# NAIC 2024 Summer National Meeting Highlights

**August 28, 2024**

The National Association of Insurance Commissioners (the "NAIC") held its 2024 Summer National Meeting (the "Meeting") from August 12 to August 16, 2024, in Chicago, Illinois. Debevoise attorneys attended many of the conference sessions in person or virtually and, in this Debevoise In Depth, we highlight our top takeaways from the meeting, focusing on developments that may be of particular interest to our insurance industry clients, colleagues and friends.

## Key Takeaways:

- The NAIC continues to monitor the cross-border reinsurance market and dialogue with other jurisdictions, seeking to ensure U.S. cedents and their policyholders are protected.
- The Life Actuarial (A) Task Force exposes a draft "Actuarial Guideline" requiring asset adequacy testing ("AAT") using a cash-flow testing methodology that evaluates ceded reinsurance as an integral component of asset-intensive reinsurance.
- The Capital Adequacy (E) Task Force recommended the formation of a new working group to review non-investment-related factors that affect RBC formulas and discussed a draft proposal (2024-16-CA) revising the Risk-Based Capital Preamble to prohibit public disclosure of RBC levels by companies in press releases or earnings presentations.
- The Risk-Based Capital Investment Risk and Evaluation (E) Working Group continues its work toward developing an RBC methodology for collateralized loan obligations ("CLOs").
- The Valuation of Securities (E) Task Force adopted a revised amendment to the Purposes and Procedures Manual of the NAIC Investment Office, authorizing the procedures over which the Investment Analysis Office will retain discretion and

through which it will be able to contest NAIC Designations assigned through the Filing Exempt (FE) process.

- The Privacy Protections Working Group plans to move forward with revising the existing Model Law 672 rather than continuing to draft Model Law 674.

## Cross-Border Reinsurance Developments

The Life Actuarial (A) Task Force ("LATF") met on August 11 and 12, 2024 to consider, among other things, a proposal to require asset adequacy testing (AAT) for ceded life and annuity reinsurance transactions. The proposal emanated from LATF meetings beginning in March 2024 following release of a report from the American Academy of Actuaries titled "Asset Intensive Reinsurance Ceded Offshore from U.S. Life Insurers (with focus on Bermuda)." In the ensuing five months, U.S. regulators have grown increasingly concerned about asset-intensive reinsurance activity where reserves are potentially being held in lower amounts than U.S. statutory requirements. Responding to these concerns, LATF exposed for comment at the NAIC Spring 2024 National Meeting a proposal (the "AAT Proposal") to require AAT using a cash-flow testing ("CFT") methodology to provide state regulators with better insight into the assets and reserves supporting ceded businesses to meet policyholder obligations.

During the August 11 session of LATF, Fred Andersen, Chief Life Actuary at the Insurance Division of the Minnesota Department of Commerce, presented a slide deck and facilitated a discussion with regulators and stakeholders. The session covered feedback on the AAT Proposal received by LATF, highlighting areas of consensus as well as topics needing further examination and discussion.

One aspect of the AAT Proposal that has attracted much attention is the proposed retroactive application of the requirements back to 2020–2021 (or perhaps even earlier), coinciding with the proliferation of large offshore reinsurance transactions. Other commentators expressed concern that the AAT requirement could interfere with the Covered Agreements (i.e., the Bilateral Agreement on Prudential Measures regarding Insurance and Reinsurance between the U.S. and the EU/UK) by ostensibly requiring collateral to be posted by non-U.S. reinsurers, which may otherwise be exempted by the Covered Agreements.

Mr. Andersen also led a discussion of a "strawman" draft Actuarial Guideline on AAT for Reinsurance (the "Actuarial Guideline") exposed by LATF as part of the meeting materials, mostly to advance the conversation around the AAT Proposal and invite

further discussion rather than as a draft that LATF recommends adopting in its present state.

The Actuarial Guideline, which was exposed for a 60-day public comment period ending October 11 (though some parts were exposed for shorter periods), establishes safeguards within the domestic cedent to ensure that assets supporting reserves continue to be adequate based on “moderately adverse conditions.” The Actuarial Guideline includes a target effective date of December 31, 2025.

Cross-border reinsurance was also discussed at the meeting of the Financial Stability (E) Task Force on August 13, 2024. Robert Kasinow (Acting Deputy Superintendent, New York State Department of Financial Services) gave an update on the Macroprudential (E) Working Group meeting held on July 8, which was in regulator-to-regulator session, to discuss cross-border reinsurance. At that meeting, certain regulators asked NAIC staff to conduct additional analysis of cross-border reinsurance activity, including a breakout of the types of products ceded and the jurisdictions of the reinsurers, and report back to the working group.

Mr. Kasinow also gave an update on various NAIC actions addressing the 13 “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers” adopted by the NAIC in 2022. With respect to the NAIC’s response to consideration number 13 (“[i]nsurers’ 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”), the report presented by Mr. Kasinow notes the ongoing work by LATF on the AAT Proposal discussed above.

## Risk-Based Capital (“RBC”) Developments

### Formation of New RBC Working Group

The Capital Adequacy (E) Task Force (“CATF”) recommended the formation of a new NAIC working group to review non-investment-related factors that affect RBC formulas. According to the referral for the new working group, since the inception of the RBC formulas in the early 1990s, many of the risk factors have not been evaluated or updated. CATF determined that a regularly scheduled analysis of these risk charges is necessary to maintain the accuracy of the formula and to stay current with economic conditions. CATF also noted that the IAIS Insurance Core Principles (ICPs) speak to the periodic review of the solvency framework. This new working group, to be called the Risk-Based Capital Risk Research (E) Working Group, would be charged with performing a comprehensive review of the RBC framework for all business types.

### Public Disclosure of RBC Levels

CATF also discussed a draft proposal (2024-16-CA) to revise the Risk-Based Capital Preamble to prohibit public disclosure of RBC levels by companies in press releases or earnings presentations. By way of background, earlier this year, CATF formed an RBC Purposes and Guidelines Ad Hoc Subgroup to recommend revisions to the RBC Preamble to clarify and emphasize the intended uses of RBC, which was to identify troubled companies and not intended to be used as a measure of strength.

As discussed in our Debevoise Update, if adopted, 2024-16-CA may conflict with historical disclosure practices and certain accounting and regulatory requirements relevant to insurance companies. For example, the proposal would arguably conflict with the GAAP Accounting Standard, which requires insurance entities and entities controlling U.S. insurance subsidiaries to disclose in their financial statements the amount of statutory capital and surplus required to satisfy regulatory requirements.

### RBC Factor for Residual Tranches

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBC IREWG") voted to retain the original adoption of the interim 45% RBC factor for all residual (i.e., equity) tranches of asset-backed securities following a proposal by an interested party that the 45% RBC factor be applied to broadly syndicated loan (BSL) CLO equity and a 30% RBC factor for private credit CLO equity.

### CLO Modeling Project

RBC IREWG and the Financial Condition (E) Committee received updates on the CLO RBC modeling project. By way of background, the RBC IREWG asked the American Academy of Actuaries (the "Academy") for support in creating an RBC framework for asset-backed securities. The Academy is now working to identify a set of comparable attributes that can be used to segregate CLOs into risk buckets. The Academy will likely identify different sets of comparable attributes for debt tranches vs. residual tranches and expects to present its findings in early 2025. After the RBC IREWG identifies comparable attributes for CLOs, the remaining steps include a development of factors and extension of CLOs to other asset-backed securities.

## Statutory Accounting Developments

### Principles-Based Bond Project

The Statutory Accounting Principles (E) Working Group ("SAPWG") provided an update on the implementation of the principles-Based Bond Project (the "Bond

Project"), the final exposure of which was previously adopted with an effective date of January 1, 2025. At its May 15, 2024 meeting, SAPWG exposed updates to its draft issue paper, which provides a detailed review of the discussions and decisions surrounding the Bond Project over the last four years. In addition to incorporating several revisions based on comments from interested parties, SAPWG revised paragraph 36 of the issue paper, concerning the time frame in which insurers should assess whether a security qualifies for reporting as a bond. The revised sentence states that "[t]he determination of whether an investment qualifies as a creditor-relationship, and then as an ICO or ABS (as applicable), requires an assessment by the reporting entity *of the full structure as it is ultimately intended by the issuer at time of acquisition*." The revised issue paper was adopted, subject to further revisions with respect to debt securities issued by funds (as discussed below). In addition, SAPWG exposed a Question-and-Answer Implementation Guide, which provides further guidance on how the Bond Project guidance should be applied to specific investment structures.

Previously, SAPWG exposed revisions to both SSAP No. 26R—Bonds and the draft issue paper for the Bond Project, clarifying the guidance for debt securities issued by funds. Based on comments from interested parties in the interim, the Working Group re-exposed revised language on a shortened time frame for comments (September 6, 2024). The revisions clarify that debt securities issued by funds that are not registered with the SEC "must be classified in accordance with the issuer's primary purpose. If the primary purpose is for raising debt capital, then it must be assessed as an ABS, regardless of the amount of debt issued."

### Combining Coinsurance and Yearly Renewable Term ("YRT")

SAPWG noted developments with regard to its previously discussed concerns around overstated credit for reinsurance for life reinsurance treaties that combine interdependent coinsurance and YRT features. SAPWG expressed its view that such interdependent contract features must be treated in the aggregate for purposes of determining compliance with reinsurance risk transfer rules. SAPWG requested additional details from the industry on the extent to which existing contracts would be impacted and indicated that SSAP No. 61R would be re-exposed with further revisions through September 27, 2024 in order to be discussed further at the fall NAIC meeting.

### Repacks and Derivative Wrapper Investments

SAPWG also discussed exposed edits to SSAP No. 86—Derivatives to incorporate a new SAP concept around debt security investments with derivative components that do not qualify as structured notes (so-called credit repack investments). This is an investment that involves debt securities sold to a special purpose vehicle, wrapped with a derivative and repurchased by the company. SAPWG noted that these repacks would not be considered a bond under the revised bond definition. As such, the exposed guidance

clarifies that such instruments should be reported in a bifurcated fashion, as a sale on Schedule D-Part 4 and as a new acquisition on Schedule D-Part 3.

## Development in NAIC Designation of Investments

The Valuation of Securities (E) Task Force ("VOSTF") discussed and adopted proposed changes to the definition of "NAIC Designation" in the Purposes and Procedures Manual of the NAIC Investment Office ("P&P Manual"). An NAIC Designation is a proprietary symbol used by the NAIC Securities Valuation Office ("SVO") to denote a category or band of credit risk for an issuer or for a security. However, a large proportion of fixed-income securities held by insurers are filing-exempt ("FE"), meaning they automatically receive an NAIC designation that matches the rating given by an NAIC-recognized Credit Rating Provider, as outlined in the P&P Manual. Securities that are not FE must be submitted to the SVO for evaluation and the assignment of an NAIC designation.

The adopted changes to the P&P Manual include the addition of a new paragraph under "Regulatory Objective" to further define "investment risk" and explain why it is replacing the term "credit risk" as the focus of the NAIC Designation definition. "Investment risk" focuses on the "likelihood that an insurer will receive full and timely principal and expected interest," whereas "credit risk" focuses on an issuer's ability to make payments in accordance with contractual terms. VOSTF expressed its view that focusing on investment risk is a better measure of what an NAIC designation represents, since "focusing on credit risk alone would limit the SVO's ability to appropriately assess certain risks."

VOSTF also discussed and adopted a revised amendment to the P&P Manual, which authorized the procedures through which the Investment Analysis Office ("IAO") will retain discretion over and be able to contest NAIC Designations assigned through the FE process when it determines that a given NAIC designation is not "a reasonable assessment of investment risk of [a] security for regulatory purposes." The adopted amendment will take effect on January 1, 2026 (but may be extended to accommodate needed technical enhancements to IAO systems). The revised amendment incorporated many recommendations from interested parties, including:

- The process will be consistently applied to all Credit Rating Providers and is not expected to be used often.

- The IAO, prior to inviting insurers to discuss an affected security, will provide a written summary of its rationale and what it believes the NAIC Designation to be.

- Affected insurers would retain discretion to include the Credit Rating Provider in discussions with IAO.

- Other authorized parties (defined as "[h]olders of the affected securities that agree to the confidentiality provisions required by the NAIC") are allowed to discuss the security with the SVO.

- The annual summary of reviews will be anonymized and will not disclose information on specific securities, Credit Rating Providers or impacted insurers.

- A revised adopted amendment would include a review or "look-back" period to ensure that the process is working as intended.

Notably, the Financial Condition (E) Committee (VOSTF's parent committee) deferred a decision to adopt the revised amendment to the P&P Manual, indicating that there would be a subsequent meeting to discuss the amendment.

## Privacy Protections Developments

The Privacy Protections (H) Working Group provided an update regarding the revisions to the Privacy of Consumer Financial and Health Information Regulation Model Law (#672). During the meeting, it was reiterated that the Working Group had decided to pause work on the new Privacy Model Law #674 draft to focus on updating the existing Model Law #672. The revisions to Model Law #672 are designed to address modern privacy concerns by incorporating principles from NAIC Privacy Models, including Model Laws #670, #672 and #674, as well as state comprehensive privacy laws. The group has narrowed its focus to four key privacy principles: (1) third-party arrangements; (2) the right to access, correct and delete data; (3) the sale of personal information; and (4) the handling of personal information.

Following the meeting, the Working Group published the "Chair Draft Amendments to Model Law #672" for a 30-day public comment period, starting with Section 5 on Third-Party Arrangements. This section outlines the contractual obligations for when a licensee discloses consumers' personal information to third-party service providers, including limitations on data use, data deletion or return requirements, and data security obligations. The Working Group requested that interested parties only provide comments on the Third-Party Arrangements section of the draft during this initial 30-day public comment period. The other key sections of the draft address consumer data requests, the sale of personal information, and the use and disclosure of sensitive personal information.

The group clarified that the Chair Draft is a preliminary starting point and does not represent any formal agreement by the Working Group. Transparency and consensus-building among industry members, consumer groups and regulators remain a priority. To facilitate this, the group has published additional materials, including drafting outlines and a document comparing how NAIC Privacy Models incorporate core privacy principles addressed in state privacy laws. The timeline for the revisions is expected to extend through the end of the year, with the possibility of requesting additional time if necessary.

## Big Data and Artificial Intelligence Developments

In July, prior to the Summer National Meeting, the Big Data and Artificial Intelligence (H) Working Group convened to discuss the results of its home AI and Machine Learning Survey. The findings were consistent with previous surveys conducted in the Life and Personal Passenger Auto sectors, revealing that 70% of reporting insurers plan to use AI and ML in various operational areas. This is comparable to the 88% reported in the Personal Passenger Auto sector and 58% in Life. The survey also indicated that the primary use cases for AI and ML in the home insurance context align with those identified in earlier surveys, including claims processing, marketing, underwriting/pricing and fraud detection. Moving forward, the group will focus on analyzing the use of AI and ML in the Health Insurance sector.

During the recent Innovation, Cybersecurity, and Technology (H) Committee meeting, a brief update was provided on the adoption of the Model AI Bulletin, which was formally adopted in December 2023. Fifteen states have already adopted some form of the NAIC Bulletin within less than a year of its release. The flexibility of the NAIC Model Bulletin allows states to tailor enforcement to their specific needs, which is why attention to each state's unique adoption is crucial. For example, Connecticut requires domiciled insurers to certify their compliance annually, a requirement not imposed by all states.

The newly established Third-Party Data and Models (H) Task Force convened to explore various risk-based approaches to regulating third-party data and AI. While no formal decisions have been made regarding the adoption of a specific risk-based framework, the discussion highlighted several potential models for consideration. These included Colorado's "Trust but Verify" approach, the NAIC's state-specific market conduct model, and a tiered risk-rating system. These examples may serve as potential foundations as the Task Force develops its regulatory framework.

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