17, 2023 meeting, the **Risk-Based Capital Investment Risk and Evaluation (E) Working Group** heard an update from the American Academy of Actuaries (the “AAA”) on the AAA’s principles for structured securities RBC, which include (1) developing a process to determine when an asset class needs to be modeled and whether securities within an asset class need to be modeled individually to determine RBC charges and (2) “candidate-principles” for consideration by the Working Group. The AAA focused on its revised set of “candidate-principles,” which incorporate comments from the Working Group. The revised, proposed “candidate-principles” are as follows:

- The purpose of RBC is to help regulators identify potentially weakly capitalized insurers; therefore, changes that have only a small impact on RBC ratios may not justify a change to the RBC formula.
- Emerging investment risks create concerns for regulators, and existing regulatory tools can be considered alongside RBC for addressing these newer risks—but RBC needs to be considered when there are material solvency issues.
- C-1 requirements reflect the impact of risk on statutory surplus. Changes in accounting treatment will affect RBC.
- C-1 requirements for a given tranche should align with that tranche’s risk, to the extent practical, rather than simply tracking the rating of the underlying collateral.
- C-1 requirements on asset-backed securities (“ABS”) should treat collateral as a dynamic pool of assets, incorporating future trading activities that are reasonable and vary appropriately by economic scenario.

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

While the Working Group generally agreed with the proposed principles, a discussion ensued with regard to the third principle regarding the reflection of risk on statutory surplus, specifically around the calculation of C-1, the quantifying of assets and the relative effect on statutory surplus. The AAA also clarified that incorporating future trading activity in the determination of C-1 requirements allows for a more appropriate understanding of the horizon of a given investment, and therefore results in more accurate capital charges. As future trading activity is typically already embedded in ratings, members of the Working Group agreed that it should continue to be assumed in models projecting future cash flows for purposes of determining RBC charges going forward.

While regulators generally agreed with the notion that RBC requirements should align with the risk of a given tranche as a whole, multiple regulators were also wary of the notion that the unrated status of underlying collateral “has no bearing” on the determination of a requirement. That terminology offered by the AAA struck certain Working Group members as inconsistent with the principle that with greater uncertainty and less information, reserve requirements should be approached with greater conservatism. The AAA noted that a lack of a rating for certain underlying collateral does not necessarily signal a lack of information, and that, given the impracticality of obtaining ratings on miniscule pieces of collateral comprising an ABS, that rating is still present in the form of the rating of the applicable tranche. The Working Group agreed with the characterization and asked that the AAA alter its phrasing to clarify the principle to avoid suggesting that unrated status should have no implication for the determination of risk.

The AAA was asked to make several changes based on the discussion and to circulate a final report as soon as possible for approval by the Working Group. Once established, the Working Group, in collaboration with the AAA, intends to apply these candidate principles to the development of a risk measurement framework for collateralized loan obligations (“CLOs”).

Principles-Based Bond Definition

Following years of development of its “principles-based bond definition” and its adoption of the same at the NAIC summer National Meeting, the **Statutory Accounting Principles (E) Working Group** (“SAPWG”) continued to develop and clarify its resultant guidance, focused primarily on reporting matters including proposed revisions to *SSAP 21R – Other Admitted Assets*, reflecting additional reporting guidance

for debt securities that do not qualify as bonds. SAPWG noted that its principles-based bond issue paper, which had been exposed simultaneously with the SSAP 21R revisions and which provides additional guidance for the treatment of debt securities that do not qualify as a bond, received no further comment and directed NAIC staff to continue updating the issue paper in connection with the proposed revisions to SSAP 21R.

The **Capital Adequacy (E) Task Force** (“CATF”) discussed a referral from SAPWG regarding the Schedule BA Proposal for Non-Bond Debt Securities. Also discussed were possible structure changes in the Bond page to reflect the split of the Annual Statement Schedule D, Part 1 into two sections for credit obligations and asset-backed securities. This proposal was also forwarded to the Working Group.

VOSTF considered SAPWG’s referral on the proposal to report debt securities that do not qualify as bonds on Schedule BA. SVO staff highlighted that the proposal uses existing Schedule BA reporting provisions for SVO-assigned NAIC Designations and that maintaining the status quo will align with efforts to reduce blind reliance on ratings. The Task Force agreed with the SVO staff’s recommendation to maintain its policy of allowing bond RBC factors associated with NAIC Designations assigned by the SVO to apply only to investments that have been appropriately reported on Schedule BA and to expand the application of the same treatment across all statement types, adopting the SVO’s recommendation as its own and issuing the same to CATF for its consideration.

The **Blanks (E) Working Group** released an exposure that would categorize debt securities on Schedule BA that do not qualify as bonds under *SSAP No. 26—Bonds or SSAP No. 43R—Asset-Backed Securities* and are captured in scope of *SSAP No. 21R—Other Admitted Assets*.

Negative Interest Maintenance Reserve (“IMR”)

Similar to the slowdown in activity related to the principles-based bond definition following its adoption at the summer National Meeting, issues related to the admission of net negative IMR received less attention during the Meeting following SAPWG’s adoption of an interim solution to admit net negative IMR up to a cap. However, CATF heard an update from SAPWG regarding its ongoing discussions on the allowance of negative IMR. At the Meeting, SAPWG established as an agenda item a long-term project to collect and consolidate accounting guidance for Asset Valuation Reserve and IMR, including net negative IMR, and it has formed an **IMR Ad Hoc Working Sub-Group**, which has begun meeting on a biweekly basis. While the development of a long-term solution on the admission of net negative IMR remains on SAPWG’s agenda, a permanent solution to the issue does not appear to be immediately forthcoming.

Collateral Loans

Several proposed revisions related to Schedule BA reporting lines were discussed and exposed by SAPWG. Following SAPWG's adoption in September of SSAP 48 revisions intended to clarify reporting of residual interests on Schedule BA, an updated proposal was exposed in order to solicit more specific feedback from the industry as to the contours of the investment subcategories for SSAP 48 reporting lines. Over the objection of at least one interested party, the exposed revisions still incorporate a reporting line subcategory for non-registered private funds within the SSAP 48 reporting category. Revisions to SSAP 21R were also exposed in order to significantly expand reporting lines in Schedule BA for collateral loans. The intention of these proposed revisions is to enable regulators to more easily identify the various investment categories in which the underlying collateral might fall under. Each exposure period runs until January 22, 2024.

Repurchase Agreement Programs

The **Life RBC (E) Working Group** discussed a proposal received in September from the American Council of Life Insurers to establish eligibility criteria for conforming repurchase agreement programs in order to align RBC factors applicable to repurchase agreement programs with the RBC factors applicable to compliant securities lending programs, an item which had been reviewed a few years prior. Included in the proposal are additional financial statement disclosures to assist regulators in understanding the use of repurchase agreement programs and evaluating their compliance with the criteria. The proposal was well-received by the Working Group, which anticipates the solicitation of further input from other NAIC groups and a formal discussion of the proposal in the new year.

Other

Following from prior meetings, which focused on the **Financial Condition (E) Committee's** Framework for Insurer Investment Regulation (the "Framework"), the Committee received oral comments in response to the Framework. The Committee Chair noted that there would be further opportunities to comment on the Framework. Common themes among the commenters emphasized the importance of transparency in the development of the new Framework, calls for the Framework to reflect consistent treatment across asset classes and requests that the Committee take a broad view of emerging risks. The Committee will continue to develop the Framework and expects to expose an updated draft in January 2024.

Joint Meeting of the Financial Stability (E) Task Force and Macroprudential (E) Working Group

At the joint meeting of the **Financial Stability (E) Task Force** and **Macroprudential (E) Working Group**, the members heard a presentation on the Financial Stability Oversight Council's ("FSOC") interpretive guidance regarding nonbank financial company designations. This is a nonbinding approach to how FSOC will observe and analyze financial markets to identify systemic threats. Significant changes include removing cost/benefit analysis, equal weighting for designations with the American Bankers Association and not evaluating the "likelihood" of systemic threats. For more information on FSOC's proposal, please see the Debevoise Banking Group's blog post [here](#).

The joint meeting adopted the proposed 2023 Liquidity Stress Testing ("LST") Framework. This included minor edits from the 2022 framework.

The Working Group announced it will update its risk assessment dashboard in 2024. They will incorporate climate risk metrics, and their risk assessment work will include comparisons to FSOC's recently published framework.

Climate Change

A noteworthy development at the Climate and Resiliency (EX) Task Force was the adoption of the NAIC National Climate Resilience Strategy for Insurance. This strategy is the first ever forward-looking climate strategy document released by the NAIC. The five major elements to the forward-looking strategy are: (1) identify and coordinate how we measure protection gaps and then set priorities for reducing those gaps, (2) create a new blueprint for expanding flood insurance, (3) bring together the data from the upcoming property and casualty call with additional resources to understand how insurance companies are reacting to risk, (4) create and coordinate new resilience tolls to assist all state regulators in developing or refining state-level incentives for risk mitigation and (5) bring in the solvency workstream, which is finalizing their recommendations for scenario analysis tools—an important issue for resilient insurance markets. The National Climate Resilience Strategy for Insurance was ultimately adopted and sent to the plenary session for a vote, but that was not without debate. A couple of states and various interest groups spoke against its adoption. Most of the criticism centered around the sufficiency of the data collection process and the fact that the document was not made available for public comment. The Task Force's adoption of the strategy was timely, particularly as Former Secretary of State Hillary Clinton called for

reform of the industry during a panel on climate resiliency at COP28 on the same day and the International Association of Insurance Supervisors (the “IAIS”) launched a public consultation on climate risk the week before.

The Task Force also heard a presentation on parametric insurance, a nontraditional insurance product that has been a hot topic in the property and casualty insurance space.

International Insurance Relations

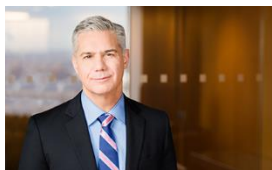
The **International Insurance Relations (G) Committee** approved the NAIC’s comments on the IAIS’s public consultations on the draft Insurance Core Principle (“ICP”) 14 (Valuation) and ICP 17 (Capital Adequacy), which were largely editorial. They also adopted their 2024 proposed charges, which are substantially similar to their current charges. The **Macroprudential (E) Working Group** heard that the IAIS Global Monitoring Exercise is expected to be published soon.

There was a discussion during the Committee’s meeting on the evolution of group capital and supervision recognition including a review of the *Credit for Reinsurance Model Law* (#785), *Credit for Reinsurance Model Regulation* (#786) and reciprocal and qualified jurisdictions. There was also an overview of the U.S.’s covered agreements with the European Union and the United Kingdom. Regarding improvement of group supervision, the NAIC aims to “maintain the walls but enhance the windows” for regulators. They anticipate that the 2020 revisions to group capital calculation and LST will be implemented in all jurisdictions by 2026. These revisions are expected to become an accreditation standard.

Matt Walker from the Federal Reserve Board (the “FRB”) discussed the recently finalized building block approach (the “BBA”). The BBA is an aggregation-based approach that applies to FRB-supervised companies, meaning companies with both an insurance and banking practice. It becomes effective January 1, 2024. The FRB will continue to coordinate with states and share information they receive throughout the implementation process.

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Please do not hesitate to contact us with any questions.



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