

CLIENT ALERT

NAIC Report: 2022 Fall National Meeting

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AUTHORS

Kara Baysinger | **Leah Campbell** | **Stephanie Duchene** | **Matthew J. Gaul**
Michael Groll | **David Heales** | **Donald B. Henderson, Jr.** | **David G. Nadig**
Allison J. Tam

The National Association of Insurance Commissioners (the “[NAIC](#)”) held its 2022 Fall National Meeting (the “[Fall National Meeting](#)”) from December 12-16, 2022 in a hybrid format, with attendees participating virtually or in person in Tampa, Florida.

NAIC President and Idaho Insurance Director Dean L. Cameron opened the Fall National Meeting with his reflections on the NAIC’s key priorities and activities during the past year, including promoting diversity and inclusion in the insurance sector; creating connectivity, collaboration and innovation among regulators, insurers and policyholders; and working towards uniformity in state-based and international systems of insurance regulation.

Highlights from the Fall National Meeting include:

- The Macroprudential (E) Working Group continues to make progress to address the list of “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity Owned Insurers,” which involves NAIC review of a variety of topics, including insurer acquisition procedures, related party agreements, insurer investments, such as collateralized loan obligations, and reinsurance arrangements.
- The Statutory Accounting Principles (E) Working Group (“[SAPWG](#)”) exposed a new agenda item for discussion addressing statutory accounting treatment of a net negative interest maintenance reserve (“[IMR](#)”) balance. This is a time-sensitive matter since life insurance companies are concerned about the negative consequences associated with IMR treatment in a rapidly rising interest rate environment.

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- SAPWG is now targeting a January 1, 2025 effective date for changes related to the Bond Project, and has exposed for comment revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities* and related materials, which are available [here](#).
- The Valuation of Securities (E) Task Force (“[VOSTF](#)”) adopted an amendment to the P&P Manual to update instructions for related party and subsidiary, controlled and affiliated investments (“[Related Party Investments](#)”), and SAPWG adopted and exposed revisions to clarify statutory accounting guidance on related party reporting.
- VOSTF also exposed for comment a proposal to define “Structured Equity and Funds” investments (e.g., rated notes) and require such investments to be filed with the SVO for review, which is available [here](#).
- The Innovation, Cybersecurity, and Technology (H) Committee announced a plan to develop a regulatory framework for the use of artificial intelligence and machine learning (“[AI/ML](#)”) by the insurance industry in the form of a model interpretive bulletin.
- The Privacy Protections (H) Working Group announced its intention to expose an initial draft of a new NAIC *Consumer Privacy Protections Model Act (#674)* in late January 2023.

NAIC members also elected the following officers for 2023:

- **President:** Missouri Insurance Director Chlora Lindley-Myers
- **President-Elect:** Connecticut Insurance Commissioner Andrew Mais
- **Vice President:** North Dakota Insurance Commissioner Jon Godfread
- **Secretary-Treasurer:** Virginia Commissioner of Insurance Scott A. White

The report below further summarizes key activities at the Fall National Meeting, and certain interim conference calls and other developments leading up to the Fall National Meeting, that may be of interest to our clients in the insurance industry.

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GLOSSARY

“ACLI” mean the American Council of Life Insurers.

“Bond Project” means the NAIC’s principles-based bond project, which aims to clarify what should be considered and reported as a bond on Schedule D-1 (Long-Term Bonds) of an insurance company’s statutory financial statements and to improve accounting and reporting.

“Certified Reinsurer” means a reinsurer that is domiciled in a “Qualified Jurisdiction” (meaning a non-U.S. jurisdiction listed on the NAIC list of “Qualified Jurisdictions” established pursuant to the NAIC Process for Evaluating Qualified and Reciprocal Jurisdictions) that is eligible to qualify for reduced reinsurance collateral pursuant to the 2019 amendments to the Credit for Reinsurance Models.

“CLO” means collateralized loan obligation.

“ComFrame” means the Common Framework for the Supervision of Internationally Active Insurance Groups developed by the IAIS.

“Covered Agreements” means the U.S./EU Covered Agreement and the U.S./UK Covered Agreement, both as defined below.

“Credit for Reinsurance Models” means the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786).

“Dodd-Frank” means the Dodd-Frank Wall Street Reform and Consumer Protection Act.

“Financial Analysis Handbook” means the Financial Analysis Handbook published and maintained by the NAIC.

“Financial Condition Examiners Handbook” means the Financial Condition Examiners Handbook published and maintained by the NAIC.

“FIO” means the Federal Insurance Office of the United States Department of the Treasury.

“FSB” means the Financial Stability Board, a nonprofit international body composed of representatives from international jurisdictions, as well as representatives from international financial institutions and international standard-setting, regulatory, supervisory and central bank bodies, that monitors and makes recommendations about the global financial system.

“G-SII” means Global Systemically Important Insurer, as designated by the FSB.

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“Holistic Framework” means the framework developed by the IAIS to assess and mitigate systemic risk in the global insurance sector.

“IAIG” means an internationally active insurance group.

“IAIS” means the International Association of Insurance Supervisors.

“ICS” means the Insurance Capital Standard being developed by the IAIS to apply to IAIGs.

“LST” means Liquidity Stress Test, which is an annual filing by a life insurance company that satisfies the test’s scope criteria pursuant to the relevant state’s insurance holding company laws. The LST filing provides an insurance regulator with quantitative and qualitative insights for macroprudential surveillance.

“LATF” means the Life Actuarial (A) Task Force.

“Market Regulation Handbook” means the Market Regulation Handbook published and maintained by the NAIC.

“NFIP” means the National Flood Insurance Program, managed by the Federal Emergency Management Agency.

“ORSA” means an Own Risk and Solvency Assessment.

“ORSA Guidance Manual” means the ORSA Guidance Manual published and maintained by the NAIC.

“P&P Manual” means the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

“RBC” means risk-based capital.

“RBC Instructions” means the RBC instructions adopted by the NAIC, as such RBC instructions may be amended by the NAIC from time to time in accordance with the procedures adopted by the NAIC.

“Reciprocal Jurisdiction Reinsurer” means a reinsurer that is domiciled in a “Reciprocal Jurisdiction” (meaning a non-U.S. jurisdiction listed on the NAIC list of “Reciprocal Jurisdictions” established pursuant to the NAIC Process for Evaluating Qualified and Reciprocal Jurisdictions) that is eligible to qualify for zero reinsurance collateral pursuant to the 2019 amendments to the Credit for Reinsurance Models.

“SSAP” means Statement of Statutory Accounting Principles.

“SVO” means the NAIC’s Securities Valuation Office.

“Summer National Meeting” means the NAIC 2022 Summer National Meeting.

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“U.S./EU Covered Agreement” means the Bilateral Agreement Between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on September 22, 2017.

“U.S./UK Covered Agreement” means the Bilateral Agreement Between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on December 11, 2018.

“Valuation Manual” means the Valuation Manual published and maintained by the NAIC.

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I. Private Equity and the Insurance Industry

A. Macroprudential Working Group Provides Updates on Private Equity Considerations Work Plan

At the Summer National Meeting, the Macroprudential (E) Working Group (the “MWG”) of the NAIC adopted a plan to address the list of “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity Owned Insurers” (the “Considerations”), as reported [here](#). The MWG and other working groups shared updates regarding the status of the Considerations at the Fall National Meeting, as set forth below:

- Consideration One: 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, 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).

Status: The MWG referred this Consideration to the Group Solvency Issues (E) Working Group (“GSIWG”). At the Fall National Meeting, GSIWG received and discussed this referral with a focus on enhancing training and increasing uniformity for state insurance regulators reviewing insurance company acquisition (“Form A”) transactions. GSIWG directed NAIC staff to develop advanced financial regulatory training opportunities for regulators, and requested that regulators identify and share Form A “best practices” with other states and the NAIC to incorporate in future training.

- Consideration Two: Control is presumed to exist where ownership is greater than or equal to 10%, but control and conflict of interest considerations may exist with less than 10% ownership. For example, a party may exercise a controlling influence over an insurer through board and management representation or contractual arrangements, including non-customary minority shareholder rights or covenants, investment management agreement (“IMA”) provisions, such as onerous or costly IMA termination provisions, or excessive control or discretion given over the investment strategy and its implementation. Asset-management services may need to be considered in addition to ownership when assessing and considering controls and conflicts.

Status: This Consideration was also referred to GSIWG since it overlaps with Consideration One above. At the Fall National Meeting, GSIWG members expressed a goal to come to a consensus on when “control” of an insurer may be found aside from the “bright line rule” of 10% ownership of voting securities. GSIWG will assemble a drafting group of regulators to develop ideas for training regulators and sharing best practices. GSIWG members also discussed that information regarding disclaimers of control should be shared as part of this process, as well as creating a contact list of state regulators with particular expertise.

GSIWG will prioritize its work on Considerations One and Two in early 2023.

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- **Consideration Three:** The material terms of an IMA and whether they are arm's length or include conflicts of interest—including the amount and types of investment management fees paid by the insurer, the termination provisions (how difficult or costly it would be for the insurer to terminate the IMA) and the degree of discretion or control of the investment manager over investment guidelines, allocation and decisions.

Status: The MWG referred this Consideration to the Risk-Focused Surveillance (E) Working Group (“RFSWG”), which discussed the referral during an interim meeting on November 1, 2022. The RFSWG has an ongoing project to update general guidance in the Financial Analysis Handbook and Financial Condition Examiners Handbook regarding affiliated service agreements, particularly agreements with market-based fee structures, as we reported [here](#). A small drafting group has met throughout 2022 to discuss the revisions and intends to share a proposal with the full RFSWG and expose it for public comment in early 2023. The RFSWG agreed to defer its review of Consideration Three until the current project is completed.

- **Consideration Four:** Owners of insurers, regardless of type and structure, may be focused on short-term results that may not be in alignment with the long-term nature of liabilities in life insurance products. For example, investment management fees, when not fair and reasonable, paid to an affiliate of the owner of an insurer may effectively act as a form of unauthorized dividend in addition to reducing the insurer's overall investment returns. Similarly, owners of insurers may not be willing to transfer capital to a troubled insurer.

Status: At the Summer National Meeting, the NAIC adopted a new actuarial guideline for asset adequacy testing, *Actuarial Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves* (“AG 53”), which addresses this Consideration and is described in greater detail [here](#). The MWG also referred this Consideration to the RFSWG for review with respect to affiliated agreements and fees, including potentially suggesting guidance for the appropriate entities to provide capital maintenance agreements. The RFSWG will turn to this referral after its general affiliate agreement guidance project is completed, as discussed above.

- **Consideration Five:** 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, including, but not limited to, PE owners. For example, a reliance on third party administrators due to the acquiring firm's lack of expertise may not be sufficient to administer the business. Such practices could lead to lapse, early surrender, and/or exchanges of contracts with in-the-money guarantees and other important policyholder coverage and benefits.

Status: There have been no updates on this Consideration since the Summer National Meeting, but the MWG intends to focus on it in 2023.

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- Consideration Six: No uniform or widely accepted definition of PE and challenges in maintaining a complete list of insurers' material relationships with PE firms. This definition may not be required as the considerations included in this document are applicable across insurance ownership types.

Status: As previously reported [here](#), no action will be taken on this Consideration since regulators agree the focus should be on activities and not specific types of owners.

- Consideration Seven: The lack of identification of related party-originated investments (including structured securities). This may create potential conflicts of interests and excessive and/or hidden fees in the portfolio structure, as assets created and managed by affiliates may include fees at different levels of the value chain—for example, a CLO, which is managed or structured by a related party.

Status: Per the MWG's work plan, the related party transaction reporting requirements effective for year-end 2022, as discussed in Section II.C below, will address this Consideration. The RFSWG's work surrounding affiliate agreements may also touch on this Consideration.

- Consideration Eight: Although the NAIC's Annual and Quarterly Statement blanks include affiliated investment disclosures, it is not easy to identify underlying affiliated investments and/or collateral within structured security investments. Additionally, transactions may be excluded from affiliated reporting due to nuanced technicalities. Regulatory disclosures may be required to identify underlying Related Party Investments and/or collateral within structured security investments. This would include, for example, loans in a CLO issued by a corporation owned by a related party.

Status: The approach to this Consideration overlaps with Consideration Seven, above, regarding SAPWG's new reporting requirements, and Consideration Ten, below, related to privately structured securities.

- Consideration Nine: Broader considerations exist around asset manager affiliates (not just PE owners) and disclaimers of affiliation avoiding current affiliate investment disclosures.

Status: The MWG has stated that the Schedule Y, Part 3 reporting requirement, which went into effect for year-end 2021 to identify all entities with a greater than 10% ownership regardless of whether a disclaimer is in place, addresses this Consideration. SAPWG's ongoing Bond Project, discussed in Section II.B below, further addresses this Consideration.

- Consideration Ten: The material increases in privately structured securities (both by affiliated and non-affiliated 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.

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Status: The new AG 53 addresses this Consideration, since it includes disclosure requirements for the referenced risks. The MWG also referred this Consideration to VOSTF, which (along with related NAIC groups) has been working on a project to determine appropriate RBC charges for CLOs held by insurers. Since the Summer National Meeting, regulators' focus has expanded from a concern with RBC arbitrage for CLOs (i.e., under present RBC formulas, an insurer's ownership of every tranche of a CLO may have a lower risk weighting than ownership of the underlying assets, even if the insurer is in the same economic position as direct ownership) to a broader assessment of the ways in which the risk profile of these structured securities differs from that of the underlying collateral and warrants different RBC treatment. VOSTF's stated goal is to allow insurers to continue to participate in CLO markets while avoiding investment structures that pose risks to policyholders.

At the Fall National Meeting, VOSTF exposed for comment until January 6, 2023 a proposed amendment to the P&P Manual to assign the NAIC's Structured Securities Group the responsibility of financially modeling CLO investments for the assignment of NAIC Designations (i.e., SVO ratings), as discussed in Section II.C below. VOSTF also exposed a proposed CLO modeling methodology for comment until February 13, 2023. The current VOSTF exposures are available [here](#). The methodology is based on an evaluation of all debt and equity tranches of a CLO under stress scenarios, but does not yet include the scenarios, which will be the subject of more in-depth discussions once the methodology is agreed upon. VOSTF anticipates that these changes would be implemented with an effective date of January 1, 2024.

With respect to RBC charges for CLOs, VOSTF sent a referral to the Capital Adequacy (E) Task Force and its RBC Investment Risk and Evaluation (E) Working Group, requesting that they consider adding two new RBC factors to account for the tail risk in any structured finance security. The referral also recommends adding NAIC Designation Categories (e.g., 6.A, 6.B and 6.C) with possible interim RBC factors of 30%, 75% and 100%, respectively. The proposed RBC factors would only be an interim step until structured finance securities can be studied more fully. At the Fall National Meeting, the RBC Investment Risk and Evaluation (E) Working Group exposed this referral, available [here](#), for a comment period ending January 27, 2023, noting that evaluating appropriate RBC treatment of asset-backed securities is its top priority for 2023.

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

Status: The MWG referred this Consideration to VOSTF, which previously formed an *ad hoc* group to address this in what is expected to be a multi-year project. The MWG reported at the Fall National Meeting that there have been no updates with respect to this Consideration, although VOSTF noted that it expects to have agenda items related to credit rating providers at upcoming meetings in 2023. Additional updates related to initiatives at VOSTF are discussed in Section II.D below.

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- Consideration Twelve: The trend of life insurers in pension risk transfer (“PRT”) business and supporting such business with the more complex investments outlined above.

Status: The MWG expects that certain prior NAIC actions will address this Consideration, including: (i) the new AG 53, which generally aims to ensure claims-paying ability with respect to complex assets; (ii) the new charge added to the 2021 Life Risk-Based Capital Formula related to longevity risk transfer business, which regulators will monitor; and (iii) modifications to the reporting of PRT transactions adopted by SAPWG in May 2021. LATF is also considering the development of PRT/longevity risk mortality factors. In addition, NAIC staff is holding discussions with Department of Labor representatives and industry groups, which will conclude in 2023.

- Consideration Thirteen: 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.

Status: The MWG reported at the Fall National Meeting that it has been focused on this Consideration and has held several confidential meetings with insurance groups and regulators and will complete those meetings in early 2023. The goal is to develop a “template” to allow regulators to “easily identify and understand the true economic impacts” of such reinsurance transactions.

B. Other NAIC Macroprudential Initiatives

1. *Liquidity Stress Test*

The Financial Stability (E) Task Force and the MWG jointly adopted the 2022 LST framework, which remains substantively unchanged from last year and will be used for life insurers’ filings in 2023. The LST’s primary objective from a macroprudential standpoint is to assess the impact of potential asset sales by life insurers on the capital markets under various stress scenarios.

Justin Schrader (NE), Chair of the MWG, provided a high-level summary of the 2021 LST results, which are based on filings by 22 life insurance groups representing approximately 60% of the life insurance industry’s cash and invested assets. In the 2021 LST, the largest asset sales came from the investment grade corporate and U.S. Treasury and Agency categories, which is consistent with the 2020 LST results. The aggregated results from the 2021 LST are encouraging as NAIC staff determined that the “2021 LST filings continue to show the amount of potential assets sold would not be significant given historical daily trading volumes by asset type.”

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II. Financial Condition Regulation

A. NAIC to Consider Industry Request Regarding Statutory Accounting Treatment of Negative IMR

At the Fall National Meeting, SAPWG and LATF discussed an October 31, 2022 letter from the ACLI, available [here](#), requesting urgent action to address industry concerns with current statutory accounting guidance requiring the nonadmittance of negative IMR in a rising interest rate environment (the “[ACLI Letter](#)”). Background on the statutory accounting concept of IMR and a summary of the related discussions at meetings of SAPWG and LATF is provided below.

1. *Background: IMR in Statutory Accounting and the ACLI Letter*

IMR is a statutory accounting concept introduced in 1992 that applies to short- and long-term fixed income investments. Life insurers must establish an IMR balance on their statutory financial statements for realized gains and losses resulting from changes in the overall level of interest rates between the time of purchase and sale of these investments. To prevent immediate balance sheet fluctuations that would misstate the insurer’s financial position, IMR requires that gains or losses be amortized over a bond’s remaining term to maturity, notwithstanding a sale, rather than being reflected in income immediately.

Negative IMR is generated when bonds are sold at a capital loss due to rising interest rates. Currently, a net negative IMR balance is disallowed under statutory accounting. This has not previously been an issue for insurers because IMR’s introduction was followed by a falling interest rate environment for many years. However, with the current rapid rise in interest rates, some life insurers face diminishing net positive IMR balances and, due to the disallowance of net negative IMR, balance sheet treatment of capital losses that may not accurately reflect their surplus and financial strength. The ACLI Letter accordingly proposed the allowance of a net negative IMR balance, and requested urgent action by SAPWG to address this issue by year-end 2022.

2. *SAPWG to Consider IMR in 2023 and Encourages Affected Insurers to Seek Permitted Practices for Year-End 2022*

At the Fall National Meeting, NAIC staff presented, and SAPWG exposed for comment, a new SAPWG agenda item (Ref# 2022-19 (SSAP No. 7 – IMR)) to consider IMR. The agenda item includes an assessment by NAIC staff of 2020-2022 IMR balances, indicating the growing significance of the issue raised in the ACLI Letter. Specifically, the assessment indicated that, since year-end 2021, 71 life insurers have gone from a net positive IMR balance to a zero IMR balance on the liabilities page (presumably, these insurers would list a net negative IMR balance on the assets page if allowed).

SAPWG Chair Dale Bruggeman (OH) suggested that any decision to allow a net negative IMR balance would need “guardrails” to alleviate regulators’ concerns over unrestricted treatment of a deferred loss as an asset, and could include requirements as to what can be done with the proceeds of a bond sale (e.g., whether replacement bonds must have the

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same term), restrictions on whether a deferred loss asset may be included in “normal” surplus (to avoid dividends being paid out of a deferred loss), or special treatment in circumstances where insurers are hedging with derivatives. SAPWG plans to compile a list of possible guardrails, including information from state regulators on restrictions imposed when permitted practices are issued. Industry members were asked to comment on what the list should include and to share details of any unique considerations they face. A joint, regulator-only meeting of SAPWG and LATF is expected to be held prior to the 2023 Spring National Meeting.

Responding to industry’s request for relief by year-end 2022, Mr. Bruggeman encouraged affected life insurers to speak with their domestic state insurance regulators and seek a permitted practice, if applicable. Comments from regulators at both SAPWG and LATF meetings indicate that some companies have already started this process.

3. *IMR-Related Activity at LATF*

As it considers the statutory accounting implications of the IMR issue described above, SAPWG emphasized that it will need to work with LATF, which has recently considered short-term guidance for purposes of asset adequacy testing and principle-based reserving with respect to IMR. At the Fall National Meeting, LATF adopted a memorandum developed by NAIC staff in response to the ACLI Letter. The memorandum acknowledges that certain references to IMR in the Valuation Manual and RBC Instructions do not currently address net negative IMR balances, and recommends that for year-end 2022, IMR allocation in sections VM-20, VM-21 and VM-30 of the Valuation Manual should be “principle-based,” “appropriate,” and “reasonable,” and that companies should not be required to allocate any non-admitted portion of IMR for purposes of these sections unless granted a relevant permitted practice. LATF plans to circulate the memorandum to the chief financial examiners of each state regulator.

B. Bond Project Update

SAPWG is now targeting a January 1, 2025 effective date (revised from January 1, 2024) for changes related to the Bond Project, which aims to clarify which securities should be reported as a bond on Schedule D-1 (Long-Term Bonds) of an insurance company’s statutory financial statements and to improve accounting and reporting of these investments.

At an interim meeting held on November 16, 2022, SAPWG exposed revised drafts of *SSAP No. 26R—Bonds* (“SSAP No. 26R”) and *SSAP No. 43R—Asset-Backed Securities* (“SSAP No. 43R”) reflecting the current bond definition and related guidance for a comment period ending on February 10, 2023. Key revisions include: (i) the addition of transition guidance for reclassifying securities from Schedule D-1 to the newly applicable schedules when needed; and (ii) changes to address interested party concerns that embedded derivatives could have been excluded from bond treatment under the previously exposed version of the amendments.

At the November 16, 2022 interim meeting, SAPWG also exposed for comment until February 10, 2023 a document setting forth changes to align other SSAPs with the bond definition.

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At the Fall National Meeting, SAPWG exposed an updated issue paper and three additional documents relating to the Bond Project with the following changes, which are exposed for comment until February 10, 2023:

- The revised issue paper reflects the current status of the Bond Project and includes updated guidance on the treatment of feeder funds. Consistent with the previous draft, the issue paper concludes that a structure representing a feeder fund should not automatically qualify for or be precluded from bond classification (i.e., substance over form should be determinative). The revisions include language regarding elements indicating that such an arrangement may not be a debt-backed structure in substance (e.g., discretion of an underlying fund manager to withhold distribution of the underlying cash flows).
- SAPWG exposed revisions to the annual statement general instructions, new Schedule D, Part 1, Section 1 (detailing issuer credit obligations), and new Schedule D, Part 1, Section 2 (detailing asset-backed securities) for public comment.
- SAPWG also exposed a document identifying where other schedules and reporting instructions reference bond reporting and may require corresponding revisions.

All exposure documents related to the Bond Project are available [here](#) for review.

C. Update on Related Party Reporting

1. *P&P Manual Amended to Update Instructions for Related Party Investments*

At the Fall National Meeting, VOSTF adopted an amendment to the *Subsidiary, Controlled and Affiliated (SCA) Debt or Preferred Stock Investments* section of the P&P Manual. The amendment results from SAPWG's recent adoption of revisions to SSAP No. 25—*Affiliates and Other Related Parties* ("[SSAP No. 25](#)") and SSAP No. 43R, which clarify the definition of "affiliate" and incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of whether they meet the "affiliate" definition, as we reported [here](#). Interested parties had commented that if investments previously reported as unaffiliated are in fact required to be reported as affiliated, they could lose their filing exempt status with the SVO, which prompted SAPWG to refer the matter to VOSTF.

The P&P Manual amendment: (i) clarifies that the *Subsidiary, Controlled and Affiliated (SCA) Debt or Preferred Stock Investments* section refers not only to affiliate transactions in which there is direct or indirect control between the reporting insurance company and a transaction entity, but also to related parties where relationships other than control, as listed in SSAP No. 25, might exist; (ii) expands the definition of SCA and related party debt to include structures in which the underlying credit exposure would qualify as a related party pursuant to SSAP No. 43R, even if the issuer is not a related party or SCA; and (iii) clarifies the circumstances under which such investments are eligible for filing exemption.

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2. *Clarifications to Statutory Accounting Guidance on Affiliated and Related Party Reporting*

SAPWG exposed for comment until February 10, 2023 revisions to SSAP No. 25, available [here](#) for review, to clarify that any invested asset held by a reporting entity that is issued by an affiliated entity, or that includes the obligations of an affiliated entity, is an affiliated investment. SAPWG also adopted revisions to footnotes in SSAP No. 25 and SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities* to clarify that, for foreign open-end investment funds, ownership percentage is not deemed to reflect control unless the entity actually controls with the power to direct the underlying company.

D. Valuation of Securities

At the Fall National Meeting, VOSTF discussed several key initiatives related to the SVO's credit quality assessment of investments made by insurance companies, in addition to the topics of Related Party Investments and CLOs, as described in Section I.A of this report.

1. *Structured Equity and Funds*

VOSTF exposed for comment a proposed amendment to the P&P Manual, available [here](#), to add instructions for “Structured Equity and Funds,” in response to the SVO's concerns after reviewing certain such investments, which were described in a staff memo as “investments in notes issued by, and of equity or limited partnership interests in, a special purpose vehicle, trust, limited liability company, limited partnership or other legal entity that operates as a feeder fund which itself invests, directly or indirectly, in one or more funds or other equity investments” (e.g., rated notes). Historically, such structures have qualified as bonds and bypassed reporting and RBC requirements for equity and fund investments. These kinds of investments have also relied on credit rating provider ratings to qualify for exemption from filing with the SVO for review. SVO staff is concerned that such structures lack transparency since there are multiple “layers,” including different private parties and private ratings. SVO staff acknowledged that many of the transactions the SVO has concerns about may no longer qualify for bond treatment in the future as a result of the Bond Project, as discussed in Section II.B above. However, given the significance of the SVO's concerns and the fact that the bond definition is not expected to be effective until 2025, the SVO proposes to amend the P&P Manual to include a definition for “Structured Equity and Funds” and to provide that such investments must be submitted to the SVO for review. Comments on this proposal from interested parties are due by February 13, 2023.

2. *NAIC Designations*

VOSTF directed NAIC staff to continue work on a proposed P&P Manual amendment regarding the use of NAIC Designations for investments. NAIC Designations are used as an indication of risk in a number of NAIC processes, including for credit quality assessment of investments by the SVO, for assignment of RBC factors, for statutory accounting valuation purposes, in state investment regulations that incorporate NAIC guidance and in determining eligibility of reinsurance

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collateral. VOSTF's goal is to clearly articulate what an NAIC Designation is in a definition that applies to all of these processes. To that end, the proposed P&P Manual amendment clarifies that the assignment of an NAIC Designation to a security considers and/or reflects (i) the likelihood of timely payment of principal and/or interest, (ii) the probability of default, (iii) the appropriateness of the RBC factor that will be applied to the security, and (iv) statutory accounting, reporting, state investment laws and other NAIC-developed regulator guidance embodied in state law.

E. Receivership and Insolvency Matters

1. *Amending the Property and Casualty Guaranty Association Model*

The Financial Condition (E) Committee adopted a Model Law Development request to consider proposed amendments to the *Property and Casualty Insurance Guaranty Association Model Act* (#540) to ensure that cyber insurance policyholders are provided with guaranty fund coverage, which include adding a definition of cyber insurance and applicable coverage limitations. The Receivership and Insolvency (E) Task Force's goal is to adopt these amendments within a similar timeframe as the amendments to Model #540 related to restructuring mechanisms.

2. *Pre-Liquidation Memorandum of Understanding Adopted*

At an interim meeting on November 15, 2022, the Financial Condition (E) Committee voted to adopt a Memorandum of Understanding ("MOU") that outlines a process by which a state insurance department and the relevant property and casualty guaranty fund can share information regarding potentially troubled companies before a formal liquidation proceeding is underway. The MOU is intended to serve as a regulatory tool for state insurance departments before a property and casualty insurer's liquidation process commences.

F. Developments Related to Corporate Division and Insurance Business Transfer Transactions

1. *Progress on Foundational Principles and Best Practices*

In an interim meeting on November 9, 2022, the Restructuring Mechanisms (E) Subgroup discussed comments on draft documents that the Subgroup had exposed in May 2022, setting forth "Foundational Principles" and "Best Practices" for state insurance regulators to use in reviewing insurance business transfer ("IBT") or corporate division transactions. The documents are intended to provide guidance on minimum review standards, and comments focused on the following three areas:

- Use of Independent Experts. Subgroup members agreed that the documents should reflect that IBTs will require review by independent experts but that state departments of insurance should have discretion on whether to hire experts in corporate division transactions, since corporate divisions are more similar to a Form A review process and a department may have the requisite expertise in-house.

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- Guaranty Fund Considerations. Representatives of guaranty associations and members of the Subgroup emphasized the overall goal of ensuring that guaranty association coverage is not reduced, eliminated or otherwise changed by a restructuring transaction. For instance, involved insurers should be appropriately licensed to maintain guaranty association coverage in all relevant states, with Subgroup members noting that it is the company's burden to provide information for the regulator to conclude that the transaction does not adversely affect guaranty association coverage. The Receivership (E) Law Working Group is also working on revisions to Model #540 to ensure that under the model, guaranty association coverage is not lost as the result of a corporate division transaction or IBT. The changes are expected in 2023.
- Approval Standards. The Foundational Principles discuss the appropriate standard or framework for regulators to use when approving a restructuring transaction. Commenters proposed various standards seen in other regulatory review contexts (e.g., the relevant transaction will not have a material adverse impact on policyholders). Discussions on the draft Foundational Principles and Best Practices will continue at future meetings.

III. Reinsurance Matters

The Reinsurance (E) Task Force met virtually on November 17, 2022 in lieu of the Fall National Meeting and heard the following updates.

A. Reinsurance Collateral Reduction Applications and Passporting

The Reinsurance Financial Analysis (E) Working Group (“ReFAWG”) continues to assist states with reviewing reinsurance collateral reduction applications to determine whether an applicant reinsurer meets the regulatory requirements to be recognized as a Certified Reinsurer and/or a Reciprocal Jurisdiction Reinsurer. As of November 17, 2022, ReFAWG had approved 40 applications by reinsurers for Reciprocal Jurisdiction Reinsurer status and for “Passporting,” the process giving a state discretion to defer to the collateral reduction (i.e., Certified Reinsurer and/or a Reciprocal Jurisdiction Reinsurer) status of a reinsurer by another state. ReFAWG expects to approve additional applications by year end. The NAIC publishes a complete list of Certified Reinsurers and Reciprocal Jurisdiction Reinsurers [here](#), along with a list of insurance department representatives best suited to answer questions about reinsurance collateral reduction applications in each state [here](#).

Although not required by law, the Reinsurance (E) Task Force continues to recommend submission of applications to ReFAWG in order to ensure uniformity in the review process, which can better equip ReFAWG to answer questions from governments, foreign jurisdictions or other interested parties.

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B. Qualified and Reciprocal Jurisdictions

At its November 7, 2022 meeting, the Mutual Recognition of Jurisdictions (E) Working Group (formerly the Qualified Jurisdictions (E) Working Group) reapproved the status of seven existing Qualified Jurisdictions on the *NAIC List of Qualified Jurisdictions*. While most of the current Reciprocal Jurisdictions included on the *NAIC List of Reciprocal Jurisdictions* are afforded automatic status by virtue of the Covered Agreements (i.e., jurisdictions included in the European Union and the United Kingdom), Bermuda, Japan and Switzerland were also reapproved by the Working Group to maintain their Reciprocal Jurisdiction status.

C. State Implementation of the 2019 Revisions to the Credit for Reinsurance Models

The Reinsurance (E) Task Force also received an update that all 56 NAIC jurisdictions successfully adopted 2019 revisions to the Credit for Reinsurance Models (the “2019 Revisions”), as previously discussed [here](#), by September 1, 2022, the date for possible federal preemption of state law under the Covered Agreements. The amendments became an NAIC accreditation standard as of September 1, 2022, with enforcement beginning on January 1, 2023.

The Reinsurance (E) Task Force reminded states that enacting legislation is only the first step to bringing state credit for reinsurance laws into compliance with the Covered Agreements to avoid federal preemption. Additional steps must also be taken, such as ensuring that state insurance departments have a process in place for timely review of Reciprocal Jurisdiction Reinsurer applications and that states have established a website with information about the application process for Reciprocal Jurisdiction Reinsurers. The NAIC has been working with state insurance departments to ensure that their websites will be in compliance by the end of 2022.

Dodd-Frank authorizes FIO to review state laws and regulations and make federal preemption determinations with respect to the Covered Agreements. Importantly, FIO reported on September 30, 2022 that it did not recommend taking any action as a result of inconsistency between the Covered Agreements and state credit for reinsurance laws, although it will continue to monitor state measures implementing the 2019 Revisions and anticipates publishing a comprehensive update during 2023.

D. State Adoption of XXX Model Regulation

The *Term and Universal Life Insurance Reserve Financing Model Regulation* (#787) (“XXX Model Regulation”), which is intended to establish uniform, national standards governing reserve financing arrangements for life insurance policies, became an accreditation standard on September 1, 2022 with enforcement beginning on January 1, 2023, as reported [here](#). As of October 27, 2022, the NAIC reported that 25 jurisdictions had adopted the XXX Model Regulation, with adoption under consideration by eight more jurisdictions.

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IV. Innovation, Cybersecurity and Technology

A. NAIC to Develop a Model Bulletin on Use of Artificial Intelligence in Insurance Industry

The Innovation, Cybersecurity and Technology (H) Committee “Collaboration Forum” on “algorithmic bias” (i.e., the unfair discrimination by insurers during an insurance transaction resulting from bias in AI/ML-driven algorithms and complex predictive models, as previously reported on [here](#)) is developing a regulatory framework for the use of AI/ML by the insurance industry in the form of a model interpretive bulletin. The bulletin will be principles-based with articulated standards that apply at a high level to the use of artificial intelligence supported decision-making.

The (H) Committee has developed a high-level table of contents for the model bulletin consisting of four sections: (i) an introduction with background and legislative authority, (ii) a definitions section based on vocabulary that has been under development by the (H) Committee, (iii) regulatory expectations for the use of AI/ML by the insurance industry incorporating governance standards expectations (e.g., enterprise risk management) and (iv) regulatory oversight and examination standards addressing topics such as market conduct and financial and rate filings. The goal is to expose sections of the model bulletin one at a time, likely beginning with the definitions section.

Commissioner Birrane stated that work will begin immediately after the Fall National Meeting with the hope of engaging in a robust discussion at the 2023 Spring National Meeting.

B. Update on New Privacy Model Law

The Privacy Protections (H) Working Group received approval from the Executive (EX) Committee at the Summer National Meeting to replace two existing models—the *Insurance Information and Privacy Protection Model Act* (#670) and the *Privacy of Consumer Financial and Health Information Regulation* (#672)—with one new model, as reported [here](#). During the Fall National Meeting, the Working Group announced that it intends to expose an initial draft of the new *Consumer Privacy Protections Model Act* (#674) in late January 2023. The new Model #674, which will apply to all lines of business, is intended to be the “best of both” Model #670 and Model #672 and will be influenced by existing state and federal privacy regimes. The Working Group will also expose a white paper intended to provide additional context on certain provisions of Model #674. The Working Group will discuss comments on these exposures at the 2023 Spring National Meeting, and anticipates voting on Model #674 and the white paper next summer.

C. Big Data and Artificial Intelligence Working Group Updates

At the Fall National Meeting, the Big Data and Artificial Intelligence (H) Working Group provided the following updates on its AI/ML survey project:

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- A report on the private passenger auto survey was published on December 8, 2022, which is available [here](#). Potential next steps for the NAIC include evaluating this report and further exploring AI/ML model usage and the amount of human involvement in decision-making, insurer data elements, governance frameworks, consumer data recourse and third-party regulatory frameworks. The NAIC may also pursue additional white papers on AI/ML best practices.
- Ten states are participating in a survey regarding the use of AI/ML in the homeowners insurance space. The states have issued an informational notice and a formal examination call letter to 194 companies. Companies licensed to write home insurance in any of the 10 requesting states with at least \$50 million in national home insurance premium for 2020 were required to respond to the survey by December 15, 2022.
- Fourteen states are participating in a survey regarding the use of AI/ML by life insurers and are currently collecting data from 192 life insurance companies.

In connection with its project on the insurance industry's use of third-party data, the Working Group has created a regulatory framework document, which could be used in conjunction with guidance in the Market Regulation Handbook, containing examination standards and questions that regulators can use to obtain information about AI/ML models and data used in AI/ML models from insurers and third parties. The proposed framework, which consists of suggested questions and defined terms to assist regulators with understanding the AI/ML model or data in question, will be exposed until February 13, 2023 and is available [here](#) for review.

V. Other Topics of General Interest

A. Topics of Interest to the Life Insurance Industry

1. *Accelerated Underwriting*

An *ad hoc* drafting group within the Accelerated Underwriting (A) Working Group has been drafting guidance for state insurance regulators with respect to the use of accelerated underwriting in life insurance and has received feedback from the Market Conduct Examination Guidelines (D) Working Group, Big Data and Artificial Intelligence (H) Working Group and those members involved in the Collaboration Forum on the current working draft of the regulatory guidance. The Working Group intends to incorporate this feedback and provide an exposure draft in early 2023 for public review and to make a referral to the Market Conduct Examination Guidelines (D) Working Group.

2. *Amendments to Suitability in Annuity Transactions Model Regulation*

Amendments to the NAIC *Suitability in Annuity Transactions Model Regulation* (#275) that the Life Insurance and Annuities (A) Committee adopted in February 2020 have been adopted by 29 states, with six additional states expected to adopt in

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2023 or 2024. The amendments clarified that all recommendations by agents and insurers must be in the best interest of the consumer and that agents and carriers may not place their financial interest ahead of the consumers' interest in making an annuity recommendation.

B. Climate and Resiliency Considerations for the Insurance Industry

The NAIC's Climate and Resiliency (EX) Task Force expects work to begin in 2023 on enhancements to the Financial Condition Examiner's Handbook, Financial Analysis Handbook and ORSA Guidance Manual to incorporate climate risk concepts, and the Task Force may assist in the development of a white paper on parametric products that is under consideration by the Property and Casualty Insurance (C) Committee.

The Catastrophe Insurance (C) Working Group discussed the latest extension of the NFIP, which is set to expire at 11:59 PM on December 23, 2022. Another short-term extension is expected to be granted.

VI. **International Matters**

A. FSB Endorses the Holistic Framework

The International Insurance Relations (G) Committee focused on the FSB's announcement on December 9, 2022 to endorse the Holistic Framework, which uses an activities-based approach to assess and mitigate systemic risk in the insurance sector, while discontinuing the designation of G-SIIs. The FSB's decision has been well received by the IAIS and the NAIC.

The IAIS adopted the Holistic Framework in 2019 and the implementation process began in 2020, at which time the FSB suspended the G-SII identification process. The FSB's recent decision was based on the results of this implementation period, which demonstrated the benefits of the Holistic Framework. Jonathan Dixon, Secretary General of the IAIS, highlighted some of these benefits at the Fall National Meeting:

- The annual Global Monitoring Exercise (the "GME") conducted by the IAIS, which consists of two data collections to detect the build-up of systemic risk in the global insurance sector, represents the Holistic Framework's risk assessment side, and has been more comprehensive and versatile in times of crisis than the G-SII approach.
- The Holistic Framework supports a "more robust, collective discussion" among insurance supervisors on key risks and the potential build-up of systemic risk in the insurance sector.
- The Holistic Framework's macroprudential policy measures (i.e., the ComFrame standards) apply to a much broader sector of insurance companies (i.e., 49 IAIGs) compared to nine former G-SIIs.

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In order to monitor systemic risk in the insurance sector, the FSB will rely on assessments produced by the IAIS under the Holistic Framework, and in 2025, the FSB will review its experience utilizing the Holistic Framework. Also in 2025, the IAIS will conduct its triannual review of the assessment methodology used for the GME.

For more information about the Holistic Framework, see our 2019 Fall National Meeting report, available [here](#).

B. Updates on the IAIS's Holistic Framework

Secretary General Dixon said the IAIS had recently finalized liquidity metrics that will help the IAIS monitor liquidity risk in the global insurance sector, with results to be shared in the IAIS's 2023 Global Insurance Market Report.

During the past 18 months, the IAIS conducted an intensive Targeted Jurisdictional Assessment (“TJA”) of 10 major insurance markets, including three markets in the U.S. (Connecticut, New Jersey and New York), which showed a good level of observance of the Holistic Framework supervisory material. The TJA included discussion with the IAIS on recovery and resolution since this topic requires coordination among regulators. Representatives from the three states highlighted for the IAIS that the resolution process in the U.S. is designed to be group- or company-specific. As a result of these discussions, the GSIWG and Receivership and Insolvency (E) Task Force will work together in 2023 to develop a template that U.S. regulators can use in discussions with international supervisors to describe the U.S. resolution process. Insurance supervisors are focused on operational resilience in light of technological advances, changes to how people work and increasing cyber threats. The IAIS published a draft issues paper in October 2022 addressing cyber resilience, third-party outsourcing, and business continuity management. The public consultation on the paper closes on January 6, 2023. In 2023, the IAIS will consider how cyber operational risks in the insurance industry can impact financial stability. It will also explore how the GME could be used to monitor such risks on a permanent basis.

VII. Other Updates

Additional, briefly noted updates from the Fall National Meeting are summarized at a high level below:

- Development of Electronic Form A Database. The NAIC has been working on the development of an electronic Form A database and considering how the database can also be used for Form E (Pre-Acquisition Notification Regarding Potential Competitive Impact of Proposed Merger or Acquisition) filings. The goal is to create a single uniform Form A application where the industry can file a Form A in any state and multiple states at once, capturing all state-specific requirements. The NAIC will survey states in 2023 regarding state-specific requirements that should be included in the database. This state-specific survey will address confidentiality questions, which is expected to add complexity to the project given the different state approaches to confidential treatment. The Form A database project is expected to continue throughout 2023, with the goal to complete the project by 2024.

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- Long-Term Care. The Long-Term Care Insurance (EX) Task Force met virtually in lieu of the Fall National Meeting and is focused on implementing the Long-Term Care Insurance Multistate Actuarial Rate Review Framework (“LTCI Framework”) that the NAIC adopted at the NAIC’s 2022 Spring National Meeting, as we reported [here](#). Since the Spring National Meeting, the Task Force has met in a regulator-only session to discuss results of a confidential pilot project of five companies using the LTCI Framework. The Task Force is also monitoring cost of care inflation as a source of financial stress and uncertainty for carriers over the next year.
- NAIC Adopts the ComFrame Revisions to NAIC Guidance Documents. In 2021 and 2022, the NAIC developed revisions to the Financial Condition Examiners Handbook, the Financial Analysis Handbook and the ORSA Guidance Manual that incorporate certain ComFrame elements deemed appropriate for the U.S. insurance regulatory system. For instance, a new section was added to the ORSA Guidance Manual describing enterprise risk management expectations that should be addressed in an IAIG’s ORSA Summary Report, and the updated Financial Analysis Handbook describes additional procedures for analyzing an IAIG’s financial condition where a state insurance regulator is the global group-wide supervisor. The proposed revisions were adopted by the Executive (EX) Committee and Plenary at the Fall National Meeting. For more information about the changes, see our 2022 Summer National Meeting report, available [here](#).
- Review of the *Unfair Trade Practices Act* (#880) to Address Lead Generator Concerns. During its meeting on December 15, 2022, the Market Regulation and Consumer Affairs (D) Committee adopted a request to review the *Unfair Trade Practices Model Act* (#880) in order to expand the model to (i) provide authority to regulate lead generators by defining “Health Insurance Lead Generator,” (ii) prohibit lead generators from engaging in unfair trade practices and (iii) delineate what marketing-related activity of lead generators are unfair trade practices.
- NAIC Review of Model Laws. The Executive (EX) Committee adopted a memorandum and charge outlining an effort to review model laws to ensure that they remain relevant and align with current strategic objectives. NAIC staff has recommended archiving certain models in 2023, including those that were adopted before the year 2002, have been adopted by 10 or fewer states or are not associated with accreditation.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Kara Baysinger

415 858 7425

kbaysinger@willkie.com

Leah Campbell

212 728 8217

lcampbell@willkie.com

Stephanie Duchene

310 855 3066

sduchene@willkie.com

Matthew J. Gaul

212 728 8261

mgaul@willkie.com

Michael Groll

212 728 8616

mgroll@willkie.com

David Heales

212 728 8294

dheales@willkie.com

Donald B. Henderson, Jr. David G. Nadig

212 728 8262

dhenderson@willkie.com

312 728 9097

dnadig@willkie.com

Allison J. Tam

212 728 8282

atam@willkie.com

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