WILLKIE FARR & GALLAGHER LLP

CLIENT ALERT

Willkie London, International Insurance Industry Review, Corporate and Risk Transactions, Regulation and Tax Developments

April 2024

To Our Clients and Friends:

You would be forgiven for thinking that the macroeconomic uncertainties of 2023 brought on by record high inflation and interest rates, geopolitical headwinds and supply chain disruptions, exacerbated by events like the Ukraine war and the more recently renewed tensions in the Middle East, would have a debilitating effect on the (re)insurance sector. On the contrary, demand for risk transfer was stronger than ever, marking 2023 as a standout year for (re)insurance carriers and intermediaries whose bottom lines benefitted from an extended hardening of the underwriting cycle.

In this instalment of our International Insurance Industry Review, Corporate and Risk Transactions, Regulation and Tax Developments, we report on trends in insurance and reinsurance in 2023 and early 2024 with a focus on developments in M&A, the Lloyd's market, legacy transactions, insurance-linked securities ("ILS"), longevity and pension de-risking, capital markets activity, regulation, tax and antitrust. The territorial remit of our review covers, in the main, the United Kingdom, Europe and Bermuda; however, in the section where we discuss trends and developments in the pension risk transfer ("PRT") market, we also look at developments in the US, Canada and Japan, and in the ILS and capital markets sections, we delve into developments that are applicable to the ILS market as a whole and the key EU, UK and US listing markets, respectively.

Whether it is recent M&A trends in (re)insurance, continued interest in Lloyd's, regulatory responses to private equity investments in the legacy and life (re)insurance sector, innovation spurred on by the continuing effects of a hard reinsurance market on ILS or even the continuing evolution of the UK regulatory landscape post-Brexit, we hope that you will find something in this Year in Review that is of interest and thought-provoking and we welcome any questions you may have.

All the best,

Insurance Transactional and Regulatory Group,
Willkie Farr & Gallagher (UK) LLP

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I. RECENT UK AND EUROPEAN M&A ACTIVITY

A. Overview

With the ongoing war in Ukraine, the outbreak of the war in Gaza, high interest rates and current levels of inflation, 2023 was unsurprisingly a challenging year for M&A and deals in the UK and continental Europe. However, despite challenges, our own experience and public reports reflect that the UK and Europe have actually seen a steady rise in overall deal volume across the insurance sector compared to 2022.

That said, the numbers do not paint the entire picture and different segments of the UK and European insurance industry have been impacted in different ways. While large-cap M&A has slowed down as acquirers are reluctant to take on larger amounts of leverage and commit capital for these types of acquisitions, there has been a steady flow of mid-market deals and continued interest from private equity in the sector, with a particular focus on broker, intermediary and fee-based insurance businesses.

Additionally, there have been pockets of increased deal activity in the Lloyd's of London ("Lloyd's") market, with the Lloyd's ILS platform attracting more investment and capital from financial investors. The run-off and legacy deal space has also continued to generate M&A and reinsurance transactional activity, which we will discuss in further detail below.

B. Downturn in Large-Cap M&A Activity

Deal values have declined in 2023, with insurance sector deal values in the billions being few and far between. One of the biggest insurance carrier deals in the UK and European insurance sector during 2023 was the acquisition of Liberty Mutual Holding Co.'s ("Liberty") European business by Generali Group for €2.3 billion ($2.5 billion). Liberty disposed of its operations in Ireland, Northern Ireland, Portugal and Spain, exiting these non-core markets to focus on US property and casualty ("P&C") insurance. This deal is a good example of a general trend towards "de-globalization" that we have seen in recent years and that was noted by panellists at a conference that we hosted in London in September 2023 on the insurance sector landscape, as insurance groups look to consolidate their presence in their key markets while disposing of businesses in markets considered non-core. We expect this trend to continue into 2024, with insurance groups (including, privately held groups potentially looking to make an initial public offering ("IPO") in particular) continuing to look at ways to restructure their businesses to optimize capital, operational efficiency and shareholder value, with disposals of non-core or non-performing business units being central to this strategy.

While the number of large-cap M&A deals has fallen during 2023, there has still been a steady flow of mid- (to upper mid-) market deals which have been less affected by market volatility and the global and macroeconomic factors noted above. In particular, we have seen insurance carriers using M&A to broaden their distribution channels such as Aviva's acquisition of AIG Life Limited from Corebridge Financial, Inc. for £460 million and Allianz S.p.A.'s agreement to acquire Tua Assicurazioni from Assicurazioni Generali S.p.A. for €280 million. These deals, while typically specific to a segment or business unit of the buyer, can also drive growth and help buyers transform specific portfolios and expand business lines.

C. Continuing Private Equity Interest and Broker/Fee-Based Insurance M&A on the Rise

Two key trends that we have observed in recent years are (i) private equity investment in the (re)insurance sector; and (ii) continued interest in fee-based and capital light insurance businesses, both of which have continued to be dominant factors throughout 2023.

This past year, private equity investors have continued to invest heavily in the sector and one of the more notable events was Bain Capital Insurance closing its first private equity fund at $1.15 billion. The fund focuses on middle market transactions in North America and Europe with several investments having already been completed such as the launch of German insurance brokerage platform "Summitas Gruppe".

We have also seen private equity turning to alternative capital solutions such as investing in ILS, particularly in the Lloyd's market. Lloyd's has worldwide appeal to investors due to its global license access, deep talent pool and relatively attractive capital requirements. Moreover, it reported a £3.9 billion profit for the first half of 2023. Last year we saw an expansion of the Lloyd's ILS platform, London Bridge 2 PCC Limited ("London Bridge 2"), to welcome more capital, including capital from private equity and financial investors. The expansion permits new types of reinsurance transactions, particularly excess of loss deals, and now allows both preference shares and debt securities to be issued by the cells of the structure. These changes are aimed at making the transfer of different kinds of risks to capital market investors simpler. Earlier this year, Ariel Re used London Bridge 2 as a vehicle to secure $170 million of financing, becoming the first sponsor to raise capital through this structure. We discuss the London Bridge platform in more detail in Part III (*Insurance Linked Securities (ILS) Market Update*) and in the tax section of Part VI (*Principal Regulatory, Tax and Antitrust Developments*).

Private equity interest (direct or through portfolio companies) in insurance intermediaries continued across Europe in 2023. Pollen Street made a strategic investment in Italian broker Wide Group, and towards the end of the year, a company backed by funds of private equity firm Permira agreed to acquire GGW, a European insurance brokerage platform. These are just two of numerous examples of private equity / broker deals in 2023.

It is not only private equity interest that has driven the acquisition of fee-based businesses such as MGAs, brokers and distribution providers. Strategic and trade buyers have played a significant role where looking to expand their UK and European footprint or product lines. UK-based insurance firm Howden Group Holdings started off 2023 by completing its acquisition of reinsurance intermediary TigerRisk Partners, and continued to its rapid expansion across Europe with the acquisition of a number of European brokers throughout the year. The Ardonagh Group also made a number of acquisitions across Europe, including acquisitions of Swiss and Dutch brokers. AssuredPartners also aggressively pursued acquisitions to bolster its growth in the financial services space.

D. 2024 Outlook

As we anticipate the deal flow in 2024, M&A activity in the insurance sector is already showing signs of a steady increase. We have heard reports of more deals being prepped for market in 2024 and in Q1 of 2024 we have seen two major names announce their entry into Lloyd's; first Aviva with its £242 million acquisition of Probitas (subject to regulatory approvals), shortly followed by The Fidelis Partnership being granted in principle approval from Lloyd's to launch its own syndicate, showing that the Lloyd's market is very much open for business.

In December, we saw one of the biggest deals in the insurance sector in 2023, with Aon's commitment to acquire retail broker NFP from Madison Dearborn for a reported deal value of around $13.4 billion, subject to customary conditions including regulatory approvals. While this is largely a deal to consolidate Aon's position in the US, it is a sign that large-cap M&A is likely to tick upwards in 2024. Given that broker activity has remained consistent year on year, insurance broker and other fee-based acquisitions may well lead the way for the UK and European insurance M&A market in 2024.

II. UK LEGACY DEALS

A. Overview

In tune with M&A activity in the broader UK and European insurance markets, which rose steadily in 2023 in spite of challenging macroeconomic and geopolitical circumstances, the volume and size of UK and European legacy deals trended positively in 2023. Over the past few years, the legacy market has gone from strength to strength as it has become a key part of global insurers' capital management toolkits.

This has been no less evident than in 2023, with significant deals involving loss portfolio transfer, adverse development cover and reinsurance to close solutions in the company and Lloyd's markets demonstrating how the market has developed – from being viewed historically as a home for distressed portfolios to now providing a variety of structured solutions as part of business-as-usual capital management for traditional (re)insurers' back-book business. The market is in good health but not without some associated growing pains. The growth of the legacy market has led to increased regulatory scrutiny of transactions, and with a drive for more disciplined pricing and operational efficiency, firms are also under greater pressure from their investors to achieve targeted returns.

We have explored in more detail below some of the key themes we have seen in the market over the last 12 months, which look set to continue for the remainder of 2024 and beyond.

B. Coming of Age in an Increasingly Competitive Market

As we have commented in recent years, legacy has been expanding into new areas of the insurance market as participants grow in sophistication and seek out new opportunities. Lloyd's is a market that, with its reinsurance to close ("RITC") model, has long been a natural yet less trodden path for legacy players. In the past 18 to 24 months, we have seen significant legacy activity and innovation in the space, and an increased focus on the benefits that run-off players can bring beyond the traditional insurance marketplace.

The first quarter of 2023 saw the year kick off at a pace with multiple competitive third party RITC transactions brought to market and targeted at legacy players with their own syndicates, including RiverStone, Marco Capital, Compre, Premia and Enstar. This included a return of 2022's pioneering split RITC structure, with RiverStone and MS Amlin combining a reinsurance to close of the 2018 and prior years of account of MS Amlin

Syndicate 2001 with a loss portfolio transfer ("LPT") of specific discontinued classes in the 2019 to 2021 years of account, involving net technical provisions of £1.2 billion.

Outside of the Lloyd's market, the increased capital support provided by private equity backing the legacy market was deployed in some significant deals announced at the start of the year. Compre, continuing its expansion into North America, announced a transformational LPT with SiriusPoint covering approximately $1.3 billion of reserves. Marco Capital also completed a hat trick in Q1 2023, announcing the acquisition of a portfolio of Gibbon Pool liabilities from Allianz, the acquisition of Navigators International Insurance Company from The Hartford and an LPT transaction with Markel involving a portfolio of UK motor liabilities, providing cover of up to £200 million. An outlier in that they are not significantly backed by private equity (albeit counting private equity amongst their investor base), Enstar was not to be outdone and announced a ground-up LPT with QBE involving the assumption of approximately $1.9 billion of net loss reserves. Similarly, publicly traded Randall & Quilter ("R&Q") was active in Q3 2023, announcing the disposal of its portfolio management business, Accredited, to Onex Partners for $465 million, and the LPT of an $80 million book of business with a UK motor insurer.

Continuing the theme from 2022, the deal flow in 2023 was not as active in the UK and European life legacy market as the non-life legacy market, with investors focused on integrating some significant transactions completed in the latter part of 2022, including divestments by Zurich, of its Italian life and pensions back-book to GamaLife, and a German legacy life book to Viridium. Life legacy consolidator Athora continued its expansion in Europe, completing the acquisition of the WTW Premium Pension Institute in the Netherlands and continuing to work towards closing a major transaction announced with AXA Germany, representing €19 billion of assets under administration, which is expected to close in Q1 2024. In Q3 2023, Swiss Re announced it had closed an LPT with Kookmin Best Insurance Company involving $100 million in reserves for US commercial and workers' compensation business, showing that while activity has been lower, appetite in the wider life legacy market remains.

In recent years, we have also seen Germany, Italy, France and Benelux become attractive jurisdictions for life legacy consolidators, not least because the life insurance market generally has undergone significant consolidation, in turn, prompting insurers to seek to optimize their capital deployment and dispose of legacy business. As discussed above, these deals continue to be attractive and, notwithstanding the reduced deal volume overall in 2023, in August Monument Re announced the acquisition of a run-off block of Belgian retail life policies and annuities from Federale Verzekering. Early signs suggest a positive outlook for transactions in the life market in 2024, which began strongly with Baloise Belgium and RGA executing an asset-intensive reinsurance transaction involving RGA reinsuring approximately 57,000 Belgian life insurance policies and total reserves of approximately EUR 900 million.

Whereas the deal flow through the first quarter of 2023 was marked by its volume, reports suggest that while the pace of activity did not continue through the year, the aggregate deal value remained consistent with 2022 despite fewer transactions announced. This is consistent with the size and types of life and non-life deals we have seen coming to market, and reflects the prevailing view from traditional global insurers that legacy players are becoming more sophisticated and that the market is more attractive than ever as a capital management tool.

Insurers are acutely aware of the benefits that the run-off market can provide as well as the people, specialisms and systems that have helped augment its reputation for focusing not only on efficient run-off management, but also customer care and value. We have also seen an increased appetite on the buy-side for reinsurance-only transactions, leaving claims handling with the primary insurer, thereby alleviating one of the key concerns amongst traditional insurers about ensuring the quality of underlying customer care.

C. Discipline and Innovation Point the Way Forward

We discussed above that traditional insurers have become more cognizant of the benefits that the legacy market can provide in managing their back-books. Legacy is an increasingly competitive space where pricing is disciplined and the majority of players are backed by significant private equity capital, namely Compre (by Cinven), Marco (by Oaktree) Catalina and Athora (both by Apollo), Fortitude Re (by The Carlyle Group), DARAG (by Keyhaven, Crestview and Aleph), RiverStone (by CVC), Carrick (by Sequentis) and Premia (originally sponsored by Arch Capital and Kelso & Company).

We have seen that private equity backers have driven increased capital, professionalism and sophistication in the market. Groups have turned inwards and looked to consolidate and reorganise for corporate, operational and capital efficiency reasons. They have also sought to augment their existing businesses to develop sub-specialisms within legacy, such as Compre's continued focus on growing its medical malpractice portfolio, completing the acquisition of Covéa subsidiary, Medical Insurance Company. We know from our clients that developing trust over time through specialism, multiple transactions and relationship-building all contribute to a growing confidence in legacy and its importance to the insurance sector as a whole. We expect the theme of developing key strategic partnerships between traditional insurers and legacy players will continue as the market matures further. As we commented in our previous iteration of this publication, the market is becoming more disciplined in its pricing and we saw that continue throughout 2023 as, while deals remain competitive, the margins are finer and key differentiators other than price have become even more relevant to sell-side considerations.

D. Cementing Legacy as a Key Capital Management Solution

While major insurers are dedicating more time and resources to actively managing and marketing their legacy books to divest of non-core or non-profitable business as an ordinary course part of their business, they are increasingly employing third parties to help them do so efficiently alongside their day-to-day businesses.

Another key factor in the growth of the legacy space and the number of transactions coming to market in formal, competitive processes has been the involvement of brokers. In the past few years, there has been a major transformation in how brokers have dedicated specialist teams to legacy, including, among others, Acrisure, Aon, Gallagher Re, McGill & Partners and Guy Carpenter. Such brokers are helping to structure and execute broader capital management solutions on behalf of sell-side insurers, which include traditional and structured reinsurance, portfolio transfers and RITCs. Over the past 12 to 18 months, a significant number of the transactions we have worked on have been intermediated in the same way as traditional insurance M&A and we see that as a major driver of the pipeline for 2024.

E. Increased Focus on the Market Leads to Growing Pains

With increased market activity and growth comes increased regulatory awareness and scrutiny. We have highlighted the significant benefits that private equity investment has brought to the market. However, there are also tensions that must be balanced between the shorter-term goals of private equity investors and the importance of ensuring that traditional insurers' customers are adequately serviced in the long term.

In 2023, the administration of private equity-backed Italian life insurer, Eurovita, has brought those tensions into greater focus and we consider that the resulting focus placed by regulators on transactions in Europe and elsewhere will become more of a regular feature than an exception, both in life and non-life deals. We expect that the related investor scrutiny of firms' profitability, sustainability and pricing/operational discipline will drive further transactions and the possibility of consolidation in 2024.

On the life side of the market, it was reported in Q4 2023 that Bermuda-based life consolidator Monument Re was exploring its strategic options after reporting a drop in its capital ratios in 2022. Likewise, reports suggest that private equity was considering the potential sale of German life insurance consolidator Viridium – who as noted above completed one of the most significant transactions of 2022 – pointing to potential further consolidation next year as shareholders assess their strategic options in light of market challenges.

On the non-life side, one of the more noteworthy events from the first quarter of 2023 was Apollo's decision to diversify Catalina away from non-life legacy risks and re-focus its business on closed life books. This added to the competition and capacity crunch within the non-life legacy market, cementing the importance of standing out amongst the competition, while also highlighting some of the challenges the market is facing in spite of its growth. It also led to one of the larger deals in Q3 2023 as mentioned earlier, with the announcement that RiverStone had agreed to acquire Catalina Insurance Ireland, with total reserves of approximately $350 million.

We are aware of other firms exploring potential divestments of non-profitable business and/or fresh investment which we believe will lead to further deal activity on the buy-side of the market in 2024. As discussed above, one of the more significant divestments of the year was R&Q's announced sale of Accredited in a move to streamline its business. At the end of 2023 and related to R&Q's profitability review, it was reported in December that the Bermuda Monetary Authority ("BMA") is undertaking a review of R&Q Legacy and has put a hold on the approval of new external legacy transactions, as well as the redemption of certain notes issued by one of its Bermuda entities. We expect legacy firms throughout the market will continue to focus more keenly on profitability versus pure growth, driving further competition and finer margins for the most desirable books of business as they come to market.

F. Room to Grow

It is clear that in the past few years, the life and non-life legacy market has experienced major growth in size and value that it brings to the wider market. The development of sub-specialisms and new deal structures such as the split RITC demonstrates that it is also a market with capacity for innovation and there are other possible solutions that can be deployed and are yet to be fully explored. The industry as a whole is taking on new exposures and is seeking to free up trapped capital, meaning that it is not just the buy-side but also the sell-side who are looking to become more sophisticated about how they structure transactions. Traditional life and non-life insurers are acutely aware of the capital benefits and other efficiencies that legacy solutions can provide, and the pool of motivated buyers backed by third party capital offer attractive opportunities and potential new avenues for risk transfer.

We are also aware of potential alternatives being discussed in the market, such as syndicated reinsurance-only structures, partnerships between legacy and traditional reinsurers and ILS-structured solutions. While these are relatively nascent conversations, they became louder in 2023 as the market looks to expand its offering and capture more opportunities.

G. An Upward Trajectory in an Increasingly Challenging Environment

Despite the UK and Europe being battered by macro-economic and political headwinds in 2023, the life and non-life legacy market has remained strong and shows no signs of slowing down. There was significant deal volume and capital deployed over the course of the year which we see continuing in 2024.

While we expect that the regulatory scrutiny that has become more acute in 2023 may ultimately result in an increase in the time and cost of obtaining regulatory approvals particularly on larger transactions, we do not see that reflected in the market's deal appetite in general, at least in the short term. There are signs that some of the challenges we saw in 2023, both external from regulators' scrutiny and internal from investors, will crystallize further in 2024 and may drive greater consolidation in the market as well as back-book deal activity. The signs are positive and the market remains strong. We expect the remainder of 2024 to see sustained activity on the non-life side and likely increased activity on the life side as UK and European legacy continues to cement itself as a key feature of the wider insurance sector capital management toolkit, and firms turn inwards to consolidate and achieve efficiencies in their existing businesses as well as continuing to grow outwards.

III. INSURANCE-LINKED SECURITIES (ILS) MARKET UPDATE

A. Overview

2023 was the year everyone was hoping for in ILS. Record issuances (approximately $15 billion in aggregate principal amount in Rule 144A cat bonds, topping the amount in 2022 by circa $6 billion), limited catastrophe (cat) losses and the expansion into new perils, including cyber. The ILS market needed a year like this to reaffirm the investment case and dispel critics, and 2023 delivered in spades.

The continuation of the hard market in 2023 meant that ILS remained competitive on pricing for cedants as compared to the traditional market, whilst also reaching pricing levels that meant that investor appetite remained strong. 2023 also saw a further embedding of the asset class as a key component of (re)insurance groups' outwards programs, with 14 new entrants to the cat bond market, including Pacifica, The New Zealand Earthquake Commission and VKB Re, as well as several high profile returns to the cat bond market, including Hiscox and Allianz. Another striking element on the 2023 cat bond class was the large number of European cedants, including first-time cedants. Many market commentators expect that cedants' appetite for alternative capital in Europe will continue to increase and that as European groups see their peers using the alternative capital market more, those groups will also consider moving into the market, particularly to place their most remote layers.

In 2022, a relative lack of capacity in the ILS market led to lower levels of ILS issuance as well as a tightening of terms, moving the market. These revised terms, such as new extension mechanics in cat bonds that deter cedants from trapping capital, survived the expansion of investor capital in 2023, although there was some softening. For example, in 2022, cedants were typically obliged to pay a spread of 3% to extend the portion of a cat bond that was not likely to be loss effected, whereas, by the end of 2023, 2.5% had become the norm.

There were more aggregate transactions (which are exposed to attritional losses to some extent) and a wider variety of non-peak perils covered in transactions in 2023, beginning to reverse a trend in 2022, where constrained capital allowed investors to put their collateral to work in per occurrence structures and transactions that focused on fewer named perils.

Further innovation could be found in ILS outside the traditional P&C lines, with transactions covering cyber, legacy and long tail business such as life and casualty continuing to expand, while ESG continued to be a driver of investor interest.

In summary, ILS proved its durability as an asset class and continued to cement its importance at a time when capacity in the traditional markets continued to be constrained.

B. Trapped Capital

The challenging investment environment in 2022 led to investors seeking (and achieving) new terms in their ILS transactions, in addition to the higher rates. Although there was a retrenchment of some of these terms in 2023, the terms related to trapped capital seem like permanent features of the ILS environment and we discuss those below.

Trapped capital remains a perennial concern for investors and in 2022 they extracted new extension mechanics on cat bonds, which mean that cedants must pay more to retain collateral that is unlikely to be paid out (based on the application of decreasing multiples, or so-called 'Threshold Factors'). This new transaction feature is now standard across the cat bond market and is in the vast majority of cat bond transactions. Cedants have been willing to accept these new terms as they always have the flexibility to delay a return of collateral that is likely to be loss impacted at lower spreads and if, at the end of the risk period, there is a high degree of uncertainty related to the final loss numbers for an event, they still have the option to hold back additional collateral above the loss impacted principal, provided they pay a spread of 2.5% or, less commonly towards the end of 2023, 3% on such retained collateral.

Given the trend in sidecars and other collateralized reinsurance in recent years towards thinking creatively about trapped capital (as discussed in our 2021 Year in Review) it is perhaps unsurprising that the cat bond market has now also had similar treatment and investors have been able to find higher returns in respect of capital that is trapped.

In addition, we have seen the focus on trapped capital in sidecars and collateralized reinsurance continue with investors permitting cedants to trap less capital by bringing down buffer tables, by pushing for the buffer loss factor to be applied from the date of each individual loss occurrence (rather than from the date of the last loss occurrence in a risk period) and through the use of more generous rolling capital structures that allow investors to shift more capital on a reserved loss basis without applying buffer loss factors. The combination of these mitigating factors and a relatively benign year for major catastrophe losses in 2023 has led to a resurgence of interest in sidecar structures. Some investors were more willing to be exposed to the greater volatility associated with these vehicles (such volatility owing to the broader exposure to non-peak perils, ceded on a proportional basis, than is the case with cat bond structures which are underwritten on a non-proportional basis at remote attachment points) in order to benefit from the higher risk premiums on offer.

C. ESG

In 2023, ESG continued to be a feature in ILS, as it was across the capital markets. In Europe, the introduction of the EU Sustainable Finance Disclosure Regulation ("EU SFDR") required financial services providers and owners of financial products to analyse and disclose ESG considerations to their investors. In the third quarter of 2023, the UK's version, the Sustainability Disclosure Requirements, entered into force. Broadly, these require asset managers to determine whether their investments satisfy certain ESG criteria and to make appropriate disclosures to their investors. In addition, new rules to guard against greenwashing will mean that ILS issuers and sponsors will need to carefully consider whether any of their claims have ESG components.

Asset managers are increasingly aligned to the ESG cause and are looking for asset classes that satisfy ESG criteria to enable them to satisfy increasing client demand for ethical investing. ILS, particularly in the P&C space that supports communities following natural catastrophes, is viewed positively as a potential ESG asset and many expect sponsors to be able to make ESG appeals in their future ILS issuances.

Although there has not been a "green" cat bond since Generali launched Lion Re in 2021, investors are taking a keen interest in cedants' ESG credentials. For example, providing ESG questionnaires detailing how cedants manage their ESG responsibilities has become commonplace on transactions and are a prerequisite for a number of fund managers before they participate in a transaction. In the sidecar space, we have seen an uptick in investors requiring exclusions from the reinsured business to ensure that they are not providing reinsurance coverage for underlying policyholders in a number of industries that are at odds with investors' own ESG policies, such as exclusions from insuring fossil fuel companies, tobacco producers and retailers or certain weapons manufacturers.

Many market commentators are pointing out that there are ESG mandates that could be tapped by ILS sponsors, particularly if, by doing so, it will allow them to obtain favourable pricing (as it did for Generali) from a wider investor base, which in turn have ESG regulatory mandates to comply with in their portfolios. Given the mutual benefits involved between investors and sponsors, it is expected that there will be more "green" cat bonds in the future and that there will continue to be a push in sidecar transactions that the business reinsured matches investors' ESG requirements.

D. Non-Cat Transactions

ILS as an asset class continued to build on some of the advances made in 2022 and showed its ability to innovate, particularly as it has continued to expand its offering to non-natural cat transactions.

(i) ***Cyber***

Cyber risk has long been ripe for ILS exploitation – particularly since it is a typical exclusion found in many ILS transactions – but many investors have been concerned by the relative infancy of cyber modelling and some have expressed concern that the different models that are now available to the market give very different views of the potential risks. However, in 2023, it is clear that investors are becoming increasingly comfortable with the modelling of cyber risk as cat bond transactions sponsored by Beazley (the market's first private cat bond), AXIS, Chubb and Swiss Re brought a combined $415 million of cyber risk to the ILS market. Another milestone is AXIS's Long Walk Re 2023-1 transaction, which was the world's first 144A cyber catastrophe bond.

Given the recent transactions, which have effectively proven the concept of cyber ILS, and the continued hard market in cyber driven by an increase in insurance penetration, increasing digitization and the potential severity of cyber-attacks, we believe that other (re)insurance groups will now also seek to get cyber coverage through ILS. In addition, cyber is not correlated to natural catastrophe risk allowing investors another hedge within ILS asset classes. Some market participants are sceptical that cyber risk is as uncorrelated to the wider macroeconomic environment. For example, there is a concern that an outbreak of hostilities between states could lead to both an economic downturn at the same time as increased cyber losses due to cyber-attacks from state and non-state actors. However, the predicted uptick in cyber losses resulting from the Russian invasion of Ukraine did not materialise and this may support a view that cyber is also a natural hedge to wider macroeconomic trends.

(ii) ***Life***

Life and annuity sidecars have also grown in popularity, using third party capital to support life and annuity reinsurance while also often providing asset management services to try to secure a return on the assets used as collateral. Please refer to our 2023 Insurance Year in Review for 'M&A in the Insurance Industry' under Part III (US Sidecars in M&A Deals and Other Transactions) for a description of recent activity and the structures that have been brought to market.

(iii) ***Legacy***

As noted in Part II (*UK Legacy Deals*) above, legacy transactions continue to be a feature of the reinsurance market. The proliferation of transactions, particularly large-scale transactions, has encouraged new capital to enter following the 2021 transaction, Gibson Re, which was R&Q's legacy sidecar. In 2022, Fleming Re was launched to support its legacy casualty business with ILS capacity. Fleming Re uses a loss portfolio transfer mechanism that will tranche liabilities meaning that investors can choose to shorten the tail if they want to, thereby allowing investors with a shorter investment horizon to come into the product.

(iv) ***Casualty***

Traditionally, casualty ILS transactions have required investor capital to be tied up for over five years to take account of the long tail of casualty books. However, in 2022 and 2023, there was renewed focus on casualty as an ILS class, with more capital moving into long tail business. There have been a number of innovations to ensure that investors are tied into casualty deals for shorter periods of time, thereby opening up the class to a wider group of investors. One solution has been to use fronting (re)insurers that, for an additional fee, will retain the tail on the casualty business after the transaction comes to an end. Another solution was pioneered by RenaissanceRe's casualty ILS vehicle, Fontana Re, which has an embedded liquidity feature. Fontana Re uses licensed (re)insurers to provide perpetual cover, allowing investors to roll in and out of the structure (subject to minimum holding periods). As part of the agreement by RenaissanceRe to purchase Validus from AIG in 2023, AIG agreed to make a significant investment into Fontana Re in time for the January 1, 2024 renewal, providing Fontana Re with increased underwriting capacity.

In addition, in 2023, AXIS Capital and Stone Point launched a collateralized reinsurer, Monarch Point Re, which will provide coverage for a diversified portfolio of casualty risks that are written by AXIS Capital's (re)insurance subsidiaries.

As for the other non-cat perils discussed in this section, casualty ILS brings additional non-correlated risks to a portfolio, which provides asset managers with an additional hedge within ILS as an asset class, as well as generally acting as a hedge to wider macroeconomic trends (excepting those lines of business within the casualty insurance framework which are exposed to downturns in the economy and so are not a natural hedge such as financial lines insurance).

E. London Bridge

After a slow start, in which the UK ILS regime struggled to compete with more established ILS markets, 2023 marked a watershed year with the Lloyd's ILS platform, London Bridge, reaching over $750 million in aggregate ILS issuances.

In particular in 2023, Beazley sponsored the first cat bond, Fuchsia Re, to use the London Bridge 2 structure. The Fuchsia transaction was the first excess of loss transaction to be consummated using the London Bridge 2 platform, with prior transactions providing quota share reinsurance coverage for cedants. Following on from this first cat bond transaction and several proportional transactions, London Bridge provides a range of alternative capital solutions to Lloyd's businesses. Given the streamlined process for bringing a transaction to market through the London Bridge platform, we expect a number of transactions to come to market as (re)insurers with a presence at Lloyd's continue to expand their outwards programs.

F. Florida Assignment of Benefits

In recent years, the Florida insurance market had seen an increase in losses and loss adjustment expenses due to the prevalence of Assignment of Benefits ("AOB") claims. Through AOB, homeowners are increasingly assigning the benefit of their insurance recovery to third parties (including the right to claim back legal fees if they were successful in arguing for a larger than initially offered pay-out). AOB in Florida has been characterised by an inflated size and number of claims, increased litigation, interference in the adjustment of claims and the assertion of bad faith actions and one-way attorney fees. In December 2022, a special session of the Florida legislature passed Senate Bill 2-A ("SB 2A"), which was signed into law by the governor on December 16, 2022. SB 2A seeks to address some of the abuses that have led to increased insurance litigation costs in Florida, including (i) eliminating a statutory right for insureds or other beneficiaries to be awarded attorney fees for judgments or decrees against insurers in suits arising under residential or commercial property insurance policies, (ii) prohibiting the assignment, in whole or in part, of any post-loss insurance benefit under any commercial or residential property policy issued on or after January 1, 2023, (iii) requiring a finding by a court of law of breach of contract on the part of an insurance company before an insured can sue such company for bad faith in the settlement of claims and (iv) clarifying the process by which an insurance company may include binding arbitration clauses in their policies. Many commentators expect that these changes will help reduce the trapping of capital in ILS that has been loss affected by Florida events, but it is too early to tell what medium- to long-term impact SB 2A will ultimately have in significantly reducing elevated rates of litigation, fraud and other abuses in the Florida property insurance market.

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

A. Introduction

2023 saw continued strong demand for PRT solutions in the UK and US, with higher interest rates generating a favourable environment for pension schemes to transact. Reported transactions point to deal volumes near or above record levels in those key markets and to continued growth in the Dutch, Irish and Canadian markets.

This year in review summarizes these developments in the PRT market in 2023. Taking each key market in turn, we summarize notable transactions, market trends and, where relevant, key regulatory and other developments that shaped the market in 2023.

B. Developments in the United Kingdom

(i) *Deal volumes*

It is estimated by Hymans Robertson that £50 billion of retirement income was secured through buy-ins and buy-outs during 2023, making 2023 a record-breaking year for the UK bulk annuity market and surpassing the previous peak of £43 billion of premium paid in 2019. This record number is even more impressive given transactions' nominal values decrease as interest rates increase. As a result, other things being equal, insurers need to insure more liabilities to reach the same volumes when compared to a lower interest rate environment (as applied, for example, in the previous record-breaking year of 2019).

Buy-ins and buy-outs have become increasingly affordable for defined benefit ("DB") pension schemes, as strong asset returns, decreasing pensions liabilities and stalling life expectancy changes have improved scheme funding levels. (See the '*trends driving the market'* section below.) Improved funding levels were a welcome development for DB pension schemes, which remain eager to de-risk particularly following the 2022 liability-driven investments ("LDI") crisis. The demand for bulk annuities in 2023 was further supported by strong reinsurance market capacity. Strong demand for bulk annuities has meant that insurers need to be more selective about the transactions they quote on. All the active bulk annuity insurers who responded to a market survey conducted by Aon in 2023 identified capacity constraints as one of the key challenges in meeting demand, with a limited pool of experienced professionals available to guide a transaction from bid to close.

(ii) ***Trends driving the market***

- Interest rates: The persistence of high interest rates bolstered demand for bulk annuity transactions in 2023. The Bank of England raised its base rate to curb inflation from 3.5% at the beginning of 2023 to 5.25% in August 2023. Higher interest rates improve scheme funding levels by reducing the discounted present value of pension scheme liabilities and raising gilt yields to more than offset the impact of a fall in equity markets and other growth assets. This makes bulk annuity transactions more affordable for pension schemes. While market commentators anticipate central bank rate cuts in 2024 as signs emerge that the recent inflationary trend is beginning to subside, the Bank of England has so far held interest rates steady, which should support continued high demand in the PRT market.

- Longevity expectations: Improved scheme funding levels have also been supported by stalling longevity expectations in recent years. The Institute and Faculty of Actuaries ("IFoA") biometric assumption setting working party on the subject has argued that, stripped of the "noise" of the COVID-19 pandemic, recent data indicates a pattern of higher non-COVID-19 excess deaths post-pandemic and, potentially, a different mortality and improvement regime. Possible drivers suggested by the IFoA include the re-emergence of influenza, health service disruption and treatment backlogs, lifestyle changes (with shifts in activity and alcohol consumption levels), the cost of living crisis, and poorer long-term health as a secondary impact of COVID-19 infections.

- Funded reinsurance: In response to schemes' demand for buy-ins and buy-outs, insurers continued to partner with reinsurers to support their capacity, reduce the resulting risk and capital burdens and diversify their investments. Funded reinsurance was a popular choice for insurers in 2023, as the transfer of both asset and longevity risk means that insurers reduce the regulatory capital they are required to hold against these risks (and the risk margin reflecting the cost of raising such capital), while accessing assets beyond their own origination capacities. We have also observed an increasing number of funded reinsurance deals in recent years. More broadly, we understand that reinsurers have responded to this demand for funded reinsurance, given the potential to earn an investment return from the transferred premium assets and the risk diversification benefits of taking on UK longevity risk. This is illustrated by the entry into the UK market of Resolution Re, the Bermudian reinsurance platform of Resolution Life, which concluded its first funded reinsurance transaction opposite a UK insurer in October 2023 and not long after completed its second funded reinsurance, at the end of 2023, to reinsure the market and longevity risks of approximately 90,000 in-payment policyholders with aggregate liabilities worth approximately £2 billion. Warwick Re, another Bermuda-domiciled reinsurer, also entered the UK bulk annuity market towards the end of 2023 with the conclusion of an approximately $500 million funded reinsurance transaction with Just Group plc.

- Illiquid assets: Insurers have historically been reluctant to accept in-specie illiquid assets in bulk purchase annuity premium payments, given the resources required to diligence, price and manage such assets, and the failure of many illiquid assets to comply with matching adjustment (“MA”) eligibility requirements. Despite these challenges, we have seen increased willingness from insurers during 2023 to accommodate schemes by accepting a portion of premium as in-specie illiquid assets and/or allow a portion of the premium payment to be deferred to allow time for the illiquid asset to be sold or run off. This willingness is driven by insurers’ imperative to win business from schemes, instigate portfolio diversification and benefit from the potential investment returns that illiquid assets can bring.

  To the extent insurers are not willing to hold such assets, they may look to use them to purchase reinsurance. We have seen a corresponding willingness on the part of reinsurers to accept such assets as premium in funded reinsurance arrangements and, in turn, to pledge them as collateral that secures the transaction. Such use of illiquid assets gives rise to legal and regulatory considerations. For example, legal requirements for transferring ownership or granting security over different illiquid asset types, potentially across various jurisdictions, require careful consideration. If the bulk purchase annuity transaction makes use of a deferred premium component, it could also impact the payment mechanics for the reinsurance premium where a buy-in or buy-out and its reinsurance are transacted simultaneously and subject to similar scale-down or termination terms if the scheme fails to satisfy the premium in full. Despite the structuring challenges, we are seeing parties seeking to build bespoke solutions to enable the use of illiquid assets in funded reinsurance arrangements. We believe that illiquid assets will continue to be a key feature of bulk annuity insurance and reinsurance transactions in 2024.

- Full scheme transactions: Improved scheme funding levels are also driving a trend from partial buy-ins to full scheme buy-outs that include both pensioners and deferred members. It has been reported that only three of the 95 deals completed in the first half of 2023 were pensioner-only transactions. The inclusion of deferred members and their greater potential variability in the longevity expectation could give rise to commercial challenges, particularly in setting assumptions regarding their mortality, marital status and commutation rates. It appears, however, that the market is finding solutions to these commercial complexities as the inclusion of deferred members is an increasingly common feature of transactions in the UK bulk annuity and related reinsurance markets.

(iii) ***Overview of 2023 transactions***

Given sustained growth in market activity and resulting insurer capacity constraints, there is a clear impetus for new entrants to capitalize on the surge in demand. Market commentators have speculated over the past few years that the UK bulk annuity market is likely to see new insurer entrants; this came to pass in 2023 when M&G plc concluded a £331 million buy-in with the M&G Group Pension Scheme in September. In the process M&G plc became the ninth active insurer in the UK bulk annuity market and the first new entrant in seven years. It has not taken long for another insurer to be added to that number, with Royal London announcing on March 8, 2024 that it intends to enter the bulk annuity market, following the insurance of two schemes affiliated to the Royal London group in December 2023 and January 2024 respectively. The number of bulk annuity insurers promises to grow in coming years, with Lane Clark & Peacock ("LCP") predicting that 2024 will see another new insurer entering the market, either through the acquisition of one of the existing bulk annuity providers or as a new provider. 2024 should also see some consolidation in the UK bulk annuity market, with Rothesay Life ("Rothesay") and Scottish Widows announcing in March 2024 that an agreement has been reached for the transfer of the Scottish Widows bulk annuities portfolio to Rothesay by way of a Part VII transfer.

For the established insurers, the surge in demand has resulted in a busy market in 2023 at every level. The three largest deals of the year were concluded by Pension Insurance Corporation ("PIC"), Legal & General ("L&G") and Rothesay. The largest ever deal was concluded in February, with PIC insuring the pensions of 40,000 members representing £6.5 billion in liabilities across two schemes sponsored by the RSA Group. L&G, in turn, concluded the year's second largest transaction in November, being a £4.8 billion full buy-in with the Boots Pension Scheme. L&G noted that this is also the largest single scheme transaction of its kind in the UK by premium size. The third largest transaction was Rothesay's £4 billion buy-in of the liabilities of the Co-operative Pension Scheme.

Notably, whilst large deals kept the market busy in 2023 the smallest end of the market remains the busiest, according to Aon. Sixty-seven percent of all deals completed in the first half of 2023 were under £100 million, with insurers becoming increasingly streamlined in their approaches to ensure they are able to serve increasing demand from smaller schemes.

Longevity swap transactions also had another busy year, with publicly announced longevity swaps entered into in respect of more than £10 billion of liabilities across four transactions. The largest swap announced in 2023 was the £5 billion transaction between the BT Pension Scheme and the Reinsurance Group of America ("RGA"), pursuant to which the scheme used its existing captive insurer to intermediate the swap. The scheme initially established the captive to facilitate its 2014 intermediated £16 billion longevity swap transaction with Prudential Insurance Company of America, which to our knowledge remains the largest UK longevity swap transaction to date. The second largest longevity swap reported in 2023 was the MMC UK Pension Fund's £2 billion longevity swap with Munich Re which was intermediated by Mercer ICC Limited, a Guernsey incorporated cell company managed by Marsh Captive Solutions Guernsey. Finally, the third largest longevity swap was concluded by the Nationwide Pension Fund, being a £1.7 billion longevity swap with Prudential Financial ("Prudential") and Zurich Assurance Ltd. (Zurich) in June 2023, with Zurich intermediating the transaction.

In addition to notable publicised transactions, we have observed a busy year in transactions which have gone unannounced, but represent a key segment of the UK PRT insurance market and the reinsurance capacity that supports it. Several funded reinsurance transactions have been closed with market participants who do not publicly announce such transactions. Insurers have also entered into several repeat deals for new tranches of schemes, and repeat longevity reinsurances with reinsurers – in each case leveraging the existing relationships between the parties and their existing agreement as to some or all terms to expedite deal execution. We have observed parties using "framework" agreements to this end, whereby several insurance or reinsurance transactions are executed under an overarching master framework agreement on common terms by entering into a short-form "confirmation" agreement. Flow arrangements have also continued to be used to support the reinsurance of smaller and/or simpler buy-in transactions. In both framework and flow arrangements, we have also observed an increased capacity of the parties to accommodate deferred members – and to amend existing arrangements to provide for them to be reinsured.

2023 also marked the first commercial consolidator transaction in the UK market, with Clara-Pensions ("Clara") covering Sears Retail Pension Scheme's 9,600 members. Clara has said that this transaction prompted a substantial uptick in interest from schemes such that their pipeline has grown to £9 billion of scheme liabilities, representing around 100,000 members. They have also emphasised that, while they see consolidation as a step in the journey towards buy-out, a buy-out continues to be "the gold standard for member security". The second commercial consolidator transaction was entered into on March 14, 2024, with all of the 10,400 members of the Debenhams Retirement Scheme set to join Clara, and the market will no doubt watch this space in 2024 to see whether Clara's initial transactions prompt more schemes to pursue commercial consolidators as an alternative de-risking option, on the route to buy-out or as a solution in itself. We expect that these decisions will be influenced by the Mansion House Reforms and, as is illustrated by the responses to the corresponding government consultation, the competing views held in the market regarding the merits of commercial consolidators (*see the 'Mansion House Reforms' section below*).

(iv) ***Regulatory Developments in 2023***

2023 saw further steps taken in the ongoing post-Brexit reform of Solvency II – the prudential regulatory regime inherited by the UK from the EU – as well as increased regulatory scrutiny of the bulk annuity market. This backdrop of regulatory reform will continue to develop and influence the bulk annuity market into 2024.

- PRA review of bulk purchase annuity reinsurance: In 2022, the PRA raised concerns regarding concentration and recapture risk in the life insurance sector stemming from increased use of longevity reinsurance, funded reinsurance and illiquid assets. The PRA continued this focus in 2023 by carrying out a thematic review of bulk purchase annuity deals and, following its review, released statements that set out its expectations for funded reinsurance in the UK market. These include the PRA's "Dear CRO Letter" published in June 2023 and the funded reinsurance consultation paper issued by the PRA in November 2023, which the PRA intends to convert into a "Supervisory Statement" in Q2 2024 once it has received comments from the industry. Supervisory Statements set out non-binding regulatory guidance that informs the PRA's supervisory decisions and is given weight in the industry.

  The PRA raised the concern that risk is increasingly concentrated in a number of highly correlated and increasingly credit-focused overseas reinsurers. It also raised the concern that, in an attempt to close deals in a competitive market, insurers may be inclined to agree to collateral assets that are not appropriate to back their liabilities, are not practical to recapture (or manage following recapture), or that otherwise carry risks that are not properly considered. A reliance on the asset origination capacities of overseas reinsurers also conflicts with the secondary objective recently assigned to the PRA by the UK government to support competitiveness and growth in the UK market (for which the UK government hopes its reforms to Solvency II encourage insurers to increase productive investment in the UK, in sectors such as social housing and infrastructure). The competing imperatives of high demand for PRT solutions and capacity constraints, encouragement to invest, but increased regulatory scrutiny, create a difficult landscape for insurers to navigate.

The PRA's expectations, as set out in the consultation paper, broadly require:

- insurers to set counterparty limits which take into account their need for a diversified asset strategy, operational capabilities to manage the collateral assets following recapture, and the risk of recapturing assets from multiple highly correlated counterparties (in particular, reinsurers with similar credit-focused business models);

- insurers' collateral policies to include details on approaches to credit assessments, valuation methodologies, MA eligibility monitoring, solvency capital requirement ("SCR") modelling, and investment management approaches on recapture;

- insurers to formulate a recapture plan for their funded reinsurance arrangements to demonstrate that their business models can survive any single recapture event and multiple recaptures from correlated counterparties. The recapture plan must include a step-by-step plan for the transfer and subsequent management of the collateral assets;

- insurers' calculation of the counterparty risk component of their SCR to take into account all the material and quantifiable risks relating to funded reinsurance arrangements; and

- insurers' modelling not to assume that recaptured assets will form part of their MA portfolio unless the insurer can clearly demonstrate that the assets would satisfy the insurer's MA conditions (particularly when recapturing under stressed conditions), but to "*take into account the rebalancing and trading activities necessary to achieve compliance with the MA conditions*" upon a recapture, and not to assume that they will be able to rely on management actions in a recapture unless they can clearly demonstrate that they have the "*operational readiness and capabilities required to perform the management actions*" in stressed conditions.

The PRA has recognised the value of funded reinsurance as part of a diversified asset strategy and has not given any indication that it will expressly limit its use. However, the PRA's consultation paper cautions insurers to exercise moderation when engaging in funded reinsurance. The PRA has expressed a willingness to develop funded reinsurance policy and supervisory measures in due course and indicated that one of its insurance supervision priorities for 2024 is to continue to monitor the use of funded reinsurance in the UK life market.

- <u>IAIS 2024 Global Monitoring Exercise (GME):</u> The International Association of Insurance Supervisors (IAIS) have observed that the growing use of cross border asset-intensive reinsurance raises certain supervisory concerns, including knowledge gaps in non-domestic prudential frameworks, limited information exchange, conflicts of interest within corporate structures and, similarly to the PRA, concentration risks. The IAIS have said that they will continue gathering information on the structural shifts in the life insurance sector, through the 2024 GME, and will develop an issues paper for consultation in the first half of 2025. The issues paper will, among other things, "*share supervisory practices for monitoring, analysing and supervising risks associated with cross-border asset-intensive reinsurance, including jurisdictional approaches to capital and collateral requirements, reserving and asset valuation*."

- Solvency II Reform: The UK government's intention to reform the Solvency II regime as it applies in the UK (also referred to as "Solvency UK") remains a key area of interest to the pensions de-risking market. Following the government's April 2022 "Review of Solvency II" consultation paper, and its subsequent November 2022 response, the PRA published two consultation papers during 2023 seeking industry input on its proposed reforms to the Solvency UK. These consultation papers are "CP19/23 – Review of Solvency II: Reform of the Matching Adjustment" (published September 2023) and "CP12/23 – Review of Solvency II: Adapting to the UK insurance market" (published June 2023), which was followed up by the related PRA policy statement "PS2/24 – Review of Solvency II: Adapting to the UK insurance market" in February 2024.

  Among the key proposals for reform are changes to the methodology for the calculation of the risk margin, which came into effect on December 31, 2023. The risk margin is the amount insurers are required to hold in addition to the assets held against their liabilities and regulatory capital requirement. It is intended to cover the cost of raising capital to meet that regulatory capital requirement if the insurer was required to recapitalise or transfer its liabilities to another insurer following an adverse shock. The changes are estimated to reduce the risk margin by 30% for non-life insurance obligations and 65% for life insurance obligations. The reduction is achieved by reducing the fixed cost of capital rate used in the calculation of the risk margin (often criticised as too high) from six percent to four percent and introducing a "risk tapering factor" which, in the case of life (re)insurance obligations only, discounts the present value of the projected capital such that later years count for less in the calculation. Nevertheless, following its consultation with insurers, the PRA does not expect this change to the methodology to decrease the demand for reinsurance.

  Another key feature is the much-anticipated relaxing of the eligibility criteria for MA assets, which is to come into effect at the end of June 2024. The MA allows an insurer to reduce the measure of its best estimate of future liabilities (and hence, the amount in assets required to support it) by applying a more favourable discount rate where the cash flow of assets held against those liabilities is suitably matched to them. The rationale for the MA is that an insurer matching liability and asset cash flows will not be forced to sell those assets before maturity. It can therefore be assumed to no longer be subject to the asset's liquidity risk (that is, the risk of selling at an undervalue on a secondary market) and can therefore take account of the compensation the asset delivers for that liquidity risk (the liquidity premium). Currently, to ensure matching, only assets with "fixed cash-flows" are eligible. The reforms propose to also permit assets that have "highly predictable cash-flows", provided the latter group of assets make up no more than 10% of an insurer's MA portfolio. Further proposals that we expect insurers to welcome are:

- the removal of the limits to the amount of sub-investment grade assets that may be included in the MA portfolio;
- a streamlined MA application process for certain assets; and
- less severe (or less immediate) consequences for breaching MA conditions.

Increased flexibility in MA eligibility is, however, countered to some extent by measures intended to improve "*responsiveness to risk and enhancing firms' responsibility for risk management*". One way in which the reforms seek to achieve this is by ensuring the fundamental spread properly reflects risks in insurers' MA investment strategies. The fundamental spread is used to determine the extent of the MA uplift on the discount rate that an insurer can apply when discounting its liabilities. It does so by reflecting the risks to which an insurer remains subject even when matching asset and liability cash flows. These are excluded in the calculation of the MA benefit so that the level of MA benefit only reflects the liquidity premium, not the residual risk. The PRA has proposed, as part of the Solvency UK reforms, that fundamental spread calculations are made more sensitive to credit risk and, where assets with "highly predictable cash flows" are included in the MA portfolio, that the fundamental spread is increased to take account of the additional risks associated with such assets (such as reinvestment and liquidity risks) compared to assets with fixed cash flows. The reforms also require that an attestation is given to the PRA by one of the insurer's senior managers (i.e., an individual whose appointment requires regulatory approval and against whom the regulator may take action for a breach of regulatory requirements by the firm) that the fundamental spread is set at a sufficient level and that the MA reflects only the 'liquidity premium'. Further reforms aimed at bolstering policyholder protection are the increased frequency of stress testing and the requirement that an insurer should show, as part of their MA application, how they have assessed the suitability and risks of MA assets in compliance with the Prudent Person Principle. The Prudent Person Principle is the overarching rule governing insurers' investment activity under Solvency II and requires insurers to "*only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs*."

The previously expressed timeline for the implementation of the Solvency II reforms called for the changes to the risk margin to be in force by the end of 2023, the MA reforms to be in place by the end of June 2024 and the remainder of the new regime to come into force by the end of 2024. The PRA has said in its January 11, 2024 Dear CEO Letter that they are considering feedback received from the market on the September 2023 consultation paper and will publish final policy statements in 2024 to ensure changes to Solvency UK can be completed by the end of 2024.

Other Solvency II reforms are broadly aimed at easing the burden of reporting and administration requirements for insurers and we discuss these in more detail in Part VI (*Principal Regulatory, Tax and Antitrust Developments*) below.

- Mansion House Reforms: On July 11, 2023, the Chancellor of the Exchequer Jeremy Hunt announced, in a speech at Mansion House, a series of measures that are aimed at taking advantage of Brexit by positioning the UK as a growth-friendly market. The measures and subsequent consultation documents (referred to collectively as the "Mansion House Reforms") include reforms intended to increase investment by pension schemes in productive UK assets, increase the consolidation of pension schemes and generally improve outcomes for pensioners while stimulating productive investment in the UK economy.

  As part of the Mansion House Reforms, the Department for Work and Pensions ("DWP") launched a call for evidence on July 11, 2023 titled "Options for Defined Benefit Schemes" that invited input from the industry on (i) DB schemes' ability to invest in productive assets, (ii) the extraction of scheme surplus and (iii) the establishment of a public consolidator, or the potential for the Pension Protection Fund ("PPF") to act as a public consolidator, to operate alongside commercial consolidators (see more on commercial consolidators below).

  Consultation responses to these proposals were mixed: insurers and pension consultants generally asserted that the buy-in and buy-out market has sufficient capacity to accept these schemes, but trustees of some smaller schemes argue that they are not well served by the buy-in and buy-out market and that a small-scale public-sector consolidator would be beneficial. Whether or not the PPF would be well placed to perform this role also received mixed reviews in the consultation, with its strong reputation and experience being weighed up against considerations of fairness to schemes paying the PPF levy and pensioners whose benefits are paid by the PPF. Ultimately the government decided that there is a place in the DB market for a public consolidator aimed at schemes that are unattractive for buy-out providers or commercial consolidators and that this will benefit the economy by reducing scheme costs and allowing access to productive assets that smaller schemes could not otherwise access. The government has not yet decided who that consolidator will be, but its initial view is that the PPF would be well placed to serve this function.

  In 2023, the DWP also renewed its focus on commercial consolidators as part of the Mansion House Reforms and the wider government agenda to encourage investment in productive UK asset classes. In July 2023, it reported on responses to its 2018 consultation paper and set out the key features of the permanent regulatory regime that it proposes to replace the TPR interim regime for commercial consolidators, with legislation to follow as soon as parliamentary time allows. It argues that the buy-in and buy-out market does not have the capacity to serve all DB schemes and that there is demand for an alternative option for schemes that cannot afford to transfer their risk to an insurer. The intention is for commercial consolidators to only be an option for schemes that cannot afford to reach buy-out. Given the security that a buy-out offers members, the permanent regime proposed by the DWP will include eligibility criteria to act as a regulatory "gateway" to ensure that schemes that are able to transact a buy-out do so and do not consolidate into a commercial consolidator. According to the DWP, the target schemes in scope of consolidation into a commercial consolidator are schemes that have funding levels between 70% and 90% of bulk annuity pricing, because a buy-in or buy-out is unlikely to be achievable for these schemes in the near term but they have sufficient funding to afford the expected price of entry into the consolidator. As noted above, Clara transacted the first such commercial consolidator transaction in 2023, with more expected to follow.

C. Developments in Europe

(i) *Netherlands*

The Netherlands has for several years been considered the most promising market for pensions de-risking in continental Europe. By 2023, industry consolidation through several mergers and acquisitions of PRT insurers made them more profitable and better able to transact. Meanwhile, mergers and acquisitions of defined benefit pension schemes and recent improvements in pension schemes' funding levels, owing to improved debt yields, has made schemes similarly better able to transact. In December 2023, NN Life entered into a pair of longevity risk transfer transactions with Prudential and Swiss Re, respectively, pursuant to which NN Life transferred longevity risk valued at approximately €13 billion in the aggregate, reinsuring more than 200,000 policies. This is the second longevity reinsurance transaction between NN Life and Swiss Re, with the first completed in May 2020.

In 2023, insurers increased their capacity to meet schemes' increased demand for PRT solutions. For instance, a strategic cooperation arrangement between L&G and Lifetri, announced in March 2023, has now expanded the number of potential bidders in the Dutch PRT market beyond incumbents such as Athora Netherlands, ASR, and NN Group.

Dutch commentators have noted that the Dutch Pensions Act, which took effect on July 1, 2023, is expected to catalyse significant change in the Dutch PRT market. The Dutch Pensions Act requires Dutch pension schemes to transition from defined benefit accrual (currently adopted by the majority of Dutch employer pension scheme members) to defined contributions only, on or before January 1, 2028. The Dutch Pensions Act also instigates a flat contribution structure (regardless of age), specifies proportions that partners can receive from their members' benefits, and provides for a new capital contribution defined contribution scheme for pension insurers that, according to one survey, a significant portion of company pension schemes are expecting to use. Consultants have noted that many schemes and insurers have begun preparing for PRTs, but are waiting for large transactions, that develop legal and regulatory compliance comfort, to complete before proceeding.

(ii) *Ireland*

With an estimated €100 million worth of PRT transactions in the first half of 2023, and, as one commentary noted, only two insurers writing material volumes of PRT since

2020, the Irish market has remained small relative to the US and the UK. However, Milliman LLP ("Milliman") reports that there have been some transactions aimed at achieving capital requirement and risk margin reductions, including a significant annuity reinsurance transaction for one life insurer and an amendment to the longevity reinsurance arrangements of another.

(iii) ***Funded Reinsurance***

On February 1, 2024, Baloise Belgium NV ("Baloise") entered into an asset-intensive reinsurance transaction with RGA, pursuant to which RGA reinsured 57,000 life insurance policies with reserves of approximately €900 million. This is a notable transaction in continental Europe where asset-intensive reinsurance is less common than in the UK (where the same structure is often referred to in the PRT context as "funded re"). RGA posts collateral in favour of Baloise to secure its liabilities under the transaction.

D. Developments in North America

(iv) ***United States***

- <u>Deal volumes</u>: Like the UK, the US continues to see growth and activity at all segments of the PRT market. Market watchers estimate that $45 billion in total sales value was reached in the US PRT market in 2023. That would make 2023 the second busiest year to date, standing behind only the $52 billion written in 2022. The first half of 2023 was reported to be the busiest six months on record. In that period, insurers wrote $22.5 billion of premium across 289 transactions, which marked a 28% increase over the first half of 2022. The second half of the year usually sees an uptick in activity. In 2023, that uptick took the form of total deals, rather than total sales with the total number of transactions for the year reaching 773. This marks a new record for number of transactions, comfortably exceeding the 568 PRT transactions reported for the full year of 2022.

- <u>Overview of 2023 transactions</u>: Six jumbo transactions had been announced in 2023. They include a $1 billion transaction pursuant to which Prudential insured the pension plan of Public Service Enterprise Group Inc. ("PSE&G"), announced in August; an $8.1 billion transaction in which two Athene subsidiaries insured AT&T Inc.'s pension plan, announced in May; and again Athene insuring approximately 85% of ATI Inc.'s $1.77 billion liabilities, announced in October. Other jumbo transactions involved three unnamed sponsors who transferred $2 billion, $1 billion, and $1 billion respectively, each to unnamed insurers.

  Market commentators have noted that deal volume records are likely the result of increased activity in mid-to-smaller sized transactions. Some of 2023's mid-market deals include the following: Principal Life Insurance Co. insured $184 million of NOV Inc's pension plan liabilities; L&G Retirement America ("LGRA") and RGA split a $309 million liftout for PPG Industries Inc.'s pension plan; AAR Corp. transferred all of its plan's liabilities to American National Insurance Company and American National Life Insurance Company of New York; Centrus Energy Corp. transferred approximately $186.5 million of its pension plan obligations to an unnamed insurer;

two Fidelity subsidiaries (Fidelity & Guaranty Life Insurance Company and Fidelity & Guaranty Life Insurance Company of New York) provided approximately $250 million of group annuity contracts to a Unisys Corporation pension plan; and Pacific Life insured $115 million of United States Steel Corporation's plan liabilities.

- Trends driving the market: There are several factors that may incentivise sponsors to de-risk. Foremost among them is demand. Notably, MetLife's 2023 Pension Risk Transfer Poll suggested that 89% of surveyed plan sponsors intend to completely divest of plan liabilities across an average of 4.1 years, and 21% of such sponsors say they intend to terminate their plans, while 49% intend to pursue retiree liftouts. One potential headwind for well-funded plans is that the longer term benefit of de-risking may not actually outweigh the significant costs and divestiture of capital that the purchase of a group annuity contract would entail. We have observed efforts by well-funded plans to explore proof-of-concept transactions that would allow them to off-load pension liabilities, while improving commercial benefits by retaining the benefit of their plan assets. This will be a space to watch in 2024, as we expect such efforts to continue and if successful, they may add a new dimension to the US market.

  In unpacking the drivers of sponsors' demand for PRT, MetLife's poll found that sponsors' current primary catalysts for initiating PRTs are macroeconomic factors, particularly inflation (49% of surveyed sponsors), followed by market volatility, interest rates, and increasing numbers of retirees (each 42%, respectively) and economic recession (31%). Market-specific factors of favourable buy-out pricing (35%) and Pension Benefit Guaranty Corporation ("PBGC") premiums (24%) are seemingly still primary concerns albeit relatively less predominant. Nevertheless, as discussed in our prior Year in Reviews, marked increases in PBGC premiums during the last decade have pushed plan sponsors to de-risk, and this year the PBGC announced further expected rate increases to $101 per participant for 2024, following a rise to $88 in 2022 and $96 in 2023. Moreover, Milliman have noted that pension plans' funding levels remained positive for PRT transactions throughout 2023, ending the year 0.2% higher than year-end 2022, with funding ratios increasing in the second and third quarters despite dropping in the first and fourth quarters.

  While PRT demand has increased, the number of insurer participants has remained steady at approximately 21, following the entry into the market of three insurers in 2022 – Global Atlantic Financial Group, RGA and American National Insurance Corp. Market. Analysts have commented that insurers tend to focus their bids on particular market segments due, at least in part, to the administrative challenges of conducting large transactions. Despite that, it has been reported that the increased number of insurers has, in turn, increased competition for bids (that may further explain steadying pricing that Milliman has observed) and facilitated exploration of other transaction arrangements that reduce transaction costs while accommodating sponsors' preferences.

- Single stage buy-outs: MetLife's poll also highlighted that an increasing number of sponsors are interested in pursuing single buy-outs as an alternative to the more typical incremental approach to de-risking via multiple deals over the course of several years. While the latter approach is still favoured, 45% of sponsors noted that they would prefer a single annuity buy-out transaction, up significantly from the 37% in 2022. The MetLife poll indicated that sponsors are concerned with missing an opportunity to secure a competitively priced buy-out, due to interest rates levelling or declining, which may explain why more sponsors seek a single buy-out.

- Buy-ins: Favourable buy-out pricing may be driving further growth in the number of buy-in transactions in the US market. Buy-ins are well-established in the UK market because they allow pension schemes to lock-in pricing and capacity in advance of termination. We have long expected buy-ins to gain a firm foothold in the US market for similar reasons, and we observed in our 2021 Year in Review that sponsors were increasingly considering buy-ins in the US market. That trend continued in 2022, which saw $3.6 billion in reported buy-ins, and in the first three quarters of 2023 eight reported buy-ins were transacted, totalling an estimated $3.9 billion of premium. While buy-ins currently comprise a niche in overall market volumes, we would expect their overall share of the market to continue to grow in the coming years. In particular, they may present an attractive alternative for some sponsors given the strong interest in de-risking in the US market.

- Split deals: Split deals allow insurers to pool capacity, while reducing transaction risks for large and complex deals. They have long been a feature of the US market. Recent transactions include IBM's $16 billion deal with Prudential and MetLife in 2022 and, on the other side of the market, PPG Industries' $309 million split deal with LGRA and RGA this year. There is potential for increased numbers of split deals in the future, especially as insurers seek to maximise capacity in the context of sponsors' stronger PRT demand.

- Sidecars and captives: In our prior Year in Reviews, we discussed new Bermuda-domiciled sidecar structures formed to invest in life and annuity (re)insurance. That trend has continued and is discussed in more detail in our 2023 Insurance Year in Review for 'M&A in the Insurance Industry' under Part III (US Sidecars in M&A Deals and Other Transactions). There are several sidecars now operating in Bermuda that offer additional sources of capital for life and annuity (re)insurance. In 2023, a number of reinsurance sidecars were established focusing on life and annuity (re)insurance, including Prismic Life Reinsurance Ltd (sponsored by Prudential and Warburg Pincus), ACRA 2 (sponsored by Athene and Apollo), Ivy Re 2 (sponsored by Global Atlantic and KKR), and Kindly Re (sponsored by Kuvare and Davidson Kempner). Sidecars that precede 2023 include

ACRA Re (sponsored by Athene and Apollo, and established in 2019), Ivy Re (sponsored by Global Atlantic and KKR in 2020), SkyRidge Re (sponsored by Security Benefit and Eldridge in 2021), Martello Re (sponsored by a US insurer and its affiliate investment management firm in 2022) and AEL Bermuda Re (sponsored by American Equity LIC in 2022). The growth in this market sector indicates increasing maturity for drawing third party capital into life and annuity (re)insurance.

Also in 2023, Fidelity Investments announced the creation of Soteria Reinsurance Ltd., a Bermuda-based reinsurer that will focus on PRTs and retail annuities. This follows L&G launching another Bermudian reinsurer, Legal & General Reinsurance Company No. 2, in December 2022. As observed in our previous Year in Reviews, Pacific Life Re, Phoenix Re Ltd. and Monument Re are also writing PRT business out of Bermuda.

This area of the market has not been without setbacks. In our 2018 Year in Review, we commented on the launch of Langhorne Re, a closed-ended Bermudian reinsurance vehicle sponsored by RGA and Bermuda reinsurer Renaissance Re, that was established to acquire closed in-force life and annuity blocks. After not having entered into any transactions during its four-year life span, it was reported in February 2023 that investors had decided to wind down the vehicle. In light of the number of other life and annuity sidecar vehicles that have launched in the market, some of which have reported entering into transactions, the winding down of Langhorne Re does not appear to represent a lack of demand in this space.

- Reinsurance: We have also observed that more insurers are looking to obtain reinsurance cover for their increasingly large books of PRT liabilities. In particular, we have seen insurers look to establish flow reinsurance arrangements that afford them the certainty of pricing as they bid on active deals. To that same end, another notable development is the potential growth of longevity reinsurance in the US. There have been two reported deals in the US to date: RGA's $1.7 billion longevity swap with Western & Southern Financial Group in December 2022 and RGA's longevity swap with an unnamed insurer in 2018.

The widespread implementation of longevity reinsurance has faced headwinds in the US PRT market. Nevertheless, the US Society of Actuaries reported in their February 2023 newsletter that demand for longevity reinsurance transactions in the US market may increase for several reasons. First, there have been significant improvements in mortality data in the US which enable reinsurers to provide more attractive underwriting, and thereby reduce an impediment that has been a material bar to longevity reinsurance in the US, which unlike the UK, has not had access to credible mortality data via readily available national death records and mortality improvement studies (such as the UK CMI model). Second, longevity reinsurance has been proposed to be in scope for the National Association of Insurance Commissioners'

("NAIC") principle-based reserving guidelines under VM-22 of the NAIC Valuation Manual, which could result in clearer accounting treatment guidelines on the reserve and capital treatment for longevity transactions in the future. Finally, the new C-2 longevity factors in the NAIC Risk Based Capital formula will mean that longevity reinsurance could be used to improve an insurer's capital ratio. We understand that the NAIC is scheduled to provide further recommendations in 2024 and we will be watching for more development of longevity reinsurance in the US.

- Regulatory developments: A topic relevant to the US PRT market is the potential update to the US Department of Labor's ("DOL") Interpretive Bulletin 95-1. Our Client Alert briefing on NAIC's 2023 Fall National Meeting (found here) reported that NAIC staff are holding discussions with the DOL concerning various topics, including work to update Interpretive Bulletin 95-1.

  In August 2023, the Advisory Council on Employee Welfare and Pension Benefit Plans ("Advisory Council") to the DOL Regarding Interpretive Bulletin 95-1 recommends that the DOL "make no changes" to Interpretive Bulletin 95-1, noting that since the issuance of Interpretive Bulletin 95-1 there have not been any defaults or failures of any group annuity. The Advisory Council considered ownership structure, types of assets and liabilities, and the availability of reinsurance, among other topical issues, in making this recommendation. Notably, the Advisory Council appears to not be of the same view as the UK regulator that further regulation may be needed to address those topical issues. The DOL was to review standards guidance for fiduciaries in selecting annuity providers for group annuity contract purchases and report its findings to Congress by 2023 year-end. This will be a topic of interest for the market in 2024.

(v) ***Canada***

The Canadian PRT market has continued to develop. An increase in interest rates and widening of credit spreads led to a decrease in pension liabilities and a general increase in funded status of Canadian pension plans in 2022, resulting in an estimated record-breaking C$10.58 billion (US$7.8 billion) of PRT insurance from 155 transactions, up from C$9.75 billion (US$7.7 billion) and 149 transactions in 2021. Commentary from Canadian market analysts suggests that similar levels of PRTs are expected for 2023.

Notably, the Weyerhaeuser Company announced an annuity purchase in the fourth quarter of 2022 covering approximately C$570 million (US$420 million) of Canadian pension liabilities to an unnamed insurance carrier. This transaction is the latest in a series of PRTs that Weyerhaeuser Company has completed in recent years and the first involving Canadian liabilities. Previous transactions include the 2019 purchase of a group annuity contract from Athene, covering an estimated C$2 billion (US$1.5 billion) in US pension plan liabilities, and the 2020 purchase of a group annuity contract from MetLife, covering approximately C$1 billion (US$765 million) in US pension plan liabilities. Interestingly, LifeWork's (now TELUS Health) purchase of annuity contracts in the second quarter of 2022 for the Stelco Inc. Retirement Plan was structured as a buy-in transaction, suggesting that buy-ins will continue to play a role in the evolving Canadian PRT market. More recently, in April 2023, Alcoa Corporation transferred an estimated C$315 million (US$235 million) of its Canadian pension plan liabilities to Industrial Alliance Insurance and Financial Services Incorporated with a group annuity contract, and in December 2023, LGRA announced “a recent” estimated C$350 million (US$260 million) PRT with an unnamed Canadian pension scheme.

Like the US, the Canadian market has also seen an increase in the number of active insurers. It has been reported that nine insurers were actively quoting on group annuities as of early 2023, with Assumption Life being the latest market entrant in 2022. Market analysts suggest that the PRT market is segmented by transaction size, and that appetite for large transactions appears to remain with BMO Insurance, Brookfield Annuity, Desjardins Insurance, Industrial Alliance, RBC Insurance and Sun Life.

E. Developments in Japan

At ¥97.3 trillion (approximately US$875.5 billion), total Japanese defined benefit assets were estimated to be the world’s third largest in 2021. However, with ¥113.4 trillion (approximately US$1 billion) of liabilities that same year, Japanese DB schemes were 14% unfunded – bucking the trend we have seen in the US and UK. Whilst corporate defined benefit schemes’ liabilities have, according to market watchers, been trending downwards, funding levels have similarly decreased and may be a contributing factor to muted demand for PRT solutions in the Japanese market. Moreover, when compared to UK and US contemporaries, reports note that a far larger proportion of pensions are taken as lump sum cash-outs, which may also explain the lower levels of demand for Japanese PRT transactions.

Nevertheless, the reinsurance market for Japanese life and annuity policies remains strong, reflecting US reinsurers’ appetite for those liabilities. In 2023, Global Atlantic completed its first block reinsurance transaction in Japan, with Manulife, for Japanese, and also US, life, annuity, and long-term care liabilities across three tranches. In April 2023, an unnamed Japanese life insurer and Fortitude Re closed two block reinsurance transactions through a Bermudian subsidiary, Fortitude International Reinsurance Limited. Another, unnamed Japanese insurer entered into its first fixed annuity flow arrangement with Resolution Re, the Bermudian reinsurance platform of Resolution Life. Resolution Life previously transacted a reinsurance agreement with Dai-Ichi Life (Japan) in 2022. In November 2023, it was announced that Athene entered into a reinsurance transaction covering an in-force block of life insurance policies for FWD Life Insurance Co. Ltd. of which the mortality risk was retroceded to Swiss Re.

F. Looking Forward into 2024

The market goes into 2024 facing a degree of uncertainty as to the economic and regulatory environment. Whilst market analysts broadly expect a reversal of the current higher inflation and interest rate trend, the pace of this reversal is unclear, as is whether it will be arrested by further geopolitical changes. There are also several regulatory developments, with both the UK and EU’s prudential regulation undergoing a process of reform, and increased attention in the UK on the bulk annuity market and its use of funded reinsurance.

Despite this uncertainty, there is no sign that the currently buoyant market will slow. Demand for bulk annuity transactions remains high in the UK, with a large proportion of scheme liabilities still uninsured and a continued appetite of scheme employers to see this liability fall away from their balance sheet. The demand looks likely to continue to strain the human resource, underwriting and asset-sourcing capacity of bulk annuity insurers. Market participants are likely to continue to have to triage transactions in light of these resource constraints. In the UK market, while both the need for regulatory approval and the already established position of existing players creates high barriers to entry, the continued high demand begs the question whether there will be one or more new entrants into the market in coming years, as some market watchers have predicted. Regardless of any new entrant, several analysts anticipate that activity levels will not slow and deal volumes will be higher again in 2024, with a continued trend towards full scheme transactions and megadeals.

The US market has already gotten off to a quick start – Prudential announced the closing of a $4.9 billion PRT transaction with Shell USA, Inc. in early February – and looks likely to continue the trend of high transaction volumes and activity given the exceptional level of market demand. MetLife's poll reported that nine in 10 companies plan to completely divest all of their DB pension plan liabilities in an average of 4.1 years and 85% of plan sponsors are concerned about missing a window of opportunity to secure an annuity buy-out at competitive rates, which is likely to drive demand to de-risk in 2024 and beyond.

While no other market has seen volumes comparable to the UK and US, we expect continued interest in the growth of other markets for pension de-risking – particularly in the Netherlands where Prudential's and Swiss Re's recent transactions bode well for potential additional deals. We will continue to monitor developments in other markets, including Belgium and Ireland, for continued growth, as well as for the possibilities for development elsewhere, be it in some of the jurisdictions often mentioned as new frontiers, like Australia, or elsewhere.

V. CAPITAL MARKETS ACTIVITY AND REGULATORY DEVELOPMENTS

It is hoped that 2024 could signal a crucial year in the recovery of both the debt and equity markets globally. With some exceptions, capital markets activity in 2023 continued to be hindered by broader economic uncertainties, market volatility and geopolitical instability. Stabilising inflation and interest rates at the end of 2023, and into early 2024, have cultivated talk of a more promising deal pipeline going forward. Although there is cause for cautious optimism, it is anticipated that investors are still waiting to see whether central banks will require further action, and how markets will react, before ramping up their support for new deals.

On the rule-making front, a number of new regulatory measures were announced in the US and the UK in 2023 (with effect from 2024), which are anticipated to bear on the implementation of compliance procedures and transaction execution. This section seeks to draw out some of those key rule-making initiatives and analyse how those are expected to impact international capital markets in 2024, particularly in the UK and US, for foreign private issuers ("FPIs").

A. European and UK Capital Markets Activity

In Europe, Solvency II rules have historically allowed issuers to grandfather certain Solvency I capital items until December 31, 2025 so that they could be used to demonstrate solvency under Solvency II. The Solvency II regime, which came into force in 2016 and set new capital requirements for insurers, and granted a 10-year grace period for junior bonds which did not then satisfy the new regulations to be replaced. It has been anticipated that instruments with redemption dates beyond January 1, 2026 will need to be restructured or divested. In January 2024, Allianz SE bought back €1.5 billion of its old-style 3.875% Fixed-for-life perpetual securities, which are set to lose regulatory value at the end of 2025, and priced a new €1 billion Tier 2 issuance at 4.85%. In November 2023, Coface SA issued €300 million subordinated Tier 2 notes in order to refinance its outstanding €227 million guaranteed subordinated 4.125% notes due on March 27, 2024, and Aviva issued £500 million 6.875% Tier 2 Fixed Rate Reset Notes due in 2053 under its £7 billion Euro Note Programme. Phoenix Group Holdings plc, esure Group plc, RSA Insurance Group Limited and Admiral Group plc similarly conducted tender offers earlier in 2023 in order to repurchase expiring subordinated notes.

The sector has also continued its support for sustainability-linked and green instruments. In January 2024, Assicurazioni Generali S.p.A. placed two new Euro-denominated Tier 2 bonds, for €500 million and €750 million, due in January 2029 and in January 2034, respectively, both issued in green format in accordance with Generali's Green, Social & Sustainability Bond Framework. In December 2023, ASR Nederland N.V. issued a €600 million green senior debt instrument in its inaugural green bond issue under its Green Finance Framework established in 2022, the proceeds of which are anticipated to support ASR's transition to a more sustainable lower carbon economy. In April 2023, NN Group similarly settled a green debt offering of €1 billion of subordinated notes. This was the second issuance under NN Group's Sustainability Bond Framework, which was established in February 2022 with the aim of financing green and social projects. In January 2023, Baloise Holding Ltd successfully placed a CHF 175 million senior green bond due in January 2032 in alignment with its existing Green Bond Framework.

In notable European transactions related to deal-making and new listings, in July 2023, Aegon completed the combination of its Dutch pension, life and non-life insurance, banking, and mortgage origination activities with ASR, and began its asset management partnership with ASR. As part of the transaction, Aegon received €2.2 billion in cash proceeds and a 29.99% stake in ASR. The combination is reported to have created the number two insurance company in the Netherlands, with significant scale across different segments. In October 2023, Nasdaq Helsinki admitted Mandatum plc (the company incorporated following the demerger and separation from Sampo plc) to trading on the official list. By separating Mandatum from Sampo, the company is reported to have simplified the group and created two entities that are well placed to create shareholder value. Mandatum offers customers a wide array of services covering savings and investment and personal risk insurance.

In other activity, 2023 saw the usual deal flow for customary frequent MTN issuers in Europe and the UK, such as Aviva, AXA and L&G.

B. UK and European Regulatory Developments

In a bid to continue making the UK's capital markets more competitive, the UK government has prioritised updating the UK's listing regime and prospectus regime, with updates expected to enter into force in 2024.

In relation to the UK's listing regime, the FCA published draft updated listing rules ("UKLRs") on March 7, 2023, which are expected to take effect in the second half of 2024. The key updates to the existing regime for listing on the London Stock Exchange's main market are:

- Listing Segments. The UKLRs replace the existing standard and premium listed segments of the London Stock Exchange with a single listing segment: the commercial companies segment. This will require companies to comply with a single set of rules which are more stringent than the current rules for standard listed companies, but less onerous in certain ways that the current rules for premium listed companies.

- Sponsors. All companies listed on the new commercial company segment will be required to retain a sponsor. However, the sponsor's role will be curtailed in comparison to its current role for premium listed companies, and will be focused on transactions that result in a significant increase in an issuer's share capital or constitute a reverse takeover or related party transaction.

- Historical Financial Information. Prior to these reforms, in order to qualify for admission to the premium listed segment of the London Stock Exchange, issuers needed historical financial statements covering 75% of their business for a period of three years. This was a major deciding factor in several issuers choosing to list initially on the standard segment. Under the UKLRs, there is no similar requirement, meaning that issuers with short financial histories will be able to list on the new commercial companies segment.

- Significant Transactions. Under the current regime, premium listed issuers must obtain shareholder approval for certain significant transactions and related party transactions. Under the UKLRs, a shareholder vote will not be required for significant transactions, including related party transactions. However, a shareholder vote will still be required if an issuer proposes to undertake a reverse takeover.

The UKLRs also retain certain parts of the existing listing regime. For example, issuers that have a standard listing when the UKLRs enter into force will continue to be subject to the prior listing regime until they voluntarily transition to the new commercial companies listing segment. In addition, issuers that have a controlling (> 30%) shareholder must continue to have a relationship agreement in place, pursuant to which the controlling shareholder agrees to allow the issuer to carry out an independent business.

In January 2024, HM Treasury published the Public Offers and Admissions to Trading Regulations 2024, under which the FCA is empowered to make rules relating to the UK's prospectus regime. The FCA intends to consult on its proposed rules in the summer of 2024, with the new rules coming into force as early as 2025. Although the FCA's proposals have not yet been published, a key update to the UK's prospectus regime includes a change to when an approved prospectus must be published in the UK. Currently, an approved prospectus is required to be published if there is either an offer of securities to the public in the UK or admission to trading on a UK regulated market. Under the new regime, an approved prospectus will be required only in the case of an admission to trading on a UK regulated market. In fact, the new regime will flip the status quo, and instead of an offer to the public being permitted once there is a prospectus, an offer to the public will be prohibited unless it fits into one of the prescribed exemptions. Most of the exemptions from the requirement to publish a prospectus have remained and a number of new exemptions were added to the list. It is intended that this will remove confusion and duplication over when an approved prospectus is required to be published in the UK. In addition, the reforms to the prospectus regime aim to encourage issuers to make certain types of forward-looking statements (such as projections) easier to include in prospectuses by making it harder for investors to make claims against issuers in the event such forward-looking statements fail to materialise.

In times of increasing investment in ESG and focus on sustainability, rule-making initiatives have been keeping up. In June 2023, the International Capital Market Association issued an updated version of its Sustainability-Linked Bond Principles. In November 2023, the EU's Green Bonds Regulation entered into force, with application from December 2024. The EU's Green Bonds Regulation is a voluntary standard for issuers of bonds that wish to use the designation 'European Green Bond' or 'EuGB' for suitable bonds that are made available to investors in the European Union. While there is currently no formal proposal for an equivalent UK green bond standard, in August 2023, the UK's Green Technical Advisory Group recommended that a voluntary UK green bond standard should be put in place. Furthermore, in November 2023, the FCA published a policy statement entitled 'PS23/16 Sustainability Disclosure Requirements (SDR) and investment labels', which sets out final rules and guidance for FCA-authorised firms to comply with in order to help consumers understand the extent to which investments and products are sustainable.

C. US Capital Markets Activity

As we know, in 2023, the insurance sector saw Skyward Specialty, Fidelis and Hamilton complete IPOs and also saw Apollo-owed Aspen announce its intended IPO. Fidelis sold $210 million of stock at an approximate $1.5 billion valuation in its IPO and Hamilton sold $247.5 million at a $1.65 billion valuation. Given the number of Bermuda reinsurers founded in the past five to ten years, whose investors are presumably seeking liquidity, we expect 2024 to remain active in M&A and IPOs.

D. US Capital Markets Regulatory Developments

In the United States, issuers and investors are now subject to additional disclosure rules, most notably concerning compensation clawbacks, cybersecurity, beneficial ownership reporting and share repurchases, as well as a heightened focus by regulators on high-risk areas such as crypto assets and sanctions.

In January 2023, the final rules on clawbacks of executive compensation required by the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") became effective. FPIs must now file their clawback policies as an exhibit to their annual reports on Form 20-F. If an FPI is required to prepare an accounting restatement triggered by the recovery of erroneously-awarded incentive-based compensation under its clawback policy, it must provide disclosure of such clawback under a new Item 6-F of Form 20-F.

In February 2023, amendments to Rule 10b5-1 under the Exchange Act became effective. FPIs are now required to file a copy of their insider trading policies and procedures as an exhibit to Form 20-F, and an FPI is required to make additional disclosures in its Form 20-F regarding its procedures for its directors, officers and employees buying and selling its securities in compliance with insider trading laws.

Also in February 2023, the SEC adopted a rule amendment to shorten the standard settlement cycle for most routine securities trades from two business days after the trade date to one business day after the trade date (from 'T+2' to 'T+1'). The amendment is one way in which the SEC is seeking to address recent occurrences of market volatility. The compliance deadline for the rule change will be the end of May 2024.

In June 2023, as mandated by Dodd-Frank, the SEC amended Regulation M to eliminate the current investment grade exceptions to Rules 101 and 102, and replace them with exceptions that use alternative standards of creditworthiness that are not based on credit ratings. Now, instead of an investment grade rating, the new exception relies on an issuer's probability of default, as determined by the lead manager in a distribution using a 'structural credit risk model'. Regulation M is designed to prevent anyone with a financial interest in a distribution from manipulating the market price, and thereby misleading potential investors as to the true state of the public market for the securities being distributed. Rules 101 and 102 of Regulation M govern the activities of issuers selling security holders, underwriters, and other persons participating in a distribution of securities.

In September 2023, the SEC's final rules on cybersecurity disclosure became effective. FPIs are now required to include disclosures relating to cybersecurity risk management programs in their Form 20-F and to report material cybersecurity incidents otherwise publicised in their home jurisdictions on Form 6-K.

The SEC has also continued its focus on climate and ESG risks and opportunities and has published its rulemaking list which contains certain ESG-related rulemakings that the SEC is considering. In March 2024, the SEC adopted final rules requiring registrants to provide additional climate-related information in their registration statements and annual reports, including in their financial statements. The final rules set forth requirements for disclosure of material climate-related risks, mitigation activities, targets and goals, and governance. The rules also require disclosure of certain greenhouse gas emissions metrics and attestation of emissions disclosures. Multiple parties initiated litigation challenging the final rules, and in April 2024, the SEC voluntarily stayed the final rules pending completion of judicial review.

VI. PRINCIPAL REGULATORY, TAX AND ANTITRUST DEVELOPMENTS

A. Overview

Over seven years have passed since the result of the Brexit referendum and the topic still looms large in the rear-view mirror. Despite the passage of time, only limited rapprochement has been achieved between the UK and the EU. This has been caused in part by the acrimonious nature of their divorce in February 2020, and the continued tension over longstanding issues such as the Northern Ireland Protocol.

An exception to this estrangement is that the parties finally signed the Memorandum of Understanding ("MOU") on June 27, 2023, some two years after the text was originally agreed in March 2021. The MOU has more than a merely symbolic benefit, and will create a forum for continued regulatory cooperation via the creation of a Joint EU-UK Financial Regulatory Forum (the "Forum"), which will meet semi-annually to improve transparency between the parties, work towards achieving compatibility of each other's regulatory standards and will exchange information of common interest relating to financial services regulation.

There are, however, limits to what the MOU is likely to achieve in practice. In particular, whilst the Forum will be used to discuss the adoption, suspension and withdrawal of equivalence decisions, the MOU does not actually set out a roadmap for achieving bilateral EU-UK equivalence, or any other forms of deepening of mutual market access. Further, the passage of time may have reduced the Forum's importance, as financial services entities established in either the UK or the EU have long since abandoned hope of direct cross-border access via "passporting" (or similar) rights.

The year 2024 will bring about material regulatory divergence between the UK and the EU, as both the UK government and the EU's various authorities continued their respective reviews of the Solvency II Directive during the course of 2023. This, along with developments in the Lloyd's market for 2023, are discussed further below.

B. UK Regulatory Developments

(i) *Introduction to the Future Regulatory Framework*

The UK government believes that the ability to make wholesale changes to UK financial services regulation is a major benefit of Brexit, and in furtherance of this, it has been consulting with industry stakeholders on "the Future Regulatory Framework Review" since October 2020. The cornerstone of this new regime is FSMA 2023, which received Royal Assent on June 29, 2023 and now forms part of UK law. FSMA 2023 is an ambitious piece of legislation, which effects certain immediate changes, and also signals potential projects aimed at replacing EU-retained regulation with substitutes that are more tailored to the UK market.

One of the immediate changes implemented by FSMA 2023 is that both the UK's PRA and the Financial Conduct Authority ("FCA") are bound by a new secondary objective to facilitate the international competitiveness of the UK economy (including, in particular, the financial services sector), and its medium- to long-term growth, subject to aligning with international standards. The UK regulators regard this new objective as an important change, and it is expected to be applied pervasively, in addition to the regulators' primary objectives of preserving consumer protection, market integrity and the safety and soundness of UK-regulated firms. Accordingly, this new objective could represent increased opportunities for industry stakeholders to participate in new and innovative projects, fewer hurdles to effective competition and a welcoming regulatory environment for prospective controllers of regulated entities.

However, the medium- to long-term lens through which the UK regulators will approach this new objective is likely to mean that a level of close regulatory scrutiny will continue, particularly in respect of proposed acquisitions or commercial ventures that are geared towards immediate returns at the potential expense of customers. The reference to applying international standards will also preclude the UK from deregulating its financial services sector to the point of being an outlier in the global community.

FSMA 2023 also enhances the UK regulators' ability to impose conditions when approving change in control notifications. The UK regulators' powers were previously limited so that the use of conditions was only possible where it was considered to be a fundamental feature of the approval decision. A UK regulator now has a much broader ability to impose conditions where it appears "*desirable to impose those conditions to advance any of that regulator's objectives*". The UK regulators' exercise of this power is most likely to occur in scenarios where the regulators have already identified regulatory issues in the target firm, such as capital deficiencies, recent oversights in systems and controls, or perceived weaknesses in a firm's governance arrangements.

In respect of longer-term changes, the government's planned overhaul of UK financial services regulation took centre stage on December 9, 2022, when the Chancellor of the Exchequer published a collection of announcements known as the "Edinburgh Reforms"; reflections of the government's ambition for the UK to be the world's most innovative and competitive financial centre. Following this speech, a series of announcements were made relating to the practical implementation of these reforms in the Chancellor's "Mansion House" speech given in July 2023.

The government (or more specifically HM Treasury) intends to replace retained EU law in "tranches" given the sheer size of the task, with the first tranche including the proposed changes to the UK Solvency II Regime.

(ii) ***Reform of the UK Solvency II Regime***

HM Treasury began consulting with industry stakeholders on changing the regulatory obligations that the UK Solvency II regime places on UK-regulated firms in July 2021, and on November 17, 2022, published its "Review of Solvency II: Consultation – Response", containing its finalised package of reforms. As expected, key regulatory changes related to the rules on the risk margin, the matching adjustment and the range of available investment assets in matching adjustment portfolios.

HM Treasury subsequently placed two Statutory Instruments before UK Parliament on December 8, 2023 to effect these changes, which were made on December 31, 2023. HM Treasury's amendments to the risk margin entered into force from this date. Other regulatory changes will mainly come into force on June 30, 2024, although the introduction of PRA rule-making powers relating to the matching adjustment came into force on April 1, 2024.

Please see Part IV (*Development and Trends in Longevity, Pension Close-Outs and De-Risking Transactions*) above.

As mentioned in Part IV (*Developments and Trends in Longevity, Pension Close-Outs and De-Risking Transactions*), the PRA consulted on a large number of new rules in its Consultation Paper CP12/23 entitled 'Review of Solvency II: Adapting to the UK insurance market' covering areas where HM Treasury has chosen not to legislate directly. The PRA has focused on measures designed to simplify existing Solvency II requirements, to allow improved flexibility for others, and to encourage entry into the UK market. These proposals include:

- simplification and process improvements to the calculation of the transitional measure on technical provisions ("TMTP") to reduce the cost and complexity for firms, including the cost of retaining legacy Solvency I models by which to benchmark the TMTP. (The TMTP is a synthetic asset added to a Solvency II insurer's balance sheet to reflect the impact of implementing Solvency II as compared to the prior prudential regime. It reduces in value over the course of the transition period of 2016 to 2032 to smooth that impact as it runs off over time);

- streamlined rules for internal models (reducing prescriptive requirements and introducing more supervisory judgement and principles-based requirements);

- greater flexibility in the calculation of group solvency requirements;

- the removal of certain requirements for branches and international insurers operating in the UK (to increase the attractiveness of the UK sector to inward investment);

- streamlining and removal of reporting requirements, leading to an overall reduction in the frequency and number of reporting requirements;

- a new mobilisation regime to facilitate entry and expansion for new insurers and facilitate competition; and

- increases to the size thresholds at which Solvency II applies so more small insurers fall outside the regime.

The PRA published its corresponding Policy Statement in February 2024, in which it stated its intention to implement the rules broadly as proposed in its Consultation Paper. The key change is that the PRA intends to further increase the Solvency II threshold relating to a firm's gross written premium income to £25 million (rather than £15 million as originally proposed). The PRA plans to implement these changes by December 31, 2024, so that impacted firms have sufficient time to implement the new rules into their internal systems and controls.

(iii) ***Increased Regulatory Discretion for the UK Regulators***

Another key feature of the Future Regulatory Framework is a shift of the burden of regulation from primary legislation to the UK regulators' implementation of new rules into the PRA Rulebook and the FCA Handbook via their existing rule-making powers contained in the

Financial Services and Markets Act 2000 as amended and supplemented from time to time. HM Treasury intends that this approach will increase the flexibility of UK regulation, by allowing the UK regulators to quickly adapt regulation in light of market changes. It remains to be seen how this will impact the shape of prudential and conduct regulation in the UK, but greater PRA and/or FCA discretion is likely to emphasise the importance of a successful dialogue between firms and their regulatory supervisors.

(iv) *New UK Regime for Captive Insurers*

HM Treasury also announced plans to consult on a new regime for UK captive insurers in the Autumn Statement of 2023, and is set to launch a consultation on proposed features of the new regime in Spring 2024. Although no details on the scope and content of this new regime were disclosed in the initial statement, HM Treasury stated that its objective would be to create *"a new framework for encouraging the establishment and growth of captive insurance companies in the UK"*, which suggests that UK captive insurers could benefit from lighter touch prudential regulation when the regime is in place. This potential regulatory development is likely to be welcomed by the UK captive insurance sector and wider industry participants, particularly given the level of (re)insurance rates in the current hard market.

(v) *Conclusion*

The Chancellor's regulatory reforms have largely been welcomed by stakeholders in the financial services sector, who hope that they will have the intended impact of boosting the competitiveness of UK financial services. HM Treasury hopes the potential benefits of these reforms could be widespread, including a significant increase in UK jobs and additional investment as the UK becomes an increasingly attractive place to do business. However, the success of these reforms will ultimately depend upon their execution, and a significant amount of work is required over a number of years before they will be entirely implemented.

C. Developments at Lloyd's

(i) *Introduction*

Lloyd's has spent the year making notable progress on its existing projects, including its "Blueprint Two" program and its focus on improving underwriting results. We set out the key developments in the Lloyd's market from 2023 in the paragraphs below.

(ii) *Progress on Blueprint Two*

As we have published in previous versions of the Year in Review, Lloyd's is in the process of implementing its "Blueprint Two" program, a multifaceted project to migrate the market's outdated, paper-based systems to a new digital ecosystem that is faster, more automated and cheaper for market participants and customers.

After a significant amount of work undertaken throughout 2022 and 2023, Lloyd's has finally announced that the Lloyd's market will be moved over to a new digital platform powered by 'Velonetic', a joint venture between Lloyd's, the International Underwriting Association and DXC Technology. The new Lloyd's platform will eventually provide automated processing capabilities in respect of both open market and delegated authority insurance transactions, commencing from initial onboarding to settling claims. It is also expected that the new platform will increasingly integrate artificial intelligence technologies as they become available.

Lloyd's has announced the roll-out of Blueprint Two in two phases. The target launch date for Phase One is October 2024, and will involve all customers being moved over to the new Velonetic platform in order to receive services relating to processing and settling premiums and claims. Phase Two, which has been delayed from the end of 2024 to April 2025, will result in the full digitalisation of Lloyd's processes in respect of both delegated authority and open-market business. Once Phase Two has been implemented, the new digital platform will provide the following benefits to the Lloyd's onboarding and claims handling processes:

- Onboarding: Brokers will no longer place risks using a paper-based system, and the various Lloyd's IT systems that were not interoperable will be replaced by a new fully digitalised and streamlined process. Background checks required to be performed as part of the onboarding process will be run automatically, and the process will use a single harmonised data standard.

- Claims Settlement: Similarly, both open market and delegated authority business will move away from a manual claims-handling system. Under the new regime, a new Digital Processing Platform (known as "ICOS") will support faster and automated claims handling through digital collaboration between brokers and insurers. ICOS will also enable connectivity with third party services, such as loss event information and integration with other third party experts who perform part of the claims handling process.

(iii) ***Next Steps***

As stated above, Lloyd's has delayed its planned implementation of phase two of Blueprint Two, which is intended to go live in April 2025. Once this phase is in place, the market will work in a fully digital and cloud-based environment that matches the forward-thinking insurance business underwritten by its participants.

(iv) ***Financial Results for 2023***

Lloyd's has continued to enjoy the benefits of an increased focus on underwriting results and has demonstrated a notably improved underwriting performance for the 2023 underwriting year, reporting their best results in recent history. Following encouraging half-year results, Lloyd's posted strong underwriting results for the full year, by nearly doubling its underwriting profit to £5.9 billion (in comparison with its 2022 results) and a fall in its combined ratio to 84 percent (down from 91.9 percent in relation to 2022). However, Lloyd's has made no progress reducing its expense ratio, which Blueprint Two will hopefully help with once implemented.

Lloyd's results were predominantly the result of a growth in profitable underwriting from existing syndicates, foreign currency movements and risk-adjusted rate increases.

D. EU Regulatory Developments

(i) ***Introduction***

In contrast to the potential 'big-bang' of UK regulatory change following Brexit, the EU has adopted a more measured approach to reviewing its own regime. The European Commission published the following proposals for reforming the EU insurance regulatory architecture on September 22, 2021: (a) a package of proposed reforms (the "Proposed Reforms") to the Solvency II Directive; and (b) the introduction of a new Insurance Recovery and Resolution Directive ("IRRD").

The European Council and the European Parliament have reviewed both of these proposals in the intervening period, and published their respective versions of the texts during the course of 2022 and 2023. The EU legislative bodies agreed upon compromise versions of the texts in December 2023, and each entity will now vote whether to adopt the texts via its respective legislative processes. If the texts are adopted, they will thereafter be transposed into the national law of EEA member states ("Member States"). We set out the current status of each proposal in the paragraphs below.

(ii) ***Review of Solvency II***

As we reported in previous editions of our Year in Review, the European Commission prepared the Proposed Reforms on the basis that they considered Solvency II is generally working well, and that no fundamental changes are currently required. A number of key proposals were therefore intended to further the EU's broader political and economic aims, including incentivizing long-term investment in infrastructure and adapting the Solvency II framework to the European Green Deal, a package of policy initiatives introduced by the European Commission that aim to facilitate the EU reaching climate neutrality by 2050. Certain proposed regulatory changes considered in the Proposed Reforms overlap with HM Treasury's own review of Solvency II (as discussed in further detail in the UK regulatory section above), such as making its application more proportionate to smaller firms, and reviewing the matching adjustment and the risk margin. Other areas of reform relate to cross-border supervision issues and create macro-prudential tools.

Consistent with the EU's legislative process, the Proposed Reforms have been reviewed by both the European Council and the European Parliament during the course of 2022 and 2023. The European Council published its position first, on June 17, 2022, in which it agreed with the European Commission that Solvency II has generally been working well.

By contrast, the Economic and Monetary Affairs Committee of the European Parliament, the committee with responsibility for reviewing and commenting upon the Proposed Reforms, proposed 805 amendments to the text over the course of 2022 and only agreed upon its proposed version of the text on July 27, 2023.

The version of the updated Solvency II text agreed by the European Parliament and the European Council reflect a number of the European Parliament's proposals. Key points arising out of this version of the text are as follows:

- the finalised text builds upon the existing language contained in Solvency II regarding proportionality of treatment for certain smaller undertakings. In the updated text, proportionate treatment is afforded to 'low-risk profile' and 'small and non-complex undertakings'. 'Low-risk profile undertakings' (which will be defined in secondary legislation, rather than the updated Solvency II text) can benefit from proportionality measures without requiring prior consent from the regulatory authority in the applicable Member State. By contrast, the updated Solvency II text defines 'small and non-complex undertakings' as entities whose technical provisions from life / non-life insurance activities are below certain limits based on annual gross premium income written across the EU (amongst other criteria), and precludes entities that use full or partial internal models. The updated text requires entities to notify Member State regulatory authorities for prior authorisation to be treated as a ‘small and non-complex undertaking’;

- the EU legislative bodies have agreed to increase the Solvency II thresholds. Consistent with the European Commission’s original recommendations, Solvency II will not apply to firms whose: (i) annual gross written premiums do not exceed EUR 15 million (currently EUR 5 million); and (ii) technical provisions, gross of amounts recoverable from reinsurance contracts and special purpose vehicles, do not exceed EUR 50 million (currently EUR 25 million);

- (re)insurers must take into account the financial risks arising from short, medium and long-term sustainability factors, including those arising from the EU’s transition to a sustainable economy;

- the Solvency II text amends the conditions for (re)insurers’ ability to apply favourable capital treatment to their own funds held as long-term equity investments; a regulatory incentive for EU (re)insurers to invest in long-term projects that will facilitate the bloc’s transition to a greener economy. The EU accepts that the original criteria for this capital treatment are regarded as too difficult for firms to comply with and, consistent with the European Parliament’s proposed amendments, has included a revised list of conditions in the updated text;

- the updated text also contains a number of changes relating to the calculation of technical provisions, including risk-free interest rates, the risk margin and the volatility adjustment; and

- the updated Solvency II text includes new rights afforded to Member State regulatory authorities when notified of a (re)insurer’s deteriorating solvency position. The new provision states that regulatory authorities may take any proportionate measures to remedy the deterioration. In particular, Member States must ensure that their regulatory authorities can require the administrative, management or supervisory body of the (re)insurer to update and take the measures set out in their pre-emptive recovery plan drawn up under the IRRD (please see the section below where we discuss the IRRD in more detail).

The timings for agreeing the final form of the Solvency II reforms are unclear. However, Member States may take guidance from the proposed implementation dates contained in the European Parliament’s proposed text: Member States shall transpose the updated text into their domestic legislation by June 30, 2025, and EEA (re)insurers must comply with them from January 1, 2026.

(iii) ***The IRRD***

The IRRD is intended to be a harmonized recovery and resolution planning framework, which ensures that insurers in the EU are better prepared in times of financial distress, and national supervisory authorities are equipped with a set of resolution tools for early intervention if insurers are either failing or are likely to fail. The IRRD therefore aims to address current perceived discrepancies between the insurance recovery and resolution regimes established under the national laws of

Member States, which could impede effective international cooperation if an EU insurance group experiences financial stress.

The EU's consultation on the implementation of the IRRD framework has been conducted in parallel with a similar process undertaken by the UK's HM Treasury, which sought industry feedback on a proposed Insurer Resolution Regime during the course of 2023. Following receipt of positive feedback from the UK insurance industry, HM Treasury will work with the UK Parliament to implement domestic legislation at some point in the future. No timeframe has been given for the implementation of this new legislation, and it is expected that HM Treasury will only turn to the Insurer Resolution Regime following the UK general election, which is due to take place later in 2024.

The IRRD text agreed between the European Parliament and the European Commission in December 2023 contains the following features:

- each Member State must set up an insurance resolution authority, which must prepare resolution plans setting out the resolution actions that they would 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*;

- EU insurers and insurance groups are required to prepare pre-emptive 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 60 percent of their markets are subject to recovery plans and 40 percent are subject to resolution plans;

- resolution authorities are provided with a range of regulatory tools, which they may use to resolve the financial condition of (re)insurance undertakings, including: (1) writing down or conversion of capital instruments, debt instruments and other eligible liabilities; (2) withdrawing an undertaking's authorization to conclude new insurance or reinsurance contracts in order to facilitate an orderly run-off; and (3) selling all or part of an undertaking's business on commercial terms; and

- establishment of a framework for cross-border resolution within the EU to take into account the international nature of EU (re)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 EU level.

Under the IRRD regime, small and non-complex undertakings are not subject to pre-emptive recovery and resolution planning requirements (save where they represent a particular risk at national or regional level). Further information about the scope of the IRRD will be set by EIOPA in the form of technical standards.

The EU legislative process for the IRRD is running broadly in parallel with the process for finalizing Solvency II. The EU legislative bodies have not stated when they expect the IRRD to enter into force. However, the updated IRRD text provides that the text must be in force 24 months after its formal adoption at EU-level, which is expected to occur during the first half of 2024. It is therefore likely that EU (re)insurers will become subject to the Directive during the course of 2026.

E. UK and EU Antitrust Developments

(i) *Mergers and Acquisitions*

In March 2024, the Competition and Markets Authority ("CMA") cleared the acquisition of AIG Life Limited, the UK life insurance business of Corebridge Financial, Inc., by Aviva after launching a merger inquiry on 8 February 2024.

Also in March 2024, Venus Topco Limited (parent of Markerstudy Group) received clearance from the CMA to acquire Atlanta Investment Holdings 3 Limited, part of the Ardonagh Group that owns household insurance-broking brands Swinton and Carole Nash. As a result, creating one of the UK's vertically integrated motorcycle insurance companies.

In May 2023, AXA received unconditional clearance from the European Commission to increase its presence in the Spanish property, casualty and health insurance markets through its acquisition of the Spanish operations of Groupe Assurances du Crédit Mutuel. The European Commission found that the transaction did not give rise to competition concerns given the companies' moderate combined market positions resulting from the transaction and the very limited vertical links between the companies' activities.

In June 2023, the Dutch Authority for Consumers & Markets ("ACM") unconditionally cleared the acquisition of Aegon Nederland by ASR Nederland. The ACM found that post-transaction, sufficient competition will remain in the property, casualty and income protection insurance markets in which both parties are active.

(ii) *Anticompetitive conduct - insurer offers commitments to bring an end to Spanish unfair competition investigation*

The Spanish National Markets and Competition Commission ("CNMC") has accepted commitments from DKV Seguros y Reaseguros, S.A.E. ("DKV") (part of the ERGO Group, a subsidiary of Munich Re), ending its investigation into potentially unfair conduct by DKV. Following a complaint received through a mailbox set up to protect consumers during the COVID-19 crisis, the CNMC found that DKV unilaterally cancelled the temporary disability policies of a number of self-employed policy holders and encouraged them to take out other services instead. The CNMC considered that DKV had taken advantage of the pandemic to impose changes to contractual terms on its customers, inter alia by citing a non-existent regulatory requirement as a pretext to cancel the policies.

In February 2023, DKV undertook to compensate (i) all affected policyholders that suffered temporary disability, with the amount they would have been due under their policy, (ii) policyholders that took out temporary disability insurance elsewhere once they found out that their DKV policy was cancelled; and (iii) policyholders who took out hospitalisation cover from DKV instead of the cancelled temporary disability cover.

(iii) *Net Zero Insurance Alliance*

At least seven members of the Net Zero Insurance Alliance (including five of the eight founding signatories), namely AXA, Allianz, Hannover Re, Munich Re, SCOR, Swiss Re and Zurich, withdrew their membership. These withdrawals from the alliance, which is part of the Glasgow Financial Alliance for Net Zero set up by UN climate envoy Mark Carney, followed "serious concerns" raised by US Attorneys General in letters sent to the alliance's members that the alliance violated antitrust laws by unfairly targeting the oil and gas industry.

F. Tax Considerations for London Bridge

The London Bridge structure has proven particularly attractive for investors searching for exposure to risk from the Lloyd's market in a largely tax neutral onshore structure. Each cell in London Bridge Risk PCC Limited ("London Bridge 1") and London Bridge 2 should be a qualifying transformer vehicle for UK corporation tax purposes and therefore benefit from an exemption from UK corporation tax in respect of profits arising from insurance risk transformation activities. However, that exemption is subject to a targeted anti-avoidance rule ("TAAR") which applies if the main purpose of the arrangements is to secure a tax advantage.

Willkie has previously worked with clients to seek advance clearance from HM Revenue & Customs ("HMRC") on the application of the TAAR in a number of structures. However, following an update to its guidance in November 2022 to state that the TAAR will not apply if an investor has only structured its arrangements to take advantage of the special tax treatment available to cells, HMRC have indicated that they will no longer provide clearances in most cases.

While this change is not expected to have a material impact on transactions, investors and sponsors should take care to record their commercial rationale for entering into a structure utilizing London Bridge as a matter of good practice.

G. Bermuda Corporate Income Tax

In 2023 we saw a surprise shift in the tax landscape for the (re)insurance industry with the Bermuda government passing legislation on December 27, 2023, the Corporate Income Tax Act 2023 (the "CIT Act"), to enact a corporate income tax ("CIT") at a rate of 15%, which will become effective for accounting periods starting on or after January 1, 2025.

(i) *Overview*

The Bermuda government's shift in position on corporate tax has been greatly influenced by the adoption of the OECD/G20's proposals to effect a global minimum tax ("Pillar 2") and the implementation of the OECD/G20's model rules on Pillar 2 (the "Model Rules") into domestic legislation in numerous jurisdictions globally.

In introducing the CIT, the intention of the Bermuda government was to design a regime that would be treated as a "covered tax" for the purposes of Pillar 2 top-up taxes in other jurisdictions. In principle, therefore, any CIT payable by multinational groups operating in Bermuda should not be an additional tax cost but rather a reallocation of taxes that would otherwise be payable in other jurisdictions. Importantly, the Bermuda Government has provided that these rules will take priority over any tax assurance certificates previously given to businesses operating in Bermuda.

(ii) ***Key design features***

The CIT should only apply to those entities that would otherwise be caught by top-up taxes of other jurisdictions implemented in accordance with the Model Rules. Accordingly, the CIT is limited to multinational groups (as defined in the Model Rules) with global revenues in excess of €750 million in two of the previous four tax years.

Additionally, the legislation includes a number of exemptions which will be familiar to those looking at the application of Pillar 2. For example, an entity which is an "excluded entity" under the Model Rules (such as pension funds and investment funds) are expected to be excluded from CIT. The legislation also mirrors the Pillar 2 proposals with respect to multinational groups with limited international presence: effectively, groups with (i) entities in five or fewer jurisdictions outside Bermuda and (ii) aggregate tangible assets in those non-Bermuda entities of €50 million or less, may be outside the scope of CIT for a five-year period.

Importantly, whilst the CIT's application is generally limited to Bermuda entities of multinational groups within the scope of Pillar 2, the Bermuda government has not implemented Pillar 2 and top-up taxes in respect of non-Bermuda group entities are not expected to be payable by Bermuda entities.

Other design elements of the CIT have clearly been influenced by the economy's reliance on the insurance sector. For instance, for Bermuda (re)insurers, losses can be carried forward to offset future tax liabilities and shared amongst Bermuda entities within the same group.

Further, the new regime is not expected to materially impact the Bermuda ILS market since the typical structures used for ILS transactions involve stand-alone special purpose insurers ("SPI") set up as orphan companies with shares settled on charitable trust and so are detached from both cedants and investors. These entities are incorporated solely to facilitate ILS transactions, and in isolation, are unlikely to meet the criteria for forming part of a multinational group (within the meaning of the CIT Act and the Model Rules) and so would not be expected to be consolidated into the accounts of ILS investors or the cedant sponsor. However, not every ILS transaction involves the use of an off-balance sheet transformer vehicle akin to an SPI and so each structure should be carefully considered to understand the applicability or otherwise of the CIT Act on the ILS transaction in question.

(iii) ***Deviations from draft legislation***

Prior to adoption of the legislation, the Bermuda government published and consulted on draft legislation in November 2023. While the final legislation closely aligns with the consultation proposals, for those familiar with the draft there are some notable changes.

The most significant of these deviations are:

- the removal of allowances for certain foreign tax credits of non-Bermuda entities related to income earned by Bermuda entities, notably including the removal of allowances for US taxes paid on Subpart F/global intangible low-taxed income inclusions from Bermuda entities that are controlled foreign corporations (“CFC”) for US tax purposes; and

- the inclusion of a limited two-year election available to exclude from the CIT base certain income of a Bermuda entity that is a CFC for US tax purposes.

(iv) ***Final remarks***

Whilst the CIT remains limited in scope and should not materially increase the tax cost for multinational groups with operations in Bermuda, the regime presents a new administrative challenge for insurance groups. Aside from the obvious ongoing reporting obligations, insurance groups will have to carefully consider whether any of the 24 elections in the final legislation are applicable to exempt or otherwise limit the impact of the CIT to their operations.

VII. GLOSSARY

A. Definitions

"ACM" means the Dutch Authority for Consumers & Markets.

"Advisory Council" means the Advisory Council on Employee Welfare and Pension Benefit Plans

"AOB" means Assignment of Benefits.

"Apollo" means Apollo Global Management.

"Athene" means Athene Holdings Ltd.

"Baloise" means Baloise Belgium NV.

"BMA" means the Bermuda Monetary Authority.

"CFC" means controlled foreign corporations.

"CIT Act" means the Bermuda Corporate Income Tax Act 2023.

"CIT" means Corporate Income Tax.

"CMA" means the UK Competition and Markets Authority.

"CNMC" means the Spanish National Markets and Competition Commission.

"DB" means defined benefit.

"DKV" means DKV Seguros y Reaseguros, S.A.E.

"Dodd-Frank" means the Dodd–Frank Wall Street Reform and Consumer Protection Act

"DOL" means the US Department of Labor.

"DWP" means the UK Department for Work and Pensions.

"EEA" means European Economic Area.

"EIOPA" means the European Insurance and Occupational Pension Authority.

"ESG" means environmental, social and governance.

"EU" means the European Union.

"EUGBS" means the European Green Bond Standard.

"EU SFDR" means EU Sustainable Finance Disclosure Regulation.

"FCA" means the Financial Conduct Authority.

"Forum" means the Joint EU-UK Financial Regulatory Forum.

"FPI" means foreign private issuer.

"FSMA 2023" the Financial Services and Markets Act 2023.

"HMRC" means His Majesty's Revenue & Customs.

"HM Treasury" means His Majesty's Treasury.

"IBM" means International Business Machines Corporation.

"ICOS" means the new core solution for open market and delegated authority claims processing as part of Lloyd's Blueprint Two program.

"IFoA" means the UK Institute and Faculty of Actuaries.

"ILS" means insurance-linked securities.

"IPO" means initial public offering.

"IRRD" means Insurance Recovery and Resolution Directive.

"LDI" means liability-driven investments.

"LCP" means Lane Clark & Peacock.

"LGRA" means L&G Retirement America.

"Liberty" means Liberty Mutual Holding Company.

"Lloyd's" means Lloyd's of London.

"London Bridge" means London Bridge 1 and London Bridge 2.

“London Bridge 1” means London Bridge Risk PCC Limited.

“London Bridge 2” means London Bridge 2 PCC Limited.

“LPT” means loss portfolio transfer.

“L&G” means Legal & General.

“MA” means matching adjustment.

“Mansion House Reforms” means the reforms announced by Chancellor of the Exchequer, Jeremy Hunt, on July 11, 2023.

“Member States” means EU member states.

“MetLife” means MetLife, Inc..

“MGA” means managing general agent.

“Milliman” Milliman LLP.

“Model Rules” means the OECD/G20’s model rules on Pillar 2.

“MOU” means the Memorandum of Understanding on Cooperation in Financial Services.

“MTF” means multilateral trading facility.

“MTN” means Medium-Term Note.

“NAIC” means the National Association of Insurance Commissioners.

“PBGC” means Pension Benefit Guaranty Corporation.

“PIC” means the Pension Insurance Corporation.

“Pillar 2” means the OECD/G20’s proposals to effect a global minimum tax.

“POAT Regulations” means the Public Offers and Admissions to Trading Regulations 2023.

“PPF” means the Pension Protection Fund.

“PRA” means the Prudential Regulation Authority.

"Proposed Reforms" means the European Commission's package of proposed reforms to the Solvency II Directive published on September 22, 2021.

"PRT" means pension risk transfer.

"Prudential" means Prudential Financial, Inc..

"PSE&G" means the Public Service Enterprise Group Inc.

"P&C" means property and casualty.

"R&Q" means Randall & Quilter.

"RGA" means Reinsurance Group of America.

"RITC" means reinsurance to close.

"Rothesay" means Rothesay Life.

"SB 2A" means Florida's Senate Bill 2-A.

"SCR" means solvency capital requirement.

"SEC" means the US Securities and Exchange Commission.

"Solvency II" means Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance.

"Solvency UK" means the Solvency II regime as it applies in the UK.

"SPI" means special purpose insurer.

"TAAR" means the targeted anti-avoidance rule.

"TMTP" means the transitional measure on technical provisions.

"TPR" means The Pensions Regulator.

"UK" means the United Kingdom.

"UKLRs" means the draft updated listing rules, as published by the FCA on March 7, 2023.

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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, UK, Lloyd's, Europe and Bermuda. Willkie's Corporate Insurance teams in London and New York are both ranked Tier 1 / Band 1 by Chambers and the Legal 500.

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