

# NAIC 2024 Spring National Meeting Highlights

March 29, 2024

The National Association of Insurance Commissioners (the “NAIC”) held its 2024 Spring National Meeting (the “Meeting”) from March 15 to March 18, 2024, in Phoenix, Arizona. Debevoise attorneys attended many of the conference sessions in person or virtually and, in this update, we highlight our top takeaways from the meeting developments that may be of particular interest to our insurance industry clients, colleagues and friends.

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## Cybersecurity

The Cybersecurity (H) Working Group adopted the Cybersecurity Event Response Plan (“CERP”). The CERP is voluntary guidance intended to support a state department of insurance (“DOI”) when responding to a notification of a cyber event from a regulated insurance entity. The guide includes information on the process for responding to cybersecurity events, such as the DOI’s initial and subsequent engagement with the licensee, what information the licensee should provide to the DOI, and communications among stakeholders (e.g., consumers, law enforcement, and other regulators).

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## Big Data and Artificial Intelligence

The Big Data and Artificial Intelligence (H) Working Group published the NAIC Model Artificial Intelligence (“AI”) Adoption Map, which shows all of the states that have adopted the NAIC Model AI Bulletin. The map will be updated regularly and identify the states that have modified the Model AI Bulletin. Six states—Alaska, Connecticut, Illinois, New Hampshire, Rhode Island and Vermont—have already adopted the Model AI Bulletin in some form. The Working Group is continuing its AI/Machine Learning (“ML”) survey process and is also currently comparing the Model AI Bulletin against the White House Executive Order on AI as it monitors federal regulation of AI / ML in an attempt to help harmonize requirements. The Working Group is also focusing on algorithmic bias this year and whether it is able practically to create a synthetic data set for testing use within models.

The newly formed Third-Party Data and Models (H) Task Force held its first public meeting and outlined its initiatives regarding third-party models and data usage. The Task Force plans to survey and examine the current third-party models being used in the market and to develop a framework for oversight of those models.

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## Private Equity

The involvement of private equity in the insurance industry has been a matter of increasing focus for regulators both in the U.S. and elsewhere. The NAIC has been particularly focused on its work on the 13 *Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) owned insurers*. The NAIC has completed its work on four of the 13 Considerations in relation to:

- (1) Asset manager affiliates and disclaimers of affiliates, (2) identifying related party-originated investments (including structured securities) and (3) identifying underlying affiliated or related party investments and/or collateral in structured securities—in each case, the Statutory Accounting Principles (E) Working Group (“SAPWG”) determined that its previous initiatives had addressed particular concerns arising from private equity and no further work was necessary.
- (4) Defining private equity—the Macroprudential (E) Working Group (“MWG”) has determined that it would not be feasible to determine a definition.

Work is continuing on nine of the 13 Considerations, with open areas covering a variety of topics, including:

- Ownership, structuring and control—in particular, regulators have expressed concerns about owners who are focused on short-term results and/or are unwilling to support a troubled insurer;
- Operational, governance and market conduct practice;
- Privately structured securities and other issues related to complex investments; and
- Offshore and/or complex reinsurance arrangements.

In addition to the work of the NAIC, the Meeting also included updates on:

- the International Association of Insurance Supervisors’ (the “IAIS”) 2023 Global Insurance Market Report, which covered private equity’s involvement in the life

insurance industry and how that is related to affiliated transactions and potentially riskier investment strategies deployed by private equity-owned or affiliated life insurers. This focus on investment strategies, and particularly on an increased allocation of capital to less liquid investments, is mirrored in the NAIC's own work in its workstreams focusing on the accounting treatment of collateralized loan obligations ("CLOs") and other structured securities.

- the Bermuda Monetary Authority's (the "BMA") December 2023 paper regarding the supervision of private equity owned insurers, which relates to the broader, ongoing assessment of Bermuda's regulatory framework, including changes to capital requirements, reserving, governance and risk management requirements, and additional supervisory reporting and review requirements (including requiring BMA approval of all long-term block reinsurance transactions). The paper continued the theme of regulatory concerns with regard to higher allocations to illiquid assets, potential weaknesses in governance, complex corporate structures, and potential conflicts of interest.

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## Funded Reinsurance

Various NAIC committees referred to the rise in cross-border asset-intensive reinsurance (also known as funded reinsurance), particularly where the risks are ceded offshore. This has been another issue that has seized the attention of regulators globally. Notably, the Life Actuarial (A) Task Force ("LATF") discussed a proposal to require asset adequacy testing ("AAT") for ceded reinsurance transactions. The discussion on this item was lively between regulators and stakeholders with particular areas of disagreement over whether and how to apply AAT to offshore business and whether formulaic AAT is a proper fit ostensibly to measure the adequacy of reserves held by the reinsurer. Other areas of discussion included the meaning of "gross of reinsurance" testing, materiality determinations, aggregation level and prior approval, asset assumption and retrospective versus prospective application of AAT. Notably, on the last issue, LATF appeared to support retrospective application of AAT, perhaps going back to 2020, which is around the time that many large life and annuity transactions became prevalent. A presentation on the AAT proposal was exposed for a 60-day public comment period ending May 17, 2024.

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## Combining Coinsurance and YRT

The SAPWG discussed (following a referral by the Valuation Analysis (E) Working Group) concerns around overstated credit for reinsurance with regard to life reinsurance

treaties that combine interdependent coinsurance and yearly renewable term (“YRT”) features. The SAPWG exposed modifications to SSAP No. 61R that provide risk transfer should be evaluated in the aggregate for contracts that involve more than one type of reinsurance with interdependent features, such as an experience refund that is based on aggregate experience, and add a reference to paragraph 6 or A-791 (the paragraph of the risk transfer rules for life reinsurance regarding the “entire agreement” requirement and the effective date of reinsurance agreements) to the credit for reinsurance guidance on YRT. The public comment period on the exposed revisions to SSAP 61R ends on May 31, 2024. This item has also been moved to the active listing of the maintenance agenda, and so we expect will likely be an area for further discussion going forward.

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## Principles-Based Bond Project

The SAPWG adopted the final exposure for the principles-based bond project, involving updates to SSAP No. 21R—*Other Admitted Assets*, with updates primarily dealing with residual interests—for example, to clarify that an “equity position in an [asset-backed securities (“ABS”)] Issuer, as defined in SSAP 26R, would be classified as a residual tranche.” The exposure was made effective as of January 1, 2025, but allows for the early adoption of the guidance. The NAIC is also working on a training program on this item.

The SAPWG also exposed revisions to both SSAP No. 26R—*Bonds* and the draft issue paper for the principles-based bond project, clarifying the guidance for debt securities issued by funds. The revisions are intended to eliminate the rules-based provision, pursuant to which currently Securities Exchange Commission registration for a fund is required, and instead to permit debt securities issued by funds to be classified as issuer credit obligations if the fund represents an operating entity. The issue paper guidance continues to provide that collateralized fund obligations and other similar structures would be required to be assessed as ABS to determine if they qualify for bond reporting. The issue paper also includes guidance to assist in determining whether a fund represents an operating entity. The exposure of the revisions was accompanied by a request for regulators and the industry to provide comments that address proposed language (i) that assists with clarifying the scope of guidance for the types of debt securities issued by funds that should be considered operating entities and (ii) to better define the extent of debt that may be issued to fund operations.

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## Treatment of Structured Securities

In 2023, the NAIC decided, on an interim basis, to increase the risk-based capital charges for ABS residual tranches from 30% to 45%. This change is due to take effect by the end

of 2024. The NAIC at the time gave interested parties and the industry one year to show whether this 45% capital charge is appropriate. Oliver Wyman was engaged to conduct an independent analysis of the relative risk of ABS tranches and to provide such data to the NAIC for discussion. Upon receipt of the report, the Risk-Based Capital Investment Risk and Evaluation (E) Working Group suggested that the report provides persuasive evidence that the 45% charge is appropriate. The Working Group heard from interested parties, including the American Council of Life Insurers (the “ACLI”), which asked for a one-year deferral on implementation of the change. The ACLI indicated that it is working on two projects on residual tranches and would like more time to pressure test the proposals. Also, the ACLI indicated that the report may justify a 45% charge for CLOs, but not other asset classes, and that it may be in a position to show that tranche risk can vary based on tranche classes. However, the Working Group responded that the 45% factor has been set and the report appears to justify this charge, and further noted that the NAIC has already waited one year on this issue so a further deferral is not warranted. The Working Group exposed the Oliver Wyman report and will schedule a call after the exposure period ends.

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## Negative Interest Maintenance Reserve (“IMR”)

The SAPWG exposed changes to the annual statement instructions to remove the guidance that directs all preferred stock to be allocated between IMR and asset valuation reserve (“AVR”) based on NAIC designation, and to clarify that mandatory convertible preferred stock is reported as equities through AVR. This reflected a change to the original proposal exposed after discussion with interested parties, who questioned whether mandatorily redeemable preferred stock should be treated similarly, given that the guidance in *SSAP No. 32R—Preferred Stock* requires a fair value measurement for all mandatory convertible preferred stock investments.

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## Investment Management

In furtherance of the NAIC’s work on investment management arrangements, the Risk Surveillance (E) Working Group exposed proposed changes to:

- the general interrogatories sections of annual and quarterly financial statement filings—these would require reporting companies to list both primary and sub-advisors by name and type of affiliation; and
- the NAIC’s *Financial Analysis Handbook* and the *Financial Condition Examiners Handbook*—these update guidance around the review of affiliated investment

management services and agreements. In particular, the guidance asks examiners to review the reasonableness and fairness of investment management agreements.

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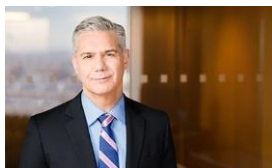
## International Matters

A number of key international developments were raised during the Meeting, including:

- The IAIS is on course to finalize the Insurance Capital Standard (“ICS”) this year with the final version due to be agreed in December. It remains to be seen, what, if any, further changes might be made following the confidential five-year reporting period, which ends this year.
- On the aggregation method comparability assessment, the International Insurance Relations (G) Committee indicated that the review remains on track. There are a few discrete areas where further analysis is needed, and there will be additional targeted data collection. A final decision is expected in Q4 2024.
- The IAIS is currently looking into developing its strategic plan for 2025-2029. The IAIS will be sharing more in April / May with the aim that the plan will be approved in June at the IAIS Executive Committee level and the final plan is expected to be approved in the General Meeting of the IAIS in September. It remains to be seen exactly what will be in the plan, but it is expected that it will focus on climate risk, artificial intelligence and reinsurance.

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Please do not hesitate to contact us with any questions.



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