WILLKIE FARR & GALLAGHER LLP

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Willkie Insurance Industry Review

Corporate and Risk Transactions, Regulation and Tax Developments

February 2022

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To Our Clients and Friends:

When we wrote the introductory note for the 2020 Year in Review, we, like many others, did not expect to still be addressing COVID-19 and its direct impact a full year later. The insurance industry has continued to adjust and adapt in myriad ways, and as advisors to our clients, we have done the same. As lawyers, we learn all we can from the flux of events in order to better evaluate the ongoing needs of our clients and provide the best forward-looking solutions. COVID-19 and its implications, from the human and health toll it is taking on families across the globe to its impact on how we work and relate to each other, will undoubtedly continue to affect the insurance industry for years to come.

As we use this opportunity to present our insights and observations on a remarkable and remarkably active year, we continue to offer our thoughts and best wishes to our clients, friends and others who have been impacted by the global pandemic. As always, we also wish to thank our clients for the privilege of advising them on significant transactions and issues involving the insurance industry in 2021, and we look forward to continuing to work with you in the future.

Sincerely,

Insurance Transactional and Regulatory Practice,
Willkie Farr & Gallagher LLP

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I. REVIEW OF M&A ACTIVITY

A. United States and Bermuda

2021 represented another robust year for insurance industry M&A activity, taking in stride the ongoing COVID-19 pandemic, and occurring within the context of a global mergers and acquisitions boom across all industries (with global M&A hitting new highs in 2021 and a significant increase in numbers of deals from 2020). More than 250 life, health and P&C deals were announced in 2021 compared to 230 in 2020. Furthermore, 2021 reflected an uptick in the number of "megadeals" involving United States insurers in the life and health sector.

The largest United States or Bermuda (a deeper discussion of trends in the Bermuda M&A market appears below) deal announced last year was Apollo Global Management's acquisition of the majority stake of Athene Holding Ltd. in a stock-for-stock transaction implying a total equity value of Athene of approximately $11 billion. This deal was notable for a number of reasons including the existing relationship (including Apollo's existing investment management arrangement with the company and its 25% stake in its equity) between Apollo and Athene and as a data point for how financial sponsors may view their investments in insurance companies in comparing their performance to the broader sector (for those that are public).

The largest United States deal announced last year was Allstate's agreement to sell a portion of its life business, Allstate Life Insurance Company, and certain related subsidiaries to The Blackstone Group ($4.00 billion) – the New York business and Allstate Life Insurance Company of New York were separately sold in a smaller transaction to Wilton Re – followed closely by Great-West's acquisition of the full service retirement business of Prudential ($3.55 billion) and MassMutual's acquisition of Great American Life Insurance Company from American Financial Group ($3.5 billion).

We note that in a continuing trend, much of the deal activity in 2021 – particularly in the life and health sector – involved the sales of blocks of businesses effected through reinsurance, which are transactions not always reflected in public M&A databases and listings, for example Talcott Resolution's reinsurance of a significant block of fixed indexed annuity liabilities from Allianz Life (with a portion placed with Resolution Life), or where the "purchase price" in such transaction can be difficult to assess (in comparison to the overall amount of liabilities involved). Though this may make comparisons to prior periods difficult, it is notable that in addition to the transactions described above, there were a number of other United States life and health deals involving purchase prices in excess of $1.0 billion, some of which we discuss below.

i. Life and Health Transactions

While The Blackstone Group's completed $4.00 billion acquisition of Allstate Life Insurance Company and the Talcott Resolution/Allianz Life transaction noted above do continue the trend of financial sponsors acquiring insurers (via M&A transactions or reinsurance) with large fixed annuity and life insurance reserves, and sponsor-backed roll-up vehicles such as Fortitude Reinsurance Company Ltd. continue to acquire United States businesses such as Prudential Annuities Life Assurance Corporation ($1.5 billion), and evidence financial sponsors' willingness to move in and out of assets in the space (for example, The Blackstone Group's acquisition this year follows its sale in 2020 of FGL Holdings to Fidelity National), financial sponsors' involvement in the industry is also evidenced by strategic partnerships with a focus on asset management and asset rebalancing, which can be paired with the acquisition of minority positions. In July, AIG announced a strategic partnership with Blackstone for its life and retirement business that featured entry into a Strategic Asset Management relationship and the sale of certain affordable housing assets to Blackstone Real Estate Income Trust ($5.1 billion) that was significantly larger than the value (in absolute terms) of the 9.9% equity stake Blackstone received in the enterprise ($2.2 billion). For the asset manager, we can presume the transaction provides significant and stable investable assets without the requirement for a significant equity

investment or the burdens associated with majority control of an insurer. For AIG, the transaction provides financial flexibility and support for potential separation of its life and retirement business. The ongoing long-term low interest rate environment preceding the recent uptick in rates continued to fuel desires from insurers to exit certain lines of capital-intensive, low-return businesses and provide an opportunity for asset managers and financial sponsors to acquire blocks of business in reinsurance transactions (as well as M&A). Increased competition for such blocks, and legal entities, also contributed to increased competition for insurance "shell companies" among financial sponsors and other parties looking to enter into the industry (either on an active basis or in acquiring runoff blocks of business). The 2021 market for blocks of life and annuity businesses remained robust, though the economic headwinds (increases in interest rates) and long period of activity will bear considering in how long such trends can continue in 2022 and beyond.

As discussed in more detail below in the Regulatory section of our Year in Review, certain subcommittees of the NAIC have recently been focused on matters related to the ownership of insurance companies by private equity firms. This has culminated in the designation of an NAIC committee, the Macroprudential (E) Working Group, to oversee ongoing and future NAIC initiatives related to private equity ownership of insurance companies. While a number of regulatory considerations identified by the NAIC could affect strategic owners as well as private equity owners, certain of the issues under consideration focus on the terms of investment management agreements with affiliated entities, including the amount and types of management fees paid by the insurer, the termination provisions (the difficulty and cost of termination) and the degree of discretion or control of the investment manager over investment guidelines, allocation and decisions. The recent discussions at the NAIC have thus far focused primarily on potentially requiring enhanced disclosures from private equity owners. Private equity buyers can expect increased scrutiny during the Form A process and should be prepared for protracted discussions with regulators and longer lead times that may affect the pre-signing auction process. Conversely, the regulatory focus on private equity may prove advantageous for traditional insurance holding companies participating in the same auctions in order to make strategic investments.

As we have noted in prior years in review, much of the M&A activity in the life insurance industry over the last several years has been driven by private equity sponsors seeking to acquire blocks of fixed annuity and life insurance policies. While not all private equity sponsors have adopted the same investment thesis, the attraction of the life and annuity business for many sponsors has been a consequence of their desire to leverage their investment management expertise with respect to certain asset classes which they perceive as being underallocated compared to other general account assets (e.g., structured credit). In some private equity-sponsored acquisitions of life and annuity companies and blocks of business, the sponsor has sought to condition its obligation to close on the approval of the terms of an investment management agreement between an investment management affiliate of the sponsor and the target which would become effective at the closing.

It is too early to tell whether the NAIC focus on private equity will result in new regulations and whether any such regulations will have merely a disclosure focus or a substantive bite. From a deal-making perspective, however, both buyers and sellers will be increasingly focused on the allocation of closing risk – particularly in deals which implicate some of the Macroprudential Working Group's regulatory considerations such as related-party investment management agreements and who bears the risk of disapproval. As a practical matter, pre-signing conferences with regulators which are already becoming the norm in certain states may become more widely used as parties seek closing certainty. The practical consequence may be that transaction timelines become stretched out as interaction with regulators becomes increasingly front-end loaded.

Strategic M&A in the life sector was also strong, including large-scale transactions such as, in addition to MassMutual and Great-West's activity noted above, CUNA Mutual's acquisition of Assurant's Global Preneed business ($1.35

billion) and Prudential's spinoff of Jackson Financial Inc. ($1.765 billion) and a number of sub-$1 billion transactions. Of interest coming out of 2020, and with an eye towards increased regulatory and antitrust scrutiny in the Biden administration, the previously announced Aon and Willis Towers Watson merger was terminated prior to completion under review by the United States Department of Justice.

ii. Property/Casualty Transactions

Consistent with 2019 and 2020, P&C M&A transactions did not supercharge deal volume in 2021 and, in comparison to 2020, 2021 featured fewer "megadeals" in the sector. We believe that between the relative absence of financial sponsor activity, prior years of historic consolidation and economic factors, the P&C M&A market is less frothy than its life and health counterpart.

Despite the absence of any M&A transactions in the United States involving a purchase price in excess of $1 billion, a number of smaller P&C transactions were effected throughout the year, involving financial sponsors (such as the acquisition of ProSight Global ($586 million)) and strategic acquirers (Progressive's acquisition of Protective Insurance Corporation ($338 million)).

iii. United States Involvement in the International M&A Market

United States involvement in the international M&A market (and international interest in the United States) was noteworthy in 2021. Throughout 2021, some very significant foreign or internationally headquartered insurance groups and firms advanced strategic development opportunities through investment in United States insurance companies. Worthy of particular note are public announcements and M&A activity by Japanese insurers in 2021 which may indicate a new wave of successful United States acquisitions by Japanese companies. Emblematic of this trend is Mitsui Sumitomo Insurance's previous announcement about its intent to deploy significant capital ($4.5 billion) to purchase United States insurance companies, and its subsequent acquisition of United States managing general agency International Transportation and Marine Office in 2021 in line with this stated course of action. Tokio Marine Holdings acquired Reliance Standard Life Insurance Company in 2021, formal approval for which was provided by the New York State Department of Financial Services in early 2022. On the basis of additional public announcements that have been made, it is expected that increased M&A activity from significant Japanese insurance groups will continue in 2022.

However, increased regulatory scrutiny both in the United States and internationally contributed to a slowdown, and in some cases, a breakdown of acquisitions in the United States by certain foreign insurance companies. Chinese insurers were particularly impacted by regulatory hurdles including those related to CFIUS considerations in the United States and the tightening of outbound overseas investments by Chinese regulators. The termination of China Oceanwide Holdings Group Co., Ltd.'s proposed merger with Genworth Financial, Inc. after over four years of work on the matter is of particular note in 2021. Anticipated expanded CFIUS review may interrupt the growth in recent years of Chinese involvement in the United States insurtech market as well.

2021 saw some notable outbound international M&A activity by United States insurance groups. Most significantly, Chubb acquired Cigna's life and non-life insurance companies relating to its personal accident, supplemental health and life insurance business in various Asia-Pacific markets for $5.75 billion. In addition, certain United States-based and global insurance groups increased their stakes in foreign joint ventures, including Chubb's greater presence in China (it became the majority shareholder of Hutai Insurance) and MetLife's expanded footprint in India (through its purchase of an additional significant minority stake in PNB MetLife India Insurance Company).

Large United States brokers contributed a significant portion of international insurance M&A activity in 2021. For example, Arthur J. Gallagher completed its acquisition of Willis Towers Watson's treaty reinsurance brokerage operations in December 2021, resulting in a combined business that spans 31 countries. Notably, this transaction was finalized following the ultimately unsuccessful merger

of Aon and Willis that was in progress earlier in the year. Additionally, Marsh increased its stake in Marsh India Insurance Brokers from 49% to 92%. Current trends point to continued activity around insurance brokerage consolidation in 2022, including cross-border M&A, driven in part by a growing presence of private equity-backed buyers.

iv. Sponsored Demutualizations

In our 2020 Year in Review, we discussed sponsored demutualizations and their differences from the so-called "subscription rights" demutualization transactions discussed in years past (with sponsored demutualization referring back to the more traditional distribution to policyholders of their allocable share of the demutualized company's surplus in the form of stock or cash proceeds from a sponsored demutualization). 2021 featured several examples of sponsored demutualization transactions, including multiple announced transactions led by sponsor Constellation Insurance Holdings (an insurance holding company backed by CDPQ and OTPPB) in the demutualizations of Ohio National and Columbian Mutual Life Insurance. Notable issues in these transactions include: (i) the form and manner of policyholder consideration – in Ohio National, for example, Constellation will fund cash payments or policy benefits in the aggregate amount of $500 million to policyholders for extinguishment of their membership interests in the mutual, (ii) commitments from the financial sponsors to infuse additional capital (up-front or conditioned upon insurer needs) – for example, in the Ohio National transaction, a $500 million infusion over four years, (iii) structuring considerations for financial sponsors that are driven by the ownership structure of the sponsor/funds and requirements of the ultimate equityholders, and (iv) dividend protection which can vary between a formula-based open block framework or creation of a closed block. During 2021, the impact of COVID-19 on dividends generally created interplay with these provisions beyond what is otherwise typical for a deal of this sort. As these involve financial sponsors and, in certain instances, the sponsor party to the relevant agreements may be a newly created shell, credit considerations for funding closing payments and post-closing capital considerations (for example, guarantees and the appropriate entities up the chain for such guarantees) may be a key topic.

v. Deal Points

While COVID-19 was certainly a relevant factor in M&A transactions, impacting the economy, the insurance industry and the broader tapestry of our lives, 2021 saw a significant decrease in the role of COVID-19 in acquisition agreements. By the end of 2020/beginning of 2021, M&A participants appeared to have a better handle on how COVID-19 was affecting their own and targets' businesses and the treatment of COVID-19 in acquisition agreements became less of a hot topic. Continued references to COVID-19 focused on (i) exclusion or inclusion of measures of "material adverse effect" and similar terms (and whether disproportionate impacts were similarly excluded or included), (ii) acknowledgement of the need to comply with COVID-19-related laws and broadly applicable measures/ recommendations of governmetal authorities in relation to positive and negative interim operating covenants, (iii) the impact of COVID-19 on "ordinary course of business" and "past practice" metrics and (iv) representations and diligence around PPP loans, tax deferrals, COVID-19-related actions and similar matters. This is certainly not to say that COVID-19 was not a topic of negotiation or, in certain deals, a critical issue driving individualized approaches to related matters; however, the market was coalescing around a treatment within certain bounds for your typical transaction.

Worth noting, however, are two emerging issues impacting deal documents in 2021 that we expect to continue to be relevant in 2022: (x) the increased request for inclusion of data, seriatim file and similar representations in life and health deals which may support valuation/pricing calculations beyond typical representations relating to the appraisal, and (y) end-of-year limitations in the R&W insurance market.

Regarding data, seriatim file and similar representations, 2021 saw what we believe to be a meaningful increase in the number of buyers of life and annuity businesses and

blocks seeking representations as to the material accuracy, source and support for the seriatim file and other data that is provided for their use in valuing the business sold. While these transactions are typically valued, in part (and acknowledging buyers will have their own "secret sauce" for valuation) around a third-party appraisal on the block, which is typically the subject of certain representations by a seller, buyers have begun to ask for broader representations on particular data sets (typically identified by schedule or otherwise) that may be centerpieces of their valuation. While customary limitations on the sufficiency of reserves continue in place in many of these transactions, these representations are noteworthy in how granular they can get in terms of line-level data. Sellers should be careful in considering requests for these representations and their scope, in particular in seller-indemnification transactions, as these could be a potential source of "foot fault" and sources for a number of claims that can reduce deductibles. Given the granular level of the subject matter, consideration of specific de minimis exclusions or deductibles may be useful for sellers. We note that for buyers such representations may provide additional comfort on key metrics and data beyond what the general financial statement and books and records representations can provide, and are worth considering where there is particular data beyond (or not necessarily the focus of) the appraisal that is relevant for valuation. We noted examples of such situation in variable annuity block transactions.

Regarding R&W insurance, while use of R&W insurance remains less prevalent in insurance industry transactions than in, for example, the broader private equity M&A world, it continues to be discussed and used in broad swaths of transactions (including insurers, block reinsurance, insurance intermediaries and other transactions). Given the significant increase in M&A volumes in 2021, we noted increased difficulty towards the end of the year in securing quotes from underwriters for R&W insurance. While some of this appeared to be driven by deal sector (healthcare insurance/intermediaries was particularly difficult and involved notable exclusions of topics to the policy), it also appeared to be more broadly driven (and non-deal specific) by insurers reaching their internal quotas on the amount of R&W insurance they were looking to write for the year and individuals/teams limited in their ability to accommodate high deal volumes. While it is difficult to say if 2022 will feature a similar issue, both from the perspective of deal volume and the potential for insurers to increase capabilities and appetites for R&W insurance, it is something to consider for Q4 transactions (and deal timing compared to Q1 2023) – in particular on transactions where sellers or buyers exhibit a strong preference for R&W insurance over traditional indemnities.

B. United States Insurtech

Insurance sector industry reports and analyst insights – having one eye trained on the technological transformation well underway in other areas of financial services and the world economy more broadly – have been predicting the arrival of the insurtech revolution for some years now. Perhaps in a different way than envisaged by some, a transformation has unquestionably now occurred. Fueled in part by the lifestyle changes necessitated by the COVID-19 pandemic, legacy carriers now universally recognize that investment in digital technology provides access to new markets and has the potential to materially improve underwriting, claims handling, and customer service capabilities while simultaneously driving down costs. Insurtech startups, often working with reinsurers, have introduced a great many innovative products and services in recent years and legacy carriers have been quick to follow or otherwise partner with those driving the innovation, including through investments in, or acquisitions of, the startups themselves. As such, "insurtech" is no longer synonymous with disruption; rather, the opportunities presented by innovation are recognized by all industry stakeholders.

i. Insurtech Investments

The scale of the opportunity to transform traditional insurance processes is reflected in the record-breaking global investment in insurtech transactions in 2021. Willis Towers Watson estimated that insurtechs raised $10.5 billion during the first three quarters of 2021, while market-scanning platform Sønr put total investments at $39.14

billion for that period. Funding in 2021 far surpassed what was invested into insurtechs globally in 2020 and in 2018 and 2019 combined. It remains to be seen whether insurtechs will sustain that level of funding infusions in 2022 as bond yields likely improve and the Federal Reserve likely raises interest rates a number of times. Additionally, the shares of publicly listed insurtech companies have plummeted in the last year, challenging some of the valuation assumptions underpinning recent private funding rounds (as to which see further below).

While most of the insurtech investment funding in 2021 related to early stage start-up ventures, some of the highest profile transactions in the United States were private investment in public equity ("PIPE") transactions associated with high-profile "go-public" special purpose acquisition corporation ("SPAC") mergers. However, each of the insurtechs caught up in the SPAC boom in Q4 2020 and Q1 2021 has seen its share prices tumble and stay down since going public. For example:

- Homeowner insurtech Hippo, which announced its intention to go public in March 2021, has lost more than 70% of its value since listing in August 2021, dropping from a market capitalization of $5 billion to less than $1.5 billion within a matter of months, having been adversely impacted by, among other things, 83% of the capital raised by the relevant SPAC being withdrawn prior to listing and reporting loss ratios for its business as high as 161%, causing investors to be concerned about its ability to turn a profit going forward.

- Personal auto insurtech Metromile, which announced its intention to go public through a SPAC merger in November 2020, saw its market capitalization reduce by around 80% in the nine months between being listed on NASDAQ in February 2021 and being sold to fellow listed insurtech Lemonade for $500 million in November 2021. Lemonade has been the outlier among the publicly traded insurtechs, with a share price remaining following a traditional initial public offering ("IPO") in July 2020.

- The newly public health insurtechs Oscar Health, Clover Health and Bright Health Group, each of which entered the public markets with high SPAC valuations, have all clocked in near triple-digit medical loss ratios and have consequently similarly suffered big falls in share price.

- One theme that is emerging from the torrid time that most United States insurtechs have been having in the public markets over the past 12 months is that financial startups are likely to pause their go-public ambitions until they have a path to being self-funding or, at the very least, be more likely to pursue more modest SPAC valuations or pursue a traditional IPO approach as part of a go-public exit strategy.

ii. Insurtech Mergers and Acquisitions

Insurtechs are actively pursuing mergers and acquisitions for several reasons:

- Firstly, many insurtechs are now of a sufficient size to allow for them to pursue their desired revenue growth through acquisitions. Examples of this from 2021 include the acquisitions: (i) by Next of AP Intego, its rival small business-focused insurtech, in March 2021; (ii) by Coalition, the cybersecurity program manager, of commercial insurance program manager Attune to create (what the parties claim to be) the world's largest commercial insurtech; and (iii) by Corvus of fellow United States cybersecurity agency Wingman in August 2021 and cybersecurity underwriting platform and Lloyd's coverholder, Tarian Underwriting.

- Secondly, the product innovations of insurtechs provide an opportunity for legacy carriers to add a new and complementary offering to their own product offerings and generally add impetus to their own digital transformation. Put another way: insurtechs are no longer just risk originators with a good branding; rather, they have spurred the development of software for the entire industry. For example, the acquisition by USAA of Noblr, the personal auto reciprocal insurance carrier, in June 2021, allowed USAA to augment its current "behavior-based" telematics-powered program, SafePilot, with Noblr's "usage-based" product.

- Thirdly, corporate venture capital is often being used by insurers as a mechanism to source and evaluate potential insurtech acquisition targets, and a number of insurers are now stepping up and purchasing their corporate venture capital portfolio companies. For example, in January 2021, American Family Insurance acquired its portfolio company, Bold Penguin, a commercial insurance rater and lead-exchange platform.

- Fourthly, several insurtechs have "proven their concept" through successfully operating as program managers and have sufficient capital to move to a hybrid insurance intermediary/carrier business model so as to no longer need to wholly rely on a carrier's capital, but instead underwrite their risk themselves and compete with insurers directly. Given speed-to-market and typically ambitious growth targets, insurtechs typically seek to make this transition through the acquisition of the stock of an existing "shell" insurance company that is not currently writing business but that possesses licenses to write insurance in a number of states. However, there are currently a limited number of widely licensed P&C or life/health shells available to buy. This has created a hot market with a consequent increase in price for suitable insurance carrier vehicles. Examples of insurtechs successfully acquiring shell carriers in 2021 include the (i) acquisition by Bestow, the term life insurtech, of Centurion Life Insurance Company; and (ii) acquisition by Pie, the workers' compensation insurtech, of Western Select Insurance Company.

- Fifthly, investors in insurtechs are likely to see sale of their investments as an attractive exit alternative to the go-public route, given the difficulty which insurtechs have generally been having in the public markets from Q2 2021 onwards (as discussed above).

- Lastly, while the most successful insurtech ventures moved beyond the seed and venture-capital rounds of financing to advanced funding rounds and sales, we are starting to see a number of insurtechs quietly flounder as funding rounds dry up as investors lose patience or burn rates are mismanaged. These insurtechs are frequently subject to "fire sales" as other market participants look to snap up platforms, licenses and technology for a bargain price before the insurtech runs out of cash. Willis Towers Watson has recently estimated that more than 450 insurtechs have quietly failed over the past decade.

iii. Reciprocal Insurance Exchanges

Over the last five years, several reciprocal insurance exchanges have been launched including Vault in 2017, Kin and Noblr in 2019, Branch and TRUE in 2020 and SURE in 2021. Other well-known reciprocal insurers are USAA, Farmers Insurance, PURE and Erie Insurance. Reciprocal insurance exchanges are owned by their policyholder-members who insure each other and exchange insurance policies to spread risk among themselves and share in the underwriting profits generated. There are no shareholders. Reciprocal insurance exchanges are managed by a management company – or attorney-in-fact – in return for a fee. In January 2022, Tower Hill Insurance Group launched a reciprocal insurance exchange with an initial surplus commitment of $200 million led by entities controlled by Gallatin Point Capital with additional capital support being provided by Vantage Group and RenaissanceRe. Tower Hill intends to renew its existing Florida homeowners book into the new reciprocal insurance exchange. Tower Hill indicated that this was the best option for it as a private company to keep supporting the growth of its book of business without diluting existing shareholders, going public or selling the company. Reciprocal formations have recently become popular among insurtech startups, among others, in part because of the fee income and leaner balance sheet profile of the attorney-in-fact compared with more traditional insurance companies.

iv. Embedded Insurance Allowing for New Entrants into the Insurance Distribution Chain

Another accelerating trend in the insurance industry is partnerships with established non-insurance brands to create value and drive growth. In particular, embedded insurance – where insurance is bundled within the purchase of a non-insurance product or a service from a third party – has emerged as a key distribution channel as sellers

of insurance look to the market to create new revenue streams and lower distribution costs. While embedded insurance is not a new concept – travel insurance or rental car insurance has been cross-sold by non-insurance brands for many years – technology (and particularly the use of APIs) has allowed for sophisticated embedding of products in a fashion without the need for expensive tech builds or disruptions to purchase flows. Being in a position to capitalize on the brand and data of companies closest to customers presents all insurance carriers and agents with great potential for growth, and can be transformative for market entrants with a huge boost in profile.

Notable examples of this trend from 2021 include (i) Chewy's white-labelled pet insurance and pet wellness plan partnership with Trupanion; (ii) Experian's acquisition of United States-based insurance aggregator Gabi for $320 million in November 2021; and (iii) Ford (through Allstate), Toyota (through Nationwide), Tesla (through State National) and General Motors (through American Family, using its OnStar brand) moving into personal auto insurance. You are also seeing certain insurtechs, like Cover Genius, successfully build global distribution models entirely around such embedded insurance partnerships. Other United States-specific examples include Matic (in the homeowner insurance space) and Spot (in the accident and health space).

C. The United Kingdom and Europe

2021 was another notable year of M&A and investment activity in the United Kingdom, Lloyd's and E.U. markets. The 2020 trend of deal-making continued with equity capital raisings for public and private carriers, including the deployment of capital from the "startup class of 2020-21" such as Inigo, Mosaic, IQUW, Conduit and Vantage, as well as scale-ups for incumbent players such as Ark and Fidelis.

These and other insurers raising capital were looking to be first movers to harness the potential returns from a hardening (re)insurance market. Following these capital raisings, however, it is being reported that certain lines of business are now beginning to experience a gradual softening of rates, largely due to increased capacity in the market, suggesting that the pricing momentum in some lines of business may be starting to wane. This comes at the same time as the market has endured a period of major loss activity in the forms of Hurricane Ida and Storm Bernd and various other significant weather-driven catastrophe events, which have exposed balance sheets to the potential of negative underwriting returns.

Despite the mix of catastrophe losses, the shift in the rating environment and the continuing economic challenges brought on by COVID-19, the (re)insurance M&A market has been resilient over recent months. This has been the case particularly in relation to fee-based insurance businesses such as pure play managing general agents (MGAs) and brokers. Support from investors for the intermediary market, in particular where there is an innovation and technology angle, has been robust in the past decade as revenues and profits for these businesses are not as directly dependent on the status of the underwriting cycle as compared to (re)insurance carriers whose returns are also dependent on underwriting risk. Several U.K. brokers' deal-making sprees continued, culminating in Howden's acquisition of Aston Lark for around £1.1 billion.

The interest in providing capital for underwriting risk tends to be more cyclical, with investors being more cautious about the ability to deliver the desired returns where there has been a lower underwriting rate environment, but renewing their interest and activity in this area as rates harden. A great deal of the investment activity in the (re)insurance sector in 2021 was derived from private equity houses, whether for startups or incumbents with exposure to underwriting risk, or for the intermediary market with little or no exposure to underwriting risk.

The continued low interest rate environment is another factor which has driven M&A activity in the sector which, along with substantial dry powder being available for deployment, means investors continue to look further afield for yield opportunities. It remains to be seen how this dynamic may shift if central governments decide to increase interest rates in 2022 to offset increased levels of inflation caused by supply chain disruptions, labour market demands and other factors.

I. Review of M&A Activity

The legacy sector has become increasingly competitive over the last couple of years as new capital has been raised by newer players such as Marco and Carrick, as well as by the established names such as RiverStone, Darag, Compre, Randall & Quilter ("R&Q") and Premia. Many (re)insurance carriers continue to see the benefits of achieving finality in discontinued lines of business via the runoff market, allowing them to achieve a greater focus on core businesses and releasing capital to reinvest in support of future growth aspirations. This trend was seen in both the P&C and the life insurance markets, with the consolidation of closed-book life insurance portfolios being a driver of M&A activity in the European life insurance sector. In a similar vein, an increasing number of legacy players have moved into the Lloyd's space, with some establishing specific reinsurance-to-close syndicates in order to secure opportunities to underwrite runoff liabilities in underperforming lines of business. This is driven in part by the Lloyd's Corporation's performance drive, causing many syndicates to focus their management activities on their ongoing businesses. Another area of runoff activity observed in 2021 was the interest of the European legacy market in the United States corporate liability space.

The general trend of U.K. and European insurance groups looking to digitally transform their operations and distribution channels through M&A and strategic alliances accelerated during the pandemic and continued in 2021. Since the outbreak of COVID-19, many (re) insurance carriers and their investors have increasingly seen the benefits of adopting technology to streamline their operations. Other evidence of technology's impact on the (re)insurance sector in 2021 was through the soaring valuations of certain insurtech companies in 2021 as evidenced in funding rounds by seed investors.

The year also produced some unusual M&A headlines with the abandonment of the Aon-Willis Towers merger, due to competition concerns in the broker sector, and an ultimately unsuccessful takeover bid for the mutual life insurer Liverpool Victoria ("LV") by private equity group Bain Capital, which fell short of the three-quarters majority vote required for members' approval. Given there were specific reasons as to why such transactions did not complete, we are not expecting these abandoned deals to be the beginning of universal trends in the sector.

The restructuring of U.K. and European listed insurance groups was another trend we observed through 2021 as carriers saw the opportunity to offload non-core businesses which attract large capital charges in the pursuit of a more streamlined business model. Notable common themes from the various public announcements by carriers in 2021 were their commitments to focus on core markets, capital efficiency and digital transformation, even if in certain circumstances some of such carriers were facing external pressure by shareholder activists to do the same.

i. Listed Group M&A

A few listed U.K. and European insurance carriers have been feeling some heat from activist investors in 2021 in response to their lower valuations during the pandemic, or in some cases a degree of historical overexpansion, which had left some of them vulnerable to challenge. The wider view amongst activists and corporate advisers has been that the stock prices of insurers have been trading at deep discounts to respective potential value, and some have built large cash piles after dividends were held back during the height of the pandemic.

While certain listed insurers, like Assicurazioni Generali SpA responded to the pressure from activists by carrying out share buybacks, others have responded by disposing of non-core businesses through M&A. Aviva plc, with added pressure from activist investor Cevian, which holds approximately a 5% stake in the London-listed insurer, finalized the implementation of its comprehensive strategy announced in 2020 to divest from non-core markets to focus on Britain, Ireland and Canada. In 2021, Aviva agreed to sell its French business to Aéma Groupe for €3.2 billion, its Polish business to Allianz for €2.5 billion and the remainder of its Italian operations to CNP Assurances and Allianz for €873 million. A couple of additional examples of disposals under pressure from activist investors to realize value were Hong Kong - and London-based life insurance group Prudential plc's demerger of its United States business, Jackson Financial Inc., in September allowing it to focus on

its Asia and Africa strategy, after it came under pressure from Third Point to separate the division, as well as the decision by Nordic insurance group, Sampo, to sell down its stake in Nordea Bank to allow it to focus on its insurance operations due to pressure from Elliot Management.

Despite the perceived pressure from activist investors, in 2021 a number of U.K.- and European-listed insurers were already strategically focused on reshaping their portfolios in order to realize capital efficiency gains and focus on core markets, as evidenced in public statements made by carriers like Aviva and Zurich. Examples of Aviva's divestments of non-core businesses are outlined above; however, in the case of Zurich Insurance, the Swiss insurer announced towards the end of 2021 the disposal of its Italian life and pensions back-book to Portuguese insurer GamaLife. The transaction released $1.2 billion of capital for the Swiss insurer. The strategy of improving capital utilization through consolidating closed-book life business is a trend which we discuss further in the "Runoff M&A" section below. Zurich also announced its plans to sell its Australian general insurance assets at the end of 2021, and we expect to hear more on the sales process in 2022.

While some carriers focused on trimming and reshaping their businesses, others pursued a strategy of acquiring bolt-on companies in order to grow in their core markets. Allianz's acquisition of Aviva's Polish and Italian businesses mentioned above are examples of this, and a similar strategy is expected to be carried out by Generali in 2022 given their public announcement in December 2021. Phillipe Donnet, the Generali CEO, stated that a significant portion of the M&A budget in 2022 is to be allocated to insurance and asset management targets in Europe and Asia and asset management targets in the United States and the U.K.

A different type of pressure that Aon plc and Willis Towers Watson had to contend with in 2021 came from regulators, rather than from investors. The $30 billion merger of major listed insurance brokers announced in 2020 was terminated in June 2021 following a decision by the United States Department of Justice (DOJ). Validating some of the (re)insurance market's fears about the power that the combined entity would have had over distribution channels, the merger was called off over concerns of the DOJ that the combined company would mean worse insurance terms for policyholders, despite the European Commission's approval of the tie-up. The outcome demonstrates that, even where deal teams consider and plan for challenges on competition grounds, there is a limit to the degree of consolidation that can occur amongst top-tier brokers before regulators intervene.

Finally, the shrinking number of London-listed multi-line insurers continued, following the completion in June 2021 of the $10.2 billion takeover of RSA Insurance Group plc by Intact Financial Corp and Tryg A/S. The outcome of the transaction is that Intact retains RSA's Canadian, U.K. and international entities, while Tryg retains RSA's Swedish and Norwegian operations. Both Intact and Tryg now co-own RSA's Danish business.

ii. Private Equity in Insurance M&A/Capital Raising

Although the hardening of premium rates continued into 2021, albeit at a slower rate, there were still pockets of opportunities in the risk-bearing segment of the (re) insurance sector that private equity capitalized on in 2021. Notable transactions included financial investor support for scale-ups, including Sixth Street's $500 million investment in Convex and Alchemy's $90 million investment in Lloyd's specialist insurance and reinsurance group, Apollo. Private equity was also instrumental in supporting start-up (re) insurance carriers in early 2021, with the likes of Mosaic and IQUW emerging onto the scene with backing of private equity investors. Mosaic, a Lloyd's startup led by former Ironshore COO Mitch Blaser, launched its operations in Q1 2021 with the help of an anchor investment from Golden Gate Capital. IQUW received a $350 million capital commitment in June from private equity firms Aquiline and Abry Partners alongside an Aquiline-led investor group, which was aimed at supporting IQUW's goal of becoming a diversified, specialist (re)insurer and also to build on the recent backing of Lloyd's Syndicate 1856.

A feature in both the Mosaic and IQUW startups is the strategic deployment of technology in their operations. Mosaic partnered with a technology firm to build an

insurtech platform using blockchain, machine learning algorithms and advanced analytics, which it intends to monetize through deals with other carriers. IQUW, through external partnerships and internal data science talent, is also building an insurtech platform which will allow it to use data and machine learning algorithms to inform its underwriting decisions and provide end-to-end efficiencies. It is unsurprising that private equity investors are willing to back insurance startups with a technology angle as private equity players are generally able to leverage their complementary expertise as investors in the technology sector.

Another area of continued interest by private equity sponsors in 2021 has been their focus on fee-based insurance businesses. Potential changes to the calculation of capital gains tax is reportedly pushing U.K. owners and managers of brokers to consider sales of their businesses. Intense private equity interest in the brokerage sector and the presence of trade players armed with fresh capital have been keeping valuations for such businesses robust, as private equity investors seek out cash-generative businesses which provide exposure to the insurance sector without the volatility that comes with balance-sheet businesses.

We therefore expect private equity interest and activity to extend the trend of consolidation within the mid-tier broker market into 2022; absorbing the space that was once occupied by Jardine Lloyd Thompson ("JLT") before JLT was bought by Marsh & McLennan in 2019. Two broking groups, Howden and Ardonagh, both backed by private equity sponsors, are known for continuing ambitions in this space. One transaction in 2021 which demonstrates such consolidation came in the form of Howden's agreement in October to acquire Aston Lark for around £1.1 billion. It was one of a few examples of Howden's appetite for M&A in recent years and represents the biggest acquisition secured by the expansive broker thus far. The deal also provides a liquidity event for Aston Lark's private equity owners, Bowmark Capital and Goldman Sachs Asset Management. Aston Lark's business saw a significant growth in the gross written premiums it placed during its six-year private equity ownership, from £100 million to £1 billion. With a similar appetite for deal making, Ardonagh completed its refinancing in December 2021, valuing the company at $7.5 billion through a capital injection from Abu Dhabi Investment Authority, HPS Investment Partners and Madison Dearborn Partners, and creates further impetus for the intermediary to continue expanding through M&A in 2022. It is estimated that Ardonagh would have spent more than $1 billion on M&A through the end of 2021, and this is largely down to the support provided by its private equity owners.

MGAs are another type of fee-based insurance business which continue to attract private equity interest. Former Dual CEO, Shane Doyle, signed up in 2021 to launch an MGA backed by private equity house JC Flowers. The underwriting unit is to be run and branded separately to JC Flowers' broking operation, Oneglobal. The startup MGA represents a further example of the model in which a parent company looks to diversify with both broking and MGA underwriting arms, as Howden does with its underwriting unit, Dual, and AJ Gallagher does with its subsidiary, Pen Underwriting.

In the same way as the mid-tier broker market is experiencing consolidation backed by private equity, so too is the MGA market, as fee-based underwriting businesses reach the next stage of their maturity. In August 2021, Dual agreed to purchase former rival and United States based MGA, Align, increasing its premiums under management to $2 billion. Similarly, Pen Underwriting agreed to buy the MGA Manchester Underwriting Agencies in October 2021. Other compelling evidence of the maturity of the MGA market was demonstrated in CFC's deal in October 2021 with private equity houses EQT and Vitruvian which secured a valuation of £2.5 billion, and in the sale of a majority stake in Velocity Risk Underwriters LLC, the MGA established by ILS and catastrophe specialist Nephila Capital, to funds managed by Oaktree Capital Management, L.P.

However, despite the continued influence of private equity in the insurance sector in the U.K. and Europe, one pushback against a private equity suitor in 2021 was from the mutually owned life insurer, LV. As noted above, the £530 million takeover bid by Bain Capital for LV was

voted down by its members in December 2021. Despite Bain stressing its long-term commitment to the business, LV's management were unable to convince policyholders of the benefits of demutualization. It was arguably the public and press scrutiny that surrounded the deal that led to its collapse, and so private equity investors may tread cautiously before considering a takeover of mutual insurers in the future, particularly where the benefits of the transaction to policyholders might be less apparent than to the management team or the investor.

iii. Lloyd's M&A and Capital Raisings

Lloyd's has recognized premium rate trends and permitted market-wide premium growth of 15% to £43.7 billion in 2022 from the written premium forecasted in 2021. This represents the first time since the introduction of the Corporation's performance drive that all syndicates, whether "light-touch" or "high-touch," have been allowed to increase their stamp capacity. Another welcome prospect for Lloyd's stakeholders in 2022 will be the soft launch of the new Lloyd's principle-based supervisory regime: a measure which is anticipated to lessen the degree of red tape that Lloyd's is often perceived of having placed on those participating in the market. However, despite these new measures, a core focus of Lloyd's in 2022 will be on pricing and reserving adequacy in light of higher levels of inflation currently being experienced, particularly if the market is to achieve a planned combined ratio of 95%.

2021 also saw disposal transactions in the Lloyd's market, syndicates being placed into runoff and even (re)insurance companies making the decision to pull their business from the Lloyd's platform and instead write business via the company market. In September 2021, AXA XL decided to move its circa $400 million reinsurance business, previously underwritten through Lloyd's Syndicate 2003, into the company market effective January 1, 2022. Although this transition might be seen as a negative for the Lloyd's market, AXA XL stressed that the move was part of its ongoing work to simplify AXA XL's Reinsurance legal entity structure, rather than a deliberate withdrawal from the Lloyd's market altogether: AXA XL's direct insurance business will continue to be written via Lloyd's Syndicate 2003. On the other hand, Coverys Syndicate 1975, the medical malpractice syndicate launched at the beginning of 2018, will be placed into runoff at the end of 2022 as the decision was made by Coverys Managing Agency to switch to a company market platform on account of not being able to achieve its desired speed and scale of growth within the confines of the Lloyd's performance framework.

Complementing the trend noted above of scale-up and start-up transactions in Lloyd's was the Ariel Re transaction, providing capital for its 2021 year of account. Pelican Ventures and J.C. Flowers acquired Ariel Re from Argo Group, with Ryan Mather (the former CEO of Ariel Re) returning to lead the company. Under the terms of the deal, JC Flowers and Pelican provided Ariel Re's capital for funds at Lloyd's, while Argo retained historical reserves.

iv. Runoff M&A

Building on the momentum observed in recent years, the legacy market was active throughout 2021. Such activity included acquisitions by traditional runoff acquirers, such as the European P&C insurance runoff group, Marco Capital Holdings Limited's acquisition of Capita plc's insurance business, comprising Capita Commercial Insurance Services ("CCIS") and Capita Managing Agency ("CMA"): a move which is aimed at increasing Marco's operational capabilities. Following the announcement, which is still subject to regulatory approval, CMA was appointed as managing agent of Marco's new reinsurance-to-close syndicate which gained in-principle approval by Lloyd's in October 2021 and CCIS was contracted with Marco for technical support services.

2021 also saw certain mid-market runoff specialists increase their capacity following injections of capital, notably from private equity investors: the buy-out of Compre by Cinven, alongside British Columbia Investment Management Corporation, completed in April 2021. The acquisition will enable Compre to continue its expansion plans in the United States market, having established its Bermuda platform in 2020. This follows a general trend, which we expect to continue into 2022, of European mid-market legacy carriers expanding into the United States,

with a further example being Darag's receipt of regulatory approval in late 2021 for the purchase of a Texas-based insurer in runoff which Darag will use to build out their United States offering.

Following a mass exit of multiple classes of businesses in the Lloyd's market, triggered by the Corporation's performance drive, the legacy market is expecting a swathe of runoff liabilities, and therefore opportunities to take on books of business from carriers looking to focus on core business and benefit from a release of capital. A standout transaction in 2021 which reflects this trend was the loss portfolio transfer between Canopius and RiverStone, allowing Canopius to exit discontinued classes of business encompassing $780 million of net liabilities. Other recent deals completed by RiverStone include the $380 million loss portfolio transfer with Brit and a £370 million reinsurance-to-close transaction with Hamilton Syndicate 4000.

R&Q also developed a Lloyd's runoff presence through its acquisition of the Vibe managing agency and corporate member, and Compre established a syndicate in partnership with Apollo at Lloyd's, in the process inking a deal for its 2017 and prior liabilities.

Runoff M&A activity amongst U.K. and European life insurers in connection with closed-book business continued to be prevalent in 2021 as persistently low interest rates put pressure on life insurers' margins. An example of this was the announced acquisition by Athora in Belgium of NN Insurance's closed-book individual life portfolio, which is expected to complete in mid-2022, subject to regulatory approval. The transaction represents Athora's first portfolio acquisition since it acquired the operations in January 2019 and increased its assets under management from €7.3 billion as at December 2020 to €10.6 billion. Another example was the announced sale by Phoenix Group, the closed-book life insurer, of Ark Life Assurance Company to Irish Life in July 2021, with the aim of allowing Phoenix to simplify its European operations and accelerate cash releases. We expect that there will be more opportunities for back-book consolidation M&A as life insurers look to dispose of their capital-intensive legacy books.

v. U.K. Insurtech M&A and JVs

We have already touched on how the existence of technology in Mosaic's and IQUW's offering is likely to have given these startups an edge when it came to convincing private equity investors to invest. For established players, the goal of reducing expense ratios, improving risk-to-capital matching and heightening customer experience through technology remains high on the agenda. Spurred on by the pandemic and throughout 2021, many insurance carriers looked to bolster their digital offering through M&A and strategic alliances with technology partners.

An example of a strategic partnership in 2021 which enhanced the digital distribution offering of an insurance carrier was the deal between Booking.com and Zurich's subsidiary, Cover More. The arrangement allows Cover More to provide travel insurance services to Booking.com in Europe. Zurich also resorted to M&A to enhance its technology offering when it announced the acquisition of Estonia-based company, Alpha Chat, in December 2021. This transaction will allow the Swiss insurer to tap into Alpha Chat's use of conversational artificial intelligence technology and further enhance the group's digital capabilities.

2021 was also a year where insurtech companies in the aggregate raised a record-breaking amount of capital, surpassing the $10 billion mark in Q3 2021, as investors continue to anticipate the potential value, and by extension the potential returns, that can be derived from disrupting the (re)insurance market. The largest capital raisings announced in 2021, however, were concentrated into a small pool of companies, indicating that only a handful of insurtech companies were winning the lion's share of investments by seed capital. Eight insurtech companies reached unicorn status in 2021, bringing the total number of insurtech unicorns to 24. One of these unicorns was Marshmallow, the U.K. motor insurer now valued at more than $1.25 billion, having raised $85 million in a Series B funding round in September 2021, with backers including Passion Capital, Investec and SCOR. Other insurtech unicorns which raised significant amounts of capital in 2021 included Wefox (a digital insurance carrier focused on

personal P&C insurance based in Germany and operating across Europe) which raised $650 million in a Series C round and Bought by Many (a pet insurance agency operating in the U.K.) which raised $350 million in a Series D round.

Insurtech M&A deals and joint ventures which enhance an insurance group's digital transformation and distribution channels are likely to be a driver of investment activity in 2022. Subject to decisions by central governments to increase interest rates aggressively in 2022 to offset rising levels of inflation which could impact the valuations of insurtech companies (and technology stocks in general), we also expect insurtech capital raisings to remain strong in the coming year.

D. Bermuda

Although several years of consolidation among Bermuda-domiciled reinsurers has reduced the number of Bermuda-domiciled acquisition targets, a standout transaction in 2021 which bucked this trend was the resurrection of the $9 billion takeover deal of PartnerRe by French mutual insurer, Covéa. The deal, which had collapsed at the height of the pandemic when Exor rejected Covéa's attempt to renegotiate terms due to the impact of COVID-19, was revived when both parties announced the agreement in October 2021. In terms of deal size, it represents the second highest in dollar terms that the Bermudian M&A market has ever experienced, only behind the $15.3 billion deal for XL Catlin by AXA in 2018.

However, the transaction is arguably an outlier in terms of the general M&A trends we have seen in Bermuda in the last few years given the unique drivers behind it: Exor had been looking for an exit to its PartnerRe investment for some time and faced a paucity of options when the deal originally fell through in March 2020 and Covéa has long been seeking a reinsurance platform, even pursuing Scor and AXA XL Re before focusing its attentions on PartnerRe. Partner Re, since its inception in 1993, had diversified well beyond its roots in Bermuda to become a global (re) insurance group with European, U.K., Asian and United States operations.

We suspect that Covéa's purchase of PartnerRe, if it completes, is the tail end of an active cyclical period of reinsurance M&A and a reversion to a more muted M&A environment in Bermuda. However, we do expect Bermuda groups to follow the trend highlighted above in the U.K. and Europe to streamline operations and shed underperforming or nonstrategic businesses. Examples of this were provided by Argo Group's sale of its Brazilian operations, its Italian subsidiary and shutting its E.U. platform in Malta in 2021. Finally, returning to our theme of startups and scale-ups, where Bermuda remains a leading domicile for such (re) insurers, we also suspect that these newly capitalized players will have their time to shine in the M&A cycle in due course, as their owners seek liquidity.

II. INSURANCE-LINKED SECURITIES MARKET UPDATE

A. Introduction

Insurance-Linked Securities ("ILS") is the name given to a broad group of risk-transfer products through which insurance and reinsurance risk is ceded to the capital markets. This group of products is continually evolving to meet market and investor demand, and includes catastrophe bonds, sidecars, industry loss warranties, collateralized reinsurance and insurance-based asset management vehicles.

B. Market Overview: Reallocation and Innovation in the ILS Market

The year 2021 has demonstrated that quality underwriting matters, as certain segments of the ILS market (catastrophe bonds in particular) have seen significant growth, while others (such as quota shares and higher frequency aggregate structures) have languished.

Last year saw another cycle that included relatively high levels of natural catastrophe losses, starting early with Winter Storm Uri in February 2021, followed by the floods in Europe during the summer, and culminating in losses from Hurricane Ida.

The period 2017 through 2021 has been characterized by substantial catastrophe and other losses (e.g., COVID-19 losses), which has meant multiple years of trapped capital for investors, reducing the average return over a short- and medium-term horizon. The convergence of these factors has meant that investors must put up new capital if they want to continue to participate, or to upsize their participation, in ILS strategies in new underwriting years, while also shouldering returns that are less stellar than were seen in the period before 2017, an era of relatively low levels of natural catastrophe losses.

The 2021 losses have had two key impacts: (i) to continue to squeeze available capital in the ILS market; and (ii) to encourage greater scrutiny of natural catastrophe modelling. As a consequence, investors are applying renewed rigor and discipline in their assessment and selection of ILS products for investment and cedants have at times had to revisit and adapt their sidecar and collateralized reinsurance strategies, in the face of the changing loss environment, in order to attract the capital available, whilst allowing the cat bond market – which generally provides coverage for more remote layers – to continue to expand.

In our view, 2021 was another move toward cementing ILS as a long-term market, showcasing its capacity for innovation, on the part of investors and sponsors alike, to make the market work for each of the constituent groups, in the face of some challenging loss conditions. Some of the trends we have observed in 2021 and in the 2022 renewals are set out below:

i. Increased Scrutiny of Models and Climate Change

As the frequency and severity of natural catastrophes increase, including secondary perils such as wildfire, severe convective storm and flood, investors (and reinsurers in the traditional market) are taking a closer look at the models for these perils and, in particular, how they account for climate change. The focus on secondary perils was particularly acute in 2021 given nearly three-quarters of natural catastrophe losses in 2020 were caused by secondary perils according to Swiss Re's sigma research.

In addition, as consensus grows that the current worldwide rates of inflation are not just transitory, and while the supply chain crisis and pandemic-driven worker absences continue to have an impact on demand surge, investors have been focusing on whether the impact of such inflationary pressures on potential losses might in fact outweigh the relatively limited rate increases that have been available for loss-affected regions and perils in recent years. Related to inflationary pressures, is so-called social inflation, such as the result of increased claims litigation in Florida and other catastrophe-exposed markets.

Modeling of peak perils has also not escaped 2021 unquestioned – Hurricane Ida surprised many with its

catastrophe losses, which are still developing, and which served to highlight how many models have not been able to keep up with demand surge and COVID-19-related inflationary pressures.

The rate corrections in the United States southeast following Winter Storm Uri and in the parts of Europe affected by the flooding caused by storm Bernd have only confirmed to investors that rates were incorrectly priced for these secondary perils previously and it is not clear that the current rate rises will be sufficient for investors.

This additional scrutiny has led to some skepticism by investors around the ability of modeling – and the related pricing of ILS products – to adequately predict the likelihood of losses occurring in their ILS investments. To combat these risks, (re)insurers and risk modelers are beginning to update their natural catastrophe models to account for the inflationary pressures on the models, and particularly to scrutinize the models used for secondary perils, which have seen a particular growth in frequency.

These shortcomings have led to a re-disciplining by investors, often resulting in a resizing or indeed a reallocation of investor capital as more particularly described below.

ii. Impact of Investor Scrutiny on ILS Market

The narrowing of available capital and the sense from investors that models are not adequately accounting for inflation, combined with concerns around climate change and its impact on the severity and frequency of cat events, have led to changes in investor allocation. This change in behavior has led to a shrinking in available capital in products where there have been frequent recent losses, namely quota share arrangements (both collateralized reinsurance and sidecars) and aggregate and low-level excess-of-loss (“XoL”) transactions. These transactions are characterized by a higher likelihood of losses and, therefore, more susceptible to climate change, inflation (including resulting from COVID-19) and social inflation. The impact of climate change and “unmodeled” risks related thereto, is also weighing on underlying investor allocations (e.g., global pension and sovereign funds) to ILS funds, and therefore may be impacting the overall level of available ILS capital.

Although reinsurance sidecars and collateralized reinsurance transactions are usually conducted privately and, therefore, exact data is not always publicly available, we have observed another year where many quota share transactions have renewed either at the same level, or at slightly contracted levels, when compared with previous years, particularly where those transactions are supporting retro products. Given rising investor sentiment that a relatively high number of medium to large loss events may be the “new normal,” investors are increasingly looking to insulate themselves from the “from the ground up” losses that characterize proportional ILS transactions.

Aggregate and low-level XoL transactions were also scarcer in 2021 and in the 2022 renewals season for similar reasons, with investors concerned that the perceived higher frequency of events might push aggregate covers into loss positions, while demand surge, a more volatile climate and other inflationary pressures are more likely to help losses attach on low-level XoL transactions. To counter these pressures, investors have been focusing on raising the attachment point of XoL transactions (rather than pushing on pricing) and, for aggregate transactions, the move towards second-event cover that we saw in 2020 has continued, with some XoL transactions even becoming third-event covers, and with investors pushing for larger deductibles.

Another result of the increase in losses attributable to secondary perils and the challenges to the modeling discussed above has been that the appetite to provide cover for secondary perils or retro in quota share, aggregate or low-level XoL transactions has been particularly subdued, with cedants often having to narrow the range of perils included in transactions in order to get the deal done.

However, there is also a rosier picture for quota share transactions: we have observed an uptick in bilateral collateralized reinsurance transactions, with pension funds, private equity funds, hedge funds and other asset managers seeking to put their assets to work. As investor familiarity

with the asset class expands, some of these pension funds, private equity funds and hedge funds have made their own dedicated hires in the (re)insurance and ILS space and are now investing in ILS directly for the first time, having historically only invested through larger ILS managers, if at all. This new direct approach allows these pension funds, private equity funds and hedge funds to remove one layer of fees and to take greater control of their investments. Single investor sidecar and collateralized reinsurance transactions often have some bespoke features that allow for greater direct bargaining between cedant and investor than traditional marketed sidecars, which can help to mitigate some of the investors' concerns around negotiating returns (including conversations on fees), the inclusion or exclusion of secondary perils, trapped capital and commutation, whilst still allowing cedants to place cover not already placed in the current traditional market at acceptable rates.

Another benefit for cedants to these arrangements is that they are often longer-term agreements than the traditional one-year sidecar, helping the cedant to plan for future years and to be confident of some rolling capacity from the collateralized market.

iii. Cat Bonds Continue to Perform Well

In contrast to some other types of ILS, cat bonds have continued to flourish, with total issuances in 2021 setting a new record for issuances for the second year in a row, with approximately $14 billion of coverage placed by approximately 45 unique cedants. Cat bonds typically (although not always) are structured higher in the reinsurance capital stack and have several structural features designed to mitigate unknown risks, such as a third-party modeling firm, defined perils and larger deductibles.

Some investors are reallocating funds to cat bonds as a result of the liquidity cat bonds offer. This can often help alleviate investor concerns related to trapped capital, in contrast to collateralized reinsurance and sidecars, which tend to have wider transfer limitations and a relatively smaller pool of potential transferees. In addition, the relatively lower risk profile of cat bonds compared to many quota share transactions and aggregate and low-level XoL transactions, remains a lure to investors. Whilst investors may be wary of the models, the higher attachment points and/or deductibles on many cat bonds ensure that the likelihood of the bond being triggered remains within investor appetite.

This enhanced investor appetite has allowed cedants to drive better pricing and more attractive terms when marketing their cat bonds. In fact, cedants have even been able to use this investor demand to buck the trend of having to retreat from secondary perils, with Fidelis' Herbie Re vehicle launching a worldwide cat bond covering 16 peak and secondary perils – setting the stage for others to follow suit, including by both Arch (with Claveau Re) and Hannover (with 3264 Re).

Another notable feature of the cat bond market in 2021 was the spate of year-end issuances, with nearly 20 new issuances in the final two months of the year compared to 14 in the same period in 2020. These late issuances stand in contrast to the challenges outlined above in relation to the January 2022 renewals (which affected the traditional markets as well as ILS renewals) and show the relative resilience of the cat bond market.

Industry-index and indemnity transactions continue to dominate the cat bond market, with cedants that are struggling to find traditional retro coverage using industry-index triggers in particular to hedge some of their retro exposure.

iv. Other Innovations

There were also some other key innovations in ILS in 2021, particularly related to how sidecars can be used to access different types of risk. Sidecars and collateralized reinsurance transactions have traditionally focused on property catastrophe business. The high levels of trapped capital in recent years have reduced the ability to diversify into other lines (such as specialty) to reduce the ILS asset class as a whole's exposure to catastrophe business.

However, W. R. Berkeley's Lifson Re sidecar, which incepted on January 1, 2021 with $250 million of capacity, has broken new ground by being able to participate in any reinsurance and retrocession cessions in the cedant's P&C business (going far beyond traditional property cat). This is expected to bring diversification to Lifson Re's portfolio as compared to the lines of business traditionally supported by sidecars.

Gibson Re, the Randall & Quilter-sponsored sidecar, raised approximately $300 million in the second half of 2021. The sidecar will be able to deploy its capital to take an 80% quota share of qualifying legacy books purchased by R&Q over a multi-year underwriting period, including loss portfolio transfer books and acquisitions.

Lloyd's of London has also embraced the sidecar as a means of allowing capital markets participants to provide capital to the Lloyd's market, without first having to undertake the sometimes lengthy and costly process of setting up at Lloyd's. London Bridge PCC, which was formed under the U.K.'s ILS regime, issued three tranches of ILS in 2021, the first of which used over £100 million, which was provided by Ontario Teachers' Pension Plan, to provide collateralized reinsurance to three Lloyd's syndicates. The transaction shows the continued investor interest in Lloyd's and the willingness of the world's leading insurance market to innovate as it has done continually for over 300 years.

The syndicates that are cedants of London Bridge PCC also point to the theme of investors wanting to diversify away from just catastrophe exposure. For example, OTPP's investment is being used to support CFC Syndicate 1988, which targets digital economy risks and Nephila, another capital provider to London Bridge PCC, is investing in its new specialty syndicate. Specialty lines have long been touted as a way for the ILS market to diversify away from traditional property catastrophe perils, but – as discussed above – relatively underdeveloped models and constraints on capital have held them back, making the Nephila syndicate and the use of the London Bridge PCC particularly exciting as a potential roadmap for others seeking to write specialty cover in order to diversify their ILS portfolios.

The London Bridge PCC at Lloyd's is yet another development highlighting the market's continued faith in the U.K. ILS regime and the ability of investors to invest through a U.K.-based tax-neutral protected cell company that allows investors tax deferral over gains until the gains have been repatriated to the investor itself.

III. EXCESS RESERVE FINANCINGS

A. Summary of Deal Activity

The year 2021 continued the favorable trend started in 2016, as the number of new excess reserve financing transactions remained consistent with 2020. Prior to 2016, the number of excess reserve financing transactions was depressed by an abundance of caution from both regulators and insurance companies in the life insurance reserve financing market, in large part because of the National Association of Insurance Commissioners[1] ("NAIC") Captives and Special Purpose Vehicle Use (E) Subgroup activities, and in particular the adoption by the NAIC of Actuarial Guideline 48 ("AG 48") in late 2014 (as further described in subsection C. of this section below), which applies to all life insurance policies issued after December 31, 2014 that fall under Regulation XXX or AXXX.

In 2020 and 2021, the number of new excess reserve financing transactions increased due to an increased level of certainty as to what regulators will permit in current and future financings. In addition, the trend of restructuring existing transactions continued, as companies sought to take advantage of lower lending rates and the continued interest by reinsurance companies in acting as financing providers. Also, the use of a captive insurer to finance XXX and AXXX policies was bypassed by some companies, by adding admitted assets to the balance sheet of the insurer. Most insurers with a history of excess reserve financing transactions completed the process of addressing the complexities of AG 48 issues in late 2016 or early 2017, with many closing new transactions involving AG 48 covered policies, or adding a block of AG 48 policies to an existing transaction, in both 2020 and 2021.

i. AXXX Market Remains Open

As was the case in 2020, several recent transactions were designed to provide reserve financing for universal life policies subject to Regulation AXXX. In 2021, the expansion of lenders willing to provide financing to fund AXXX reserves continued the trend that started in 2012. In most transactions in both the XXX and AXXX markets, commitments were for 10–25 years, although shorter terms intended to act as a financing bridge until other expected sources of funding become available are still commonly seen.

ii. Non-Recourse Transactions Remain the Structure of Choice

In 2014, prior to the effective date of AG 48, the vast majority of deals were secured by non-recourse letters of credit, contingent notes or collateral notes, as those transactions had essentially replaced traditional letters of credit among lenders and reinsurance companies active in the AXXX/XXX market. While for a time, in 2015, we saw a return to or at least a heightened interest in traditional letters of credit, the market has returned to the non-recourse contingent note structure, which remained by far the structure of choice in 2021. In the past, the obligation to reimburse the bank for any draw on the letter of credit was guaranteed by a parent holding company, thus being known as a "recourse" transaction. In a non-recourse transaction, no such guaranty is required. Rather, the ability to draw on the letter of credit or contingent note is subject to certain conditions precedent. These conditions typically include, among others, the reduction of the funds backing economic reserves to zero and a reduction in a prescribed amount of the captive insurer's capital, and a draw limited to an amount necessary for the captive insurer to pay claims then due. Because of these conditions, lenders and other funding sources became more comfortable assuming the risk of relying for repayment on the long-term cash flows from a block of universal life policies. With the advent of AG 48, some regulators initially had approached a non-recourse transaction with added caution, where the proposed "Other Security" is a conditional draw letter of credit or a contingent draw note. Transactions completed in 2021 continued to show that many regulators recognize that this approach is not expressly forbidden by the new rules, and that these bespoke sources of contingent funding are acceptable under AG 48. Collateral notes (demand

1 The organization composed of the chief insurance regulatory executives in each state and other U.S. territories.

notes backed by pools of assets) may, but typically do not, contain these contingent features and therefore should remain acceptable for financing under AG 48, at least as "Other Security."

iii. Choice of Domicile for Captive Insurers and Limited Purpose Subsidiaries

Vermont and Delaware remained the preferred domiciliary jurisdictions for captive life insurers in 2021. Several states have adopted captive insurer laws or have amended and expanded existing captive insurer laws over the past few years to facilitate reserve funding transactions. Similar to 2020, additional states, including Arizona, Nebraska and Iowa, were being utilized as captive insurer domiciliary jurisdictions. As has been the case for the last few years, the use of "Limited Purpose Subsidiary" statutes in several states has cooled off and may not currently be the captive insurer structure of choice, at least for new AG 48 transactions. The exception appears to be Iowa, where Iowa-domiciled insurers continued to utilize the Limited Purpose Subsidiary law. The Limited Purpose Subsidiary ("LPS") statutes permit a ceding company to form a captive insurer in the same domiciliary state as the ceding insurer, which has proven to provide for a more streamlined regulatory approval process for a transaction.

B. Utilized Structures

i. Limited Purpose Subsidiaries

We are not aware of any new transactions that closed in 2021 and that employed the use of an LPS law in a reserve financing transaction. Georgia, Indiana, Iowa and Texas have each promulgated an LPS statute. The advantage of an LPS over a captive insurer is that an LPS, once licensed, may provide its ceding company parent with full credit for reinsurance without posting any security in the form of a letter of credit or a credit for reinsurance trust. Under the LPS statutes, an LPS is permitted to take statutory financial statement credit for the face amount of letters of credit, as well as parental guaranties by statutory authority; the LPS need not seek regulatory approval for a permitted practice or other dispensation to use this accounting treatment. Although this was a major development in the ability to finance Regulation XXX/AXXX reserves, we have not seen the use of the LPS statutes take off as expected, likely as a result of the general caution on the part of insurers and regulators alike.

ii. Credit-Linked Notes and Collateral Notes vs. Letters of Credit

As mentioned above, recent activity in the marketplace implies that the use of contingent credit-linked notes in a role analogous to a "synthetic letter of credit" will continue, along with collateral notes, to be the structure of choice for excess reserve financing transactions. In the typical credit-linked note transactions, an SPV issues a puttable note to a captive insurer. The captive insurer's right to "put" a portion of the note back to the SPV in exchange for cash is contingent on the same types of conditions that would otherwise apply in a non-recourse contingent letter of credit transaction. The use of these notes, rather than letters of credit, has provided a means for reinsurance companies, which contractually agree to provide the funds to the SPV to satisfy the put, to enter a market that was once only available to banks. In collateral note transactions, demand notes backed by pools of assets are issued by an SPV to a credit for reinsurance trust on behalf of the captive insurer. Collateral notes are typically rated and qualify as admitted assets. The assets that back the collateral notes can be provided by banks, reinsurance companies or other providers of collateral.

iii. Use of Excess of Loss Reinsurance as a Financing Source

The use of excess of loss reinsurance agreements as a reserve financing source, although utilized in the market for several years now, saw a continued resurgence in 2021, with several financing transactions choosing an XOL policy over a credit-linked note format. In an XOL transaction, the captive reinsurer and the XOL provider, usually a professional reinsurer or reinsurance affiliate of a financial guaranty insurance company familiar with credit-linked note transactions and reserve financings generally, enter into an XOL agreement whereby the captive reinsures mortality risk and the XOL provider assumes the captive

reinsurer's collection risk. The XOL provider pays claims in excess of the economic reserve, or for a financing of policies under AG 48, the amount of "Other Security." The advantages to an XOL transaction over a credit-linked note transaction are the relative simplicity of the transaction structure and corresponding agreements, as well as a more familiar format to present to regulators. Because many of the same financing providers that participate in the credit-linked note market also offer XOL agreements as an alternative structure, we would not be surprised to see continued growth in XOL transactions in the future.

iv. Funding Sources Beyond Banks

As outlined above, the market for funding sources in XXX and AXXX transactions has expanded beyond banks in recent years through the use of contingent credit-linked notes, collateral notes and XOL agreements. Large reinsurance companies have shown a keen interest in participating in these transactions through support of the SPVs that issue the contingent notes and collateral notes and through the use of XOL agreements. With the expansion of the group of potential funding sources for these transactions, life insurance companies can seek more competitive pricing and terms. Although the past few years have shown a trend of reinsurance companies surpassing banks as the primary "risk taker" in these transactions, we note that in both 2020 and 2021 at least one bank actively and successfully entered this market as well as at least one financial guaranty insurer, which may portend the beginning of a resurgence by these companies in this market.

v. Use of Reserve Financing Structures on AG 33 Reserves for Fixed Annuity Contracts

The use of contingent credit-linked notes and XOL agreements expanded in 2020 and 2021 to address the reserve strain experienced by the issuers of fixed annuity contracts due to the application of AG 33 reserves using mortality tables that generate excessively conservative reserve requirements. In these transactions, the liability in excess of the account value of certain fixed index annuity contracts with respect to guaranteed lifetime withdrawal benefits is reinsured to the captive reinsurance company and backed by either an XOL agreement or a credit-linked note structure. Although not yet showing the same market attention as XXX and AXXX transactions, the need to finance AG 33 reserves has definitely caught the attention of several issuers of fixed annuity contracts, as well as the reinsurance companies that provide financing for these transactions.

C. Regulatory Environment

We noted above the importance of the NAIC's adoption of AG 48, which was part of the NAIC action plan to develop further regulatory requirements with respect to XXX and AXXX transactions. The adoption of AG 48 in 2014 was followed by the NAIC adopting the Term and Universal Life Insurance Reserve Financing Model Regulation and an amended version of AG 48 in December 2016. Importantly, the Model Regulation and AG 48 aimed to set standards applicable to XXX and AXXX transactions, instead of restricting them outright.

For most states, the adoption of the Model Regulation will replace AG 48. According to the NAIC, the vast majority of states had not adopted the Model Regulation as of January 1, 2022, although this is expected to change in the coming year since the Model Regulation will become an NAIC Part A Accreditation Standard effective as of September 1, 2022, with enforcement beginning on January 1, 2023.

IV. DEVELOPMENTS AND TRENDS IN LONGEVITY, PENSION CLOSE-OUTS AND DE-RISKING TRANSACTIONS

A. Developments in the United Kingdom

The U.K. pensions de-risking market has experienced a healthy level of transactions throughout 2021. As at the year-end, liabilities transferred through the bulk annuity market are expected to reach close to £30 billion and publicly announced longevity swaps total approximately £15.3 billion. This volume of U.K. pension de-risking demonstrates that market demand for de-risking transactions remains robust, with deal volumes being similar to the market activity in 2020 (see our 2020 Year in Review found here). The total volume of longevity swaps is lower than we saw at this point last year, a discrepancy which is in part because 2020 was a particularly active year for large swaps.

The year 2021 was a year of two halves for bulk annuity transactions. The first half of the year was quiet, both in terms of the number of deals and individual deal size. The second half of the year, however, was extremely busy, featuring attractive pricing likely due to insurers having excess capacity following the slow start to the year. Notable bulk annuity transactions include the £2.2 billion all-risks buy-out transaction between The Metal Box Pension Scheme and Pension Insurance Corporation announced in October, the £900 million bulk purchase annuity transaction between Kingfisher Pension Scheme and Aviva announced in July and the £760 million buy-in transaction between Sanofi Pension Scheme and Legal & General announced in October.

As well as an increased number of deals covering deferred liabilities in the bulk annuity market (which we discuss further below), a notable theme in bulk annuity transactions was the increased frequency with which we saw residual risks proposals in front-end contracts – residual risks cover was a key issue for a number of trustees. Although reinsurers were not generally expected to cover residual risks liabilities, the additional due diligence involved in insurers offering residual risks cover can result in extra uncertainty for reinsurers as the enhanced scrutiny can highlight further data issues.

We expect the high demand for bulk annuity transactions that we saw in the second half of 2021 to continue into 2022. The Pension Schemes Act 2021, which came into effect this year and is discussed in more detail below, requires that U.K. defined benefit pension schemes ("DB pension schemes") set a long-term funding objective. Surveys carried out by de-risking consultancy firms indicate that bulk annuity transactions have become the preferred de-risking strategy for DB pension schemes, as more pension schemes are planning a buy-out as their long-term funding objective instead of targeting self-sufficiency. This increase in demand for bulk annuity transactions coupled with the favourable pricing that insurers have offered over the last several years will likely result in a buoyant market for bulk annuity transactions throughout the next several years.

Turning to longevity swap transactions, four longevity swap transactions have been publicly announced in the U.K. market as having been completed during 2021: the £3 billion longevity swap between AXA UK Pension Scheme and Hannover Re, the £6 billion intermediated longevity swap between an unnamed U.K. pension fund and Prudential Financial, Inc. (with Zurich acting as the intermediary U.K. insurer), the £3.7 billion captive structure intermediated longevity swap between ICL Group Pension Plan (Fujitsu) and Swiss Re and the $3.5 billion intermediated longevity swap among an unnamed U.K. pension fund, MetLife subsidiary Metropolitan Tower Life Insurance Company ("MetTower") and Zurich as the intermediary U.K. insurer. The latter transaction was MetTower's first U.K. longevity swap.

The AXA UK Pension Scheme longevity swap is notable in that the majority of the longevity risk that was transferred relates to deferred pensioners, i.e., those persons who have not yet drawn their pension benefits. In the past, "deferreds" have typically been excluded from bulk

annuity transactions and longevity swaps due to the added complexity they present to (re)insurers – they represent both longer-dated liability (which has an impact on reserves and asset availability) and added uncertainty due to the flexibility each deferred member has in terms of such member takes its benefits. In 2021, we have observed an increased interest in (re)insuring deferreds – a notable theme in bulk annuity deals was an increased number of transactions covering deferred pensioners (both through standalone deferred transactions and transactions covering both deferred and in-pay members). As anticipated in our 2020 Year in Review, the prevalence of "master" or "umbrella" relationships (both between trustees and insurers, and cedants and reinsurers) continued, and the flexibility to include both deferreds and retirees in these structures has been important, especially given the different approaches that can be taken to covering deferred liabilities. We expect to see more bulk annuity transactions and longevity swaps providing cover for deferred liabilities in the years to come.

In our 2020 Year in Review, we commented that there are increasingly other options for trustees wishing to enter into a longevity swap who may not wish to utilise an offshore captive; in 2021 we saw this trend continue as the market showed a sustained interest in utilising a U.K. authorised insurer as an intermediary when structuring a longevity swap as an alternative to an offshore captive deal. Of note was the intermediated longevity swap between an unnamed U.K. pension fund, Zurich and Prudential Financial, which utilised an intermediated structure and was the single largest publicly announced longevity reinsurance transaction of 2021 with a deal value of £6 billion. U.K. insurers such as Zurich and L&G are now offering tailored products for this type of structure as an alternative to an offshore captive structure, which will be particularly attractive to trustees that may not be comfortable utilising offshore captives. This can add more complexity to the transaction – a U.K.-regulated insurer which is likely to be independent of the trustee and the reinsurer can add additional governance and regulatory steps, as well as an additional set of advisors that are more involved than captive-appointed counsel would be. However, they can offer an additional menu of options to trustees, both in terms of roles in the transaction (the insurer can take on responsibility for the valuation and calculation agent roles, for example) and with respect to future flexibility for trustees looking to restructure the swap in the future. As such, the use of U.K.-regulated insurers to intermediate longevity swaps is a trend that we expect to see more of throughout 2022 and beyond.

This year, we also advised on and are aware of a number of reinsurance transactions transferring both asset risk and longevity risk (referred to as funded reinsurance), a market which has grown over the last two years as insurers are increasingly interested in finding a home for their assets and as reinsurers look to capitalise on their asset management expertise. Funded reinsurance is also a neat fit for deferred liabilities, and the rise in demand for deferred coverage is also seen in the rise in demand for funded reinsurance. These transactions are less frequently announced than longevity-only transactions, though one funded reinsurance transaction which was publicly announced was the transaction between Pacific Life Re and a leading U.K. insurer, which was reported to cover around £190 million of both pensioner and non-pensioner liabilities. We are aware of several other reinsurers who are already active in the funded reinsurance market and expect to see more insurers participate in 2022 and beyond.

In our 2020 Year in Review, we noted that the immediate impact of the COVID-19 pandemic in the U.K. market was limited in terms of its impact on market volume and on the mortality assumptions used for pricing longevity transactions. Whilst this has remained true in relation to the direct impact of COVID-19 regarding the transactions that have taken place to date, the medium- and long-term impacts of the COVID-19 pandemic remain uncertain and as such could impact future pension liabilities. From an actuarial perspective, some drivers that could result in a lower cohort life expectancy include economic recessions caused by government-imposed lockdowns and postponed medical diagnoses and treatment, while drivers that could result in a higher cohort life expectancy include increases in public healthcare funding, advances in viral and vaccine-related science and behavioral changes relating to healthier lifestyle choices and better hygiene. It

remains to be seen how each of these drivers may impact longevity improvements, though we do not consider that this uncertainty will hinder the market volume; rather, de-risking via a bulk annuity transaction or longevity swap in the near future may be a strategic way for pension schemes to proactively address the risks surrounding the uncertainty of the long-term and indirect impact of the COVID-19 pandemic.

In the world of U.K. pensions generally, a major development to occur was the passing of the Pension Schemes Act into law in February 2021. The Pension Schemes Act (hereafter referred to as the "Act") has far-reaching implications on the day-to-day governance of pension schemes and greatly expands the powers of the Pensions Regulator ("TPR"), enabling TPR to achieve its goals of being "clearer, quicker and tougher" in the wake of pensions scandals such as those related to the BHS, Carillion and Silentnight pension schemes.

Key provisions of the Act include:

- the introduction of new criminal offences and civil penalties, with the most significant changes relating to the creation of the new criminal offences regarding the avoidance of employer debt and conduct which risks accrued scheme benefits, the penalty for each offence being an unlimited fine, imprisonment for up to seven years or both;
- two new grounds on which TPR can issue a contribution notice, being the employer resources test and the employer insolvency test, and a new criminal offence of failing to comply with a section 38 contribution notice;
- a new notifiable events regime, with the penalties for knowingly or recklessly providing TPR with false or materially misleading information comprising a fine or imprisonment of up to two years;
- a broad range of new powers and sanctions relating to TPR's investigatory powers;
- a duty on trustees of DB pension schemes to determine and keep under review a funding and investment strategy;
- new governance requirements requiring trustees to have regard of the impact of climate change risk on their scheme's investment portfolio and to publish information relating to the effects of climate change on the scheme;
- an amendment restricting the circumstances in which members of an occupational or personal pension scheme may transfer their accrued rights to another scheme; and
- provisions supporting the legislative and regulatory framework for pensions dashboards, including powers to compel pensions schemes to provide pension information to consumers.

Many of the regulations implementing key provisions of the Act have already been brought into force, including those relating to the new criminal offences, the new contribution notice grounds, the investigatory powers of TPR, the provisions relating to transfer values and provisions relating to climate change risk reporting. Of particular concern within the industry have been the new criminal offences, which as drafted in the Act are wide in scope, and potentially could extend to liability for persons outside of the scheme sponsor (such as advisors or counterparties) and to ordinary commercial activities (such as lending). The accompanying TPR guidance to the regulations implementing the criminal offences (published in late September 2021), however, has clarified that TPR does not intend to prosecute behavior consistent with ordinary commercial activity but rather the offences are targeted at serious examples of intentional or reckless conduct.

Further, we note that the climate change reporting obligations introduced by the Act may become an area of increasing focus for (re)insurers looking to enter into de-risking transactions with pension schemes. The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (SI 2021/839) (being the regulations enacting the climate change reporting obligations set out in the Act) came into force on October 1, 2021 and require that pension schemes adopt internal governance policies concerning climate change risks and the impact of climate change on the scheme. As such, trustees will need to consider climate

change-related risks when making important investment-related decisions, including when deciding which (re) insurer they will transact with as part of their de-risking strategy. As a result, in order to remain competitive in the de-risking market (as well as in addition to their own governance requirements) (re)insurers are increasingly taking positive steps to identify and manage climate risks in their own portfolios, and we have seen that reinsurers have already been faced with questions from both trustees and cedants on how they manage their own portfolios from a climate-risk perspective, as well as from a broader ESG perspective. This has been a strong theme for the insurance industry as a whole through 2021, as discussed further in Developments in SEC Regulation and Corporate Governance below. Looking forward, we therefore expect pension schemes, insurers and reinsurers to place more focus on their internal climate-change policies and governance processes.

In our 2020 Year in Review, we discussed in detail the assessment regime launched by TPR in 2020 for commercial consolidators, being those pension schemes into which other pension schemes can transfer their liabilities. In November 2021, Clara-Pensions became the first consolidator to obtain approval from TPR to enter into transactions. While there is no formal legislation or final regulatory framework yet in place regarding consolidators, now that Clara has been given the green light, we expect to see the first consolidator transactions in 2022 (noting however that each deal still needs to be individually approved by TPR). Further, now that TPR has completed the assessment process for one consolidator, this signals that more consolidators may be added to TPR's list of approved superfunds under the current interim guidance. Consolidators offer an alternative long-term strategy for DB pension schemes looking to de-risk and will prove an interesting space to watch as we see the market reaction to the first transactions due to come through in the coming year.

With respect to regulatory changes, the reform of risk margin remains an area of interest to the longevity risk transfer market, particularly in light of the volatility of risk margin in relation to longer-term liabilities. We refer to Principal Regulatory Developments Affecting Insurance Companies below, which contains more information on the European and U.K. reviews of Solvency II, including in particular HM Treasury's proposals relating to reform of the risk margin.

B. Developments in Continental Europe

As noted in our 2020 Year in Review, the Netherlands has continued to see significant activity in the de-risking market throughout 2021. As at the end of 2021, three significant longevity reinsurance transactions have been publicly announced as having closed in 2021 – the EUR 4.7 billion reinsurance transaction between Athora Netherlands and Canada Life Re, the EUR 3.3 billion reinsurance transaction between Athora Netherlands and Reinsurance Group of America and the EUR 7 billion reinsurance transaction between Aegon and Reinsurance Group of America. Interestingly, each of the transactions between Athora and Canada Life Re and between Aegon and Reinsurance Group of America include cover for both pensioners and non-pensioners, demonstrating that the trend towards covering more deferred liabilities is not unique to the U.K. market.

C. Developments in North America

Turning to North America, the year 2021 largely reflected a continuation of past trends as the United States market continued to rebound from the disruptive effects of the COVID-19 pandemic. There were nevertheless several noteworthy highlights.

First, the market experienced a considerable uptick in deal volume in the fourth quarter of 2020, which continued into 2021. The fourth quarter of 2020 saw $13.7 billion in sales (a 21% increase over the same period in 2019) and the year finished with a total volume of between $25 billion to $27 billion. The market built on that momentum in 2021, and it was reported that it had achieved $25.7 billion in transfers by the end of September, including $15.8 billion in buy-outs in the third quarter alone. This remarkable volume has prompted predictions that the total volume of transactions in 2021 could reach $40 billion. That level would best the previous high-water mark of $36 billion set

in 2012 off the back of Prudential Financial's transactions with General Motors and Verizon, respectively. The high volume of activity in 2021 may have reflected favorable market conditions as rising assets prices buoyed the funded status of United States plans generally. According to Milliman, the funded status of the largest United States plans increased on average from 70.7% to 85% as at the end of the second quarter.

There were also a significant number of jumbo transactions (i.e., transactions involving the transfer of $1 billion or more) and an increase in buy-in volume. While jumbo transactions are by no means rare in the United States, in recent years, the market has seen a number of small and medium-sized deals. That continued to be the case in 2021, but by the end of September, five jumbo transactions had already been reported. Buy-ins, in contrast, are comparatively rare, but continue to become less so. The fourth quarter of 2020 saw two reported buy-ins, which together comprised $1.6 billion in liabilities, according to the Secure Retirement Institute. That tally represents a new high for the United States market, and some market watchers anticipate that the total reported buy-in volume could reach $3 billion by year-end. That generally accords with our experience as we are seeing buy-ins considered more widely and would expect them to occupy an increasing share of the United States market in coming years.

Finally, we have noted in our 2020 and 2019 reviews (found here and here) that the foundations for deeper connections between the capital and pension risk transfer markets have been set in recent years. This year saw further movement in that direction as Athene Holdings Ltd. ("Athene") utilized support from Athene Co-Invest Reinsurance Affiliate ("ACRA"), the investment vehicle it established by in 2019, to support pension risk transfer transactions with Lockheed Martin Corporation ("Lockheed") and JCPenney, respectively.

Further points of continuity with past years include the continued high level of interest among plans and plan sponsors in, and their incremental approach to, de-risking, as well as the proliferation of small and medium-sized deals among publicly reported transactions.

With respect to the first point of continuity, as we noted in our January 2020 writing, the biennial Mercer/CFO Research study published in June 2019 found that 70% of plan sponsors were looking to execute a buy-out transaction in 2019 or 2020. The 2021 edition of the survey found those numbers essentially unchanged with 70% of respondents noting that their plan has purchased, or is considering the purchase of, a group annuity. A further 90% said that they had offered lump sum payouts to retirees in the last 10 years, and 77% said they were likely to offer further lump sum payouts in the next two years. Those results underscore the incremental approach to de-risking that is often seen in the United States market whereby plans offer lump sums as a precursor to, or in conjunction with, one or more buy-out transactions with one or more insurers.

The findings of the Mercer/CFO report were echoed by a survey of 253 plan sponsors undertaken by MetLife, the results of which were released in October. The survey found that 93% of plan sponsors with de-risking goals intend to divest all of their company's defined benefit pension plan liabilities, compared to 76% in 2019. Respondents cited interest rates (61%), market volatility (47%), an increase in the volume of plan retirees (37%) and favorable buy-out pricing (35%) as the principal factors behind their intentions. A further 42% of respondents stated that the COVID-19 pandemic has increased or accelerated the likelihood that they would enter into a pension de-risking transaction. Only 11% responded that the pandemic has decreased or delayed the likelihood of their doing so, which represents an 8% decrease from last year.

Turning to noteworthy deals, the largest deal of 2021 is HP Inc.'s purchase of a $5.2 billion group annuity contract from Prudential Financial. The deal, which was reported in September, transfers the pension obligations for approximately 41,000 retirees and beneficiaries to Prudential. The transaction follows HP's payment of approximately $2 billion in AICs to about 12,000 plan participants in 2020. The second-largest deal of the year to date is the sale by Athene of a group annuity contract to Lockheed. The transaction was announced in August and transferred $4.9 billion in liabilities to the insurer. The deal follows Lockheed's purchases of a $1.4 billion group

annuity contract from MetTower, which covers 13,500 retirees and beneficiaries, and a $793 million buy-in group annuity contract from an undisclosed insurer. Both deals were completed in December 2020. It also follows buy-out transactions with MetTower and Prudential Financial in 2019 and 2018, respectively, and a buy-in transaction with Athene in 2018. The deal transferred $2.8 billion in liabilities, covering approximately 30,000 retirees and deferred annuitants, to the insurer. The deal was not JCPenney's first step into the pension risk transfer market. It previously purchased a group annuity contract from Prudential in 2015 in a deal that saw liabilities for about 43,000 retirees and beneficiaries transferred to Prudential. Lockheed's and JCPenney's activity reflect an incremental approach common in the U.S. market, as plans and plan sponsors commonly undertake multiple strategic buy-outs, often building upon lump sum offers or pension freezes, as steps in multi-year processes to reduce pension liabilities.

Other noteworthy deals from the fourth quarter of 2020 and 2021 include Phillips North America LLC's transfer of $1.2 billion in liabilities to MetTower and Principal Financial Group ("Principal") in the fourth quarter of 2020. MetTower and Principal will share responsibility for the benefits of approximately 9,000 retirees and beneficiaries, with MetTower acting as administrator. Principal will have sole responsibility for 2,000 retirees and beneficiaries. MetTower also announced that it entered into a pension risk transfer agreement with Weyerhaeuser Company in December covering nearly 5,200 Weyerhaeuser retirees and beneficiaries.

Massachusetts Mutual Life Insurance Company ("MassMutual") completed a transaction with Arconic Corp., the Pittsburgh-based aluminum manufacturer, in the second quarter, which saw the insurer take responsibility for $1 billion in pension liabilities for approximately 8,400 retirees and beneficiaries. The deal follows the company's purchase of a $245 million group annuity contract from an undisclosed insurer in December.

Athene was quite active in the market this year. In addition to the matters noted above, it also concluded pension risk transfers with General Electric Company, Alcoa Corporation, and Sonoco Products Company. These three transactions saw approximately $1.7 billion, $1 billion and $900 million in pension liabilities, respectively, transferred to the insurer. The deal between Athene and Alcoa is the second between the two parties. They previously concluded the transfer of about $290 million in liabilities to the insurer in 2018.

There were also a number of small and medium-sized deals reported this year. These included Grief Inc.'s purchase of a $100 million group annuity contract from an undisclosed insurer in the quarter ended January 31 and the purchase by Vulcan Materials Co. of Birmingham, Alabama, of an $88 million group annuity contract from an undisclosed insurer in May 2021 covering approximately 2,800 pensioners and beneficiaries. In addition, Ball Corporation of Westminster, Colorado purchased a $325 group annuity contract, also from an undisclosed insurer. The deal is the third for Ball, which purchased group annuity contracts in 2017 and 2018, for $176 million and $220 million, respectively, the latter of which was issued by Prudential Financial. Federal Signal Corp. of Oak Brook, Illinois purchased a $24 million group annuity contract from an undisclosed insurer, and United States Steel Corp. purchased a $284 million group annuity contract from Legal & General America's subsidiaries, Banner Life Insurance Co. and William Penn Life Insurance Co. of New York. In the fourth quarter, Unisys Corp. announced that it had transferred $280 million in liabilities to MassMutual. The deal covers the pension benefits for approximately 11,600 retirees and beneficiaries and follows its October 2020 deal, also with MassMutual, which saw it transfer $235 million in liabilities covering about 6,900 pensioners and beneficiaries to the insurer. Unisys combined its purchase of these two group annuity contracts with the making of $276 million in lump sum payments, which it announced in December.

The expansion of the United States pension risk transfer market has not been without pitfalls. As we noted in our January 2021 review, the pension risk transfer market has come under scrutiny from the New York State Department of Financial Services ("NYDFS"). The NYDFS recently announced a $3 million penalty against Pacific Life for having "done an insurance business in New York without a

New York license in connection with its pension risk transfer business." In light of the NYDFS's recent actions, we would expect insurers to be particularly cautious going forward when undertaking business with a nexus to New York and, therefore, further announcements by the NYDFS, if any, are likely to be few in number.

As we noted last year, the COVID-19 pandemic had a more direct effect on the Canadian market because the Canadian Office of the Superintendent of Financial Institutions issued a freeze on commuted value transfers and buy-out annuity purchases that lasted from March until the end of August 2020. The freeze was intended to address high levels of market volatility, which had a deleterious effect on Canadian plan funding ratios. The result was ultimately less market activity. According to figures reported by Eckler Ltd., the market reached a total volume of C$4.45 billion in 2020 – down from C$4.5 and C$5.2 billion in 2018 and 2019, respectively.

Given the context, however, 2020's total represents a considerable volume and 2021 is likely to reflect a continued rebound when the year's final tallies are reported. This year's noteworthy deals include a C$560 million buy-in between Sun Life and Iron Ore Company of Canada, a majority-owned subsidiary of Rio Tinto, in January. The deal follows two buy-in deals in 2020 (which we noted in last year's review). This suggests that, as in the United States, buy-ins may play a larger role in the Canadian market going forward. In April, Sun Life, iA Financial Group and Brookfield Annuity, announced a group annuity buy-out transaction for General Motors of Canada Company. The deal transferred C$1.8 billion in liabilities covering over 6,000 pensioners and beneficiaries to the three insurers. Sun Life's share of the deal was C$1.1 billion balance, which made it the first C$1 billion transfer to a single insurer in a single buy-out transaction in the Canadian market. The balance of the liabilities was split between iA Financial and Brookfield, which assumed C$0.6 billion and C$0.1 billion of liabilities, respectively. The year also saw J.M. Smucker Co. purchase a group annuity contract transferring $83 million in liabilities of its Canadian defined benefit plan to an undisclosed insurer.

D. Looking Forward to 2022

At the end of 2021, all indications suggest that the U.K. and North American markets will continue to experience a robust demand for de-risking transactions in 2022.

In the U.K., key trends that we expect to continue and grow in 2022 are the high interest in including cover for non-pensioner liabilities in both bulk annuity transactions and longevity reinsurance transactions and the increased interest in utilising the U.K. insurer intermediary transactions structure for longevity swaps as an alternative to the off-shore captive structure. We also expect to see the first pension consolidator transactions announced within 2022, though whether the first transaction will follow swiftly on the heels of Clara being approved remains to be seen. Finally, we expect to see more restructurings from longevity swaps to buy-in/buy-out transactions, as schemes progress on their de-risking journeys and as some schemes enter into longevity swaps with an expectation of restructuring within a short period following entry into the swap.

In the United States, continued interest among plan sponsors and market volatility should continue to push United States plans to de-risk. There remains considerable capacity for further market activity as only $175 billion of the approximately $3.4 trillion in defined benefit plan assets have been transferred to date. We expect to see the current trend toward small and medium-sized deals and diversified, incremental de-risking continue, albeit not to the exclusion of jumbo deals. In Canada, despite the interruption posed by the COVID-19 pandemic, the foundations that have propelled significant growth in recent years remain in place, and we would expect to see the market continue to rebound in 2022.

Outside of the U.K. and North America, as well as further transactions in continental Europe, we hope to see de-risking transactions expand to new markets in 2022 – we are aware of activity in 2021 in at least one new jurisdiction, and we are excited to see new markets continue to develop, utilising technology from the U.K. market as adapted to fit the locality, as we have seen previously with Dutch indemnity deals.

V. DEVELOPMENTS IN SEC REGULATION AND CORPORATE GOVERNANCE

A. Recent SEC Developments

Prior Chairman Jay Clayton left the SEC in late 2020 and current Chairman Gary Gensler was sworn into office on April 17, 2021. Set forth below is (i) a summary of the major final rulemakings adopted by the Commission during 2021, (ii) a summary of the major proposed rulemakings issued by the Commission during 2021, and (iii) a brief discussion of the major rulemakings expected to be proposed by the Commission in 2022.

i. Final Rulemakings – Universal Proxy

On May 6, 2021, the SEC reopened the comment period for the amendments initially proposed in 2016 relating to universal proxy cards. On November 17, 2021, the SEC voted 4-1 to issue final rules requiring the use of a universal proxy card in all non-exempt solicitations involving director election contests, except those involving registered investment companies and business development companies. The rules enable shareholders voting by proxy to select both company and dissident nominees.

The prior proxy rules did not allow a shareholder voting by proxy in a contested election to replicate the vote they could cast if they voted in person at a shareholder meeting. Shareholders voting in person may select among all of the duly nominated director candidates proposed by any party in a contested election, and vote for any combination of candidates. However, shareholders voting by proxy historically have not had the same flexibility due to the interplay between state and federal law, and thus have generally been forced to choose between the proxy card of the company or of the dissident.

The final rules include a requirement that dissidents must solicit the holders of shares representing at least 67% of the voting power of the shares entitled to vote at the meeting (up from a majority in the proposing release). The adopting release noted that this requirement was intended to strike the appropriate balance to ensure that dissidents must still engage in meaningful independent solicitation efforts in order to have their director nominees elected.

There is no requirement in the final rules as to the size of a dissident's equity position in the company or the length of time it has held such position. Commissioners Peirce and Roisman each issued a statement noting that they would have preferred the final rules contain ownership requirements similar to those for shareholders who desire to introduce a proposal for a company meeting. The adopting release noted these concerns but concluded that a universal proxy requirement should not be dependent on these ownership requirements as the purpose of the rule is to allow shareholders to exercise their right to vote for directors in the same manner as they could if they attended the meeting in person.

The effective date for the final rules is 30 days after the adopting release is published in the Federal Register.

ii. Proposed Rulemakings

a. Proxy Advisory Firms

In 2019, the Commission issued guidance affirming its long-standing view that advice provided by proxy advisory firms constitutes a solicitation under the federal proxy rules under the Exchange Act.

In July 2020, the SEC passed amendments to its rules governing proxy solicitations, which amendments:

(i) require that proxy advisory firms share their voting recommendations with the public companies that are the subject of those votes before sending them to clients or at the same time;

(ii) require those firms to inform clients about the companies' response to their recommendation (requirements (i) and (ii), the "Recommendation Requirements");and

(iii) require those firms to disclose any conflict of interest in their voting advice (the "Conflicts of Interest Disclosure Requirement").

In addition, the amendments codified the 2019 guidance, and made clear that the failure to disclose material information about proxy voting advice may constitute a potential violation of the antifraud provision of the proxy rule.

The amendments took effect on November 2, 2020, but compliance was not required until December 1, 2021. A proxy advisory firm has filed suit against the SEC challenging the 2020 rule amendments and the 2019 guidance, which suit is currently stayed.

Earlier in 2021, Chairman Gensler directed the SEC Staff "to consider whether to recommend further regulatory action regarding proxy voting advice." Subsequently, on June 1, 2021, the Division of Corporation Finance issued a statement (the "CF Statement") providing that, pending further regulatory action by the SEC, it will not recommend enforcement actions based on the 2020 rule amendments or the 2019 guidance.

On October 13, 2021, the National Association of Manufacturers and Natural Gas Services Group, Inc. filed a lawsuit as to the CF Statement. The lawsuit argues that the Administrative Procedure Act requires the SEC to engage in notice-and-comment rulemaking whenever it amends a regulation, including when it desires to suspend the regulation's effectiveness.

On November 17, 2021, the SEC voted 3-2 to propose rules partially amending the 2020 rules (the "2021 Proposed Amendments"). The 2021 Proposed Amendments would remove the Recommendation Requirements and remove a note (e) that had been added to Exchange Act Rule 14a-9 (which rule prohibits false and misleading statements), to include specific examples of material misstatements or omissions related to proxy voting advice. The Conflicts of Interest Disclosure Requirement would still be in effect and proxy voting advice would remain a solicitation subject to the federal proxy rules.

Court challenges to the amendments are likely when the notice-and-comment rulemaking process is complete and final rules are issued. In any such court proceeding, the Commission will be required to show that there are "good reasons" for the changes to the 2020 rules.

In connection with the notice-and-comment rulemaking process for the 2020 rules, the Commission made adjustments to the then proposed rules based on investor comments. As to the removal of the Recommendation Requirements, the proposing release for the 2021 Proposed Amendments notes that many investors still have strong concerns about the Recommendation Requirements. The proposing release also notes that most of the major proxy advisory firms have current practices that could address some of the concerns underlying the Recommendation Requirements, including the existence of a Best Practices Principles Group comprised of most of the major proxy advisory firms.

Commissioner Peirce issued a statement in dissent, noting that (i) the Commission considered concerns raised by all commenters during the rulemaking process and the proposing release fails to identify any new concerns, and (ii) the Commission was well aware of the Best Practices Principles Group during the prior rulemaking process. She stated, "[t]he Commission lacks a sound basis for seeking to amend a brand new rule. Nothing has changed since we adopted the rule, and we have not learned anything new. The release takes a stab at justifying the rewrite but we might as well simply acknowledge that the political winds have shifted."

In his dissent, Commissioner Roisman noted that the members of the Independent Oversight Committee of the Best Practices Principles Group were selected by the proxy advisory firms themselves and that the committee's budget is funded by the proxy advisory firms whose practices are subject to review by the committee.

b. Say-on-Pay Votes

In September 2021 the SEC proposed rule amendments implementing the Dodd-Frank Act requirement that

institutional investment managers report how they voted as to each shareholder advisory vote on executive compensation matters ("Say-on-Pay"). The proposed rules would require an institutional investment manager subject to section 13(f) of the Securities and Exchange Act of 1934 reporting requirements to report annually how it voted proxies relating to Say-on-Pay matters.

The proposed rules would also require disclosure of each registered investment company's securities lending activities. Each such fund would be required to disclose the number of shares voted at a shareholder meeting and the number of shares loaned out and not recalled prior to the vote.

c. Reporting of Securities Loans

On November 18, 2021, the SEC voted unanimously to propose a rule requiring any person or entity that loans a security (debt or equity) on behalf of itself or another person or entity to report the material terms of the transaction to FINRA. The value of securities on loan in the United States as of September 30, 2021 was estimated at approximately $1.5 trillion. Broker-dealers are the primary borrowers of securities; broker-dealers that borrow securities typically re-lend those securities or use the securities to cover fails-to-deliver or short sales arising from proprietary or customer transactions.

Securities lending transactions are usually facilitated by a third-party agent such as a custodian bank, that lends securities on behalf of its custodial clients for a fee. The beneficial owners of the securities being loaned are generally large institutional investors, including investment companies, sovereign wealth funds, pension funds, collective investment trusts, and insurance companies. Section 984 of the Dodd-Frank Act provides the Commission with the authority to increase transparency with respect to the loan or borrowing of securities. Note that as this section of the Dodd-Frank Act pertains to the loan or borrowing of securities, the proposed rule does not address repurchase agreements.

For purposes of the proposed rule, a "Lender" is defined to include persons or entities that own the securities being loaned ("beneficial owners"), as well as third-party intermediaries, including banks, clearing agencies, or broker-dealers that intermediate the loan of securities on behalf of beneficial owners (each, a "Lending Agent"). A "Lender" would not include the borrower of securities in a securities loan transaction or any third party that intermediates the borrowing of securities on behalf of the borrower. Thus, the borrower would not be obligated to provide any information to FINRA pursuant to the proposed rule.

If the beneficial owner is using an intermediary Lending Agent for the securities loan, the Lending Agent would have the obligation to provide information, on behalf of the beneficial owner, to FINRA pursuant to the proposed rule. The beneficial owner of the security would only be required to provide information to FINRA pursuant to the proposed rule if such beneficial owner does not use an intermediary Lending Agent for the securities loan.

If the beneficial owner or a Lending Agent is obligated, as a Lender, to provide this information to FINRA, such Lender may contract with a broker-dealer as "reporting agent" to provide the information to FINRA on its behalf.

Public Data. Within 15 minutes after each loan is effected or modified, the Lender would be required to provide FINRA with certain information as to such transaction that FINRA will make publicly available, including (i) the name of the issuer, (ii) the amount of the security loaned, (iii) the type of collateral, (iv) certain fee information and (v) the percentage of collateral to value of loaned securities.

Confidential Data. Within 15 minutes after each loan is effected, the Lender would also be required to provide FINRA with certain information as to such transaction that FINRA will keep confidential (the information would be shared with the Commission and such other persons as the Commission may designate upon a demonstrated regulatory need), including (i) the name of each party to the transaction, (ii) if the person or entity lending the securities is a broker-dealer and the borrower is its customer,

information about whether the security is loaned from the broker-dealer's inventory, and (iii) whether the loan is being used to close out a fail-to-deliver (if the Lender has such information).

Aggregate Data. A beneficial owner or its Lending Agent, as applicable, would also be required to provide FINRA with certain other information by the end of each business day on which the beneficial owner had an open securities loan as to which the Lender was required to provide information to FINRA pursuant to the proposed rule, including (i) the total amount of the applicable security available to be lent by the beneficial owner or its Lending Agent, as applicable, and (ii) the total amount of the applicable security on loan that has been contractually booked and settled.

If the Lending Agent is a broker-dealer, items (i) and (ii) would include any such securities owned by the broker-dealer, any such securities in its margin customer's accounts and any such securities owned by its customers that have agreed to participate in a fully paid lending program.

FINRA would be required to aggregate any information it receives under items (i) and (ii) above and to make public aggregate information for that security no later than the next business day.

Public access to the securities lending information would be available on FINRA's website or similar means of electronic distribution and would be free and without use restrictions. Costs for establishing and maintaining this system would be borne by FINRA in the first instance and would be recouped by FINRA from market participants that report securities lending transactions to FINRA.

d. Rule 14a-8

On September 23, 2020, the SEC voted to adopt amendments to modernize its shareholder proposal rule, which governs the process for a shareholder to have its proposal included in a company's proxy statement for consideration by all of the company's shareholders.

The principal requirements for (1) initial inclusion in the proxy statement (the amount and length of ownership of the proposing shareholder) and (2) for subsequent resubmission if the proposal is not approved (the amount of support from other shareholders) had not been substantively amended since 1998 and 1954, respectively.

The amendments replaced the then current ownership threshold, which required holding at least $2,000 or 1% of a company's securities for at least one year, with three alternative thresholds that will require a shareholder to demonstrate continuous ownership of at least:

(i) $2,000 of the company's securities for at least three years;

(ii) $15,000 of the company's securities for at least two years; or

(iii) $25,000 of the company's securities for at least one year.

The amendments also prohibited the aggregation of holdings for purposes of satisfying the amended ownership thresholds.

The amendments also raised the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company's future shareholder meetings from 3%, 6% and 10% for matters previously voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively.

These amendments are scheduled to go into effect for shareholder meetings held in 2022.

In March 2021, Commissioner Lee, while serving as Acting Chair, asked the Staff to develop proposals for potentially revising Rule 14a-8 of the Securities and Exchange Act of 1934" itself.

In March 2021, Senator Sherrod Brown introduced a resolution calling for reversal of last year's Rule 14a-8 amendments under the Congressional Review Act (the "CRA"). The CRA allows Congress to pass a joint resolution disapproving of an agency's final rule, which requires only

a simple majority of both chambers to pass, along with the President's signature. Congress must invoke the CRA within 60 days of a finalized rule. However, the time for Senate action on the resolution elapsed and the Rule 14a-8 amendments are no longer subject to disapproval pursuant to the CRA.

Staff Legal Bulletins. On November 5, 2021, the Staff of the Division of Corporation Finance issued a Staff Legal Bulletin which explicitly rescinded three Staff Legal Bulletins issued in 2017, 2018 and 2019, respectively.

Policy Exception to Ordinary Business Operations. Rule 14a-8(i)(7) of the Securities and Exchange Act of 1934 permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations." Under this exclusion, companies may exclude proposals relating to matters that are fundamental to management's ability to run a company on a day-to-day basis unless, in the Staff's view, the proposal focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote.

Under the new Bulletin, the Staff will instead focus on whether the proposal raises issues with broad societal impact such that they transcend ordinary business. For example, the Bulletin provides that proposals raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the issue was significant to the company.

Micromanagement. Under the ordinary business exclusion, companies may exclude a proposal that "micromanages" the company, which may occur if the proposal "involves intricate detail, or seeks to impose specific time frames or methods for implementing complex policies."

In one of the rescinded Bulletins, the Staff expressed a view that its micromanagement determinations would turn on the prescriptiveness of a proposal. Under the new Bulletin, the Staff will instead focus on "the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management."

In assessing whether a proposal delves into matters "too complex" for shareholder consideration, the Staff may consider "the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic," and also references "well-established national or international frameworks when assessing proposals related to disclosure, target setting, and time frames."

The new Bulletin notes that the Staff will not concur with exclusion of climate change proposals that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

Relevance. Rule 14a-8(i)(5) permits a company to exclude a proposal that relates to operations which account for (i) less than 5% of the company's total assets at the end of its most recent fiscal year, and (ii) for less than 5% of its net earnings and gross sales for its most recent fiscal year, provided that such proposal is not otherwise significantly related to the company's business.

One of the rescinded Bulletins encouraged companies to submit a board analysis to support the argument that the proposal topic was not significantly related to the company's business. The new guidance rejects the need for a board analysis and reverts to the approach of not excluding proposals that "raise issues of broad social or ethical concern related to the company's business" even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5).

e. Share Repurchases

Since 2004, United States companies have spent $11 trillion on share repurchases, though the annual amount has declined in each of the last three years. Certain members of Congress have complained about capital being allocated to share repurchases rather than to workers.

Former Commissioner Robert Jackson has conducted extensive research in the area, concluding that insider

selling after the announcement of share repurchases is associated with poor long-term company performance. President Biden criticized share repurchases on the 2020 campaign trail. An excise tax on share repurchases has been proposed in the House and Senate as part of the corporate tax proposals.

Currently, issuers typically disclose repurchase programs following authorization of the program by the board of directors and most share repurchases are executed over time through open market transactions.

Issuers typically do not disclose the specific dates on which they executed trades pursuant to an announced repurchase program. However, pursuant to Item 703 of Regulation S-K of the U.S. Securities Act of 1933, each issuer is currently required to disclose in its periodic reports on a quarterly basis (i) information as to any share repurchases by the issuer or an affiliated purchaser during such quarter, and (ii) the principal terms of all publicly announced repurchase programs.

On December 15, 2021, the SEC voted 3-2 to propose changes to the requirements for disclosure of purchases of equity securities made by or on behalf of an issuer or an affiliated purchaser. The proposed amendments would require an issuer to report any repurchase made by or on behalf of the issuer or any affiliated purchaser of shares or other units of any class of the issuer's equity securities registered pursuant to Section 12 of the Exchange Act before the end of the first business day following execution by the issuer of a share repurchase.

The proposing release provides that the "date of execution" (i.e., the trade date) is the point of a securities transaction at which the parties have agreed to terms and are contractually obligated to settle the trade. "Issuer" would include any foreign private issuer, business development company or registered closed-end investment company.

Form SR would require the following disclosures:

- identification of the class of securities purchased;
- the total number of shares purchased, whether or not made pursuant to a publicly announced program;
- the average price paid;
- the aggregate total number of shares purchased on the open market;
- the aggregate total number of shares purchased in reliance on the safe harbor of Rule 10b-18; and
- the aggregate total number of shares purchased pursuant to a Rule 10b5-1 plan.

Form SR would be furnished, rather than filed, and the information would not be deemed incorporated by reference into filings under the Securities Act; thus, issuers would not be subject to liability under Section 11 of the Securities Act for such disclosures unless the issuer expressly incorporated such information. In addition, a late submission of the form would not affect eligibility to use Form S-3.

The proposing release also provides for amendments to Item 703 of Regulation S-K that would require an issuer to make the following additional disclosures in its periodic reports:

- the objective or rationale for its share repurchases and the process or criteria used to determine the amount of repurchases;
- any policies relating to purchases and sales of the issuer's securities by its officers and directors during an issuer repurchase program;
- whether repurchases were made pursuant to a Rule 10b5-1 plan;
- whether repurchases were made in reliance on the safe harbor of Rule 10b-18; and
- whether any of the issuer's officers or directors purchased or sold any shares that are the subject of an issuer repurchase program within 10 business days before or after the announcement of an issuer repurchase program.

In discussing the rationale for the proposed amendments, the proposing release notes, among other things, research finding (i) repurchases can serve as a form of earnings management, and (ii) compensation arrangements tied to share price or earnings per share could incentivize management to undertake repurchases in a manner to maximize their compensation repurchase program.

Commissioner Roisman issued a statement in dissent, noting that (i) share repurchases have become a politically charged issue, (ii) the SEC staff conducted a study last year of the 50 firms that repurchased the most stock in 2018 and 2019 and concluded that it was unlikely that most buybacks were motivated by a desire to inflate share prices to benefit insiders compensated in stock, (iii) the proposed daily reporting of share repurchases may be overly burdensome to companies and (iv) the daily reports could be used by traders to trade ahead of the issuer.

Comments on the proposed amendments must be received within 45 days after the proposing release is published in the Federal Register.

f. Rule 10b5-1 Plans

On December 15, 2021, the Commission voted unanimously to propose:

- amendments to Exchange Act Rule 10b5-1,
- new disclosure requirements regarding insider trading policies and the adoption, modification and termination of trading arrangements by issuers, officers and directors,
- new disclosure requirements as to equity awards made in close proximity to an issuer's disclosure of material nonpublic information,
- amendments to Forms 4 and 5 to identify transactions made pursuant to a Rule 10b5-1 plan, and
- new disclosure requirements as to dispositions by gift of securities by insiders.

Exchange Act Rule 10b5-1(c) provides an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where the trade was pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan meeting the requirements of the rule (collectively or individually, a "Rule 10b5-1 plan") adopted or entered into in good faith when the trader was not aware of material nonpublic information.

The proposing release noted concerns expressed by courts, commentators and members of Congress that this affirmative defense has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of material nonpublic information.

The use of multiple overlapping trading plans to selectively cancel individual trades, the termination of trading plans soon after adoption, and the commencement of trades soon after the adoption of a new trading plan or the modification of an existing trading plan are among the practices cited negatively in the proposing release.

The proposing release also noted that (i) some issuers have engaged in the practice of granting equity awards with option-like features to insiders in coordination with the release of material nonpublic information and (ii) some insiders may be opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities.

Rule 10b5-1 Plan Proposals. The proposals relating to Rule 10b5-1 plans would:

- require a Rule 10b5-1 plan entered into by officers and directors to include a 120-day cooling-off period before trading can commence after its adoption or modification;
- require a Rule 10b5-1 plan entered into by issuers to include a 30-day cooling-off period before trading can commence after its adoption or modification;
- require each officer (as "officer" is defined in Exchange Act Rule 16a-1(f)) and director to certify in writing to the

issuer when the officer or director adopts or modifies a Rule 10b5-1 plan that (i) they are not aware of any material nonpublic information about the issuer or the security and (ii) they are adopting or modifying the Rule 10b5-1 plan in good faith. The certification would not need to be filed with the Commission and would not be an independent basis of liability for directors or officers under Rule 10b-5;

- provide that the affirmative defense under Rule 10b5-1(c)(1) does not apply to multiple overlapping Rule 10b5-1 plans for open market trades in the same class of securities. However, the proposed amendments would not apply to transactions where a person acquires or sells securities directly from or to the issuer;
- limit the availability of the affirmative defense under Rule 10b5-1(c)(1) for a single-trade Rule 10b5-1 plan to one such plan during any 12-month period;
- provide that the affirmative defense under Rule 10b5-1(c)(1) only is available if a Rule 10b5-1 plan was operated in good faith (in addition to the existing requirement that the plan be entered into in good faith);
- require insiders to identify on Forms 4 and 5 whether a reported transaction was executed pursuant to a Rule 10b5-1(c) plan; and
- require new quarterly disclosure in Forms 10-K and 10-Q regarding the adoption, modification and termination of Rule 10b5-1 plans and other trading arrangements (disclosure would also be required for all non-Rule 10b5-1 plan trading arrangements) of Section 16 officers, directors and issuers and the material terms of such trading arrangements (including the duration of the trading arrangement and the aggregate number of securities to be sold thereunder). The proposed disclosures that would be required to be included in a Form 10-Q or Form 10-K (including the insider trading policy disclosures as discussed below) would be subject to the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002.

Insider Trading Policies. The proposing release would also require an issuer to disclose in its Form 10-K whether or not (and if not, why not) the issuer has adopted insider trading policies that govern the purchase or sale of the issuer's securities by employees and directors that are reasonably designed to promote compliance with insider trading laws.

The proposing release provides that registrants should endeavor to make disclosures about their insider trading policies from which investors can assess the sufficiency of such policies. The proposing release notes that investors may find useful:

- information on the issuer's process for analyzing whether the issuer or insiders have material nonpublic information when the issuer is conducting an open-market share repurchase;
- the issuer's process for documenting such analyses and approving requests to purchase or sell its securities;
- how the issuer enforces compliance with its policies; and
- a description of any policies that apply to other dispositions of the issuer's securities where material nonpublic information could be misused, such as through gifts of securities.

Equity Grants Within 14 Days of Disclosure of MNPI. The proposing release would also require disclosure of grants of equity compensation awards within 14 days before or after an issuer's disclosure of material nonpublic information, in order to provide shareholders information as to any "spring-loaded" or "bullet-dodging" option grants during the fiscal year. This disclosure would be required in Form 10-Ks, as well as in proxy statements and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory votes to approve executive compensation.

Information required to be provided would include the number of securities underlying the award, the date of grant, the grant date fair value, the option exercise price, the market price of the underlying securities the trading day before disclosure of the material nonpublic information, and the market price of the underlying securities the trading day after disclosure of the material nonpublic information.

The new requirements would also require narrative disclosure about an issuer's option grant policies regarding the timing of option grants and the release of material nonpublic information, including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award.

Gifts. Finally, the proposing release would require disclosure of dispositions by gift of securities by insiders on Form 4 within two business days after such a gift is made.

Comments on the proposed amendments must be received within 45 days after the proposing release is published in the Federal Register.

iii. Major 2022 Rulemakings

In December 2021, the Commission issued its Fall 2021 Unified Agenda of Regulatory and Deregulatory Actions (the "RegFlex Agenda"). The RegFlex Agenda sets forth the short-term and long-term regulatory actions that the SEC plans to take. The RegFlex Agenda sets forth 54 possible rules on the list of short-term regulatory actions, including the proposed rulemakings described above. Set forth below is a summary of certain major items on this list as to which the proposing release for such rule has not yet been issued. In addition to the below, other major items on the short-term RegFlex Agenda include (i) the definition of "held of record" for purposes of Section 12(g) of the Exchange Act, (ii) further market structure modernization, (iii) special purpose acquisition companies, and (iv) amendments to Form PF.

a. Form 13F; Short Selling

Currently, a Form 13F must be filed quarterly by institutional investment managers with at least $100 million in assets under management; this threshold has not changed since the Form was adopted in 1978. Filings are required within 45 days after the end of each quarter and funds are only required to report long positions, in addition to their put and call options, ADRs and convertible notes. Funds are not required to disclose short positions.

In response to the 2020 Form 13F rule proposal, numerous companies noted that they obtained valuable information from this Form as to the makeup of their shareholder base.

No SEC division or office conducts any regular or systematic review of the data filed on Form 13F.

The Dodd-Frank Act directed the Commission to include short-sale positions in the items required to be reported under Section 13(f) of the Securities and Exchange Act of 1934, which disclosure would be required at least monthly. The Commission has never acted on this direction.

A bill was introduced in the House of Representatives earlier this year proposing to modify Section 13(f) to redefine the scope of the rule to cover both shorts and derivatives, and also to require monthly Form 13F reporting.

Chair Gensler has directed the SEC Staff to consider new requirements for disclosure of (i) short selling, and (ii) total return swaps (Schedule 13D).

b. Schedule 13D

On October 19, 2021 Chair Gensler provided more details about the SEC's efforts to change its long-standing 5% rule for Schedule 13D. Currently an insurgent investor must file a Schedule 13D within 10 days of acquiring more than 5% of a public company's equity when it has plans to communicate some sort of strategic options for the business.

Gensler noted that in his view it is time to shorten the 10-day window and he has requested that the Staff "take a look at this." Gensler also noted that he would be supportive of requiring additional disclosures of swap positions held by investors. These positions are currently not disclosed until an investor crosses the 5% threshold based on its ownership of common equity.

c. Climate Change Disclosure

In March 2021, then-Acting Chair Allison Lee issued a public statement in which she (i) asked the Staff of the Division of Corporation Finance to evaluate the SEC disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change, and (ii) asked for public comment on climate change disclosures.

At the 2021 SEC Speaks conference, senior Staff members from the Division of Corporation Finance noted that the SEC had received more than 550 unique comment letters in response. Approximately 75% of these commenters supported mandated climate disclosure rules, and many cited a need for more consistent and comparable disclosure on climate-related risks and opportunities.

Following on the request for public input on climate, Chair Gensler noted that he wants to have a proposed rule issued and he has asked the Staff to specifically consider, consistent with commentary input, a number of areas in formulating recommendations, for example:

- whether the disclosures should be included in a company's annual report on Form 10k;
- how qualitative disclosures could answer key questions about how a company's leadership manages climate-related risks and opportunities, and how these factors feed into the company's strategy;
- the types of quantitative disclosures that the rules should require, such as those related to greenhouse gas emissions, financial impacts of climate change and progress towards climate-related goals and greenhouse gas emissions disclosure;
- how companies might disclose their Scope One emissions (emissions from a company's operations) and Scope Two emissions (use of electricity and similar resources), and whether they should have to disclose Scope Three emissions as well. Scope Three measures the greenhouse gas emissions of other companies in an issuer's value chain;
- whether there should be industry-specific metrics, such as for the banking, insurance or transportation industries; and
- whether companies should provide scenario analyses on how their businesses might adapt to the range of possible physical, legal market and economic changes that they might have to contend with in the future.

In a July 2021 speech, Chair Gensler noted that, in connection with writing the rules requiring mandatory climate disclosures, the Staff should learn from and be inspired by external standard-setters such as the Task Force on Climate-related Financial Disclosures, but that the final rules will be tailored for United States markets. Most commentators do not expect Scope Three to be part of the initial disclosure requirements.

Climate change is not an area of expertise for the Commission.

Existing Disclosure Requirements. As to currently existing disclosures, senior Staff members from the Division of Corporation Finance noted at the 2021 SEC Speaks conference that the Division had in September 2021 released a "Dear Issuer" letter that provided examples of the types of climate-related comments that the Staff may issue in the course of filing reviews. A particular area of focus is if companies provide more expansive disclosure in Corporate Social Responsibility reports than in Commission filings.

Reviewers are also looking to see if a company has not provided disclosure about applicable legislative and regulatory developments or climate-related expenditures, and if those may be important to the company. This may arise when many of the companies in the same industry discuss or disclose a particular regulation. If a company has not mentioned it, the Staff may ask for analysis on why it was not included.

Staff from the Division of Corporation Finance also noted that as companies craft their disclosures, they should

consider the Commission's 2010 guidance on climate. Many of the comments in the "Dear Issuer" letter are consistent with issues that the Commission raised in its 2010 guidance.

d. Human Capital Disclosure

At the 2021 SEC Speaks conference, senior members of the Staff of the Division of Corporation Finance noted that they were working hard to develop recommendations on human capital disclosure. As with climate, these Staff members noted that the SEC has heard that investors want more consistent and comparable disclosures to enable them to compare companies' management of their respective human capital resources.

Some of the factors the SEC is considering for more tailored disclosure include workforce turnover, skills and development training, compensation benefits, and workforce demographics, including diversity, health and safety. Another area noted by the Staff members was diversity of board members and nominees.

Some investors have called for enhancement of the Regulation S-K Item 407 disclosure requirements. Currently, the rule requires information about whether, and if so how, a board's nominating committee considers diversity in identifying director nominees.

These Staff members also noted that some institutional investors have asked for rule changes that would require companies to present information about their director nominees' gender, race and ethnicity in a structured format.

The dissenting statements from the two Democratic Commissioners as to the 2020 modernization of Regulation S-K noted the following human capital metrics as items they wanted to see included in the rule amendments: workplace flexibility and safety, employee turnover rates, part-time v. full-time workers, workforce expenses and workforce diversity.

All ESG rulemaking will likely be challenged in court. Chair Gensler has testified that investors want this information.

e. Cybersecurity

At the 2021 SEC Speaks conference, senior Staff members from the Division of Corporation Finance stated that the Division is considering recommendations in the area of cybersecurity.

These recommendations are likely to include that companies be required to (i) inform their investors about their cybersecurity risk governance practices; and (ii) provide timely disclosure about material cybersecurity risks and incidents.

In a 2021 Senate hearing, Chair Gensler stated that he anticipated rulemaking that would establish (i) what systems and measures companies need to take to manage cybersecurity risk; and (ii) what companies need to do after a cybersecurity breach.

Recent SEC enforcement actions have focused on the efficacy of companies' cybersecurity controls and procedures. Since June 2021, the SEC has brought at least five enforcement actions concerning cybersecurity disclosure controls and procedures and also commenced a sweep requesting data from hundreds of companies related to the SolarWinds compromise.

The SEC asked companies to turn over records of "any other" data breach or ransomware attack since October 2019, if they had previously downloaded a bugged network-management software update from SolarWinds. The SEC told companies they would not be penalized if they shared data about the SolarWinds hack voluntarily.

The enforcement actions focus on:

- a lack of disclosure controls and procedures designed to ensure that information about any incidents is appropriately escalated to senior management,
- a failure to tailor disclosure controls and procedures to the known risk that customer personal identifiable information ("PII") could be exploited, and/or

- a failure to follow existing disclosure controls and procedures.

Another area of focus in the actions is discovery by IT personnel of vulnerabilities which resulted in the exposure of customer PII, which vulnerabilities were discovered months and even years before the companies took sufficient action to remediate and protect customer data.

The SEC shares oversight responsibility for large financial institutions with other financial regulators, which in the United States include the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, among others. The SEC coordinates on cybersecurity matters with the Department of the Treasury and other federal financial regulatory agencies within the framework of the Financial and Banking Information Infrastructure Committee, an interagency working group.

SEC oversight may also require coordination with certain other regulatory agencies. For example, consumer protection matters with respect to SEC registrants are largely overseen by other federal regulators, including the Federal Trade Commission and the Consumer Financial Protection Bureau.

There is also a cybersecurity unit within the Department of Justice and Deputy Attorney General Lisa Monaco in 2021 announced the launch of DOJ's Civil Cyber-Fraud Initiative. DOJ plans to use civil enforcement tools under the False Claims Act to "pursue … those who are government contractors who receive federal funds, when they fail to follow required cybersecurity standards."

Disclosure can at times be at odds with the instructions provided to registrants by federal criminal authorities.

B. U.K. Corporate Governance Developments

i. Agency Responses – Reporting Reliefs

2021 was another busy year for developments in U.K. corporate governance. Whilst companies and governments continued to grapple with the ongoing effects of the COVID-19 pandemic, the arrival of the vaccine and the subsequent return to something approaching "business as usual" in the U.K. for part of the year allowed a renewed emphasis on some of the corporate governance trends that have come to dominate the past few years. In particular, the U.K. saw a renewed focus on climate change, coinciding with the UN Climate Change Conference which was held in Glasgow as well as the publication of the 2021 Hampton-Alexander Review on gender balance in FTSE leadership and the 2021 Parker Review report on ethnic diversity on boards.

Following an unprecedented raft of measures designed to ease the reporting burden of companies in the face of the pandemic in 2020, 2021 saw the majority of the temporary relief measures introduced by the FCA, the U.K. Financial Reporting Council ("FRC") and the PRA for companies with obligations to publish financial information have come to an end. For instance, the automatic extension of deadlines for confirmation statement, accounts and event-driven filings pursuant to the Corporate Insolvency and Governance Act 2020 ("CIGA") came to an end on April 5, 2021 and the pre-pandemic deadlines are once again applicable; however, companies will still have the option to apply for a three-month extension for accounts filings made after April 5, 2021. The CIGA also afforded companies greater flexibility to hold Annual General Meetings ("AGM"), including allowing meetings to be held by virtual means and extending the period in which AGMs were required to be held to March 30, 2021 (extended from December 30, 2020). There have been no further extensions to this temporary measure since March 30, 2021.

ii. The Financial Reporting Council – Corporate Governance Guidance

The FRC, responsible for publishing The U.K. Corporate Governance Code, which requires all companies with a premium listing in the United Kingdom to comply or explain against its principles, continued to update its governance guidance throughout 2021. The FRC has produced a number of important publications offering substantive guidance, recommendations and "best practice" examples.

Some noteworthy initiatives advanced by the FRC in 2021 relate to:

- *The European Single Electronic Format*. The implementation of the requirement for issuers of securities admitted to trading on E.U.- or U.K.-regulated markets to produce annual accounts in a structured electronic format was delayed due to the COVID-19 pandemic. However, it is now a mandatory requirement for financial years starting on or after January 1, 2021, for filing from January 1, 2022. The FRC and FCA issued a joint letter in November 2021 to remind CEOs of their obligation under the Disclosure Guidance and Transparency Rules (DTR 4.1.14) to produce annual accounts in a structured electronic format. The FRC Lab report on early voluntary filings of accounts in a structured electronic format noted that the majority of reports across the sample fell short of the quality expected, most commonly including tagging errors limiting their usability, as well as design issues. The FRC also noted that companies will need to devote sufficient management and operational resources to ensure that they are able to submit their annual financial reports in the required format within the required timeline.

- *Interim Reporting Thematic Review*. The FRC continues to review compliance with the FCA's Disclosure Guidance and Transparency Rules and IAS 34 "Interim Financial Reporting" for companies listed on the London Stock Exchange. The key observations identified in the review include:

  (i) The need for management commentaries to differentiate the impact that the various stages of the coronavirus pandemic had on the financial statements.

  (ii) Where necessary, give an update of the risks and uncertainties for the remaining six months of the year.

  (iii) Disclosure of events or transactions significant to understanding the changes in the financial position and performance of the company since the last annual reporting period should follow the disclosure guidance of individual IFRS to provide updated relevant information.

- *Viability and Going Concern*: In light of the challenges presented by COVID-19, the FRC recommends that annual reports and accounts include clear and comprehensive viability and going-concern disclosures, including how the company intends to navigate the uncertainties of COVID-19 and maintain their solvency and liquidity over the short, medium and longer term. The thematic review highlighted that there was a lack of sufficient qualitative and quantitative detail for the assumptions used in the assessment of viability and going concern and a lack of sufficient detail to enable a reader to assess whether the assumptions used were consistent with those applied in other areas of the financial statements.

- *Alternative Performance Measures ("APMs")*: The APM thematic review builds on a series of reviews undertaken by the FRC's Corporate Reporting Review function and the FRC Lab over the last five years. APMs are defined in the ESMA Guidelines as "financial measures of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework." Following the U.K.'s exit from the E.U., the FRC expects main market companies that use APMs to continue to apply the ESMA Guidelines. The key requirements in the ESMA Guidelines include (i) the APMs and the basis of calculation should be defined, (ii) APMs must not be presented with greater prominence than the most directly comparable measure calculated and presented in accordance with GAAP and (iii) the APMs should be reconciled to the most directly comparable measure in the financial statements. The review notes that companies should highlight limitations of their APMs, including the fact that the measures may not be comparable across companies and that profit-related APMs frequently exclude significant recurring business transactions that impact financial performance and cash flows. In accordance with the Corporate Governance Code, audit committee reports should explain the degree to which they reviewed and challenged the company's APMs.

In December, the FRC announced the areas of supervisory focus for 2022/2023, including (i) TCFD Reporting and Climate-related Reporting in Financial Statements, (ii) Business Combinations (IFRS 3), (iii) Earnings per Share (IAS 33), (iv) Deferred Tax (IAS 12), (v) Discount Rates, and (vi) Judgements and Estimates.

iii. Shareholder Advisory Bodies

In general terms, institutional investor guidance and guidelines for corporate navigation of COVID-19, climate change and board diversity for U.K.-listed issuers emphasize a company structure that possesses strong decision-making processes, sound business acumen, accurate data collection ability, succession plans, effective boards capable of steering companies toward future success while fostering positive corporate reputations, and keeping investors informed. As boards of directors meet in early 2022 to consider annual reports from board committees, shareholder engagement and related proposals for their upcoming AGMs, the following developments may be worth considering:

- *Glass Lewis*. On November 15, 2021, Glass Lewis published its 2022 U.K. Proxy Paper Guidelines, which provided an overview of Glass Lewis's approach to proxy advice in the United Kingdom. Noteworthy updates to the 2022 policy include:

  (i) *Board Diversity* – From 2022, Glass Lewis will generally recommend against the re-election of the chair of the nomination committee at any FTSE 100 board that has failed to appoint at least one director from a minority ethnic group and has failed to provide clear and compelling disclosure for failing to do so. This recommendation is consistent with the proposals from the Parker Review mentioned below, that FTSE 100 companies should have at least one director from a minority ethnic group by 2021;

  (ii) *Committee Chair* (including the Remuneration Committee Chair) – If a company has a staggered board and the chair is not up for re-election, on a case-by-case basis, Glass Lewis may recommend that shareholders instead vote against the re-election of long-serving committee member(s). Where there are ongoing concerns with a company's remuneration policy or practices, Glass Lewis will continue to recommend that shareholders vote against the re-election of all remuneration committee members; and

  (iii) *Environmental and Social Risk Oversight* – From 2022, Glass Lewis will generally recommend that shareholders vote against the re-election of the governance committee chair (or equivalent) of FTSE 100 companies that fail to provide explicit disclosure concerning the board's role in overseeing material environmental and social issues.

- *Institutional Shareholder Services Inc. ("ISS")*. ISS published its Benchmark Policy Updates for 2022 in December. The updated policies are applicable for shareholder meetings taking place on or after February 1, 2022. Key policy changes with U.K. relevance include:

  (i) *Climate Accountability* – for companies that are significant greenhouse gas emitters, ISS will generally recommend voting against the board chair where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy, including detailed disclosure in line with Task Force on Climate-related Financial Disclosures formed by the Financial Stability Board ("TCFD") recommendations and emissions reduction targets;

  (ii) *Ethnic Diversity* – ISS will generally recommend against the chair of the nomination committee (or other directors on a case-by-case basis) of a FTSE 100 company (excluding investment companies) if it has not appointed at least one individual from an ethnic minority background to the board; and

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(iii) *Remuneration (Non-Financial ESG Performance Conditions)* – ESG performance conditions may be used but targets should be quantifiable and material to the business.

- *The International Corporate Governance Network ("ICGN").* The ICGN's core policy documents include (i) the ICGN Global Governance Principles, updated in December 2020 to reflect significant societal changes, most notably those caused by the COVID-19 pandemic and growing concerns about climate change, board independence, stakeholder relations and sustainability issues, and (ii) the ICGN Global Stewardship Principles, updated in September 2020 to reflect shifts in market practice and regulation. In December 2021 the ICGN published a report known as "Viewpoint" on the importance of shareholder proposals as an investor tool. The Viewpoint report looked at how shareholder proposals are a helpful tool to address shortcomings in ESG strategy and other management practices and policies.

- *The Investment Association ("IA").* In November, the IA published updated Principles of Remuneration and issued a letter to Remuneration Committee chairs highlighting key aspects of the Principles. The IA noted that the guidance for shareholders on how remuneration committees should adjust executive pay for the impacts of COVID-19 published in April 2020 would hold true into 2022. The letter also noted that the pandemic has brought to the fore the impact ESG risks can have on sustainable long-term financial health and value of companies and therefore Remuneration Committees should be incorporating the management of material ESG risks as performance conditions in the company's variable remuneration, provided they are quantifiable metrics and clearly linked to company strategy.

iv. Environmental, Social and Corporate Governance

In Europe and the United Kingdom, ESG factors continue to be an important factor in evaluating the investment sustainability and impact of a company, and are proving to have a central role in predicting a company's future risk and return profile, including for insurance company groups. Of interest regarding investments by insurance companies, we note the E.U.'s focus on a greener, more sustainable and longer-term business environment, supported by better engagement between listed companies and their investors, which is becoming a key metric for investors seeking to measure and compare the ESG performance of listed companies. ESG issues have featured heavily in this year's updates to the policies of Shareholder Advisory Bodies.

The "Say on Climate" vote gained traction during the 2021 proxy season allowing shareholders to vote on a company's climate transition plan. Barclays plc was the first company in the U.K. to have a say on climate vote in 2020 and all U.K. Say on Climate proposals were convincingly supported in 2021. ISS will generally recommend voting on a case-by-case basis to approve the company's climate transition action plan, taking into account a number of factors, including the extent to which climate-related disclosures are in line with Task Force on Climate-Related Financial Disclosures ("TCFD") recommendations.

In July 2021 the FRC published its Statement of Intent on Environmental, Social and Governance challenges setting out the areas where ESG reporting fails to meet the demands of stakeholders, including recommendations to address such challenges. In the FRC's view, companies need to go beyond the minimum statutory reporting requirements, as outlined below, and should not use a checklist approach to ESG reporting, but rather provide detailed and company-specific ESG reporting.

Climate Reporting

The Financial Stability Board established the TCFD in 2015 to develop recommendations for consistent climate-related financial risk disclosures. The recommendations cover four main areas – governance, strategy, risk management and metrics. The key governance disclosure recommendations include describing the board's oversight of, and management's role in assessing and managing, climate-related risks and opportunities.

In March 2021, the U.K. government published a consultation on requiring mandatory climate-related

financial disclosures by listed companies, large private companies, and limited liability partnerships in which it proposed mandatory TCFD-aligned climate-related financial disclosures. These proposals build on the U.K. government's 2019 Green Finance Strategy. The FRC conducted a thematic review of the reporting of climate change in 2020 and many large companies have already started to implement the TCFD recommendations on a voluntary basis. However, for accounting periods beginning on or after January 1, 2021, U.K. premium listed companies must include a statement in their annual financial report explaining the extent of their compliance with the TCFD's 11 recommended disclosures on a comply-or-explain basis.

The Streamlined Energy and Carbon Reporting rules came into effect from April 1, 2019 and set out certain required statutory disclosures about emissions and energy use. The FRC's review found that the majority of companies complied with the minimum statutory disclosure requirements; however, the disclosure needs to be presented in an understandable and relevant way for users.

v. Other Developments

- *Proxy Contests*. After a significant decline in shareholder activism at the beginning of the COVID-19 pandemic, there was a notable uptick in the level of shareholder activism towards the end of 2020 and throughout 2021.

- Although a greater level of shareholder activism remains concentrated in the United States, the United Kingdom remains the main venue for the pursuit of activist strategies in Europe, while Japan is the main target of activism in Asia. ESG considerations are front and centre on activist shareholder agendas, especially in light of the introduction of climate change reporting requirements.

- *U.K. Say on Pay*. Executive compensation remained a key focus area in 2021. The remuneration policy of a U.K.-listed company is subject to a binding shareholder vote every three years. Shareholders are beginning to leverage votes against directors to show their displeasure on particular issues such as climate change and other environmental concerns. Although shareholder votes relating to directors' remuneration reports are advisory only, where there is significant opposition to a directors' remuneration report, the relevant issuer must consult with its stakeholders and, at the next AGM, report on how the directors have acted in relation to the concerns raised by the shareholders who voted against the resolutions. In May, the FRC and University of Portsmouth published the results of research conducted on a sample of FTSE 350 companies to determine the extent to which they have applied requirements on directors' remuneration set out in the Code. The FRC noted the positive impact the Code requirements have had on reporting, but there is still work to be done as many company reports lack detail and outcomes and include boilerplate disclosures. The research also analyzed shareholder voting on companies' revised remuneration policies at their 2020 AGMs, with the results showing that shareholder dissent on changes to directors' remuneration policy appears not only to be about maximum pay, but also about other issues surrounding those pay packages, for example changes within the company or external factors such as the level of directors' pay relative to income and pay of other employees in difficult times due to COVID-19. Georgeson's 2021 AGM Season Review found that dissent over remuneration policy votes at U.K. FTSE 100 companies increased by approximately 63% compared to 2020 and 25% of the remuneration resolutions were contested.

- *Gender and Ethnic Minority Board Representation*. The FCA published a consultation paper (CP21/24) in July 2021 on changes to the Listing Rules following the Hampton-Alexander Review and the Parker Review. The changes to the listing rules, if adopted, will require in scope companies to publish a "comply or explain statement" annually on whether they have achieved certain targets proposed by the FCA for gender and ethnic minority representation on their boards. The targets currently proposed are that (i) at least 40% of board members are women (including those who identify as women), (ii) at least one of the senior board positions (Chair, CEO, CFO or SID) is held by a woman (including those who identify as a woman) and (iii) at least one member of the board is from a non-white ethnic minority background. The consultation closed in

October 2021 and the FCA was expected to publish its findings towards the end of 2021 and proposed that the new rules would apply to accounting periods beginning on or after January 1, 2022; however, as of the date of this publication the FCA has not published any updates following the consultation period.

- The Parker Review was launched in 2016 with the goal of improving ethnic diversity on FTSE 100 boards. The report proposed that FTSE 100 firms should have at least one director from an ethnic minority background by 2021 and the same target should be met by FTSE 250 companies by 2024. An update from the Parker Review in March showed that 81 FTSE 100 firms had met the target by 2021, an increase of 19 firms from the previous year.

- The Hampton-Alexander Review, a government-backed initiative to increase the representation of women in senior leadership positions and on boards of FTSE 350 companies, set a target to have 33% of women on FTSE 350 boards and in senior leadership positions by 2020. The Hampton-Alexander Review published its five-year summary report in February noting that 220 FTSE 350 boards have met or exceeded the target, with a further 15 committed to do so. FTSE 100 and FTSE 250 boards both met the target in 2020 with current representation at 36.2% and 33.2%, respectively.

- *Restoring Trust in Audit and Corporate Governance*. In March the U.K. government published its white paper on restoring trust in audit and corporate governance with the aim to improve the quality, accuracy and reliability of the information published by large companies. This follows recent corporate failures – Carillion, Wirecard, Thomas Cook, BHS and Patisserie Valerie among them – together with concerns about the lack of competition and resilience in the statutory audit market.

VI. CAPITAL MARKETS ACTIVITY

A. U.S. Capital Markets Activity

i. Active Markets

While activity in the bond markets did not reach 2020 levels, 2021 continued to be an extremely busy year, driven by the continued low interest rates making for attractive borrowing conditions. 2021 saw approximately $1.46 trillion in investment-grade bond issuances, which marked a decline from 2020's record of $1.86 trillion, according to Refinitiv. Highly rated issuers around the globe started 2022 with a record amount of issuance, which may be a signal that companies are looking to tap the markets before interest rates move higher. According to Bloomberg, $74 billion of United States currency debt was issued from January 1 through January 10, the most ever for such a period. This figure excludes notes sold exclusively to non-United States investors.

2021 was a record year for IPOs with nearly 1,000 companies going public. Global insurance and insurtech companies raised approximately $5.39 billion from IPOs in the first three quarters, which according to S&P Global Market Intelligence is the largest amount raised through the first nine months in at least five years in the sector. There were 19 IPOs through September 2021 in the industry, the highest IPO count in that period since at least 2015. Bright Health raised $924 million in the largest insurtech IPO of 2021. Oscar Health was also among the largest insurtech IPOs, going public in March. Over roughly the past 16 months, at least four venture-backed United States unicorns entered the public markets: property insurer Hippo, via SPAC, health provider Oscar, and auto insurers Root and Metromile via SPAC. Metromile was subsequently acquired by Lemonade. Even though IPO activity was at a record high in 2021, stock performance waned. According to PricewaterhouseCoopers, roughly two-thirds of the companies that went public through traditional IPOs in 2021 have shares trading below their offer price and the insurance industry was no different.

a. Funding Agreement-Backed Note Programs

The continued low interest rate environment also encouraged further expansion of spread lending products, such as funding agreement-backed note programs. Over the last 12 months no fewer than six new issuers entered an increasingly competitive marketplace: Northwestern Mutual, Global Atlantic, Brighthouse, Fidelity & Guaranty Life, CNO and RGA. Following its spinoff from Prudential PLC, Jackson National re-entered the market after nearly two years on the sidelines.

Many of the long-established names in this marketplace remained extremely active in 2021 and this only continued in the first two weeks of January 2022, with multiple issuances across currencies from the likes of Athene, Brighthouse, CNO, Fidelity & Guaranty Life, Global Atlantic, Jackson National, MassMutual, MetLife, New York Life, Northwestern Mutual, Pacific Life, Principal, Protective Life and RGA.

We anticipate that additional companies will continue to participate in this market in 2022.

b. Sustainability-Linked Financings

2021 continued the positive trend in environmental, social and governance ("ESG") investments as investors showed continued interest in favoring companies that financed actions to address climate change and other environmental and social issues. ESG-related bond issuances continued to see a dramatic increase in 2021. While green bond issuances continued to be a major component of sustainability-related demand, sustainability and social bond issuances have also increased. According to data from Bloomberg, sustainability-linked bond issuances were up 930% year-over-year, sustainability bond issuances were up 131% year-over-year, green bond issuances were up 117% year-over-year, and social bond issuances were up 43% year-over-year.

In the funding agreement-backed note market, following on from MetLife in 2020, Equitable Holdings and Pacific Life each established its own sustainability financing framework

and closed inaugural sustainable financing issuances in 2021. MetLife also updated its funding agreement-backed commercial paper program to provide for the option to issue ESG commercial paper.

ii. SEC Comment Letters

In general the volume of SEC comment letters on periodic reports in 2021 continued to decline and was down by 20% from the previous year. In 2021, the Staff generally concentrated their comment letter focus on the same topics that have been under the spotlight in recent years and for insurance companies it was no different.

In our view, disclosures concerning non-GAAP financial measures, MD&A, fair value measurement, credit losses, revenue recognition, and reinsurance continued to receive, and will continue to receive, the majority of comments for insurance companies. Because the first three of those topics attract a large bulk of the Staff's comments, we have discussed them further below. It is important to note that the SEC continued to issue comment letters addressing registrants' COVID-19 pandemic-related disclosure in the MD&A, business descriptions and risk factors. In addition, as noted above, as part of its increased focus on disclosures related to ESG matters, the Staff has started issuing comments on climate-related disclosures, including considerations of the 2010 Climate Change Guidance.

a. Non-GAAP Financial Measures

Following the May 2016 publication of the Staff's additional Compliance and Disclosure Interpretations on Non-GAAP financial measures and subsequent updates, the Staff has consistently commented on individually tailored accounting principles and the equal or greater prominence of the comparable GAAP financial measure. In some instances the Staff has questioned certain of the adjustments used to calculate the non-GAAP financial measure in the context of the issuer's explanation as to why the non-GAAP measure is useful to investors and management, i.e., a coherent reason must exist linking each adjustment to the ultimate use of the non-GAAP financial measure. The Staff has also indicated they are taking a close look at any COVID-19 pandemic-related adjustments.

b. MD&A

The Staff continues to focus on the quantification of underlying drivers for changes in results of operations in period-over-period comparisons, further disclosure of material trends and uncertainties, or unusual or infrequent events, such as impacts of COVID-19, that will impact a company in both the near and long term. In recent years the Staff has also focused on critical accounting policies and estimates, asking for more granularity on sensitive and uncertain assumptions which require management's judgement, particularly with respect to goodwill impairment and whether the appropriate analyses are being conducted in a volatile market. The Staff is also focusing on metrics used by management in assessing performance, including how they are calculated and liquidity and capital resources discussions, including drivers of cash flows and the trends and uncertainties related to meeting known or reasonably likely future cash requirements.

c. Fair Value Measurements

Since these disclosures require significant judgement on the part of management, it is unsurprising to see that they attracted additional Staff comment. The Staff has focused on the disclosure surrounding the significant judgement and estimates, including valuation techniques and key inputs used as well as the quantitative information provided for significant unobservable inputs used in Level 3 fair value measurements, including the sensitivity related to those unobservable inputs.

B. U.K. and European Capital Markets Activity

i. Capital Markets Activity

European capital markets experienced another active year in 2021, marked by the recovery from the economic stress initially caused by the COVID-19 pandemic and the end of the Brexit transition period, among other developments. European primary capital markets continued to grow during 2021, driven predominantly by an increase in equity

issuances, which is where the largest relative gains were seen. In this context, by the end of the first half of 2021, European IPO issuances had increased 430% year-on-year and follow-on issuances had expanded 59% year-on-year[2]. The increased issuance in European equities has been driven by the reopening of European economies, and lower cost of equity, in tandem with lower market volatility, which have provided favorable market conditions. While bond issuances, as a whole, dominated in Europe in 2020, in 2021 bond markets shifted to higher-yield bonds. Investment-grade bond issuance, the largest category in terms of market volumes (€160.1 billion for E.U. countries), was down 8% year-on-year during the first half of 2021. This was however offset by a boom in high yield bond issuance, which was up 68% year-on-year for the same period, with volumes reaching €54.5 billion.[3]

It remains to be seen to what extent these capital markets-based financings can be sustained in more stabilized economic and market conditions, or whether they are a temporary result of the exceptional government, central bank and other support and relief measures of the past 18 months. It is anticipated that financial pressure is likely to increase for many businesses as various of these forms of support and relief are phased out in the coming periods, and to the extent bankruptcy and default risks rematerialize, the capital markets will be an important source of fresh capital for companies looking to help mitigate debt burdens or to continue to invest in growth and innovation.

Some representative transactions across the product range for the (re)insurance sector in the U.K. and European markets for 2021 included, in terms of regulatory capital raises, an issuance by Bain Capital-owned internet- and telephone-based insurance company, Esure Group plc, of approximately £75 million of its fixed-rate restricted tier 1 convertible notes, aimed at ensuring its growth and transformation as the U.K.'s preeminent digital insurer, and by LSE-listed Lancashire Holdings Limited in its offering of fixed-rate tier 2 junior subordinated notes, securing Lancashire's access to long-term funding and achieving more efficient capital management treatment for the group, as well as, on the equity markets side, a placing by AIM-listed Helios Underwriting plc, the unique investment vehicle which acquires and consolidates underwriting capacity at Lloyd's, of approximately £53.5 million through a placing of its ordinary shares, aimed at taking advantage of the opportunity the hardening market presents. European repeat issuers also continued to tap the EMTN markets with AXA, Generali, Prudential and Aviva accessing the markets with some of the larger EMTN transactions of the year.

2 Figures presented on an annualized basis, from The AFME Capital Markets Union Report, Key Performance Indicators – Fourth Edition, European Capital Markets – a turning point?, October 2021.

3 Figures presented on an annualized basis, from The AFME Capital Markets Union Report, Key Performance Indicators – Fourth Edition, European Capital Markets – a turning point?, October 2021.

ii. U.K. Listing Reforms, SPACs & Insurtech

(Re)insurers, brokers and insurtechs considering IPOs in London may find the path eased by U.K. listing reforms that came into force in August 2021. The reforms are aimed at ensuring London remains competitive as a premier listing venue when compared with other financial centres in the United States, Asia and Europe, and is specifically aimed at attracting more fintech and insurtech companies to the London Stock Exchange and ensuring that the U.K. positions itself as an attractive SPAC listing forum. The listing reforms are well timed for the sector, coming as a period of sustained rate hardening in the (re)insurance sector bolsters valuations for listed carriers and spurs interest in IPOs.

Some of the key reforms of greatest relevance to the industry are the premium-listed segment of the LSE opening to companies with dual-class shares under certain criteria, the reduction of the minimum free-float requirement from 25% to 15% and the loosening of the three-year track record requirement for premium listings. The dual-class share reforms and the proposed reduction in the free-float floor could prove appealing to (re)insurance startups or more established companies looking to generate some liquidity while maintaining a high degree of control. Insurtechs, as high-growth companies, in particular, would seem likely to benefit from the track-record reforms.

For insurtechs looking to use this route to go public, the key reform is, once certain criteria are met, removing the requirement that a SPAC suspend trading in its shares on the announcement of a deal, which has the effect of putting investors out of the market for a period of three to six months. One such criterion is the halving by the FCA of the minimum that must be raised at the initial SPAC listing stage, to £100 million. Another is that the SPAC must embed certain features that promote investor protection, such as the requirement for shareholder approval for any proposed acquisition and redemptions rights for investors who prefer to exit before any proposed acquisition is completed. The FCA also expanded the time limit to make an acquisition within two years of an SPAC IPO, now extendable by a further 12 months with shareholder approval, and with an option to extend by six months without a shareholder vote in certain limited circumstances (i.e., to allow a SPAC to conclude a deal where a transaction is well advanced). The reforms, it is hoped, will fuel a SPAC acceleration in the U.K.. Certainly, in November of 2021, Hambro Perks, the London-headquartered venture capital firm, was much celebrated when it raised approximately £145m in the U.K.'s first big blank-cheque debut since the reforms were implemented. The Hambro Perks SPAC will be targeting fast-growing private European tech business.

Insurtechs including Hippo and Metromile have used SPACs this way in the United States, but it is also increasingly happening across Europe. In May 2021, a new SPAC, Revo , made its debut in an IPO in Milan, gaining admission to the AIM Italia market of Borsa Italiana and raising €220 million. Revo is aimed at creating a leading insurance company focused on specialty lines and parametric risk cover, primarily dedicated to SMEs. European insurance SPAC activity has thus far centered on the Euronext Amsterdam exchange. Insurance will be one of the industries targeted by SPAC, Pegasus Europe, following a successful raise of €210 million in an IPO in Amsterdam in December 2021. Insurtech has proved a popular sector for SPAC mergers in the United States, with Hippo and Metromile using the method to go public.

iii. Consultation to Propose Divergence in U.K. from the E.U.'s Prospectus Regime

In addition to the report leading to the U.K. Listing Rules reform above, the U.K. government separately launched a consultation on the U.K. prospectus regime in July 2021. The key element of the consultation was to propose divergence from the E.U.'s prospectus regime. Of particular interest to listed insurance companies will be the proposals to:

- decouple the prospectus regimes for admission to trading and offers to the public in the U.K.;
- grant the FCA exclusive responsibility for developing and administering the rules on the requirement for and content of prospectuses for admissions to trading in the U.K.; and
- provide greater differentiation between prospectuses for initial public offers and follow-on issuances in the U.K.

The consultation, which has received overwhelming support from the legal and financial industry, closed in September 2021 and we look forward to the U.K. government's and the FCA's proposals and next steps, which are expected in 2022.

iv. Environmental Agenda Gathers Momentum

The environmental agenda has been gathering momentum in the sector, with Munich Re reporting that 2021 brought a substantial increase in the scale of insured losses from natural disasters, reportedly jumping from $82 billion in 2019 and $57 billion in 2020 to more than $120 billion in 2021. According to Munich Re, in terms of natural disasters, 2021 was surpassed on costs for the insurance industry only by 2017, when inflation-adjusted losses were $146 billion.

Climate change has found itself at the heart of the insurance sector for many reasons, having a significant impact on both the liability and the asset side of insurers' balance sheets. On the asset side, according to a Blackrock report, insurers are embedding sustainability ever more deeply into their investment selection processes, and expect to increase their allocations to sustainable investments by about 30% over the next two

years, with 95% of the report's respondents being reported as believing climate risk will have a significant or very significant impact on insurers' portfolio construction and strategic asset allocation over the next two years. In terms of policyholder liabilities and target business, in June 2021 Prince Charles visited Lloyd's to launch his Sustainable Markets Initiative Insurance Task Force, which includes several top industry executives as its members, aimed at furthering climate-positive financing and risk management solutions to encourage businesses and individuals to transition to a sustainable future. The Task Force currently anticipates launching at least two insurance products to protect priority industries such as nuclear energy, hydrogen and offshore wind, in order to enable their accelerated growth. In addition, the Task Force will also focus initially on introducing "build back better" claims clauses in home insurance policies to encourage customers to rebuild damaged properties with more sustainable materials. The group also has as some of its core tenets, a commitment to work to launch a public-private disaster resilience, response and recovery framework to mitigate against the social and economic impacts of climate change, and a commitment to develop a framework to unlock more than $30 trillion in assets under management, with a view to directing that capital towards investment in green projects and innovation geared towards driving climate-positive outcomes. Separately, and in addition, multiple insurers signed up to the net-zero underwriting alliance, a commitment to shift underwriting portfolios to carbon neutrality, aimed at overhauling the way the industry tackles climate change, reaffirming the importance of this issue for the industry.

As both the largest investors in and important issuers of bonds, insurance companies have a significant stake in making the U.K. and E.U. green and sustainability-linked bond market succeed. The United States is currently the largest source of green bonds. Looking ahead, the E.U is set to become the biggest force in the green bond market, with plans to issue around $300 billion in total over the next five years to finance sustainable investments. (Re)insurers have a key role to play in that development. Although historically (re)insurers have been among the leading investors in green bonds, on the issuer side, a recent report by Fitch Ratings has noted that while insurers are still marginal issuers in the green bond market, their green issuance is set to grow.

Green bonds and sustainability-linked bonds represent a rapidly expanding form of sustainable investing, centered around a set of environmental objectives. The proceeds of a green bond are typically ring-fenced on the issuer's balance sheet and set aside for the exclusive purpose of financing pre-identified, environmentally beneficial or sustainable projects by the issuer. As opposed to green bonds, sustainability-linked bonds are bonds whose proceeds are not ring-fenced to be applied towards green or sustainable purposes. Instead, sustainability-linked bonds will have financial or structural characteristics that will vary depending on whether the issuer meets certain predefined key performance indicators, which are assessed against certain sustainability performance targets. With a sustainability-linked bond, an issuer will be committing to improvements in the sustainability outcomes of its business within a pre-agreed timeline. Sustainability-linked bonds tend to appeal to companies that want to offer ESG bonds with fewer financial restrictions. If a sustainability-linked bond does not reach its targets by a predefined timeline, the issuer will be required to pay a step-up in the coupon.

In order to ensure transparency that facilitates the tracking of funds to environmental projects (and safeguard against so called "green-washing"), in July 2021, the European Commission proposed a Regulation on a voluntary European Green Bond Standard. This proposal will create a voluntary standard available to all issuers to help financing sustainable investments. The ICMA Green Bond Principles in the U.K., updated as of June 2021, are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market in the U.K. by clarifying the approach for issuance of a green bond. The (re)insurance industry also signaled its support, with Insurance Europe recently publishing a response to the European Commission's consultation on adopting the European Green Bond Standard to attract more finance for sustainable investment. Examples of notable activity in the sector this year include under AXA's EMTN program, its €1 billion issuance

in March 2021 of subordinated green bonds under its newly established Sustainability Bond Framework, following in the rubric of previous green bond issuances by the likes of Munich Re and Generali. With the rise in importance of ESG matters as one of the key investment considerations, we consider the green and sustainability-linked bond space an area to watch for the sector.

VII. PRINCIPAL REGULATORY DEVELOPMENTS AFFECTING INSURANCE COMPANIES

A. U.S. Regulatory Developments

As the global pandemic became a marathon with an ever-receding finish line, state insurance regulators shifted their focus from immediate crisis management to a wide range of priorities. Early in 2021, Florida Insurance Commissioner and 2021 NAIC President David Altmaier identified the ongoing effects of the COVID-19 pandemic, natural catastrophes and climate risk, race and insurance, big data and consumer data privacy, and long-term care insurance as the primary areas of focus for the organization in 2021.

In addition to these important topics, the year also brought renewed regulatory interest in ownership of insurers (particularly life insurers) by private equity groups and other "nontraditional" investors, continued work to create a principles-based definition of "bond" for accounting purposes and further discussion of insurance business transfer and company division laws.

These and other developments are summarized below.

i. NAIC Focus on Private Equity Ownership of Insurers

At the beginning of 2021, the NAIC Capital Markets Bureau noted an increase in private equity ownership of insurers (particularly life insurers), and several NAIC subcommittees examined related issues. These efforts culminated in a proposed list of "currently identified regulatory considerations" relating to private equity ownership exposed by the Financial Stability (E) Task Force on December 7, 2021.

The list was drafted in regulator-only meetings of the NAIC Macroprudential (E) Working Group ("MWG") after a public presentation by NAIC staff identifying 117 private equity-owned insurers at year-end 2020 and asserting that, unlike traditional stockholders and mutual policyholders, private equity owners "look to extract value via [investment management] fees (not primarily dividends or salaries)" from insurers. The NAIC staff noted that private equity-owned insurers are more heavily invested in asset-backed securities than the industry as a whole (25% v. 10% of total bonds in 2020).

The Task Force designated the MWG to serve as coordinator for the NAIC's workstreams for private equity-related matters, and exposed the list of "considerations" for a public comment period that ended in mid-January 2022. After receiving comments from several interested parties, the MWG revised and adopted the list of 13 considerations set forth below:

(1) Regulators may not be obtaining clear pictures of risk due to holding companies structuring contractual agreements in a manner to avoid regulatory disclosures and requirements. Additionally, affiliated/related party agreements impacting the insurer's risks may be structured to avoid disclosure (for example, by not including the insurer as a party to the agreement).

(2) Control is presumed to exist where ownership is ≥ 10%, but control and conflict of interest considerations may exist with less than 10% ownership.

(3) The material terms of the Investment Management Agreement ("IMA") and whether they are arm's length.

(4) Owners of insurers, regardless of type and structure, and asset-liability managers may be focused on short-term results which may not be in alignment with the long-term nature of liabilities in life products.

(5) Operational, governance and market conduct practices being impacted by the different priorities and level of insurance experience possessed by entrants into the insurance market without prior insurance experience.

(6) No uniform or widely accepted definition of private equity and challenges in maintaining a complete list of insurers' material relationships with private equity firms.

(7) The lack of identification of related-party-originated investments (including structured securities). This may create conflicts of interest and excessive and/or hidden fees in the portfolio structure.

(8) Though the annual statement blanks include affiliated investment disclosures, it is not easy to identify underlying affiliated investments and/or collateral within structured security investments.

(9) Broader considerations exist around asset manager affiliates (not just private equity owners) and disclaimers of affiliation avoiding current affiliate investment disclosures.

(10) 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.

(11) The level of reliance on rating agency ratings and their appropriateness for regulatory purposes (e.g., accuracy, consistency, comparability, applicability, interchangeability and transparency).

(12) The trend of life insurers engaging in pension risk transfer business and supporting such business with the more complex investments outlined above.

(13) 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.

The Task Force has emphasized that most of the considerations are not limited to private equity-owned insurers and are applicable to any insurers engaged in the respective activities.

The Task Force noted that NAIC initiatives are already addressing certain of the 13 considerations. For example, blanks proposals are being developed by the SAPWG with respect to items 7 and 8. With respect to item 9, a new Schedule Y, Part 3 that requires the identification of all entities with greater than 10% ownership of the insurer, regardless of whether the entity has made a disclaimer of affiliation, will be in effect for insurers' Annual Statements for the year ended December 31, 2021. With respect to item 11, the Valuation of Securities (E) Task Force kicked off a project at the Fall National Meeting to review the NAIC's reliance on rating agency designations to assess investment risk for regulatory purposes.

The MWG will now use the list as a basis to develop workstreams and referrals to other NAIC working groups. At its most recent meeting on February 1, 2022, the MWG emphasized that an item's inclusion on the list does not mean that the NAIC will take action on the item. Rather, the list is a starting point for regulators to consider next steps.

In addition to the NAIC's private equity focus, the FIO included a discussion on "private equity based insurers" in its annual report released on September 30, 2021. Observing that "private equity owned life insurers have continued to expand rapidly in the United States insurance industry and are now some of the largest providers of fixed annuities and pension risk transfers in the sector," the FIO report noted some observations similar to the NAIC's, regarding (i) private equity owners' use of insurance companies to generate fee income (particularly high investment management fees) rather than growth through "policy-generating activities"; (ii) investment strategies used by private equity owners, which may "have heightened credit and liquidity risk profiles as compared to other market participants"; and (iii) reliance on offshore captive reinsurers and complex affiliated sidecar vehicles in the private equity-owned enterprise. The report states that

the FIO will continue to monitor the growth and activities of private equity in the life insurance sector, as well as regulatory treatment by the states. At the December 7 NAIC Task Force meeting, Task Force members noted that they are aware and supportive of the FIO's comments, suggesting potential future coordination between the NAIC and FIO.

The NYDFS raised similar issues about private equity acquisitions of life insurers in 2013, and ultimately revised its Holding Company Act regulation (Regulation 52, 11 NYCRR 80) to address them. The revisions expanded the list of entities and individuals who must provide Form A disclosures to include general partners, managing members, managers or similar persons associated with Form A applicants. Moreover, all Form A applicants (not just private equity firms) are now required to submit a detailed five-year plan of operations that cannot be changed without NYDFS approval, and the New York Superintendent may in her discretion require any entity acquiring a New York life insurer to establish a trust for the protection of policyholders.

The recent discussions at the NAIC have thus far focused primarily on potentially requiring enhanced disclosures from private equity owners and will likely not lead to widespread adoption of New York's five-year plan, discretionary trust and other requirements. It is clear, however, that private equity buyers can expect increased scrutiny during the Form A process and should be prepared for protracted discussions with regulators and longer lead times that may affect the pre-signing auction process.

ii. Principles-Based "Bond" Definition

The NAIC Statutory Accounting Principles (E) Working Group ("SAPWG") continued to make progress with its effort to develop a new principles-based definition of "bond" for statutory accounting and RBC purposes.

The RBC regime requires insurers to hold capital against various risks, including the risk of investment loss, and insurers must hold much more capital for equity investments than for debt. Some types of investments, particularly certain asset-backed securities ("ABS"), have characteristics of both equity and debt and make drafting a simple, rigid definition challenging.

The current SAPWG effort to arrive at a comprehensive definition began in the summer of 2019 when the NAIC announced that collateralized fund obligations ("CFOs") – ABS with underlying collateral consisting of private equity fund interest – would be treated as equity for RBC purposes. Since then, the SAPWG has decided to revamp two critical statutory accounting principles: SSAP No. 26R 9 (Bonds) and SSAP No. 43R (Loan-Backed and Structured Securities) to address ABS more broadly.

In May 2021, the SAPWG exposed for comment a principles-based definition of "bond" for purposes of reporting on Schedule D-1 of an insurer's annual statement, and in August 2021, the SAPWG affirmed the concepts included in the proposed definition. The NAIC staff are now utilizing these concepts to draft an issues paper and proposed SSAP revisions. Although the proposed bond definition is not formally exposed at this time, the NAIC will continue to receive comments or questions throughout the drafting process. Interested parties have already raised concerns with the proposed bond definition insofar as it would take an "all or nothing" approach and exclude investments with both debt and equity features (e.g., certain rated notes) from being treated as bonds. We expect this to be a topic of continued discussion after SAPWG exposes the issues paper and proposed SSAP revisions in the first quarter of 2022.

At the Fall National Meeting, the SAPWG exposed for comment two documents related to this project. The first is a discussion draft that seeks input on improving "transparency and granularity in reporting," which has been identified as a key aspect of the bond definition project. Recommendations include (i) replacing the general categories listed on Schedule D-1 with more specific reporting lines, grouped by investment type and distinguished as either issuer credit obligations or asset-backed securities; and (ii) adding a new Sub-Schedule D-1 intended to detail bond investments with certain characteristics. The discussion draft also requests

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feedback on whether other columns, reporting instructions and/or investment elements should be considered as part of the project.

The Working Group also exposed revisions to the description of an ABS in the proposed bond definition to clarify that to qualify for reporting as a bond, the ABS structure must put the holder in a different economic position than if the investor owned the underlying collateral directly. The revisions propose to require that an ABS yield "substantive" credit enhancement, replacing the prior reference to "sufficient" credit enhancement. Whether a credit enhancement would be "substantial" under this standard is a transaction-specific inquiry determined from the perspective of a knowledgeable investor transacting at arm's length.

The NAIC has published both exposure drafts here, and requested any comments by February 18, 2022. The earliest anticipated effective date of any reporting changes related to this project is January 1, 2024.

iii. Insurance Business Transfer and Company Division Laws

Over the past few years, states have begun enacting statutes that allow insurers to transfer policy liabilities more efficiently and with finality. The statutes generally fall into two categories: insurance business transfer ("IBT") (which are modeled on the United Kingdom's "Part VII" transfer legislation) and corporate division ("CD"). The list of states that have passed IBT and CD laws continues to grow. Arkansas, Oklahoma, Rhode Island and Vermont have enacted IBT statutes, and Colorado, Connecticut, Georgia, Illinois, Iowa and Michigan have enacted CD statutes. In general, the statutory mechanisms allow insurers to bypass individual policyholder consent if they meet certain notice, hearing and insurance department and/or court approval requirements.

On October 22, 2021, the NAIC's Restructuring Mechanisms (E) Working Group (which was formed in 2019 but had been inactive for much of 2020 and 2021) exposed a draft white paper for a comment period that ended November 22. The white paper addresses the perceived need for IBT and CD laws and the issues those statutes are designed to remedy, summarizes existing state restructuring statutes, and considers the impact that the new forms of restructuring might have on guaranty associations and policyholders that had guaranty fund protection prior to the restructuring. The Working Group discussed written and oral comments at its meeting on December 7, 2021, and agreed that the white paper should be revised to address the comments. Some common themes highlighted by the various commenters, which included industry trade groups, insurers and regulators from Maine, Missouri and Virginia, were guaranty fund protection, the intersection of IBT and CD statutes with existing assumption reinsurance laws, and ensuring a robust and uniform regulatory review process. The Working Group plans to expose a revised version of the white paper in early 2022.

iv. Group Capital

In the past, insurance regulators had the authority to obtain information regarding the capital positions of insurance group members, although there was no analytical framework for evaluating the information consistently prior to the NAIC's development of the GCC, which process started in 2015. The GCC uses a "bottom up" aggregation method that requires an accounting of available capital/financial resources and the required regulatory capital of corporate group members. It utilizes an aggregation method that builds on the United States legal entity RBC assessment.

In December 2020, the NAIC adopted the 2020 Holding Company Act Amendments to require the ultimate controlling person of every insurer subject to holding company registration to file a confidential GCC annually with its lead state regulator, subject to certain filing exemptions. For more background information, see our report for the NAIC's 2020 Fall National Meeting.

The 2020 Holding Company Act Amendments implementing the GCC are not effective until adopted by states. As the NAIC progresses toward the implementation of the GCC by the states, its GCC workstreams were active

in 2021. Twenty-five insurance groups participated in the 2021 Trial Implementation, an NAIC accreditation standard was developed for the 2020 Holding Company Act Amendments, and the NAIC finalized regulatory guidance to address how the GCC should be used by state insurance regulators.

a. NAIC Proposes Changes to the GCC Template Based on the 2021 Trial Implementation Results

Following the completion of the 2021 Trial Implementation, the NAIC exposed a memorandum from NAIC staff summarizing proposed material changes to the GCC template and instructions, based on the trial results and feedback from the volunteer insurance groups. The proposed changes address a range of topics, including (i) removing the stress scenario from the GCC template and instructions, (ii) modifying the debt allowance limit, (iii) developing a factor for insurers domiciled in non-risk sensitive foreign jurisdictions, and (iv) modifying the treatment of asset managers. For more information regarding the 2021 Trial Implementation results and the proposed amendments to the GCC template and instructions, see our report for the NAIC's 2021 Fall National Meeting.

The NAIC is expected to address comments on the proposed changes early this year.

b. Moving Toward Effectiveness of the GCC – NAIC Exposes the 2020 Holding Company Act Amendments as an Accreditation Standard

In December, the NAIC voted to expose the 2020 Holding Company Act Amendments as an update to the NAIC accreditation standards for all states, effective as of January 1, 2026, meaning that United States jurisdictions must implement certain significant elements of the amendments in order for the state's insurance department to retain its accreditation by the NAIC. The NAIC reported that as of January 5, 2022, six states (CA, IL, MO, MT, NV and RI) have adopted the GCC amendments to the Model Insurance Holding Company System Regulatory Act and two states (CA and NV) have adopted the GCC amendments to the Model Regulation.

States that are the group-wide supervisor of an insurance group with operations in the E.U. or United Kingdom are encouraged to adopt the amendments earlier so they are effective by November 7, 2022. Under the Covered Agreements, this is the date by which the GCC is expected to meet the requirement that states have a "worldwide group capital calculation … in order to avoid the E.U. … imposing [its own] group capital assessment or requirement at the level of the worldwide parent." The accreditation proposal is exposed for a one-year period that began on January 1, 2022.

c. Adoption of GCC Guidance for the NAIC Financial Analysis Handbook

Last fall, the NAIC adopted guidance that will be incorporated into the 2021/2022 Financial Analysis Handbook revisions. The new guidance, which addresses how insurance regulators should use the GCC, will be added to the Handbook's section on group-wide supervision. As described in our report for the 2021 Summer National Meeting, the revisions address how an insurance group's GCC filing will enhance group-wide financial analysis, and they describe procedures a regulator can use to evaluate an insurance group's material risks when reviewing the GCC filing.

Following the implementation of the GCC filing requirement by the states, United States regulators will have an additional view of the business activities and underlying capital of insurance groups, since the GCC instructions require that the ultimate controlling person provide a "full inventory of the group" along with sufficient data or information about each affiliate to allow the lead state regulator to determine the appropriate scope of application of the GCC. All insurance entities and entities owned directly or indirectly by the insurance entities in a group, along with all financial entities (as defined in the GCC instructions), are to be included in the scope of the GCC

v. Innovation and Technology

a. New NAIC Innovation, Cybersecurity and Technology (H) Committee

Recognizing the need to coordinate its various efforts to address rapid technological change in the insurance industry, the NAIC voted at the Fall National Meeting to form a new Innovation, Cybersecurity and Technology (H) Committee, marking the first new "letter committee" since 2004. The (H) Committee will serve as a designated forum for cybersecurity, innovation, privacy protections and emerging technology issues. For example, the committee will focus on understanding evolving practices and innovations used by insurers and producers; coordinating efforts across the NAIC on these topics; recommending regulatory, statutory or guidance updates as appropriate; and monitoring the work of federal, state and international bodies to avoid conflicting standards and practices.

At the Fall National Meeting's Opening Session, NAIC President Altmaier stated that the new (H) Committee will focus on the use of data in the context of complex rating and underwriting models because protecting consumer data privacy is a "critical responsibility" of NAIC members.

b. Focus on Use and Protection of Consumer Data

The NAIC's stated commitment to prioritize big data and consumer data privacy is in many ways interwoven with its focus on race and insurance, as regulators engaged throughout the year with questions around how to balance promoting innovation while examining potential unintended discriminatory impacts arising from the use of noninsurance consumer data. In 2021, regulator activity in this area was most notable in Colorado, which in July passed Senate Bill 21-169 prohibiting the use of "external" consumer data or information sources (or algorithms or predictive models based on them) that unfairly discriminate against individuals based on protected classes, as we reported in greater detail here. While the bill is specific to Colorado, it has garnered interest industry-wide and follows the issuance of a 2019 circular letter by the NYDFS related to life insurers' use of external data or information sources in underwriting that are not directly related to the medical condition of the applicant, as reported here.

We expect that consumer data will be a critical focus of the new Innovation, Cybersecurity and Technology (H) Committee in 2022 and beyond, which may result in amendments to the Information and Privacy Protection Model Act (#670), Privacy of Consumer Financial and Health Information Regulation (#672) and/or the NAIC's Market Regulation Handbook (as recently recommended by the NAIC's Privacy Protections (D) Working Group and reported here).

c. NAIC Considers Making Permanent Certain Pandemic-Related Accommodations

Prior to the formation of the new (H) Committee, the Innovation and Technology (EX) Task Force had requested information from interested parties about which COVID-19 regulatory relief or accommodations related to innovation and technology should be continued or made permanent moving forward. Respondents identified new rules relating to e-commerce as a top priority, including, for example, allowing electronic signatures and electronic delivery and changing default procedures for electronic exchange of information from "opt in" to "opt out."

As a result, the Task Force voted at the NAIC's 2021 Spring National Meeting to form the E-Commerce Working Group to examine e-commerce laws and regulations, to survey states about exceptions to the federal Uniform Electronic Transactions Act, and to consider the appropriate resulting work product, such as a white paper, model bulletin or draft regulatory guidance. Task Force Chair, Commissioner Jon Godfread of North Dakota, stated that it is important to continue discussing these initiatives so as to not lose the positive developments that have come out of the pandemic. The Working Group exposed for a comment period that ended on January 24, 2022 a state survey regarding laws that impact e-commerce and electronic transactions, with the goal to create unified recommendations (such as a model bulletin) in this area.

d. Revision of Anti-Rebating Provisions in Model Unfair Trade Practices Act

On April 14, 2021, the NAIC formally adopted amendments to anti-rebating language in the NAIC's Model Unfair Trade Practices Act (Model #880) that were developed in 2020. The changes for the first time allow insurers and producers to provide "value-added products or services" at no or reduced cost when such products are not specified in the policy itself. New York and Nevada expressed concerns that the amended language presented ambiguities that could lead to unfair discrimination, but the amendments were adopted as presented. The next step is for individual states to adopt these amendments into their own insurance laws.

Once enacted by a critical number of states, we expect the new rules will accelerate innovation by insurtechs and incumbent insurers and producers in product design and in the way insurance is marketed and sold. Currently, at least 20 states have an exception in their anti-rebating laws for a "value-added" service or product. While some states have taken a similar approach to the revised Model #880 in this respect, others have adopted exceptions that are either more or less permissive than the NAIC. As a result, despite the adoption of the revised model law, there will not be a one-size-fits-all approach to these issues for entities doing business across the states.

e. Washington State Guidance for Websites that Review Insurance Plans

On February 19, 2021, the WA OIC issued Technical Assistance Advisory 2021-01 to summarize current law and provide guidance for websites that provide reviews of insurance plans ("review websites"), and the insurers and insurance producers that pay such websites. Although the Advisory does not define what the WA OIC considers to be a review website, the guidance appears to be directed at consumer-targeted websites that purport to provide independent expert evaluation of insurance providers or products. The Advisory was issued in response to the increased popularity of review websites and WA OIC's concern that such websites violate state laws regarding unlicensed insurance producer activities. The Advisory emphasizes that review websites violate the insurance law when they are not licensed as producers and urge consumers to apply for a particular kind of insurance from a particular insurer, or make representations about the terms of insurance plans – regardless of whether the website receives compensation from consumers or insurers. Insurers or producers who pay unlicensed review websites or accept business from them may also be in violation of the insurance law. According to the Advisory, the WA OIC has taken enforcement actions against one review website and an insurance producer that accepted business from the review website. Insurers and producers who do business in Washington State and seek to use review websites should confirm whether such websites are appropriately licensed and otherwise comply with the Advisory.

vi. Climate

State insurance regulators' attention to climate risks and mitigation increased in 2021, as exemplified by the actions of New York and California discussed below. NAIC President Altmaier stated at the Fall National Meeting that the NAIC's goal is to address climate-related risks through "the three main pillars of insurance regulation: financial risk analysis; insurance market availability and affordability; and consumer education and outreach." The NAIC's executive-level Climate and Resiliency Task Force has developed five workstreams: (1) Technology (focused on applying technology, including predictive modeling tools, to evaluate climate and natural catastrophe risk exposures); (2) Climate Risk Disclosure (focused on updating the NAIC Climate Risk Disclosure Survey by spring 2022); (3) Solvency (focused on financial risks to insurers from climate changes and developing financial surveillance tools to address climate-related risk); (4) Innovation (focused on the use of innovative insurance products that respond to climate-related risk); and (5) Pre-Disaster Mitigation (focused on resource sharing and participation with consumers).

At the United States federal level, FSOC released a report in October 2021 that identified climate change as an "emerging and increasing threat to financial stability," and

recommended enhancing climate-related financial risk disclosures and improving cooperation and communication among FSOC members on climate matters. Further, the SEC formed a climate enforcement task force in March 2021 and also sought public input on how the SEC can best regulate, monitor, review and guide climate change disclosures. The SEC is expected to consider a mandatory climate risk disclosure proposal in 2022 as discussed above in Developments in SEC Regulation and Corporate Governance.

International insurance regulators are also focused on climate matters, with the IAIS establishing a Climate Risk Steering Group in September 2021 to coordinate the IAIS's climate-related work.

vii. NAIC Special Committee on Race and Insurance

The NAIC formed the Special (EX) Committee on Race and Insurance in July 2020, following discussions on the role of race in the design and pricing of insurance products and the need to improve diversity in the insurance sector. The NAIC developed charges for the Special Committee in the Spring of 2021 that focus on issues related to: 1) race, diversity, and inclusion within the insurance sector; 2) race, diversity, and inclusion in access to the insurance sector and insurance products; and 3) practices within the insurance sector that potentially disadvantage people of color and/or historically underrepresented groups. The Special Committee has divided its charges among five "workstreams" that met throughout 2021. Two of the workstreams focus on diversity and inclusion in the insurance sector and within state insurance departments. Three of the workstreams focus on examining practices in the insurance industry for different types of insurance, in order to determine how barriers are created that disadvantage people of color and/or historically underrepresented groups. In 2022, the Special Committee will develop several white papers, including on terms related to unfair discrimination and disparate treatment in the P&C industry, and provider networks and cultural competency in the health insurance industry.

viii. Covered Agreement Update

The NAIC's Reinsurance (E) Task Force has remained keenly focused throughout 2021 on state implementation of the 2019 amendments to the Credit for Reinsurance Models.

Previously, the Credit for Reinsurance Models provided that in order for United States ceding insurers to receive reinsurance credit, the reinsurance was required to be ceded to United States-licensed reinsurers or secured by collateral representing 100% of United States liabilities for which the credit was recorded. In 2011, the Credit for Reinsurance Models were amended to create a framework for reducing collateral requirements applicable to non-United States insurers. The 2019 amendments to the Credit for Reinsurance Models include further revisions to implement the reinsurance collateral provisions of the Covered Agreements. The amendments will become an NAIC accreditation standard as of September 1, 2022, with enforcement beginning January 1, 2023.

The NAIC urged states to adopt the revised models as soon as possible to avoid federal preemption of any state law that treats E.U. or U.K. reinsurers less favorably than a United States reinsurer and is therefore inconsistent with the Covered Agreements. As of January 5, 2022, the NAIC reported that 46 states had enacted the amended Credit for Reinsurance Model Law (#785) and 26 states had enacted the amended Credit for Reinsurance Model Regulation (#786).

NEW YORK REGULATORY CORNER

Governor Kathy Hochul nominated Adrienne Harris in August 2021 to lead the NYDFS as its next Superintendent, and the nomination was confirmed by the New York State Senate on January 26, 2022. Superintendent Harris was an advisor in the Treasury Department and at the National Economic Council during the Obama Administration and most recently served as an executive at a national title insurance agency. Under Superintendent Harris's leadership, the NYDFS will likely continue to focus on long-standing initiatives, including the areas discussed below, as well as to potentially identify new priorities.

- Focus on Financial Risks from Climate Change

NYDFS became the first United States financial regulator to issue a holistic set of expectations around managing financial risks presented by climate change when it published final Guidance for New York Domestic Insurers on Managing the Financial Risks from Climate Change in November. The guidance builds on the NYDFS's September 2020 circular letter. The guidance requires New York domestic insurers to implement its expectations relating to board governance, and to have specific plans in place to implement the expectations relating to organizational structure, by August 15, 2022.

Also positioning the NYDFS at the forefront in this area, the NYDFS amended New York's insurance regulation governing enterprise risk management, which, as amended, requires an insurance group to include certain additional risks, such as climate change risk, in its enterprise risk management function. More recently, in November, Acting Superintendent Harris announced a dedicated new Climate Division of the NYDFS, to be led by Dr. Yue (Nina) Chen as Executive Deputy Superintendent.

- NYDFS Action on Diversity

In March, the NYDFS issued a circular letter stating that the NYDFS expects insurers it regulates to make diversity of their leadership a business priority and a key element of their corporate governance. During the summer of 2021, the NYDFS collected data from insurers that met certain New York premium thresholds regarding the diversity of their corporate boards and management, which it plans to publish on an aggregate basis in order to measure progress in the industry. The NYDFS will include diversity-related questions in its examination process starting in 2022.

- Cyber Insurance Risk Framework

In February 2021, the NYDFS issued a Cyber Insurance Risk Framework outlining best practices for managing cyber insurance risk – notably, the Framework is the first guidance on cyber insurance by a United States regulator. The Framework was announced as intended to "foster the growth of a robust cyber insurance market," and resulted from NYDFS's discussions on cybersecurity with both industry and United States and European regulators. NYDFS's issuance of the Framework follows its promulgation of its Cybersecurity Regulation (23 NYCRR Part 500) in 2017 and the creation of a Cybersecurity Division in 2019.

- NYDFS Appeals Decision Overturning Revised Regulation 187

*I*n April 2021, the Appellate Division of the New York State Supreme Court, Third Department struck down NYDFS revisions to New York Insurance Regulation 187 – Suitability in Annuity Transactions – as unconstitutionally vague. The revised regulation imposed a "best interest" standard and expanded the regulation's scope from solely annuity sales to the sale of life insurance products, as well.

Although elimination of the revised regulation would ultimately simplify compliance requirements for insurers and producers in the long run in New York, companies who have been struggling with the complexities of complying with inconsistent new sales practice standards issued by NYDFS, the NAIC and the SEC will continue to face uncertainty since the NYDFS has appealed the decision to the state's highest court and briefing on the appeal is expected to take place in early to mid-2022.

More information about the regulation, Appellate Division's decision and implications is available here.

CALIFORNIA REGULATORY CORNER

- Wildfire-Related Actions

In response to several wildfire events affecting California homeowners, and building upon similar legislation passed in recent years, the state enacted additional insurance consumer protection laws that took effect in July 2021 and require insurers to afford a wide variety of policy protections to California insureds and limit insurers' ability to cancel or non-renew policies or deny or limit coverage with respect to wildfire events. In addition, the laws extend a consumer's right to sue its insurer from one to two years. Further, on August 19, 2021 and September 20,

2021, Commissioner Lara issued one-year moratoriums, by zip code, preventing cancellations and non-renewals of residential property insurance for policyholders affected by wildfires in Northern California.

- Anti-Discrimination and Diversity & Inclusion

Commissioner Lara sponsored a number of bills that were signed into law during the 2021 legislative session aimed at expanding access to insurance, preventing discriminatory insurance practices and increasing diversity in the insurance sector. In the health insurance space in particular, new laws will allow adult children to add dependent parents to their health coverage in the individual market, require insurers in the large group health insurance market to cover "medically necessary basic health care services" such as women's reproductive services, obesity care, and organ transplants, and prohibit life and disability income insurers from (i) considering an applicant's occupation in determining whether to require an HIV test and (ii) limiting benefits payable for a loss caused by or contributed to by HIV or AIDS. On the diversity and inclusion front, new laws will (i) add gender neutral language to the Insurance Code and related laws and (ii) impose reporting requirements for underrepresented groups on insurance company boards, require insurance companies to submit their governing board policy statement or measurable goals to the Insurance Commissioner, lower the existing reporting threshold for insurance companies reporting their board and supplier diversity data, and encourage insurers to make investments with diverse investment managers.

- COVID-19-Related Actions

In November 2021 Commissioner Lara ordered the California FAIR Plan Association, an association made up of all California admitted insurers, to ensure access to basic property insurance and to implement increases to commercial property coverage limits offered to businesses. Commissioner Lara stated that the order was made in response to business owners' concerns about a lack of insurance coverage, and aimed at economic recovery from the COVID-19 pandemic. In addition, Commissioner Lara issued multiple bulletins in 2020 directing auto insurance companies to return premiums to insureds in light of the decreased risk of loss due to "stay-at-home" orders. In 2021, the CDI conducted a follow-up data call of auto insurance companies and in October 2021 ordered three companies to reimburse California drivers for excess premiums charged from the start of the pandemic, finding that premium refunds made by the companies in response to the earlier CDI bulletins were inadequate.

- Commentary

The measures implemented by the E.U. and domestic regulators, which have been numerous and wide ranging in nature, reflect their shared concerns relating to the effect of the COVID-19 pandemic on all stakeholders in the industry. These measures, as a collective, strike the right balance between ensuring that firms continue to operate effectively and treat their customers fairly, while easing the increased administrative burden that the pandemic has caused. Many of these measures were put in place quickly, in order to prevent the initial impact of the spread of COVID-19 from causing shock waves through the market that may later be difficult to repair. The regulators will be actively monitoring the situation now that these emergency procedures are in place and the effects of COVID-19 are better understood.

B. U.K. and E.U. Regulatory Developments

i. Introduction

Despite the continuance of the global pandemic, 2021 saw a return to something like "business as usual" for U.K. and European insurance regulators and the development of significant regulatory initiatives.

As the world has globally stabilised from the COVID-19 pandemic, regulators have no longer needed to urgently intervene to ensure the continued stability of insurance firms (which showed remarkable resilience during this period), or the fair treatment of customers, many of whom were financially impacted by the pandemic and were more likely to claim under their policies. Further, specifically in relation to the U.K., HM Treasury and the U.K. regulators, the Financial Conduct Authority and the Prudential Regulation Authority ("PRA"), have now implemented the

legislation and Binding Technical Standards required for the domestic prudential regime to function effectively in the immediate aftermath of Brexit.

Accordingly, both the E.U. and the U.K. have been able to look forward and consider whether the Solvency II Directive can be amended to better suit their respective markets. Regulators in both jurisdictions are aware that they are now operating in new economic and political environments. Policymakers in the U.K. intend that the U.K.'s domestic prudential regime will become more nimble in certain areas, and various rules deriving from Solvency II will be amended in favour of greater PRA discretion. By contrast, the E.U.'s focus will remain on ensuring harmonization across the bloc, and the same level of continued regulatory supervision across its Member States. Both regimes recognise the role that the insurance industry plays in rebuilding their respective economies after the pandemic. Insurers can therefore expect to receive more favourable capital treatment when making certain long-term investments that have wider economic benefits. Each regulator's review of the Solvency II Directive is set out in subsection VII.B.ii. – "E.U. and U.K. review of Solvency II."

The environment has also featured prominently in regulators' thinking. In particular, the PRA has signalled its intention to focus on the impact of climate-related risks on insurers' solvency positions. Similarly, the Society of Lloyd's, which has spent much of 2021 seeking to improve its profitability and establishing various proposals set out in its "Blueprint" publications (see subsection VII.B.vi. – "Developments at Lloyd's"), has embarked on an ambitious project of harnessing the insurance industry to effect environmental change. We discuss these aspects in subsections VII.B.iv. – "PRA's Second Climate Change Adaptation Report."

ii. E.U. and U.K. Review of Solvency II

a. U.K. HM Treasury's Review of Solvency II

HM Treasury is currently in the process of reviewing the Solvency II regulatory regime as incorporated into U.K. domestic law following Brexit. As we reported in last year's "Year in Review," HM Treasury published its "Call for Evidence" document on October 19, 2020, following which it received a number of responses from industry stakeholders before the consultation deadline on February 19, 2021. HM Treasury's "Call for Evidence – Response" (the "Response"), published July 2021, sets out these responses and the government's views on potential changes to the prudential regime.

The government's overall view on Solvency II was broadly consistent with the majority of the industry stakeholders who responded to the consultation. Solvency II is generally working well and should not be entirely replaced by a different regime. However, various aspects of the Solvency II framework were thought to be too rigid and rules-based. The government's aim is to replace these aspects with a regime that allows for a better mix of judgement and rules, which will ultimately afford greater discretion to the PRA.

In terms of next steps, the government has not made any commitments as to how the regime will change and is, instead, working with the PRA on a quantitative impact study, which will inform a comprehensive package of reforms for consultation in early 2022. The PRA has already launched a webpage setting out information about this study, which will cover the following three main areas: (i) the calculation of the Matching Adjustment; (ii) the Risk Margin; and (iii) the Transitional Measure on Technical Provisions.

KEY POINTS

The key points raised in the Response are as follows:

1. Risk Margin

Unsurprisingly, the Response started with one of the most controversial aspects of Solvency II: the Risk Margin. Respondents have overwhelmingly identified that the Risk Margin is currently too large and too volatile, due to its excessive sensitivity to interest rates. Accordingly, respondents have suggested a range of proposals for reform, including reducing the current "cost of capital" parameter in the existing methodology, incorporating a time-sensitive component (otherwise called a "lambda" factor, which would have the effect of reducing capital requirements

projected over time), and allowing for diversification between activities and entities within a group.

The government agreed that there is a strong case to reform the Risk Margin, which would free up resources on, and reduce the volatility of, insurance firms' balance sheets. The PRA is now modelling various options for reforming the Risk Margin, in advance of the anticipated consultation process on rule changes later this year.

2. Matching Adjustment

Respondents were more in favour of the current formulation of the Matching Adjustment, with a number advocating for its continued use without amendment. However, a few respondents were skeptical about the continued use of the Matching Adjustment, arguing that it is imprudent and has no clear economic rationale.

As a result, suggestions for reform ranged from fundamental reforms, such as reexamining the reasons for the creation of the Matching Adjustment, to more granular concerns, such as those relating to the calibration of the fundamental spread. Respondents also disagreed about whether the eligibility criteria for the Matching Adjustment should be loosened (for example, by allowing "highly predictable" rather than merely "fixed" cash flows) or tightened (for example, to exclude certain types of investment such as equity release mortgages).

The government is unlikely to abolish the Matching Adjustment, but may loosen significant restrictions on the types of assets that can form part of it. In addition to the prudential benefits of the Matching Adjustment, the government is likely to be influenced by the importance of insurers' long-term investments in areas such as infrastructure, and in supporting the government's aim to combat climate change. However, certain more granular changes to the Matching Adjustment can be expected, particularly in respect of assets with uncertain exposures, such as illiquid and internally rated assets.

3. Solvency Capital Requirement

a. Individual SCR Calculation

Overall, respondents supported the risk-based nature of the SCR calculation framework. Interestingly, certain respondents were in favour of replacing the one-year horizon calibration standard to a "to ultimate" time horizon. A change to the ultimate time horizon would also more adequately capture long-term risks associated with climate change, and encourage investment in long-term productive assets.

Further, certain respondents suggested that capital add-ons should be used more regularly, rather than merely as a measure of last resort.

There was broad support amongst stakeholders for the continued use of approved internal models. However, views diverged as to whether the process by which internal models are approved should be made more stringent, or less burdensome for applicants. Respondents were also in favour of a more tailored and proportionate "partial internal model" approval and supervision process.

b. Group SCR Calculation

Similarly, respondents were in favour of increased flexibility in the calculation of the consolidated group SCR. The current standard formulae under Methods 1 and 2 were generally viewed as being inappropriate for large groups and lead to SCR double-counting, operational inefficiencies and a loss of diversification benefits.

c. Government Response

The government agreed that the framework for calculating the SCR needs to change. In particular, the government considered that reforms are required to reduce the regulatory burden on firms, irrespective of whether they use the standard formula or an approved internal model. We would therefore expect to see a greater degree of flexibility in the calculation of the SCR in the future, which could include a better tailored standard formula approach.

4. Reporting Requirements

Respondents also disagreed about the current reporting requirements. Over half of the respondents considered that the reporting requirements were too onerous and needed to be reformed to reduce the volume of data submitted. Comments generally related to (i) the level of duplication between Solvency II reports and accounting disclosures; (ii) the frequency and granular nature of certain quarterly and annual reporting items, which were regarded as disproportionate; and (iii) the need for greater flexibility in reporting deadlines, which can be too close to the end of the quarter. Accordingly, most proposed options for reform centered around reducing the number and frequency of reports, and the greater use of PRA waivers.

However, other respondents were opposed to introducing changes to reporting requirements, in order to limit the extent of regulatory divergence with other jurisdictions (such as the E.U.). Reducing reporting requirements could also create frictional costs for larger insurance groups, which could reduce the attractiveness of the U.K. as a business location.

The government did not express a view on these responses. However, changes to reporting requirements are expected, as set out in the PRA's Consultation Paper "Review of Solvency II: Reporting (Phase 1)" (CP 11/21) in July 2021, which is the first output from HM Treasury's review of Solvency II. We have reported on this Consultation Paper elsewhere in this review.

5. U.K. Branch Capital Requirements

The majority of respondents supported the removal of U.K. branch capital requirements for foreign insurance firms. In particular, respondents noted that such capital requirements only provide limited prudential benefits to policyholders, given that the branch is not a separate legal entity from the head office. Respondents believe that the removal of these requirements would boost the attractiveness of the U.K. as a destination for branches of foreign insurance firms.

Blanket reforms to remove branch capital requirements are unlikely, as the PRA will be keen to ensure that U.K. policyholders have the same level of protection in respect of U.K. branches of overseas firms as they do in respect of U.K. firms. However, a degree of flexibility could be introduced (for example, by requiring that only the minimum capital requirement must be localized), if the PRA is able to strike an effective working relationship with the home state regulator.

6. Thresholds for Regulation under Solvency II

Respondents also disagreed about whether the thresholds for Solvency II regulation should be increased. Proposed threshold increases have been significant, with certain respondents suggesting that they should roughly double (i.e., to GBP 10 million in annual gross written premiums and to GBP 50 million in gross technical provisions). More conservative suggestions have included increases to ensure that the thresholds rise in line with future inflation.

Other respondents pointed to the principle of proportionality that is already embedded within Solvency II, and argued that the Directive should apply to all but the smallest insurance firms.

It is likely that the government will raise the thresholds to some degree, given its desire for a more flexible and agile system which, in turn, will be more competitive with other insurance markets. However, the government has not commented on the extent by which existing Solvency II thresholds will be raised.

7. Other Aspects of the Response

The Response also covered the following areas:

- the authorisation of new insurance firms;
- the transition of Solvency II risk-free rates from the London Interbank Offered Rate to the Overnight Indexed Swap;
- reforms to the Volatility Adjustment;
- the regulation of Insurance Linked Securities; and

- collateral arrangements and requirements for reinsurance firms.

CONCLUSION

The Response constitutes an initial phase in any reformulation of Solvency II. However, it is clear from the Response that the government will make changes to the Solvency II regime, with a primary focus on making it less rigid and cumbersome for market participants. Although wholesale deletion of certain Solvency II regulation is unlikely, formulaic rules will be replaced by increased discretion and outcomes-based supervision from the PRA. The government accepts that aspects of the Solvency II regime cannot be reformulated individually, and will be careful to ensure that it has considered the overall impact on the regime.

Insurance groups with European operations should also review the European Commission's proposed reforms of Solvency II at an E.U. level (discussed later in this Year in Review). The two reviews are catalyzed by similar drivers, and will inevitably amend the same areas of regulation. However, the two reviews are not entirely aligned, either ideologically, or in the conclusions that they draw in respect of proposed regulatory changes. These groups are therefore likely to be subject to increased regulatory complexity, as the U.K. and E.U. prudential regimes begin to diverge.

b. The PRA's Review of Solvency II: Reporting

The PRA has consulted on various changes to its reporting requirements, which are contained in its Consultation Paper "Review of Solvency II: Reporting" (CP11/21) published in July 2021. This consultation is the first to flow from HM Treasury's "Review of Solvency II: Call for Evidence Response," in which respondents expressed a clear preference for reducing the regulatory burden of supervisory reporting and public disclosure requirements. Following the closure of this consultation process in October 2021, the PRA also published stakeholders' responses in its Policy Statement "Review of Solvency II: Reporting (Phase 1)" (PS 29/21) on December 17, 2021.

The PRA intends to consult on changes to Solvency II reporting and disclosure in two phases, with this consultation process being the first. The PRA's initial focus was on the possible reduction of the volume of financial information that firms are required to report. The PRA considers that certain aspects of the reporting requirements can be streamlined, particularly where either (i) the PRA does not currently use certain templates extensively; or (ii) the frequency of certain templates may not be proportionate to the risks, size and complexity of the businesses of the majority of U.K. insurers.

The policy proposals contained in this consultation process are set out below.

Policy Proposals

The PRA's policy proposals were as follows:

1. Changes to Solvency II QRTs

The PRA proposed to reduce the number of Quantitative Reporting Templates required.

The PRA also proposed to delete all templates submitted under the financial stability reporting requirements contained in EIOPA Guidelines on Financial Stability Reporting, which represents a divergence from existing E.U. reporting requirements.

The PRA considers that the information contained in these templates either have limited prudential value, or could be derived from other information without additional burden.

2. Changes in the Minimum Capital Requirements ("MCR") Reporting Frequency

The PRA proposed to reduce the reporting frequency of firms' minimum capital requirements, by removing the requirement for firms to report this information at the first and third quarter of their financial year.

However, firms would remain expected to notify the PRA immediately if their capital fell below the level of the MCR,

and comply with applicable parts of the PRA Rulebook if they were experiencing solvency difficulties.

3. Change to the Reporting Proportionality Threshold for S.16.01

The PRA proposed to exempt pure reinsurance business from reporting on annuities stemming from non-life obligations.

The PRA recognizes that pure reinsurers often have little exposure to annuity-type businesses, and few have had to report this template to the PRA in the past.

4. Extension to the Quarterly Reporting Waivers

The PRA already provides that Category 4 and 5 insurers, whether solo or part of a group, are eligible for waivers to the PRA's quarterly reporting requirements. The PRA considers granting these waivers on a case-by-case basis.

The PRA proposed that there is greater scope to make quarterly reporting more proportionate for Category 3 firms (whether solo or part of a group), whom it also considers to be low risk.

5. Industry Responses

The PRA received 14 responses to the Consultation Paper. These responses were broadly positive, with some requesting that the implementation date stated in the Consultation Paper (March 31, 2022) be brought forward. Other respondents have suggested a further reduction to the reporting frequency proposed in respect to the MCR templates (i.e., from quarterly to semiannually).

The PRA has therefore implemented most of its proposals, with changes to the proportionality threshold for pure reinsurers set out at Item 3. above being the notable exception.

In addition, the PRA has made certain further changes to its reporting requirements based upon stakeholders' responses. These further amendments include bringing forward the implementation date for certain rules so that a number were in force by the end of December 2021, and reducing the regularity in which the MCR must be reported (from the proposed frequency of semiannually to annually).

CONCLUSION

As expected, the PRA's consultation on streamlining reporting requirements has been welcomed by the industry, which broadly considers that the current regime demands a disproportionate amount of data, too frequently and with too little flexibility on deadlines. The PRA's changes will go some way to addressing these concerns.

The second phase of the PRA's review, which will take place in 2022, will be more in-depth and will touch upon all of the components that make up the U.K. reporting and disclosure reporting framework. Following the culmination of this second review, the PRA is expected to finalise and implement its new package of reporting requirements.

c. The European Commission's Review of the Solvency II Directive

INTRODUCTION

As part of our Year in Review for 2020, we reported on EIOPA's Review of Solvency II, which culminated in various suggested changes to the regulatory regime in its "Opinion on the 2020 Review of Solvency II" ("Opinion"). As was expected, the scope of this review was fairly wide-ranging, and touched upon topics such as (i) the extrapolation of risk-free interest rates; (ii) the Volatility Adjustment; and (iii) long-term equity investments. The process of reviewing Solvency II progressed further in 2021, as the European Commission published a comprehensive package of suggested legislative reforms ("Proposed Reforms") to the Directive on September 22, 2021.

The European Commission's overarching conclusions on Solvency II are consistent with those of EIOPA: the Directive is working well, and no fundamental changes are needed at this point in time. Accordingly, although the requirement to review Solvency II is embedded in the Directive itself, the European Commission has said that it has taken into account political and economic factors in its review, which we see reflected in the Proposed Reforms.

The various rules contained within the Proposed Reforms are, however, numerous and granular and, if approved by the European Parliament and Council, will impact upon a range of EEA insurance business operations. The Proposed Reforms should therefore be an area of interest to both EEA-based (re)insurance groups, as well as to other insurance groups that may be established in third-country jurisdictions with European operations.

KEY PROPOSED REFORMS

We set out below the key points arising out of the Proposed Reforms:

(i) Incentivizing Long-Term Investment

As stated above, the European Commission has a legal mandate to review Solvency II pursuant to the terms of the Directive itself. However, in formulating the Proposed Reforms, the European Commission has intended in part to achieve consistency with the following three interrelated policy goals: (i) financing the post-COVID-19 economic recovery; (ii) finalizing the Capital Markets Union; and (iii) achieving the targets of the European Green Deal.

Specifically in relation to points (i) and (ii) above, the European Commission is keenly aware that the insurance industry *"can scale up long-term investment in Europe's recovery from the COVID-19 pandemic*." Large institutional investors, such as insurers, are instrumental to this redevelopment, by enabling small to medium-sized enterprises to reduce their overreliance on debt and by improving their equity positions. However, because of the high capital charges that apply to equity investments, Solvency II has had the effect of retrenching insurers' investments in long-term assets, and limiting their share of investment in the real economy and infrastructure, in favor of investing pro-cyclically in shorter term investments.

The European Commission has therefore included in the Proposed Reforms various measures to incentivise insurance companies to make long-term investments by reforming regulatory obstacles that impede such investments. Suggested amendments to the Directive include:

1. The Volatility Adjustment will be amended to ensure that it is more effective at mitigating the effects of short-term market volatility. In particular, the Volatility Adjustment calculation methodology will make greater adjustments for bond spreads that result from non-credit-related market movements. This is intended to have the effect of reducing the valuation of liabilities, which in turn will help to offset the fluctuation in the value of assets that insurers wish to hold long term.

2. Changes to the Risk Margin. The European Commission is proposing a time-dependent "lambda" parameter in the Risk Margin formula, which would have the effect of reducing capital requirements projected over time. We note that this is very similar to the proposals being considered in the U.K. by the U.K.'s HM Treasury in its review of Solvency II. In addition, the European Commission is also considering reducing the cost-of-capital rate used in the Risk Margin calculation from 6% to 5%. Overall, the European Commission believes these changes could reduce the size of the Risk Margin by €50 billion across the sector, which will free up capital to E.U. insurers to invest in E.U. businesses.

3. Changes to the extrapolation of risk-free interest rate term structures to ensure that insurers' technical provisions for their long-term insurance liabilities are not underestimated, where relevant financial markets are no longer deep, liquid and transparent, or where the availability of bonds is limited. The European Commission proposes to achieve this result by introducing a "smoothing point," from which interest rates are smoothly extrapolated to the ultimate forward rate. These changes will become gradually stricter and therefore increase insurers' capital requirements. In order to mitigate this effect, the changes will be phased in over a period ending on January 1, 2032.

Notwithstanding the changes to the rules on extrapolating the risk-free interest rate term structure, the overall impact of the proposed changes is estimated by the European Commission to result in the release of up to €90 billion of capital across the E.U. insurance industry in the short term, with a long-term reduction in the bloc's aggregate

capital requirements of up to €30 billion as all these new rules come into play. These proposed changes will be supplemented by further recommended amendments to the Delegated Acts, including (i) simplifying the conditions under which equity investments will be treated as "long-term"; and (ii) introducing additional proposals in relation to the extrapolation of forward rates, to achieve a result in line with EIOPA's advice in its Opinion.

(ii) Amendments Related to the European Green Deal

The European Commission has introduced new provisions that are designed to ensure that climate-related risks are better managed.

First, insurers are required to identify material exposures that they have to climate change risks and, where relevant, to assess the impact of long-term climate change scenarios to their business. Insurers that are "low-risk profile undertakings" (discussed below) are exempted from this requirement.

EIOPA is similarly mandated to explore and report to the European Commission by June 2023 whether a dedicated prudential treatment of exposures related to assets or activities that are substantially associated with environmental and/or social objectives would be justified. EIOPA is also required to review, at least every three years, the scope and calibration of the non-life catastrophe sub-module of the SCR and to report to the European Commission where there is misalignment between the SCR calculation and the climate-related risks that insurers face.

(iii) Increased Proportionality

The European Commission has conceded that the current proportionality rules do not work as intended. It has therefore put forward a significant extension of the size thresholds, meaning that smaller and less complicated insurers will be excluded from the scope of the Directive and will fall under national regimes.

In addition, the European Commission has proposed a lighter-touch framework for a new category of insurers who are identified as "low risk." The criteria for determining "low risk" insurers are relatively few in number and relate to (amongst others) (i) the level of the annual gross written premium; (ii) the level of investment in nontraditional investments; and (iii) the percentage of the undertaking's business that represents reinsurance (measured by a percentage of gross written income), as opposed to direct insurance.

Undertakings that classify as "low risk" benefit from certain regulatory exemptions and limitations, including in respect of requirements relating to: (i) quantitative regular supervisory reporting; (ii) the assignment of multiple key functions to one person; and (iii) the requirement to perform the ORSA annually, with such requirement instead being extended to two years.

Other undertakings that are not classified as "low risk" can be authorized by the relevant supervisory authority to use proportionality measures.

(iv) Increased Transparency in the Solvency and Financial Condition Report

Consistent with EIOPA's recommendations in the Opinion, the structure of the SFCR will be modified to improve accessibility for policyholders and beneficiaries.

Pursuant to these proposed amendments, the SFCR will be amended so that it will now consist of a part addressed to policyholders and beneficiaries, and a part addressed to other stakeholders (such as analysts and other market participants).

The part addressed to policyholders and beneficiaries will contain key information on the undertaking's business, performance, capital management and risk profile. By contrast, the second part will contain detailed information on the undertaking's system of governance, specific information on technical provisions and other liabilities, the solvency position and other relevant data.

(v) Macroprudential Risks

Since the COVID-19 pandemic began, the European Commission has recognized the paucity of the tools

available to European Supervisory Authorities to manage macroprudential risks. Accordingly, if these proposals come into force, insurers will be required to assess the impact of plausible macroeconomic and financial market developments on their specific risk profile and solvency needs. Undertakings will also be required to consider whether their investment strategy could have a macroeconomic effect and impact on financial markets, and have the potential to turn into sources of systemic risk.

In addition, supervisory authorities will be provided with additional powers to intervene where undertakings have not adequately addressed their liquidity vulnerabilities, and to preserve the financial position of undertakings during exceptional market-wide shocks. These powers include the ability to restrict or suspend (i) dividends and other payments to shareholders; (ii) share buybacks and repayment or redemption of own fund items; and (iii) bonuses and other variable remuneration.

(vi) Group Supervision

Finally, the European Commission has amended various aspects of the group supervision rules.

A key proposed amendment is to the definition of an "Insurance Holding Company," which now provides that in order for a company to fall within this definition, more than 50% of the parent undertaking's equity, consolidated assets, revenues, personnel (or other indicator considered relevant by the supervisory authority) must be associated with subsidiaries that are insurance or reinsurance undertakings. The inclusion of this 50% threshold is similar to one of the PRA's proposed amendments to the same definition at U.K. level (discussed elsewhere in this review).

Further, the Proposed Reforms also bring about a number of substantive changes to the way in which groups are supervised. In particular, Insurance Holding Companies and Mixed Financial Holding Companies established in the E.U. are now directly regulated under the Solvency II Directive, and are required to ensure that various conditions are fulfilled, including (i) the coordination of all subsidiary undertakings through adequate distribution of tasks amongst those undertakings; (ii) preventing or managing intragroup conflicts; and (iii) enforcing the group-wide policies that the holding company has introduced.

The European Commission has also introduced a minimum set of powers that supervisory authorities may apply to Insurance Holding Companies and Mixed Financial Holding Companies in order to ensure effective group supervision. Such enforcement tools include (i) suspending the exercise of voting rights attached to the shares of the subsidiary insurance or reinsurance undertaking; (ii) issuing injunctions, sanctions or penalties against the holding company, or members of the management of the holding company; and (iii) restricting or prohibiting distributions or interest payments to shareholders.

CONCLUSION

The Proposed Reforms are wide ranging, and are likely to further protect policyholders by ensuring that they are better informed and are not exposed to macroeconomic risks. Balanced against these additional protections are benefits for insurers and reinsurers, whose capital burdens will be eased by a more favorable treatment of long-term investments, changes to the Risk Margin, Volatility Adjustment and other measures.

It will also be interesting to see how the final, comprehensive package of E.U. reforms to the Solvency II architecture compares with the proposals that are eventually published by the U.K.'s HM Treasury. These reforms will inevitably touch upon a number of similar problems recognized in the existing Solvency II framework, such as with the Risk Margin. Similarly, both the U.K. and E.U. insurance prudential regimes will be tailored to the policy goals of (i) addressing climate-related risks; and (ii) rebuilding the U.K. and E.U. economies through incentivizing long-term investment. However, there is a real possibility of divergence. In particular, as discussed elsewhere in this review, the U.K. appears to be moving towards a simplification of certain rules and an increased reliance on PRA discretion. No such simplification of E.U. rules is envisaged, which would need to maintain a minimum degree of uniformity to regulation across the bloc.

The market will inevitably question how this potential divergence will be impacted by (and, in turn, will impact) equivalence decisions made by the U.K. and the E.U. Currently, the U.K. has granted equivalence to relevant aspects of the E.U.'s prudential regime, and would prefer for the E.U. to make reciprocal determinations. However, it does not appear that equivalence will temper the scope or pace of change in either jurisdiction. The U.K. has not suggested that its existing determinations will be withdrawn if the Proposed Reforms enter into E.U. law. Similarly, HM Treasury is not (at least overtly) influenced by the possibility of equivalence determinations from the E.U., the possibility of which remains as uncertain as ever. We therefore expect that, whilst a high degree of similarity will remain between the two regimes, insurance groups will need to come to terms with an increased degree of difference between the way in which its U.K. and E.U. operations are regulated in the future.

d. The European Commission's Proposed Insurance Recovery and Resolution Directive

INTRODUCTION

The Solvency II regime has been generally effective in ensuring a robust European insurance sector. Nonetheless, the European Commission recognizes that the financial distress of insurers cannot be completely excluded. Accordingly, in September 2021, the European Commission adopted a proposal for an "Insurance Recovery and Resolution Directive," which is designed to ensure that insurers in the E.U. are better prepared in cases of significant financial distress. Corporate insolvency procedures for insurers (which have a degree of harmonization across the E.U.) were not thought to be appropriate for insurance as they may not always ensure an adequate continuation of critical functions. The European Commission considers that there is a need for a regime to provide authorities with a set of resolution tools to intervene sufficiently early and quickly if insurers are failing or likely to fail. The Directive aims to create a harmonized recovery and resolution planning framework for E.U. insurance and reinsurance companies and groups, and will give E.U. supervisory authorities comprehensive powers to prepare for and deal with (near) failures of (re)insurers at the national level. The Directive also provides for cooperation arrangements to tackle cross-border (re)insurance failures.

The Directive is predominantly aimed at protecting policyholders, beneficiaries and claimants, who will be prioritized over shareholders and other creditors. Secondary aims are (i) maintaining financial stability; (ii) ensuring the continuity of critical functions; and (iii) protecting public funds by minimizing reliance on extraordinary public financial support.

KEY ASPECTS OF THE DIRECTIVE

Key aspects of the Directive are as follows:

- Member States are required to transpose the Directive rules into their national laws within 18 months from the Directive's entry into force. E.U. (re)insurers, insurance holding companies and mixed financial holding companies could therefore be subject to these laws by 2024, depending upon the speed of the legislative process. EIOPA will also consult on and deliver technical standards and guidelines during this 18-month period.

- Each Member State must set up an insurance resolution authority, equipped with a minimum harmonized set of powers to undertake all relevant preparatory and resolution actions. As the Directive does not state which particular authority should be appointed, Member States may select from a range of entities, including banks, competent ministries or other public authorities.

- E.U. insurers and insurance groups are required to prepare preemptive recovery plans, which set out the actions that they must take if their financial position significantly deteriorates. Member States should ensure that, overall, at least 80% of their markets are subject to such requirements, although low-risk undertakings are excluded from these requirements.

- Resolution authorities are also required to prepare resolution plans, which set out the resolution actions that each authority envisages it will take in the event that a particular entity is in a state of near failure but is still

resolvable without the assumption of any extraordinary public financial support (i.e., the entity can either be resolved using tools contained in the Directive, or can be liquidated under ordinary insolvency proceedings). Overall, 70% of undertakings in the Member State should be subject to resolution planning, although low-risk undertakings can be excluded.

- Resolution authorities are provided with a range of resolution tools, which they may use following their assessment of the *resolvability* of the (re)insurance undertaking. Such resolution tools include:
  - writing down or conversion of capital instruments, debt instruments and other eligible liabilities;
  - withdrawing an undertaking's authorization to conclude new insurance or reinsurance contracts in order to facilitate an orderly runoff;
  - selling all or part of an undertaking's business on commercial terms;
  - transferring all or part of an undertaking's business to a publicly controlled "bridge" undertaking, with the aim of selling the business to a private purchaser when market conditions are appropriate; and
  - separating impaired or problem assets and/or liabilities to a management vehicle controlled by a public authority so that they can be managed and worked out over time.
- The triggers for intervention by resolution authorities include:
  - where the insurer is in breach or likely to be in breach of its Minimum Capital Requirement and there is no reasonable prospect of compliance being restored;
  - the insurer no longer fulfils the conditions for authorization;
  - the insurer is likely to be unable to pay its debts as they fall due; and
  - extraordinary public financial support is required.
- The Directive includes specific safeguards for shareholders and creditors of the (re)insurers or (re)insurance groups in financial difficulty, as the use of resolution tools and powers disrupts their respective rights. In particular, assets of the (re)insurer or (re)insurance group can be transferred without shareholder consent, or liabilities can be written down. In such circumstances, shareholders or creditors will receive compensation if they end up in a worse position than if the insurance or reinsurance undertaking had been wound up under national insolvency proceedings.
- The Directive also establishes a framework for cross-border resolution within the E.U. to take into account the international nature of E.U. insurance groups. Resolution colleges will be established under the leadership of the group resolution authority with the participation of EIOPA, with the aim of coordinating preparatory and resolution measures amongst national authorities to ensure optimal solutions at Union level.
- However, the Directive does not provide a specific preventative power that allows the removal of management or the appointment of a temporary administrator.

CONCLUSION

The Directive is now being reviewed by the European Parliament and Council as part of the E.U.'s ordinary legislative procedure. The terms of the Directive therefore may be subject to change before it ever enters into force. In the meantime, Member States will be aware of the heavy burden that this Directive is likely to place upon them and may already be exploring options for ensuring that they are able to comply by the time it comes into force.

iii. The House of Lords Industry and Regulators Committee Inquiry into London Market Regulation

INTRODUCTION

In parallel with HM Treasury's review of Solvency II, in January 2022 the House of Lords Industry and Regulators Committee ("Committee") have launched an inquiry or "Call for Evidence" into the regulation of the U.K.

commercial insurance and reinsurance market (otherwise known as the "London Market").

The Committee recognises that the London Market is a world leader, and that (re)insurance is one of the country's major exports. The Committee therefore intends to explore the extent to which regulatory policy is well-designed and proportionately applied, and how it could be optimised following Brexit.

Scope of the Call for Evidence

As part of the "Call for Evidence," industry stakeholders have been invited to provide short written submissions on six questions (set out below) that cover both the role of the PRA and the FCA as regulators, and the appropriateness of current insurance regulation. The deadline for providing evidence is February 11, 2022.

Despite the relative brevity of this inquiry, it is therefore broader and more concerned with the commercial performance of the London Market than the recent Call For Evidence published by HM Treasury, which only covered specific aspects of domestic prudential regulation.

The questions posed in the Call for Evidence are as follows:

- Is the U.K. regulatory framework appropriate for the commercial insurance and reinsurance sectors?
- To what extent do the PRA and FCA apply and interpret regulatory policy in these areas in a proportionate manner and strike the right balance between regulation and competitiveness?
- How do the activities of the U.K.'s financial regulators affect the ease of carrying out commercial insurance and reinsurance business in the U.K.? What impact does this have on the availability and cost of insurance cover in the U.K.?
- What is the status of the London Market's global competitiveness, and how is this impacted by different regulatory approaches in other territories?
- What improvements could be made to the regulation of commercial insurance and reinsurance in a post-Brexit context?

The Committee has also held two public formal sessions, in which certain stakeholders were asked to provide evidence. As at the date of this publication, the transcript for the first of these meetings (taking place on January 25, 2022) has been published online. This session involved an interview with Caroline Wagstaff, CEO of the London Market Group, and Christopher Croft, CEO of the London and International Insurance Brokers' Association.

Next Steps

The Committee has not yet revealed when it will publish the findings of this inquiry. It is also unclear what impact, if any, they may have on HM Treasury and the PRA's respective work on the Solvency II review. However, it is likely that similar trends will arise from both inquiries.

In particular, the individuals who were interviewed as part of the first public session were in favour of the strength of the U.K. regulatory regime and did not advocate for wholesale changes to it. Instead, their concerns were broadly limited to specific issues, such as advocating for an increased focus on climate-related risks, expressing a desire to improve the competitiveness of the London Market (including facilitating a greater use of ILS structures and providing a welcoming environment for U.K. branches of E.U. insurers), and suggesting greater regulatory proportionality for smaller and low-risk insurers.

iv. PRA's Second Climate Change Adaptation Report

INTRODUCTION

The final quarter of 2021 has witnessed a plethora of climate-related activity. The key events have been political, with the 26th United Nations "Climate Change Conference of the Parties" held in Glasgow from October 31 to November 12 taking centre stage.

However, there have also been notable developments in the financial services sector. Of particular importance to

banks and insurers is the PRA's second Climate Change Adaptation Report under the Climate Change Act 2008, entitled "Climate-related financial risk management and the role of capital requirements" ("2021 Report"), which focuses on the effect of climate-related financial risks on firms' capital adequacy requirements.

The 2021 Report follows the PRA's Supervisory Statement SS3/19 "Enhancing banks' and insurers' approaches to managing the financial risks from climate change" in 2019 ("2019 Expectations"), which sets out its expectations on how banks and insurers should manage their respective financial risks arising from climate change.

Key Findings in the 2021 Report

The PRA's findings in the 2021 Report are generally positive. In particular, the PRA notes that, since the publication of its 2019 Expectations, firms' climate change considerations have shifted from constituting merely one aspect of their Corporate Social Responsibility policy to being increasingly embedded by boards and senior executives in firm-wide strategy.

However, the 2021 Report emphasises that a significant amount of work remains to be performed by both regulator and firms alike to tackle the risk that climate change poses to the financial services sector. In particular, the extent of firms' implementation of the 2019 Expectations is inconsistent, and research into the effects of climate change on firms' capital position is still in its initial stages.

The 2021 Report is therefore a continuation of the PRA's 2019 Expectations, and represents a shift in its supervisory approach to climate-related financial risks. In particular, the PRA will move away from merely assessing firms' implementation of these expectations to commencing active supervision against them (including, where necessary, the implementation of enforcement action).

The PRA's New Supervisory Approach to Climate-Related Financial Risks

The PRA will address climate-related financial risk in the following ways: (i) assessing firms against its 2019 Expectations; (ii) issuing new disclosure requirements relating to climate-related financial risks; and (iii) supervising firms' capital adequacy assessments (which will be its primary area of focus). Each of these workstreams is discussed below:

(i) Assessments against 2019 Expectations

The PRA will develop proportionate assessments of firms' individual strategies for meeting its 2019 Expectations. These assessments will draw on firms' internal management information, responses to the PRA's recent surveys and other sources of relevant information.

(ii) Disclosure Obligations

Firms will be expected to develop disclosures that relate to their management of climate-related risks. These disclosures will be made in accordance with firms' existing Pillar 3 disclosure obligations.

(iii) The PRA's Approach to Climate-Related Capital Adequacy Assessments

The PRA will focus on the supervision of firms' ability to identify and manage the effects of climate-related risks on their capital positions, and will use its existing supervisory tools to ensure that firms hold sufficient capital to account for climate-related financial risks.

If the PRA considers that a firm has not made sufficient progress in embedding its 2019 Expectations, it may be required to provide the PRA with an explanation as to how it intends to achieve compliance with them in the future. Where progress remains insufficient, the PRA may commence enforcement against the firm, or the Senior Manager with responsibility for climate-related financial risks, through the use of its existing enforcement powers, such as: (i) the appointment of a Skilled Persons Review under Section 166 of the Financial Services and Markets Act 2000; and (ii) the imposition of additional capital charges or scalars.

Limits to the PRA's Supervision of Capital Adequacy Requirements

However, there are limits to the practical impact that the PRA's proposals contained within the 2021 Report will have on regulated firms.

Firstly, the PRA is not proposing to implement specific policies on how it will supervise firms' adherence to their climate-related capital adequacy requirements. The 2021 Report is, instead, preliminary in nature and simply seeks to highlight the link between climate change and the firms' capital positions.

In addition, the PRA accepts that the application of capital adequacy requirements only relates to the consequences of climate change (in other words, the amount of capital that a firm needs to hold to account for macro and microprudential risks). The PRA, by contrast, has no intention of restricting firms from investing in businesses or industries that materially cause carbon emissions.

The PRA has opted against a more interventionist approach as (i) capital adequacy requirements are one of many factors that firms take into account when making investment decisions; and (ii) there may be unintended consequences from this use of capital adequacy requirements, as the "greenness" of an industry is not necessarily consistent with the financial risk that it represents.

Capability and Regime Gaps

The PRA is also cognisant of the practical challenge of applying existing regulatory capital rules to climate-related financial risks.

It is particularly difficult for firms to model the individual and macroeconomic consequences of climate-related financial risks, given the uncertainty as to when they may crystallise over time. Further, while the danger posed by these risks is likely to increase, their occurrence may be characterised by tipping points and will be affected by government policy interventions (such as those that will arise out of the "Glasgow Climate Pact," including attempts to limit global warming to 1.5 degrees Celsius above pre-industrial levels). There is also a lack of high quality climate data and disclosure across the economy, as financial services firms do not collect such data from their clients and the majority of businesses do not otherwise publicly disclose such information.

Additional difficulties may arise in capturing climate-related financial risks due to the design or use of the methodologies of capital regimes themselves (i.e., "regime gaps"). In microprudential regimes, methodologies are mostly calibrated using past data to capture risks that crystallise over a relatively short-term time horizon. The short-term nature of the data used may result in models underestimating future climate-related financial risks.

The PRA recognises the need to understand the materiality of each of these "gaps," both generally and in relation to specific products and exposures. Accordingly, it has already started work, both domestically and internationally, to understand the linkages between climate-related financial risks and their consequential effect on firms' capital positions. For example, both the Basel Committee on Banking Standards and the International Association of Insurance Supervisors have already started work on climate-related financial risks and their interaction with regulatory frameworks. The PRA is also putting out a "Call for Papers" on this topic and will host a Research Conference in Q4 2022.

CONCLUSION

The 2021 Report is not likely to have a pronounced impact on regulated firms, many of whom will already be considering the effect of climate change on their capital adequacy positions. Further, the 2021 Report does not provide any practical guidance to firms in quantifying the level of the climate-related risks that they face. It is therefore likely that, at least in the short to medium term, the PRA will accept that firms' approaches to identifying and managing climate-related risks will differ significantly, even across the same industries and in respect of similar risks. Any convergence brought about by the sharing of information and best practices will clearly take time, given the scale and complexity of the research involved, and the nonlinear way in which ecological risks could develop.

It is also unlikely that the PRA will introduce any material restrictions on firms' ability to invest in industries that are

responsible for significant carbon emissions in the near future. The PRA clearly believes that it has an important role to play in limiting the impact of climate change, for the benefit of both the firms that it regulates and humankind in general. However, it is rightly cognisant of its primary objectives and the potential detriment that it may cause to them by incentivising a transition to investment in "green" initiatives without a deeper understanding of their risk profile.

Nevertheless, firms should consider the 2021 Report to be a sign that the PRA is likely to become more interventionist over time, particularly with the benefit of further research and consensus amongst regulators about best practices. In particular, the PRA's focus may eventually shift from capital adequacy requirements to addressing how firms contribute to the causes of climate change. The PRA does not explain what measures it may introduce to address any such concerns. However, it has also not ruled anything out. Accordingly, although any such regulatory intervention is likely to be some years away, firms should already begin to consider both their exposure to climate-related risks and how they may be contributing to the problem.

v. PRA – Other Developments

a. Group Supervision – Consultation on the Definition of Insurance Holding Company

In September 2021, the PRA released the Consultation Paper "Solvency II: Definition of an insurance holding company" (CP17/21), which sets out its proposed approach to interpreting and applying the definition of "Insurance Holding Company" for the purposes of the Group Supervision Part of the PRA Rulebook. The PRA published this consultation at a similar time to the European Commission's publication of its Review of Solvency II (discussed elsewhere in this review), in which it proposed comparable changes to the same definition.

The main purpose of this Consultation Paper is to distinguish an "Insurance Holding Company" from a "Mixed-Activity Insurance Holding Company." Groups headed by the former, and which contain a U.K. Solvency II (re)insurer, are subject to comprehensive Solvency II group supervision rules overseen by the PRA (unless equivalence applies, or the PRA applies "other methods" of supervising the group). In particular, the group will be required to calculate its group solvency, and report regularly to the PRA on a wide range of matters relevant to its supervision of the group.

By contrast, groups headed by the latter are subject to a lighter-touch regime and are only required to report on (i) significant intragroup transactions by U.K. Solvency II undertakings within the group; and (ii) key information that the PRA would require to make appropriate decisions on the supervision of the group, such as information relating to the group's system of governance, the nature of the group's business, valuation principles for solvency purposes and its risk management systems.

It is therefore important that there is sufficient clarity between these two definitions.

Under the current definitions, an "Insurance Holding Company" is defined as a parent undertaking (that is not a U.K. Solvency II (re)insurer or a "Mixed Financial Holding Company") whose main purpose is to acquire and hold participations in subsidiary undertakings and which fulfills the following conditions: (i) its subsidiary undertakings are *either exclusively or mainly* U.K. Solvency II firms or third-country insurance undertakings; and (ii) at least one of the solvency undertakings is a U.K. Solvency II firm.

Most of this definition is fairly clear to apply in practice. However, the term "mainly" is not defined under regulation. The PRA now seeks to address this lack of transparency, as the term is relevant when distinguishing an "Insurance Holding Company" from a "Mixed-Activity Insurance Holding Company" (i.e., a parent company that is not an insurance undertaking (EEA, U.K. or third country) which includes at least one insurance or reinsurance undertaking among its subsidiary undertakings).

The PRA has put forward two proposals to clarify the distinction between the two definitions:

(i) amend the definition of "Insurance Holding Company" to interpret the term "mainly" by reference to the proportion of a group's assets, revenues or capital

requirements that are derived from insurance or reinsurance subsidiaries, or ancillary insurance services undertakings. A parent company would fall within this definition where at least two of these three measures (assets, revenues or capital requirements) exceed the 50% threshold (based on a one-year reference or a three-year average); or

(ii) clarify its expectations on the information required from firms in order to distinguish an "Insurance Holding Company" from a "Mixed-Activity Insurance Holding Company."

The PRA has included ancillary insurance services undertakings as part of the calculation in proposal (i) above to avoid the risk that holding companies could be defined as "Mixed-Activity Insurance Holding Companies" simply because of the manner in which group operations are structured. In other words, parents of insurance undertakings that do not employ their own personnel would otherwise be more likely to artificially fall within the "Mixed-Activity Insurance Holding Company" classification.

Both of these proposals have their merits, although we would expect proposal (i) to be the preferred approach. The generalized nature of this calculation could produce distorted results where groups contain a single, significant insurance entity. However, it has the benefit of transparency, and would enable insurance groups to determine for themselves the nature of their group supervision requirements. It is also interesting that the European Commission is proposing to clarify this aspect of the definition by inserting a similar test, i.e., 50% of the parent undertaking's equity, consolidated assets, revenues or personnel must be associated with subsidiaries that are insurance or reinsurance undertakings.

By contrast, the second method could increase the workload of both the group and the PRA, and reduce the efficiency of the system by delaying determinations as to how groups should be classified. This outcome would defeat the purpose of introducing additional clarifications between the two definitions.

The PRA's consultation process closed on Monday, December 6, 2021, and the PRA's proposed implementation date for the resulting changes is Monday, February 28, 2022.

b. Operational Resilience

The PRA has also continued its focus on operational resilience over the course of 2021, with the publication of the following two supervisory statements: (i) "Outsourcing and third party risk management" (SS2/21) in March 2021; and (ii) "Operational resilience: Impact tolerances for important business services" (SS1/21). These Supervisory Statements are in addition to the PRA's recent Consultation Paper "Operational Resilience and Operational Continuity in Resolution: CRR firms, Solvency II firms, and Financial Holding Companies (for Operational Resilience)" (CP21/21), in which the PRA is consulting on the direct application of certain group operational resilience rules to holding companies.

Each of these publications is discussed below.

(i) Outsourcing and Third-Party Risk Management

This Supervisory Statement, which comes into effect on Thursday, March 31, 2022, sets out the PRA's expectations on a range of topics relating to outsourcing and third-party risk management. These expectations will broadly not be new to insurers. However, firms should be aware that this document will inform the PRA's approach to supervision from the date that it comes into force.

Key points arising out of this Supervisory Statement are as follows:

Definition of Outsourcing

The PRA has not changed the definition of "outsourcing" derived from E.U. legislation (such as the Solvency II Directive). The term therefore continues to encompass arrangements of any form between a firm and a service provider by which that service provider performs a process, service or activity that would otherwise be undertaken by the firm itself. Existing requirements relating to outsourcing,

such as those contained in Article 274 of the Solvency II Delegated Regulation, will also continue to apply.

The Supervisory Statement also introduces the concept of "non-outsourcing third-party arrangements," which should be regarded as discrete from outsourcing and therefore are not impacted by outsourcing rules. In the case of insurers, these activities include the use of aggregators, such as pricing comparison platforms, and delegated underwriting (including intragroup or with another insurer). However, somewhat confusingly, where delegated underwriting is more material, the normal rules around outsourcing could apply.

This development is clearly positive for insurers, who will be able to implement proportionate systems and controls over their standard delegated underwriting authority agreements ("DUA"). However, it creates uncertainty in respect of DUAs that are more substantial, for example those agreements that are particularly complicated, relate to products that have been co-manufactured with an intermediary or involve a degree of outsourcing of an insurer's underwriting function itself (i.e., a function that performs the identification, exploration and pricing of a risk). In such circumstances, insurers should consider whether outsourcing rules ought to apply as a matter of good governance, irrespective of whether they technically do not fall within the definition of outsourcing (some in fact may still do so).

Further, firms should be aware that, whilst proportionate controls can be placed on DUAs that are not "high risk," the rules contained in the Supervisory Statement relating to more material "non-outsourcing third-party arrangements" broadly have the same impact as traditional outsourcing requirements. In particular, firms must assess the materiality of DUAs using the same criteria as for outsourcing agreements. Where a DUA is considered to be material, the insurer would be expected to notify the PRA of entry into, or a significant change of, any such agreement in the same manner as with outsourcing arrangements.

In our view, whilst the introduction of "non-outsourcing third-party arrangements" adds a degree of flexibility to certain insurers' systems and controls, it does not represent a dilution of insurers' existing obligations regarding material DUAs, which should continue to be treated in the same manner.

Proportionality and Materiality

The PRA highlights the conceptual distinction between (i) the implementation of *proportional* requirements in line with the size, nature, scope and complexity of an insurer's activities; and (ii) the *materiality* (i.e. the criticality or importance) of an outsourced function.

These concepts may be different, but there are clear links between the two, particularly given the impact that the outsourced agreement may have on insurers' ability to comply with legal and regulatory obligations. Further, proportionality and materiality can change over time and should be periodically reassessed.

Intragroup Outsourcing

The PRA has reiterated its position that intragroup outsourcing should not be treated as inherently less risky than other forms of outsourcing. However, firms may comply with the outsourcing requirements proportionately in intragroup scenarios, depending upon the level of "control and influence" that the outsourcing entity has over the service provider. For example, an insurer will have more control if there is a high degree of connectivity between the two companies' boards, committees and internal control functions, or if similar Senior Managers are appointed in both entities.

U.K. Branches of a Third-Country Insurer

The PRA has also restated its requirements in respect of U.K. branches of a third-country insurer, which have not materially changed. However, the PRA recognizes the need to apply its expectations proportionately to U.K. branches of a third-country insurer. In particular, U.K. branches of a third-country insurer can rely on (i) due diligence, materiality assessments and risk assessments of third parties performed by head office; (ii) contractual arrangements between third parties and the whole firm or

group; and (iii) audits of third parties performed by head office.

Materiality

The PRA has provided detailed guidance to firms in assessing the materiality of their outsourcing arrangements.

Firms should assess materiality periodically, and at each of the following stages: (i) prior to signing the written agreement; (ii) at appropriate intervals thereafter (e.g., during scheduled review periods); (iii) where a firm plans to scale up its use of the service or dependency on the service provider; and/or (iv) if there is a significant organizational change at the service provider.

Agreements will automatically be considered to be material if the service provider's failure impairs (amongst others) the financial stability of the United Kingdom, the insurer's ability to meet its Threshold Conditions and its compliance with the Fundamental Rules. However, insurers are encouraged to view this test holistically and have regard to other factors, such as the potential for disruption of their operational resilience, their obligations under the PRA rulebook and data protection legislation, and the impact on counterparties and policyholders.

Data Security

The Supervisory Statement also contains a lengthy chapter on data security, which it views as particularly important given the increasing amount of data stored with third parties (for example, cloud software providers).

Consistent with Article 274(e) of the Solvency II Delegated Regulation, insurers are expected to (i) classify relevant data based upon their confidentiality and sensitivity; (ii) identify potential risks relating to the relevant data and their impact (legal, reputational, etc.); (iii) agree on an appropriate level of data availability, confidentiality and integrity; and (iv) satisfy themselves that any data stored with third parties is in line with applicable legal and regulatory requirements.

(ii) Impact Tolerances for Important Business Services

The PRA also published a shorter Supervisory Statement on impact tolerances for important business services in March 2021. This Supervisory Statement remains on the PRA's core theme of operational resilience and supports the PRA's existing rules on the topic. It is therefore relevant for all U.K. Solvency II firms, including Lloyd's managing agents.

This Supervisory Statement is focused on firms' "important business services," which it defines as the services a firm provides to customers which, if disrupted, could pose a risk to a firm's safety or soundness, the financial stability of the U.K. or policyholder protection. Such services are likely to be particularly critical to the firm's business, such as its sales or claims-handling functions. Firms should therefore prioritize these services, and ensure that they are able to adapt, respond to, recover from and learn from disruptions to them.

Key points arising out of this Supervisory Statement include:

- Firms must determine what are "important business services."
- Firms should set "impact tolerances," that is, maximum tolerable levels of disruption for each important business service and keep within such impact tolerances.
- Firms should identify the necessary resources to deliver the important business services and create a governance structure around them.
- Groups will have to comply with similar requirements at group level.

CONCLUSION

These Supervisory Statements will come into effect on March 31, 2022, and form part of the U.K. regulators' broader focus on operational resilience, including the addition of a new "Operational Resilience" Part of the PRA Rulebook, which will come into effect from the same date.

The Supervisory Statement on Outsourcing and Third Party Risk Management provides further granularity to the guidance to which firms must adhere when formulating and reviewing their systems and controls. Certain insurers may

consider that their systems and controls already comply with these standards, given the PRA and FCA's historic emphasis on this area of regulation. By contrast, others will have used the time since the publication date to make requisite changes to ensure compliance. Insurers who regularly outsource via standardized DUAs may welcome an increased degree of proportionality to the way in which the PRA will oversee their systems and controls.

Similarly, the contents of the Supervisory Statement on Important Business Services are unlikely to be new for insurers, who are already subject to similar requirements in existing PRA rules (including the requirement to perform an ORSA), Senior Management Arrangements, Systems and Controls Sourcebook in the FCA Handbook and the Senior Managers regime (which requires each Senior Manager's role to be appropriately defined, and placed within the context of a governance map). However, firms should ensure that their systems and controls specifically identify and prioritize "important business services," and should consider whether they have dedicated appropriate resources to ensuring that these areas are sufficiently resilient against potential disruption. Firms should also ensure that they create a satisfactory audit trail that demonstrates their adherence to these specific rules, which will be subject to a significant degree of continued focus from the PRA when they come into force.

c. The PRA's Review of its Role in the Part VII Process

INTRODUCTION

During 2021, the PRA consulted on making various changes to the way in which it approaches Insurance Business Transfers under Part VII of the Financial Services and Markets Act 2000 ("FSMA" and "Part VII Transfers"). The PRA's Consultation Paper "Insurance Business Transfers" (CP16/21) was published in July 2021. Following the closure of this consultation process at the end of October, the PRA published the resulting Policy Statement (PS1/22) in January 2022, alongside its updated Statement of Policy "The PRA's approach to insurance business transfers."

These publications will be of interest to any domestic or international insurance company or group, which is considering group reorganisations, or selling insurance business, by way of a Part VII Transfer.

Key Changes

A number of the resulting changes are limited in nature and will not significantly affect the current approach to the Part VII Transfer process. Such changes include:

(i) providing additional guidance to firms, independent experts ("IE") and other interested parties on the PRA's role and approach to Part VII Transfers;

(ii) providing guidance on the PRA's approach where transferees are in runoff; and

(iii) providing additional guidance on the PRA's approach to friendly society transfers.

However, the PRA has introduced further provisions that concern the suitability of the transferee in certain situations, which could have a material impact upon the initial stages for such transfers if applicable to them. These provisions are only relevant where a scheme (i) involves a book of non-life insurance business in runoff, with gross technical provisions of more than £100 million; and (ii) will increase the transferee's technical provisions by more than 10%. In such case the PRA is likely to exercise its powers under s. 166 FSMA to require a skilled person within the transferee to produce a report on its operational readiness to accept the scheme in addition to the other usual procedural requirements. The PRA considers that this additional element is required as a result of what are considered to be specific risks arising from transfers in runoff, which differ from the transfer of live portfolios.

Industry Response

Industry stakeholders had raised concerns that the PRA proposals could be a prelude to all transfers being subject to the additional s. 166 exercise (i.e., not just those schemes falling within the parameters set out in items (i) and (ii) above). However, the PRA has clarified in the Policy

Statement that this is not the intention, with the requirement being limited to cases where circumstances suggest that absorbing a significant book of business is likely to result in operational implications for policyholders that would not necessarily be picked up by the more prudential-focused IE process. We therefore do not expect that these changes to the PRA rules will be of wider concern to parties wishing to utilize this mechanism

vi. Developments at Lloyd's

INTRODUCTION

The year 2021 has been an important year for the Lloyd's market. Following the turbulence of the COVID-19 pandemic in 2020, the year 2021 has presented Lloyd's with the opportunity to focus on market reforms, by commencing work on its "Blueprint" initiatives and targeting improved underwriting performances.

The paragraphs below set out the main regulatory developments that Lloyd's has experienced this year.

Appointment of Patrick Tiernan as Chief of Markets

Lloyd's calendar year commenced with the appointment of Patrick Tiernan in the newly created role of Chief of Markets, who will oversee market performance and distribution. Mr. Tiernan has over 24 years of experience in the insurance industry, most recently at Aviva where he served as the Managing Director, U.K. Commercial Lines and Global Corporate and Specialty. The task of overseeing the commercial performance of the Lloyd's market was previously the remit of Lloyd's Franchise Board, which was merged with the Council of Lloyd's in June 2020.

The appointment of Mr. Tiernan signals Lloyd's continuing attention to the economic performance of Lloyd's participants, and is likely to create renewed pressure on syndicates and managing agents to demonstrate sustainable profitability. Perennial underperformers (which make up around 15% of the market) without credible remediation plans have been informed that they may no longer have a place at Lloyd's. Similarly, Lloyd's participants have not simply been allowed to increase capacity in their 2022 Business Plans by taking advantage of rate increases.

Such increased scrutiny is clearly timely, given the recent COVID-19 pandemic and the more recent losses caused by Hurricane Ida. The increased likelihood of further catastrophic risks due to climate change will present additional tests to the resilience of the market.

In December 2021, Lloyd's announced a planned market-wide premium expansion of 15% to £43.7 billion for the 2022 year of account. This expansion has only been possible by the generation of (actual and predicted) good results in respect of the 2021 underwriting year. In September, Lloyd's published half-year results of £1.4 billion profits (before tax) and a 92.2% combined ratio (excluding COVID-19 claims). A sub-95% combined ratio for the full year is also predicted. These results represent a remarkable turnaround after a four-year loss-making streak, and Lloyd's will be keen to ensure that they continue in 2022.

Corridor Test

With effect from Q4 2021, Lloyd's has implemented changes to its long-standing "Coming into Line" ("CIL") process. This regime was set out in Y5348 "Membership & Underwriting Conditions and Requirements," first published September 24, 2021.

Pursuant to this new regime, Lloyd's members will no longer need to perform the CIL process in November and June and, instead, will comply with a single annual CIL that will be conducted in the second quarter of 2022. Any member that fails to hold assets in an amount equal to or higher than its Adjusted Economic Capital Assessment (broadly, each member's SCR, plus a 35% uplift) ("Adjusted ECA") by its "Annual CIL Date" will be served with an Overdue Notice and required to pay an administrative fine. If the shortfall (including payment of the fine) is not remedied within 10 working days, then Lloyd's may direct that the member cease underwriting at the end of the current year of account. As an alternative, the member could undertake

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to sell sufficient capacity in capacity auctions to provide funds equal to or higher than 150% of the CIL shortfall.

This annual CIL will be supplemented by Quarterly Corridor Tests, in which the solvency of each member is tested on a quarterly basis. Members must ensure that the value of their assets remains at least 90% of their Adjusted ECA. Any amounts in excess of 110% of the member's Adjusted ECA will be eligible for release.

With the exception of the Quarterly Corridor Test in Q4, if a member fails to fall within the "corridor" by the applicable deadline, Lloyd's will serve the member with an Overdue Notice and require the member to pay an administrative fine until the shortfall has been cleared.

Any member that fails to comply with its requirements by the Q4 deadline must drop sufficient underwriting capacity so that the value of its assets falls within the "corridor" of its Adjusted ECA. Continued failure by the member to adhere to its requirements could result in Lloyd's directing that the member ceases underwriting at the end of the current year of account.

It is currently unclear how this process will coincide with the 2023 Business Plan and Capital approval process. On the date of this Year in Review, Lloyd's Business Timetable only goes as far as February 2022, and Lloyd's has not yet published how these various processes will run in tandem. This situation may well be clarified in Q1 2022, ahead of any Business Plan submission deadlines in the following quarter.

Transition to Net Zero

Consistent with current concerns around the climate emergency, Lloyd's has set out how it will partner with critical industries to support and accelerate the transition to a low carbon economy. Lloyd's vision is set out in its publication "Insuring a sustainable greener future: A roadmap for climate action," dated July 2021.

Lloyd's considers that its role comprises three main areas of action:

1. creating new risk transfer solutions for green innovation;

2. supporting customers who are actively reducing the carbon intensity of their activities; and

3. harnessing the global insurance industry's capital pool and directing it towards sustainable investment opportunities.

Lloyd's has suggested several carbon-intensive industries that are key to the transition, including construction, transport (motor vehicles, maritime and aviation), nuclear hydrogen and wind. Similarly, Lloyd's provides a wide range of means by which the insurance industry can facilitate a net-zero result.

A number of these potential solutions, such as providing finance to investors and governments, and expanding insurance coverage for renewable energies, are not new and require input from the global insurance industry. However, Lloyd's has also listed a number of other actions that it has committed to deliver alone, such as conducting research to understand the profiles of new risks emerging from the transition to net zero (including new construction techniques and materials, and new fuels for planes and ships), and by providing a platform for dialogue between the insurance industry and customers relating to new insurance risks.

Lloyd's also envisages that it will deliver certain actions in its role as chair of the "Sustainable Markets Initiative Insurance Task Force" (the "Task Force").

In June 2021, and at the invitation of HRH The Prince of Wales, Lloyd's brought together leaders from a number of the largest and most influential global insurance firms to form the Task Force, which will focus on five areas of attention to accelerate the pace of the industry towards a more resilient and sustainable future. These areas are as follows: (i) driving insurance product and services innovation; (ii) implementing sustainable processes across the insurance supply chain; (iii) establishing a public-private disaster recovery framework to help protect developing nations from the evolving economic and societal

impacts of climate change; (iv) developing a framework for accelerating and scaling sustainable investment; and (v) defining the industry's ability to enable multi-sector transitions.

The initiatives suggested in Lloyd's report are ambitious and undoubtedly would have a significant impact upon the global transition to net zero if they were fully implemented. Lloyd's is also right to recognise that a number of these suggested actions can only be delivered by the insurance industry, and key players within it. For example, insurers could catalyse green construction (an industry where margins are too tight to perform climate-related research) by the introduction of "build-back-better clauses," which oblige insurers to replace existing, damaged structures with more ecological versions. Similarly, innovation in areas such as electric vehicles, and more environmentally friendly fuels for ships and planes, can only flourish if emerging risks are properly understood and covered by insurance. This report also goes further than the PRA's recent publication on the same themes (discussed elsewhere), by touching upon the risks that insurers should underwrite, and suggesting that insurers should invest in green initiatives.

However, a number of these ideas are still in embryonic form, and do not set out exactly how the global insurance industry (or even stakeholders in the Lloyd's market) will come together and effect real change. Further, although the document is called a "Roadmap," it is light on specific numerical goals and does commit to achieving even loose targets by certain dates. Lloyd's report therefore reads more as a statement of intent than a blueprint for the insurance industry to facilitate the transition to net zero.

The high-level nature of this document is nevertheless a good starting point. Lloyd's, which plays a dual role as a regulator and as a commercial marketplace, has the benefit of using both to achieve its goals. Its market players are also likely to be aligned to these aims, such is the prominence of this topic in global thinking. We therefore expect that, much as Lloyd's is the platform for commercial success in the insurance industry, it can also represent the same for championing climate-related causes.

Lloyd's Consultation on the Core Data Record

Last year, we published an article on Lloyd's latest "Blueprint Two programme"; the second phase of its "Future at Lloyd's" strategy aimed at shifting the market from archaic and idiosyncratic paper-based systems to a digital ecosystem, powered by data and technology.

A key part of this "Blueprint" was the creation of a "Core Data Record" ("CDR"), a high-quality database containing critical transactional information needed to flow through the Lloyd's market in order to drive automated downstream processes. The CDR is therefore essential to Lloyd's aim of significantly streamlining operations, reducing the cost and effort of doing business and delivering a better service to customers.

In March 2021, Lloyd's launched a consultation on the first iteration of the CDR (limited specifically to Open Market American Property), in which it sought input and feedback from market participants. This input assisted with the development and refinement of the CDR, through the validation of data inputs, testing of the technology process and data enrichment.

The outcome of this initial, specific consultation led to the development of a second iteration of the CDR, and a further consultation at the end of November, relating to all classes of business and territories. Once this second consultation has concluded on July 31, 2022, a final version of the CDR will be submitted to the Lloyd's Data Council for review. It is expected that the data standards underlying the CDR will be adopted shortly thereafter, and will be integrated into a revised version of the Market Reform Contract (known as the iMRC) in the first half of 2022.

The development of the CDR is a significant step for the Lloyd's market, as the access to comprehensive and reliable data represents one of the biggest challenges in achieving effective digitization. This project is therefore likely to be of significant interest to Lloyd's stakeholders, who soon will be able to participate in a market boosted by a move away from paper-based business and towards greater

efficiency through comprehensive and accurate data sets and electronic processes.

London Bridge Risk PCC

As part of last year's review, we reported that regulatory approval had been granted to Lloyd's sponsored U.K. Protected Cell Company, London Bridge Risk PCC ("London Bridge"), which is managed by Horseshoe and is independently owned. It was intended that London Bridge would provide an access point for new and diverse classes of both U.K. and international investors (including ILS investors), such as pension funds, who would be able to deploy funds in a tax transparent way into the Lloyd's market. Investors access risk in the Lloyd's market via London Bridge by entering into a quota share reinsurance transaction with a Lloyd's member on standard terms.

The year 2021 has seen London Bridge entering into its first two deals, involving The Ontario Teachers' Pension Plan ("OTPP") and Nephila's new specialty lines-focused Syndicate 2358. Willkie Farr had the privilege of representing both the OTPP and Nephila in these deals.

In November 2021, the OTPP, a Canadian pension investment manager with approximately $227.7 billion in net assets (including a number of ILS investments), was the first investor to provide capital through London Bridge. The OTPP's capital has been provided to a single Lloyd's member, which in turn participates on three syndicates in the Lloyd's market: CFC Syndicate 1988, Beazley's Syndicate 5623 and Beat's Syndicate 1416. Coverage began in the 2021 underwriting year of account.

In December 2021, London Bridge entered into its second transaction, this time with Nephila Capital, in respect of the corporate members that participate on its new Syndicate 2358 for the 2022 year of account. Nephila's use of London Bridge will not surprise the market. The group has a strong track record of using ILS funds to match capital with risk underwritten through its existing Syndicate 2357. This transaction is a further development of the Nephila platform at Lloyd's.

CONCLUSION

A number of the developments effected by Lloyd's have been anticipated by market participants for some time, not least since the publication of the various Blueprint documents in recent years. Of particular importance is the development of the CDR, which will assist brokers and managing agents to increase their volume of business in years to come, and improve the quality of service that they provide to customers.

In addition, the market will welcome the appointment of Patrick Tiernan and an increased focus on underwriting profits. A more successful market breeds policyholder confidence and increased investment from third-party Funds at Lloyd's providers. Accordingly, we are likely to see a number of new investors in Lloyd's in the near future, particularly given the emergence of London Bridge and new forms of syndicates, such as the "Syndicate in a Box" ("SIAB"), on which we reported last year. These new methods for entering into the market will only benefit profitability, as investors can make limited investments in novel SIABs, or cherry-pick specific underwriting teams via London Bridge. It is, however, unclear how the new CIL process will work in the 2022 year of account, particularly as it will need to function in tandem with the Business Plan process.

Finally, Lloyd's efforts for combatting climate-relating risk are still in their initial stages, and lack key detail about how Lloyd's goals will be effected in practice. However, Lloyd's should be praised for its ambitious and inclusive approach to the issue. The insurance industry is well placed to assist the transition to net zero and Lloyd's is right to harness its prominence in the global insurance sector for positive purposes. As with many climate-related initiatives, we must wait and see whether it will make a material difference to the biggest problem that humanity currently faces.

vii. E.U. and U.K. Competition Law

Following the opening of a number of significant new cases and market studies in the past few years, the insurance sector continued to be under scrutiny from competition authorities in the European Union and United Kingdom, with the European Commission, U.K. Competition and Markets Authority ("CMA"), and the FCA announcing new cases and/or continuing multiple investigations.

a. Statement of Objections Issued by the European Commission against Insurance Ireland

Two years after opening its formal investigation, the European Commission issued a formal statement of objections against Insurance Ireland in June 2021. In a press release accompanying its statement of objections, the European Commission alleged that Insurance Ireland had arbitrarily delayed, or *de facto* denied, the access of certain insurers to Insurance Ireland's data pooling system, Insurance Link.

Comprising members' claims data, such data pools are designed to facilitate the detection of fraudulent behavior and to ensure the accuracy of information provided by customers. The European Commission has acknowledged the capacity of data pools to promote market entry and to improve choice. However, it also contends that the conditions for access must not be used to exclude competitors.

According to the European Commission, the conditions of access to Insurance Link were unpredictable and hindered competition by placing insurers seeking to enter the Irish motor market at a competitive disadvantage vis-à-vis those insurers to whom access to Insurance Link was granted. The European Commission considered that the lack of access negatively affects costs, quality of services, and pricing.

Insurance Ireland will have the opportunity to submit a formal reply to the European Commission and to request a hearing. Parties under investigation by the European Commission are also entitled to offer commitments which, if they meet the European Commission's concerns, can lead to a case closure without a finding of an infringement. The European Commission has no formal deadline for reaching a final decision in the investigation.

In June 2021, the European Commission also announced that it intends to provide guidance to assist stakeholders in self-assessing data-pooling and data-sharing arrangements, in connection with the ongoing review of its regulations and guidelines concerning horizontal cooperation agreements, expected to be adopted by the European Commission in the fourth quarter of 2022.

b. Aon/Willis Merger Abandoned Following Conditional Phase II Clearance

On July 9, 2021, the European Commission announced its approval of the acquisition of Willis Towers Watson ("Willis") by Aon, subject to certain divestments by Willis to international brokerage firm Arthur J. Gallagher. The conditional clearance was granted after an in-depth Phase II investigation, opened in December 2020, in which the European Commission found that the merger, without remedies, could harm competition for commercial risk brokerage services to customers in the Space and Aerospace manufacturing risk class, and to large multinational customers specifically in the Property & Casualty, Financial and Professional, and Cyber risk classes. The European Commission also identified competition concerns in relation to reinsurance brokerage and pension administration services.

On July 26, 2021, the parties announced their decision to terminate the proposed $30 billion merger, first announced in March 2020, following a lawsuit brought by the United States Department of Justice seeking to block the deal. Aon has agreed to pay $1 billion as a termination fee.

c. European Commission Investigates FDI Measures in Insurance Sector

On October 29, 2021, the European Commission announced the opening of an investigation of the decision by the Hungarian Ministry of the Interior, taken in April

2021, on grounds of emergency legislation on foreign direct investment ("FDI") introduced during the COVID-19 pandemic, to block the acquisition of two Hungarian subsidiaries of AEGON Group. The proposed acquisition by Vienna Insurance Group, which was notified to the European Commission under the E.U.'s "one-stop shop" principle, was cleared unconditionally by the European Commission in August 2021.

Under E.U. rules, the European Commission has sole competence to review mergers which meet relevant thresholds, which the European Commission determined were met in this case. E.U. Member States may only take measures in relation to such a merger to protect their legitimate interests, provided that these are compatible with E.U. law and communicated to the European Commission in advance for assessment. The European Commission stated that the Hungarian government did not communicate the measures, or its grounds for compatibility, prior to blocking the proposed acquisition.

d. Class Action Brought against U.K. Price Comparison Website for Home Insurance

In November 2021, a collective damages action was filed in the U.K. Competition Appeal Tribunal ("CAT"), on behalf of 20 million consumers, against the price comparison website ("PCW") ComparetheMarket. The class action was brought following the infringement decision of the CMA, adopted in November 2020, in which the CMA found that ComparetheMarket's use of wide "most favored nation" clauses breached competition law.

According to the CMA's decision, such clauses prevented home insurers from quoting lower prices on rival PCWs and reduced price competition both between PCWs and between home insurers competing on PCWs. The CMA's decision is on appeal before the CAT in separate proceedings. The proposed class representative for the damages action, Home Insurance Consumer Action, is expected to apply for an order staying its claim pending the outcome of the appeal.

e. FCA Imposes New Measures for Renewals of Home and Motor Insurance

In May 2021, the FCA implemented a package of remedies to address concerns identified in the FCA's 2020 market study on general insurance pricing practices, in relation to pricing and cancellation methods for existing customers at renewal. The new measures, which entered into force on January 1, 2022, require home and motor insurers to offer renewing customers a price which does not exceed the price offered through the same channel to new customers and to offer easier methods of cancelling automatic renewals of policies, alongside additional reporting obligations to the FCA.

VIII. TAX TRENDS AND DEVELOPMENTS AFFECTING INSURANCE COMPANIES

A. 2021 United States Tax Developments

i. Application of the BEAT to Assumption Reinsurance

As discussed in prior years, the introduction of the BEAT (as defined below) in The Tax Cuts and Jobs Act (the "2017 Act") left many issues related to the application of the rules unresolved and resulted in substantial uncertainty as to the United States tax treatment of certain cross-border affiliate reinsurance transactions. As a result, many offshore insurance and reinsurance groups needed to reassess and, in some cases, restructure their cross-border affiliate reinsurance arrangements entered into in a pre-BEAT world. In Private Letter Ruling ("PLR") 202109001, the Internal Revenue Service ("IRS") issued its first BEAT ruling in affirming the industry's expected treatment of an assumption reinsurance transaction.

The base erosion and anti-abuse tax (the "BEAT") is an additional tax imposed under Section 59A of the Internal Revenue Code of 1986, as amended (the "Code") on "applicable taxpayers" in an amount equal to the excess of 10 percent (12.5 percent for taxable years beginning after December 31, 2025) of "modified taxable income" for a taxable year over an amount equal to its regular corporate tax liability for that year reduced by certain credits (the "base erosion minimum tax amount"). "Modified taxable income" generally is computed by adding back the "base erosion tax benefit" derived from a "base erosion payment," and "base erosion payment" includes, among other items, any amount paid or accrued by an "applicable taxpayer" to a "foreign related person" that is deductible to the payor and any reinsurance premium paid to a "foreign related person." An "applicable taxpayer" generally means a corporation with average annual gross receipts for the three-taxable-year period ending with the preceding taxable year of at least $500 million (subject to aggregation rules for certain groups) with a "base erosion percentage" (defined as the aggregate amount of "base erosion tax benefits" for the taxable year divided by the aggregate amount of deductions for such year) of at least three percent. A foreign person is related to the applicable taxpayer if (i) it owns 25 percent or more of the taxpayer, (ii) it is related to the taxpayer or any 25 percent owner of the taxpayer under Code section 267 (related to loss disallowance rules applicable to transactions between related parties) or Code section 707 (related to transactions between partners and partnerships) or (iii) it is related to the taxpayer under the transfer pricing rules of Code section 482. The specific inclusion of reinsurance premiums as base erosion payments was likely a response to arguments that reinsurance premiums were not deductible payments otherwise subject to the base erosion minimum tax rules under the insurance accounting rules of Subchapter L of the Code.

In PLR 202109001, a United States insurance company ("UST") retroceded business on a quote share basis to its indirect non-United States parent ("FP") and also retroceded business pursuant to a quota share funds withheld arrangement to a non-United States affiliate that was an indirect subsidiary of FP ("FA"). The quota share ceded to FA related to some of the same risks assumed by FP but was a different quota share interest. At a later date, FA retroceded the risks it assumed from UST to FP under the same terms and conditions of the original retrocession from UST (other than an adjusted reinsurance premium based upon statutory reserves at the effective date of the FA/FP retrocession).

To reduce operational and administrative burdens, UST, FP and FA entered an agreement pursuant to which FP substituted and replaced FA on the original retrocession from UST (the "Agreement"). UST paid no new consideration under this Agreement.

The IRS ruled that the Agreement constituted an assumption reinsurance agreement, resulting in a sale of the business from FA to FP, and that any amount paid in connection with the Agreement was deemed to occur between FA and FP. The IRS did not characterize the Agreement as a deemed termination of the original UST/FA retrocession agreement due to the change in the counterparty, confirming the

industry's view that the transaction should not be treated as a deemed commutation and recapture by UST followed by a new outbound retrocession transaction to FP.

ii. Affiliate Modco Reinsurance Transactions Constitute Insurance for United States Tax Purposes

In restructuring cross-border affiliate reinsurance arrangements as a result of the BEAT, many offshore insurance and reinsurance groups established, or expanded the business of, non-United States insurers electing to be taxed as United States companies under Internal Revenue Code section 953(d) if the nontax benefits of the affiliate reinsurance warranted the continuation of such arrangements. The IRS, in PLR 202109005, addressed the tax treatment of modified coinsurance ("modco") affiliate reinsurance involving a Code section 953(d) reinsurer.

In PLR 202109005, the taxpayer ("Section 953(d) Co.") was organized outside the United States and regulated as an insurance company in its domicile. Section 953(d) Co. would qualify as a non-life insurance company under Code Section 816 if it were a United States corporation and made the Code section 953(d) election. U.S. affiliates of Section 953(d) Co. insured or reinsured a diversified portfolio of third-party deferred and immediate annuity risks that qualified under Code section 72, and ceded some of these risks to Section 953(d) Co. on a modco basis. Section 953(d) Co. retroceded risks under some of its arrangements with United States affiliates to its indirect foreign parent ("FP") on a modco basis for a stated one-year term with automatic annual renewals for a number of years, unless Section 953(d) Co. provided a timely notice of nonrenewal. However, during the term of the arrangement, Section 953(d) Co. could not terminate the contract with FP if the total amount paid or payable by FP through the termination date would exceed the total amount paid or payable by Section 953(d) Co. through such date. The modco arrangement obligated FP to indemnify Section 953(d) Co. for losses in excess of aggregate specified limits relating to a number of annuity contracts. Section 953 (d) Co. entered the modco arrangement with FP to reduce or eliminate its exposure to such excess losses and to align its exposure to the risks originally assumed with its available capital and the capital of its broader group (including FP).

The payments under the Section 953(d) Co./FP modco agreement were calculated quarterly, with the formula and risk tranches determined by both an actuarial analysis and a third-party transfer pricing analysis, which took into account the reasonable probability of a loss requiring a payment by FP.

The IRS concluded that the Section 953(d) Co./FP modco arrangement was reinsurance for United States tax purposes by applying the four factors typically considered by the courts and the IRS. First, the risks were considered insurance risks, as they were underwritten by life insurance companies issuing annuity contracts and constituted risks commonly assumed by such companies. Second, the risk of loss was determined to be shifted from Section 953(d) Co. to FP, as there was a reasonable probability of loss. Third, the modco arrangement distributed risks, as there was a pooling of covered reinsurance risks covering a number of annuity contracts. Finally, the IRS determined that the modco arrangement was insurance in its commonly accepted sense, in that (1) FP was organized, operated and regulated as an insurance company, (2) FP was adequately capitalized, (3) the modco arrangement was valid and binding, (4) payments under the arrangement were based on actuarial and third-party transfer pricing analyses, (5) payments had been made in accordance with the arrangement's terms, (6) the reinsured contracts covered the risks typically associated with annuity contracts and (7) there was a legitimate business purpose for acquiring reinsurance from FP.

iii. Applicable Financial Statement Ordering Rules

As noted in last year's edition, regulations proposed in 2020 allowed for a more flexible approach to the satisfaction of the active conduct test for a non-United States insurance company to qualify for the insurance company exception to the passive foreign investment company ("PFIC") rules than the widely criticized 2019 proposed regulations. However, the focus on activities of employees and officers and the number of employees and officers drew

a significant amount of industry comment. Submissions to the IRS and the United States Treasury called for an expansion of the facts and circumstances test to take into account activities of independent contractors and other outsourcing arrangements, asserting that the IRS and the United States Treasury should not mandate the manner in which a non-United States insurer conducts its business. Other submissions noted that the perceived abuse of the insurance company exception to the PFIC rules related to overcapitalized insurers that generate excess investment earnings not needed for the insurance business, and the statutory changes made by the 2017 Act (which set forth a minimum "applicable insurance liabilities" to total assets percentage test and required more than half of the business of the insurer to be the issuance or reissuance of insurance and annuity contracts) were adequate to address this perceived abuse without the need for the prescriptive active conduct test in the 2020 proposed PFIC rules.

B. International and U.K. Tax Developments

i. OECD Global Minimum Corporate Tax Rate

A global minimum corporate tax rate of 15% is now likely to be implemented in many jurisdictions in 2023. The Organisation for Economic Co-operation and Development's (OECD) project has gathered pace over the last 12 months and now has the support of 137 jurisdictions, representing in excess of 95% of global GDP. This is likely to affect the corporate structure of many larger international insurance groups.

a. Recap – The Pillar One and Pillar Two Blueprints

In 2019, the OECD set out to tackle the challenges of digitalization: how modern technology has been able to shift the location in which businesses operate, generate profits, and pay their taxes. This manifested into two papers, referred to as the "Pillar One and Pillar Two Blueprints." These were published in Autumn 2020 and consultation among jurisdictions continued soon after.

Pillar One seeks to allocate taxing rights towards market jurisdictions, potentially changing the jurisdiction in which taxes are paid. We anticipate a sector-specific exclusion should mean that there is minimal impact on insurance groups.

Pillar Two seeks to impose a global minimum rate of tax on large corporate groups through a series of interlocking measures (GloBE Rules). The rules should apply to all international groups with consolidated revenue in excess of EUR 750 million. The OECD intends that, unlike in many controlled foreign company regimes (CFC), it should not be possible to structure around the minimum tax rate or avoid it altogether by establishing sufficient economic substance in low-tax jurisdictions.

b. Timeline to Implementation

The OECD published Model Rules, in a form ready for implementation by participating jurisdictions, on December 20, 2021. The European Union (E.U.) followed on December 22, 2022 with its own draft Directive to implement Pillar Two. In the United Kingdom (U.K.), HM Treasury and HM Revenue & Customs have launched a joint consultation on the proposed measures, with a view of legislating them in 2022. This consultation is due to close on April 4, 2022.

The OECD expects the rules to broadly be in place by 2023. The E.U. and U.K. appear to intend to adhere to this timeframe. The E.U.'s Directive has been drafted to come into effect January 1, 2023 with one provision delayed until January 1, 2024. There are some modest de minimis threshold transitional rules which may slightly delay the full effect of the measures coming into effect immediately on those dates.

One unknown is whether the United States Congress will agree to amend the law to conform to the Model Rules. The United States has its own equivalent rules under the BEAT and GILTI regimes, but these are in some respects inconsistent with the OECD's proposed measures. The OECD has noted that the coexistence of the two regimes requires further consideration. In the meantime, there is considerable uncertainty as to how United States-based multinationals will be treated if the Model Rules are adopted by other countries but not by the United States. However, it

is unlikely that United States-headquartered groups would be at an advantage compared with other groups.

c. Global Minimum Tax – the Rules

In summary, the rules are intended to operate as follows:

1. **Do the rules apply?** Firstly, groups should work out if they are caught by the rules and if any group entities are excluded. The main exclusion is for groups with consolidated revenue of less than EUR 750 million, but there are further exclusions, including those for investment funds, pension funds, government entities and vehicles they control.

2. **Calculate GloBE Income/Loss**: The net income or loss of the relevant companies is taken from the financial statements of the group parent company and adjusted as required, e.g., dividend income and some forex gains/losses are excluded.

3. **Calculate Adjusted Covered Taxes**: The corporate income taxes of the relevant entity are taken from the financial statements and certain adjustments are made as required by the rules to address tax/accounting timing differences and the use of losses. Some taxes may need to be allocated to other group companies such as CFC taxes and withholding taxes.

4. **Calculate Effective Tax Rate and Top-Up Tax:** A number of calculations are carried out, the effect of which is that if the tax paid by the group company is less than 15%, an additional top-up tax needs to be paid. There is a substance-based exclusion permitting a small proportion of profits, based on payroll costs and the value of tangible assets held, to be taxed at a rate below 15%. There is also a very modest *de minimis* threshold, applied on a jurisdictional basis.

5. **Income Inclusion Rule ("IIR") and Undertaxed Payments Rule ("UTPR")**: The additional tax should typically be paid by the group parent company under the IIR. However, this may not be possible, e.g., because the group parent is resident in a jurisdiction that has not implemented the IIR. In that case, the tax would be payable by another intermediate parent company. If this is not possible, the tax will become payable by another group company by virtue of UTPR through the denial of an otherwise deductible expense, which thereby gives rise to an equivalent corporate tax liability. Where there are group companies in several jurisdictions that have implemented the UTPR, the tax will be shared among them based on their proportionate share of employees and tangible assets.

d. The Expected Effect on the Insurance Industry

For many years, it has been possible for multinational insurance groups to secure a low effective group tax rate by reinsuring risk to low-tax jurisdictions. Such structures are likely to be affected by the new rules. Multinational groups will have their effective corporate tax rates assessed on a jurisdiction-by-jurisdiction basis. If the taxes paid in any one jurisdiction are less than 15%, the "top-up" tax would need to be paid. This liability could be picked up by a parent company, an intermediate holding company or another group company. This allocation depends on the group structure, where those companies are located, and which jurisdictions implement the relevant rules.

In light of the OECD's project, offshore financial centres (and other low-tax jurisdictions) now have a choice as to whether they wish to impose their own domestic minimum corporate tax rate of 15%. If they choose not to do so, they would in effect cede their taxing rights to other jurisdictions where the "top-up" tax would be payable.

It remains to be seen whether offshore financial centers will be able to maintain their attractiveness to the insurance industry with corporation tax payable at a rate of at least 15%. Many businesses will now be evaluating the benefits of bringing offshore business onshore. Such decisions are likely to depend on a number of factors, including the regulatory regime and personnel. The impact that the COVID-19 pandemic has had on international travel and maintaining offshore corporate residence will be a factor for some groups.

e. Concerns for the Insurance Industry with Global Minimum Tax

While the headline minimum corporate tax rate is 15%, there have been significant concerns across the insurance industry that the effect on insurers and reinsurers could be substantially worse. This is because the OECD intends that the effective tax rate under the GloBE Rules should be based on (adjusted) accounting profit. Preventing groups from calculating their effective tax rates in accordance with local deferred tax and regulatory requirements would give rise to pitfalls, as tax liabilities would likely be understated when calculating the effective tax rate for the relevant period.

The OECD has suggested a number of measures designed to allow groups to "smooth out" potential volatility arising from the taxes imposed under local law or resulting from timing differences in taxation. However, the timing differences are intended to "smooth out" over a much shorter timeframe than is required by many insurance groups. For example, current year tax expense which is not expected to be paid within three years of the close of the fiscal year is excluded from the covered tax calculation. Deferred tax liabilities must be paid within five years, unless they fall within an exception.

These concerns could be addressed if the OECD accepts that insurance groups should be allowed to use a different calculation methodology to determine their effective tax rates. While they have not done so (yet), we note that the OECD intends to allow a relaxation from the strict rules outlined above where the timing difference arises from creation of an insurance reserve. This may represent some progress since the Blueprint papers were published. We remain hopeful that with representations from the insurance industry that by the time the new rules are implemented, they will be in a workable form that does not unfairly penalize the insurance sector.

These concerns aside, it has become clear that this particular project from the OECD is now likely to have a significant impact on the insurance sector.

ii. Expansion of U.K. Stamp Duty Exemption for Certain Insurance-Linked Securities

In March 2021, the U.K. government announced its intention to encourage the use of U.K. securitisation companies as part of plans to create a more attractive regime for the investment management industry. As part of this programme for reform, HM Treasury and HM Revenue and Customs (HMRC) published a consultation paper on reforming the taxation of securitisation companies. This included consultation on the need for changes to the loan capital exemption for U.K. stamp duty (the "loan capital exemption") to provide a specific exemption for securities issued by securitisation companies, including, ILS.

Existing rules have been in place for a number of years to eliminate tax leakage in respect of profits at the level of the issuing vehicle and eliminate interest withholding tax on distributions to investors by such vehicles. However, no measures had been taken until now to specifically address the stamp duty implications of transferring the securities issued by these vehicles. There has been considerable doubt that general exclusions from stamp duty apply to many types of ILS. This potential stamp duty cost is another hurdle in convincing investors that the U.K. regime compares favourably with an offshore structure.

A number of firms, including Willkie, engaged directly with officers at HMRC to discuss the scope of a potential stamp duty exemption. We emphasised the need for any such exemption to be straightforward to apply and be as broad as possible. We explained that from a commercial perspective, it would be far preferable to allow a stamp duty exclusion on all types of ILS – both equity and debt instruments. While these comments were taken on board, unfortunately the initial consultation did not have a broad enough scope to consider a stamp duty exclusion on any equity instruments and so further discussions were limited to debt instruments only. We hope that this can be revisited in the future.

The government has now released the draft regulations (Securitisation Companies and Qualifying Transformer Vehicles (Exemption from Stamp Duties) Regulations 2022)

which introduces a targeted exemption from all stamp duty for the transfer of debt securities issued by securitisation companies and qualifying transformer vehicles. However, the exemption falls short of initial hopes by not applying to notes carrying certain conversion or acquisition rights. Whilst this reflects the existing exceptions to the loan capital exemption, it was anticipated that these exceptions would not apply to ILS arrangements, given the nature of the instruments issued, where returns are linked to the underlying performance of the (re)insurance products. Additionally, the extension of the loan capital exemption has been drafted with a capital markets instrument in mind and does not operate well for private transactions.

Therefore, while potentially helpful to some, our view is that this new exclusion does not go far enough, and we hope that further reform may come as the U.K. government continues to review its domestic regime for ILS.

iii. New U.K. Tax Regime for Qualifying Asset Holding Companies

A new U.K. tax regime for qualifying asset holding companies ("QAHCs") is due to come into force from April 2022. The implementation of this regime, currently passing through the U.K. Parliament, follows two rounds of consultation on the tax treatment of asset holding companies in fund structures, with the aim of enhancing the competitiveness of the U.K. as a location for asset management and investment funds against other jurisdictions (such as Luxembourg) commonly used by investment managers.

QAHCs which meet strict eligibility criteria (see below) and which elect into the regime will benefit from several tax advantages which aim to put investors in QAHCs in broadly the same position from a tax perspective as if they had invested in the underlying investment assets directly. The specific tax advantages which will apply under the regime include:

- exemption on capital gains on the disposal of shares;
- exemption from withholding tax on interest payments to investors in the QAHC;
- deductibility of certain interest payments that would otherwise be disallowed as distributions (for example, interest paid on profit-participating loan notes);
- capital, rather than income, treatment on buybacks of shares by the QAHC; and
- exemption from stamp duty and stamp duty reserve tax on the repurchase by a QAHC of its own shares and loan capital (but no exemption on transfer of shares in the QAHC by investors).

The main eligibility criteria for a company to join the QAHC regime are that (i) the main activity of the company is that of carrying on an investment business (other than such a business whose investment strategy includes investment in publicly listed securities); and (ii) the company is owned at least 70% by "good" investors – this broadly includes diversely held funds, pension schemes, life insurance companies and sovereign investors.

There are, of course, many considerations beyond tax which go into deciding where to establish investment holding structures, but the advantages offered by the new QAHC regime should address many of the most significant tax roadblocks faced in considering a U.K. holding structure. The availability of this new regime may help make the U.K. a viable investment holding jurisdiction for investment managers looking to establish new structures or move away from existing jurisdictions, in particular in light of the recent attention that has been given to consolidating investment operations where possible and addressing new substance requirements, as well as reputational and investor perception issues around the use of offshore vehicles.

iv. VAT Insurance Exemption – Q-GMBH (C-907/19)

In March 2021, the CJEU provided an important update on the application of the exemption from VAT for insurance brokers and insurance agents (the "Insurance Exemption"). The case reaffirms existing case law and is particularly relevant to insurers outsourcing specific services (which

may play a part in mediating insurance offerings to clients) to third parties (such as insurtech providers).

In summary, Q-GmbH was an underwriting agent and offered services in relation to specific types of insurance. These services consisted of (i) a "license fee" component to grant its customer (the insurer) a right to issue insurance policies designed by Q-GmbH; (ii) intermediary functions; and (iii) administrative services, including claims handling. The key question the CJEU was asked to consider was whether the provision of an insurance product to an insurer under a nonexclusive user license (i.e., the first component of the services outlined above) together with placing insurance contracts with customers of the same insurer and managing insurance contracts (including settlement of claims) fell within the Insurance Exemption. The CJEU regarded the intermediary functions as not essential to the provision of the insurance product, so the services were treated as independent and therefore the VAT treatment of each was subject to separate consideration.

Whether the insurance product fell within the Insurance Exemption would, the CJEU held, depend on a two-limb test:

a. Was the insurance product "related to" insurance transactions?

b. Was the insurance product "performed by insurance brokers and insurance agents"?

"Related" was sufficiently broad to not rule out that the grant of a license to a product allowing the insurer to conclude insurance contracts was related to an insurance transaction. However, whether the services were performed by an insurance broker or insurance agent, was not determined on the formal status of the supplier but on a review of the actual content of the services provided. In the case of Q-GmbH, the grant of the licenses was sufficiently disconnected from the conclusion of insurance contracts by the insurer that it could not be said that the insurance product was performed by an insurance broker or insurance agent (regardless of Q-GmbH's status as such with respect to the other services it provided to insurers). The decision was based on the fact that it was for the insurer to take the necessary steps to deal with Q-GmbH in relation to the product, which had a limited-use case for certain classes of insured persons.

v. Consultation on Transitional U.K. Tax Rules for IFRS 17

The government has published draft legislation granting powers to lay regulations to insurance companies to spread the transitional impact of IFRS 17 for tax purposes and revoke the requirement for life insurers to spread acquisition expenses over seven years for tax purposes. HMRC and HM Treasury have been engaging with industry stakeholders to establish the tax impacts of IFRS 17 and have identified that, depending on the types of insurance business written, taxpayers may have a very large one-off transitional accounting profit or loss in the first year IFRS 17 is adopted. There is a risk that such transitional accounting profits will have significant tax cash flow consequences which may have regulatory implications, given the limitations on the extent to which deferred tax assets can be recognized for regulatory purposes. Accordingly, to avoid any material solvency issues the government recognized the need to spread these one-off transitional profits and losses for tax purposes.

However, whilst the government has announced plans to introduce a spreading mechanism to deal with the transitional impacts of IFRS 17, no decisions have been made on the design of that mechanism, including the duration of the transitional spread. Importantly, HMRC opened a consultation on the design for the spreading mechanism in November 2021, which focuses on a number of accounting-specific issues as well as seeking to quantify the transitional impact of implementing IFRS 17. The consultation is open until February 22, 2022; insurers that may be significantly affected by the transition may wish to consider inputting to this consultation.

vi. Replacement of DAC6 with OECD Mandatory Disclosure Rules in the U.K.

As many readers will be aware, as part of the constant march against tax avoidance, the enactment of the so-

called "DAC6" regime by the E.U. in 2018 introduced a requirement for intermediaries and taxpayers across Europe to disclose arrangements meeting a long list of hallmarks (not all of which necessarily suggested tax avoidance activity) to local tax authorities.

Despite the U.K.'s exit from the E.U., the U.K. was expected to continue to apply the DAC6 regime when reporting commenced in January 2021. However, in an unexpected last-minute change, following agreement on the U.K.-E.U. Trade and Cooperation Agreement, the U.K. government restricted the application of DAC6 in the U.K. to cover only those hallmarks concerning avoidance of the Common Reporting Standard ("CRS") and obscuring beneficial ownership, on the basis that these remaining aspects of DAC6 will be replaced with new domestic mandatory disclosure rules ("MDR"), based on OECD model rules.

The government has now published draft legislation implementing U.K. MDR, which closely follows the OECD model, with the expectation that these will enter into force (and the remnants of DAC6 repealed) from mid-2022.

While the new regime is subject to consultation, it will be a distinct regime from DAC6 and organizations should therefore consider their compliance obligations carefully. The U.K. MDR reporting hallmarks themselves are very similar to their equivalents under DAC6 (which may particularly affect insurance groups that utilise offshore structures and which may have the effect of obscuring the identification of the beneficial ownership of certain entities), but there are important procedural differences. Among other points, reporting under U.K. MDR will no longer be exempted because of a report made by another intermediary in an E.U. member state, and a look-back period commencing in 2014 applies to promoters in respect of CRS avoidance arrangements. It would therefore be advisable for intermediaries and taxpayers to review their compliance processes in advance of the new regime coming into force to make any necessary adjustments before reporting commences.

vii. Reporting of Uncertain Tax Treatments in the U.K.

Finally, large businesses in the U.K. should be aware of new rules requiring the notification of uncertain tax treatments to HMRC with effect for any returns filed on or after April 1, 2022. While these rules are unlikely to have a direct impact on the tax affairs of businesses, they do impose additional compliance obligations, and it is expected that reports could be used by HMRC to open enquiries. For these purposes, large businesses are broadly defined as those with U.K. turnover of more than £200 million or a U.K. balance sheet total of more than £2 billion. International insurance groups that have a U.K. parent will therefore be within the scope of the new rules regardless of their presence in the U.K..

In summary, businesses in scope of the rules will be required to notify HMRC if they adopt a tax position and either (i) the business has recognised a provision in its accounts with respect to that position or (ii) that position relies on an interpretation or application of the law that is not in accordance with HMRC's known view. A third trigger was proposed in the draft legislation published in July 2021 but omitted from the latest draft of the Finance Bill published in November 2021. However, the government is considering its potential inclusion at a later date. This third limb is particularly problematic for taxpayers because it would create an obligation to notify where there is a substantial possibility that a tribunal or court would find the taxpayer's position to be incorrect in material respects.

Insurance or reinsurance groups with U.K. activities may therefore wish to review their compliance processes to take account of these new rules. In particular, groups with reinsurance arrangements involving "low tax" jurisdictions should take care to ensure the tax position adopted in respect of these arrangements is consistent with HMRC's known guidance. Although a "tax at stake" threshold of £5 million for the relevant position should mean that the obligation is only in play for transactions where detailed tax advice is being or has been taken, groups should nonetheless assess their existing transfer pricing policies to ensure they are up to date and fully reflect the underlying commercial transactions, as well as making sure these and other tax policies are consistent with HMRC's guidance.

IX. GLOSSARY

- "2017 Act" means the United States Tax Cuts and Jobs Act of 2017.
- "2019 Expectations" means PRA's Supervisory Statement SS3/19 "Enhancing banks' and insurers' approaches to managing the financial risks from climate change."
- "2020 Holding Company Act Amendments" means the amendments to the Model Insurance Holding Company System Regulatory Act and Model Regulation adopted by the NAIC in December 2020.
- "2021 Report" means Prudential Regulation Authority's (PRA) second Climate Change Adaptation Report under the Climate Change Act 2008.
- "2021 Trial Implementation" means the NAIC's Trial Implementation of the GCC template that was adopted in 2020.
- "ABS" means asset-backed securities.
- "ACRA" means Athene Co-Invest Reinsurance Affiliate.
- "Adjusted ECA" means Adjusted Economic Capital Assessment.
- "AG 48" means the NAIC Actuarial Guideline 48.
- "APMs" means alternative performance measures.
- "BEAT" means the United States Base Erosion and Anti-Abuse Tax.
- "Brexit" means the U.K. decision to, and procedure to, withdraw from the E.U.
- "CAT" means the U.K. Competition Appeal Tribunal.
- "CCIS" means Capita Commercial Insurance Services.
- "CD" means corporate division.
- "CDI" means the California Department of Insurance.
- "CDPQ" means "Caisse de dépôt et placement du Québec" or "Quebec Deposit and Investment Fund."
- "CDR" means Core Data Record.
- "CFC" means a controlled foreign corporation under United States tax law.
- "CFIUS" means Committee on Foreign Investment in the United States.
- "CI" means Collateralized Insurer.
- "CIL" means Coming into Line.
- "CIGA" means the U.K. Corporate Insolvency and Governance Act 2020.
- "CJEU" means the Court of Justice of the E.U.
- "CMA" means the U.K. Competition and Markets Authority.
- "Code" means the Internal Revenue Code of 1986, as amended.
- "Commission" means the United States Securities and Exchange Commission.
- "Covered Agreements" means the Bilateral Agreement Between the United States and E.U. on Prudential Measures Regarding Insurance and Reinsurance and the Bilateral Agreement Between the United States of America and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance.
- "COVID-19" or the "COVID-19 pandemic" means the novel coronavirus COVID-19 pandemic.
- "Credit for Reinsurance Models" means the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786).
- "Dodd-Frank Act" means the Dodd-Frank Wall Street Reform and Consumer Protection Act passed in 2010.

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- "DOJ" means the United States Department of Justice.
- "DUA" means delegated underwriting authority.
- "EEA" means the European Economic Area.
- "EIOPA" means the European Insurance and Occupational Pensions Authority.
- "EMTN" means Euro Medium Term Notes.
- "ESG" means environmental, social and corporate governance.
- "ESMA" means the European Securities and Markets Authority.
- "E.U." means the European Union.
- "Exchange Act" means the Securities Exchange Act of 1934, as amended.
- "Fall National Meeting" means the 2021 Fall National Meeting of the National Association of Insurance Commissioners, which was held from December 11-16, 2021.
- "FCA" means the U.K. Financial Conduct Authority.
- "FDI" means foreign direct investment.
- "FINRA" means the Financial Industry Regulatory Authority.
- "FIO" means the Federal Insurance Office.
- "FRC" means the U.K. Financial Reporting Council.
- "FSOC" means the Financial Stability Oversight Council.
- "GAAP" means United States generally accepted accounting principles.
- "GCC" means group capital calculation.
- "GILTI" means the United States global intangible low tax income regime.
- "GloBE" means the Global Anti-Base Erosion Proposal of the OECD.
- "IA" means the Investment Association.
- "IAIS" means the International Association of Insurance Supervisors.
- "ICGN" means the International Corporate Governance Network.
- "IFRS" means international financial reporting accounting standards.
- "ILS" means insurance-linked securities.
- "IMA" means the Investment Management Agreement.
- "IPO" means initial public offering.
- "IRS" means the United States Internal Revenue Service.
- "JLT" means Jardine Lloyd Thompson.
- "LPS" means limited-purpose subsidiaries.
- "LV" means Liverpool Victoria.
- "MAR" means the E.U. Market Abuse Regulation.
- "MCR" means minimum capital requirements.
- "MD&A" means Management Discussion and Analysis.
- "MWG" means the NAIC's Macroprudential Working Group.
- "NAIC" means the National Association of Insurance Commissioners.
- "NYDFS" means the New York State Department of Financial Services.
- "OECD" means the Organisation for Economic Co-operation and Development.
- "ORSA" means Own Risk Solvency Assessment.

IX. Glossary

- "OTPP" means the Ontario Teachers Pension Plan.
- "Part VII" means the relevant part of the Financial Services and Markets Act 2000, which governs the court-sanctioned transfer of some or all of the insurance policies of one company to another.
- "PCW" means price comparison website.
- "PFIC" means a passive foreign investment company under United States tax law.
- "PII" means Personal Identifiable Information.
- "PLR" means Private Letter Ruling.
- "PRA" means the U.K. Prudential Regulation Authority.
- "QAHCs" means qualifying asset holding companies.
- "R&W Insurance" means Representation and Warranty Insurance.
- "RBC" means Risk-Based Capital.
- "RegFlex Agenda" means the Fall 2021 Unified Agenda of Regulatory and Deregulatory Actions.
- "SAPWG" means the NAIC's Statutory Accounting Principles Working Group.
- "SCR" means Solvency Capital Requirement.
- "SEC" means the United States Securities and Exchange Commission.
- "SECR" means Streamlined Energy and Carbon Reporting.
- "Securities Act" means the Securities Act of 1933, as amended.
- "SFCR" means the Solvency and Financial Condition Report.
- "Solar Winds" means SolarWinds, Inc., a major U.S. information technology firm that was the subject of a cyberattack that spread to its clients and went undetected for months, and which was first reported by Reuters in December 2020.
- "Solvency II" means the European Union's Solvency II Directive (Directive 2009/138/EC), which went into effect on January 1, 2016.
- "SPAC" means Special Purpose Acquisition Company.
- "SPV" means special purpose vehicles.
- "SSAP" means Statements of Standard Accounting Practice.
- "TFCD" means the Task Force on Climate-Related Disclosures.
- "The Task Force" means the Sustainable Markets Initiative Insurance Task Force.
- "TPR" means The Pensions Regulator.
- "Treasury" means the United States Treasury Department and the IRS.
- "UTPR" means the Undertaxed Payment Rule.
- "VAT" means value added tax.
- "WAOIC" means the Washington State Office of the Insurance Commissioner.

Willkie's Insurance Transactional and Regulatory Practice

Willkie's Insurance Transactional and Regulatory Practice is one of the preeminent practices in the industry, representing insurance companies, investment banks, sponsors and other financial institutions in transactions involving M&A, ILS, finance, excess reserves, longevity, de-risking and traditional capital markets, as well as providing advice on regulatory and tax matters involving insurers in the United States, U.K., Lloyd's, Europe and Bermuda.

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