ANNUAL REPORT ON THE INSURANCE INDUSTRY

FEDERAL INSURANCE OFFICE, U.S. DEPARTMENT OF THE TREASURY

Completed pursuant to Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act

SEPTEMBER 2015

THE DEPARTMENT OF THE TREASURY 1789

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Glossary

A&H	....	Accident and Health
Advisory Committee	....	Advisory Committee on Risk-Sharing Mechanisms
Affected Persons	....	Traditionally Underserved Communities and Consumers, Minorities, and Low- and Moderate-Income Persons
AIG	....	American International Group, Inc.
ART	....	Alternative Risk Transfer Transaction
AXXX	....	Actuarial Guideline 38 (applicable to Universal Life with Secondary Guarantee Products)
BCR	....	Basic Capital Requirement
Captive Framework	....	NAIC XXX/AXXX Reinsurance Framework
CFPB	....	Consumer Financial Protection Bureau
CMG	....	Crisis Management Groups
ComFrame	....	Common Framework for the Supervision of Internationally Active Insurance Groups
Council	....	Financial Stability Oversight Council
DMF	....	Death Master File
Wall Street Reform Act	....	Dodd-Frank Wall Street Reform and Consumer Protection Act
DOL	....	Department of Labor
EC	....	European Commission
EIOPA	....	European Insurance and Occupational Pensions Authority
ERISA	....	Employee Retirement Income Security Act of 1974
EU	....	European Union
FACI	....	Federal Advisory Committee on Insurance
FDIC	....	Federal Deposit Insurance Corporation
Federal Reserve	....	Board of Governors of the Federal Reserve System
FEMA	....	Federal Emergency Management Agency
FHFA	....	Federal Housing Finance Authority
FINRA	....	Financial Industry Regulatory Authority
FIO	....	Federal Insurance Office
FIRM	....	Flood Insurance Rate Map
FPI	....	Force-Placed Insurance
FSB	....	Financial Stability Board

FSC	....	Financial Stability Committee
GDP	....	Gross Domestic Product
GLBA	....	Gramm-Leach-Bliley Act
G-SIFI	....	Global Systemically Important Financial Institution
G-SII	....	Global Systemically Important Insurer
GWP	....	Gross Written Premiums
HLA	....	Higher Loss Absorbency
IAIG	....	Internationally Active Insurance Group
IAIS	....	International Association of Insurance Supervisors
iCBCM	....	Cross-Border Crisis Management Group for Insurers
ICS	....	Insurance Capital Standard
ILS	....	Insurance-Linked Securities
IPO	....	Initial Public Offering
IT	....	Information Technology
IUL	....	Indexed Universal Life Insurance
L/H	....	Life and Health
M&A	....	Merger and Acquisition
MetLife	....	MetLife, Inc.
MI	....	Mortgage Insurers
Model Law	....	NAIC Credit for Reinsurance Model Law and Regulation
Model Life Guaranty Act	……..	NAIC Life and Health Insurance Guaranty Association Model Act
Model Suitability Regulation	....	NAIC Suitability in Annuity Transactions Model Regulation
Modernization Report	....	U.S. Department of the Treasury, *How to Modernize and Improve the System of Insurance Regulation in the United States* (December 2013)
NAIC	....	National Association of Insurance Commissioners
NARAB II	....	National Association of Registered Agents and Brokers Reform Act of 2015
NatCat Report	....	U.S. Department of the Treasury, *State of the U.S. Market for Natural Catastrophe Insurance* (September 2015)
NCIGF	....	National Conference of Insurance Guaranty Funds
NCOIL	....	National Conference of Insurance Legislators

NFIP	....	National Flood Insurance Program
NFIP Affordability Report	....	National Research Council, *Affordability of National Flood Insurance Program Premiums: Report 1* (March 2015)
NIPR	....	National Insurance Producer Registry
NIST	....	National Institute of Standards and Technology
NIST Cybersecurity Framework	....	NIST Framework for Improving Critical Infrastructure Cybersecurity
NOLHGA	....	National Organization of Life & Health Insurance Guaranty Associations
NPFI	....	Nonpublic Personal Financial Information
NPHI	....	Nonpublic Personal Health Information
NRRA	....	Nonadmitted and Reinsurance Reform Act of 2010
NTIS	....	National Technical Information Service
NWP	....	Net Written Premiums
NYDFS	....	New York Department of Financial Services
P/C	....	Property and Casualty
PBR	....	Principles-Based Reserving
PMI	....	Private Mortgage Insurance
PMIER	....	Private Mortgage Insurer Eligibility Requirements
PII	....	Personally Identifiable Information
Project	....	EU-U.S. Insurance Project
RAA	....	Reinsurance Association of America
RBC	....	Risk-Based Capital
RBC Ratio	....	Calculated Ratio under RBC
Reinsurance Report	....	U.S. Department of the Treasury, *The Breath and Scope of the Global Reinsurance Market and the Critical Role Such Market Plays in Supporting Insurance in the United States* (December 2014)
Report	....	U.S. Department of the Treasury, 2015 Annual Report on the Insurance Industry
ReSG	....	IAIS Resolution Steering Group
RESPA	....	Real Estate Settlement Procedures Act
ReWG	....	IAIS Resolution Working Group
ROAE	....	Return on Average Equity
S&P 500	....	Standard and Poor’s 500 Index
SEC	....	U.S. Securities and Exchange Commission

Secretary	....	Secretary of the Treasury
SNL Financial	....	SNL Financial, LC
SSA	....	Social Security Administration
Task Force	....	NAIC Principles-Based Reserving Implementation Task Force
Treasury	....	U.S. Department of the Treasury
TRIA	....	Terrorism Risk Insurance Act of 2002
TRIP	....	Terrorism Risk Insurance Program
Reauthorization Act	....	Terrorism Risk Insurance Program Reauthorization Act of 2015
USGS	……..	U.S. Geological Survey
USTR	....	United States Trade Representative
XXX	....	NAIC Valuation of Life Insurance Policies Model Regulation

I. INTRODUCTION

The 2015 Federal Insurance Office (FIO) Annual Report on the Insurance Industry (Report) is submitted pursuant to Section 502(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform Act), which requires the FIO Director to report annually to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate "on the insurance industry and any other information as deemed relevant by the Director or requested by such committees."[1]

A. Structure of the Report

The Report begins with an overview of the insurance industry that presents and analyzes the financial performance and condition of the key U.S. insurance industry sectors, namely the life and health (L/H) sector and the property and casualty (P/C) sector. The industry financial overview also includes an analysis of the risk that continued low interest rates could pose to the life insurance sector, and a discussion of insurance industry capital markets activities, including the use of alternative risk-transfer mechanisms.

The Report next includes a section focusing on matters of consumer protection and access to insurance. This section highlights developments concerning both sex and marital status as rating and underwriting factors, natural catastrophe insurance, and retirement security.

The Report then addresses a range of developments—at the state, federal, and international levels—which have occurred over the past year, and which have implications for the U.S. insurance sector. Discussions of domestic regulatory activities include updates on: the insurance-related activities of the Financial Stability Oversight Council (Council); supervision of insurers by the Board of Governors of the Federal Reserve System (Federal Reserve); the role of reinsurance captives; the Terrorism Risk Insurance Program (TRIP); state guaranty funds; cyber security and the evolving cyber insurance market; licensing of insurance producers; insurance in the housing sector; and the workers' compensation market. The international section addresses recent developments at the International Association of Insurance Supervisors (IAIS) as well as developments with the European Union (EU). Further, the section discusses FIO's continued coordination of and involvement with the EU-U.S. Insurance Project and prospects for a covered agreement between the U.S. and the EU on certain prudential insurance matters.

B. Federal Insurance Office

Title V of the Wall Street Reform Act established FIO within the U.S. Department of the Treasury (Treasury).[2] In addition to advising the Secretary of the Treasury (Secretary) on major domestic and prudential international insurance policy issues and serving as a non-voting member of the Council, FIO is authorized to:

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[1] 31 U.S.C. § 313(n)(2).
[2] Title V also designates the Secretary as advisor to the President on "major domestic and international prudential policy issues in connection with all lines of insurance except health insurance." 31 U.S.C. § 321(a)(9).

- monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system;

- monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance;

- recommend to the Council that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Federal Reserve;

- assist the Secretary in administering TRIP, established in Treasury under the Terrorism Risk Insurance Act of 2002, as amended (TRIA);

- coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the IAIS and assisting the Secretary in negotiating covered agreements;

- determine whether state insurance measures are preempted by covered agreements;

- consult with the states (including state insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance; and

- perform such other related duties and authorities as may be assigned to FIO by the Secretary.[3]

Also, before the Secretary may make a determination as to whether to seek the appointment of the Federal Deposit Insurance Corporation (FDIC) as receiver of insurers under Title II of the Wall Street Reform Act, the Secretary must first receive a written recommendation from the FIO Director and the Federal Reserve.[4] Additionally, FIO and the Federal Reserve coordinate to conduct annual analyses of nonbank financial companies supervised by the Federal Reserve to evaluate whether such companies have the capital, on a consolidated basis, necessary to absorb losses as a result of adverse economic conditions.[5]

In December 2013, Treasury released FIO's report entitled "*How to Modernize and Improve the System of Insurance Regulation in the United States*" (Modernization Report).[6] Several recommendations from

[3] 31 U.S.C. § 313(c)(1).
[4] 12 U.S.C. § 5383(a)(1)(C).
[5] 12 U.S.C. § 5365(i)(1)(A).
[6] The Modernization Report is *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/ .

the Modernization Report are discussed in this Report, and a summary of the status of and progress on each recommendation is provided in the Appendix to this Report.
In December 2014, Treasury released FIO's report entitled "*The Breadth and Scope of the Global Reinsurance Market and the Critical Role Such Market Plays in Supporting Insurance in the United States*" (Reinsurance Report).[7] The Reinsurance Report summarizes the history of reinsurance as a product and an industry, and outlines the various functions of reinsurance, including its importance following natural disasters and other catastrophes. The Reinsurance Report emphasizes that global reinsurers are vital to U.S. insurers and thus important for the general economic prosperity of the United States.

On January 12, 2015, President Obama signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2015 (Reauthorization Act).[8] In addition to reauthorizing TRIA until December 31, 2020, the Reauthorization Act included several reforms to TRIP. On February 6, 2015, FIO published *Interim Guidance Concerning the Terrorism Risk Insurance Program* to provide interim guidance that members of the public can rely on until Treasury issues final regulations reflecting the reforms and other changes included in the Reauthorization Act.[9] In accordance with the Reauthorization Act, on April 8, 2015, FIO created the "Advisory Committee on Risk-Sharing Mechanisms," which will provide advice and recommendations to Treasury with respect to the creation and development of non-governmental, private market risk-sharing mechanisms for protections against losses arising from acts of terrorism.

Title V of the Wall Street Reform Act instructs the FIO Director to submit an update to the report that FIO submitted to Congress in 2013 describing the impact of Part II of the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) on the ability of state regulators to access reinsurance information for regulated entities in their jurisdictions.[10] The update, submitted by FIO in May 2015, concludes that Part II of the NRRA has not had an adverse impact on the ability of state regulators to access reinsurance information from regulated companies.[11]

As noted in its 2014 Annual Report on the Insurance Industry, FIO focused initially on personal auto insurance in order to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons (Affected Persons) have access to affordable insurance products. FIO issued a notice in April 2014 seeking comment on development of a reasonable and meaningful definition of "affordability" and the method by which FIO should measure affordability.[12] In July 2015, FIO published a follow-up notice requesting comment on its proposed working definition for affordable personal auto liability insurance for Affected Persons, the key metrics

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[7] The Reinsurance Report is *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/ .
[8] Pub. L. 114-1, 129 Stat. 3.
[9] Interim Guidance Concerning the Terrorism Risk Insurance Program Reauthorization Act of 2015, 80 Fed. Reg. 6, 656 (Feb. 6, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-02-06/pdf/2015-02556.pdf.
[10] 31 U.S.C. § 313(o)(2).
[11] The 2015 NRRA Update is *available* at http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2015_NRRA_Report.pdf.
[12] Monitoring Availability and Affordability of Auto Insurance, 79 Fed. Reg. 19, 969 (Apr. 10, 2014), *available at*http://www.gpo.gov/fdsys/pkg/FR-2014-04-10/pdf/2014-08100.pdf.

FIO proposes to use to calculate the affordability index for Affected Persons, and the best way to obtain appropriate data to monitor effectively the affordability of personal auto insurance for Affected Persons.[13]

In September 2015, Treasury published FIO's report on the "*State of the U.S. Market for Natural Catastrophe Insurance*" (NatCat Report).[14] The NatCat Report provides an overview of natural catastrophe insurance in the United States, including homeowner insurance, flood insurance, and earthquake insurance, as well as the reinsurance market for natural disasters.

The Federal Advisory Committee on Insurance (FACI), which provides advice and recommendations to FIO in performing its duties and authorities, met in Washington, D.C. in February, May, and August 2015. On July 8, 2015, the charter for FACI was reauthorized for two years, and its membership was increased from 21 members to up to 25 members.[15]

Throughout 2014 and 2015, FIO has continued to build on its statutory role representing the United States in the IAIS and elsewhere on prudential insurance measures. FIO has taken numerous actions to coordinate U.S. efforts on international insurance matters, including ensuring that U.S. stakeholders have opportunities to meet and work with all of the U.S. participants at the IAIS. Working with state insurance regulators and the Federal Reserve, FIO regularly convenes U.S. stakeholders, including industry and consumer advocates, to meet and present to all U.S. members of the IAIS at one time. FIO will continue such engagement, which enables the U.S. members of the IAIS to receive the views of a wide range of U.S. stakeholders in a U.S.–based forum. FIO has also continued its work with the EU-U.S. Insurance Project. FIO and USTR anticipate notifying Congress of the intent to commence negotiations with the European Union on a covered agreement related to certain prudential insurance matters. These and related international initiatives are addressed in this Report.

[13] Monitoring Availability and Affordability of Auto Insurance, 80 Fed. Reg. 38, 277 (July 2, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-07-02/pdf/2015-16333.pdf.
[14] The NatCat Report is *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/.
[15] The renewed FACI *Charter* is *available at* http://www.treasury.gov/initiatives/fio/Pages/faci.aspx.

II. EXECUTIVE SUMMARY

A. U.S. Insurance Industry Financial Overview

Through 2014, the U.S. insurance industry continued to report consecutive years of good financial performance and, in the aggregate, remained in sound financial condition. Positive net income again raised reported surplus of both the life and health (L/H) and the property and casualty (P/C) sectors to record levels. The L/H sector reported approximately $354 billion of capital and surplus at the end of 2014, and the P/C sector reported approximately $689 billion in policyholders' surplus, up from $332 billion and $665 billion, respectively, at the end of 2013.

The L/H and P/C sectors both also recorded increases in aggregate net written premiums in 2014. The L/H sector's net written premiums reached $648 billion in 2014, largely the result of growth in sales of annuity products. P/C sector net written premiums were $503 billion in 2014, a record-high level. Solid gains were reported for both commercial and personal lines of business as premium rate increases and growth in the U.S. economy drove growth in aggregate premiums.

While both sectors of the insurance industry were profitable in 2014, net income for both declined from the record levels set in 2013. Growth in L/H sector revenues, which was slowed by only a slight increase in net investment income, was outpaced by growth in total expenses, and led to a 23 percent decline in pretax income compared to 2013. Significantly lower realized capital losses compared to 2013 held the decrease in net income to a lower 13 percent, or approximately $38 billion. The P/C sector reported a 9 percent decrease in net income, mainly due to a 19 percent decline in underwriting gains. The P/C sector's loss ratio increased in 2014, following low catastrophe losses in 2013. However, the sector's combined ratio remained below 100 for the second consecutive year.[16] P/C sector net income was reported at approximately $65 billion.

The insurance industry remained active in the U.S. capital markets. In the aggregate, the insurance industry raised $8 billion in new equity capital in 2014. Debt financing remained attractive as interest rates remained historically low, and the insurance industry sold an aggregate $37 billion in new debt. Merger and acquisition (M&A) activity declined in 2014 in terms of the number of transactions that were announced, but the aggregate value of those deals, $14 billion, marked a 79 percent increase over the 2013 level. By the middle of 2015, M&A activity increased significantly, with announcements of five major deals, with an aggregate value of nearly $132 billion. Several of these transactions were in the health insurance sector, and might signal competitive changes in market share.

Finally, the Report also highlights the growing role of alternative risk-transfer capital in the insurance industry. While this remains a small share of the total capital committed to reinsurance underwriting, its growth continues to put downward pressure on reinsurance premiums. The past year has witnessed continued growth not only in catastrophe bonds and other insurance-linked securities, but a very rapid

[16] The combined ratio is the sum of the loss ratio (incurred losses divided by earned premiums) and the expense ratio (incurred expenses divided by written premiums). A combined ratio less than 100 percent indicates that premiums covered losses and expenses in a given period (*i.e.*, underwriting operations made a positive contribution to net income).

pace of growth in industry-loss warranties and collateralized reinsurance. Once considered an innovative market segment, these alternative forms of risk transfer appear to be taking on permanent presence in insurance markets.

B. Consumer Protection and Access to Insurance

The Wall Street Reform Act authorizes FIO to monitor access to affordable insurance for traditionally underserved communities, minorities, and low- and moderate-income individuals. Although gender remains a common factor in insurance risk classification, some regulatory authorities have prohibited the use of gender as a rating factor in certain contexts. Transgender advocates have raised concerns because insurance applications do not indicate whether an answer to a question about sex should be based on the individual's gender identity or his/her gender marker on legal documents. The Report recommends that states consider whether and in what manner sex remains appropriate for risk classification in insurance products.

The Report notes the June 26, 2015, decision of the Supreme Court regarding same-sex marriage, reducing the potentially discriminatory impact of the use of marital status as an underwriting or rating consideration. The Report recommends that states continue to assess whether marital status is an appropriate underwriting or rating consideration due to the potential effect on the cost of insurance for widowed and divorced individuals.

The Report highlights the importance of natural catastrophe insurance for individuals and discusses the limited availability of such insurance in some geographic areas with correlated exposures to events such as flooding and earthquakes. The Report also discusses the evolving issue of whether an earthquake is solely a natural phenomenon or may also be a man-made phenomenon. If fracking or the use of waste water disposal wells is deemed to be the cause of an earthquake, policyholders may be denied coverage for resulting losses because many policies exclude losses resulting from events which are not naturally occurring. FIO will continue to monitor the developments concerning earthquakes, the impact on consumers and the industry, regulatory reaction, and the overall market for earthquake insurance.

In the context of consumer protection, the Report next considers retirement security in the United States and the role of life insurers as an important provider of guaranteed retirement income, primarily through annuity products. Treasury and the U.S. Department of Labor (DOL) continue to work on a joint initiative to encourage access to, and use of, products designed to provide a lifetime stream of income during retirement. Also, as the retirement savings market has expanded, federal authorities have proposed various measures to better educate and inform consumers about retirement savings products, and to protect consumers against inappropriate sales practices. For example, in April 2015, DOL released a proposed rule that would expand the types of retirement investment advice covered by the fiduciary protections of the Employee Retirement Income Security Act of 1974 (ERISA).

The Report reviews regulatory developments with respect to the suitability and disclosure of life insurance and annuity products. In both the Modernization Report and the 2014 Annual Report on the Insurance Industry, FIO urged the states to uniformly adopt and enforce the Suitability in Annuity Transactions Model Regulation (Model Suitability Regulation) in order to provide appropriate suitability standards for sales of annuities. Seven states adopted the Model Suitability Regulation in 2013, but the pace of adoption slowed to two states in 2014, bringing the number of state adoptions to 35. Among those 35 states, the suitability standards for annuities sales are not uniform. The continuing absence of a uniform, national annuity suitability standard is increasingly problematic given the unprecedented number and increased longevity of consumers reaching retirement age and the rising complexity of annuity products. In the absence of national standards and uniform adoption and enforcement of this basic consumer protection regulation, federal involvement may be appropriate.

The Report then describes the rapid growth of indexed universal life (IUL) insurance, which now accounts for approximately 20 percent of all individual life insurance premiums in the United States. The distinguishing feature of IUL is that growth in the value of the policy is linked to the performance of an external market index such as the S&P 500. IUL products are typically sold with illustrations of guaranteed and non-guaranteed values under different market scenarios. State insurance regulators have developed Actuarial Guideline 49 to provide guidance in determining index-based crediting rates for IUL policy recommendations. FIO encourages life insurers and the states to continue working cooperatively, and promptly, to adopt and implement a uniform framework for appropriate IUL illustrations.

Finally, the Report notes that IUL policies are not subject to suitability standards at either the federal or state level, and recommends that state insurance regulators consider whether uniform, national consumer protection standards should be adopted for IUL.

C. U.S. Regulatory Developments

The Report assesses a number of U.S. regulatory developments regarding the insurance sector.

In December 2014, the Council voted to make a final determination to subject MetLife, Inc. (MetLife) to supervision by the Federal Reserve and enhanced prudential standards.[17] MetLife is the fourth nonbank financial company to be designated by the Council. Previously, the Council had made final determinations regarding American International Group, Inc. (AIG), General Electric Capital Corporation (GECC), and Prudential Financial, Inc. (Prudential). In February of 2015, the Council adopted certain changes and formalized certain practices relating to its process for reviewing nonbank financial companies for potential designation. In July 2015, after conducting annual reviews of AIG and GECC, the Council decided to not rescind the determination of either company. The annual review of Prudential is ongoing.

The Report also considers the Federal Reserve's supervision of insurers that own an insured bank or thrift, as well as insurers designated by the Council for Federal Reserve supervision. The Insurance Capital Standards Clarification Act of 2014, enacted in December 2014, provides the Federal Reserve with flexibility to tailor its capital framework to firms that are substantially engaged in insurance underwriting activity. Accordingly, the Federal Reserve is expected to propose and adopt a regulatory capital framework for insurers subject to its consolidated supervision.

[17] The public basis for the Council's final determination regarding MetLife is *available at* http://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf.

The Report addresses state-based capital developments involving risk-based capital (RBC) and principles-based reserving (PBR). RBC does not provide an integrated view of risk for an insurer, and some critics argue that RBC is too static and conservative, fails to adequately take into account the risks associated with increasingly complex life insurance products, and leads to the increased use of captive reinsurance. To address these concerns, state insurance regulators are considering PBR, which relies upon an insurer's individualized risk modeling and analysis techniques, including the use of insurer-specific claims experience with specific portfolio(s) of business, to incorporate consideration of particularized risks and thereby more closely tailor calculations to the actual attributes of an insurer's portfolio. When at least 42 states, representing 75 percent or more of premium, have adopted these revised reserving principles, a three-year PBR implementation period will begin for new business. Wholesale adoption of PBR continues to raises concerns, including potential overreliance on an insurer's internal modeling and a shortage of resources and expertise on state insurance regulatory staffs.

The Report then considers the related issue of captive reinsurance. Addressed by FIO in the Modernization Report, this subject received continued regulatory attention in 2014 and 2015. For more than 10 years, the increased use of reinsurance captives—insurance company subsidiaries that provide regulatory capital relief to affiliated life insurers—has exposed life insurance contract holders to increased risk due to the significant amount of reserve credit (and higher resulting capital) that life insurers have been able to report because of cessions to these affiliated companies. In general, reinsurance captives are subject to less stringent regulatory requirements than commercial insurers. State insurance regulators are developing a framework for consistent standards for reinsurance captives that would allow lower-quality assets to support the so-called "redundant reserves" relating to term life and universal life with secondary guarantee products. The Report outlines FIO's concerns about the scope and yet-to-be-determined specific details of the framework, including that reinsurance captives will continue to be established in states competing to serve in that capacity.

The Report also addresses TRIP. Pursuant to the Wall Street Reform Act, FIO assists the Secretary in administering TRIP. On January 12, 2015, President Obama signed into law the Reauthorization Act, which amended the termination date of TRIP to December 31, 2020. The Reauthorization Act also reforms several provisions of TRIA and requires Treasury to issue certain new reports and engage in rulemaking. The Reauthorization Act does not alter the basic framework and functions of TRIP that have contributed to stability in the terrorism risk insurance market for the past 14 years.

Next, the Report discusses state guaranty funds, which provide policyholders with benefits and payments, up to specified statutory limits set by the states, when insolvent insurers are unable to pay policyholder claims in a timely manner. Coverage limits under state guaranty fund laws are not consistent from state to state. In addition, it is unclear how the funds would fare in the event of the failure of a large insurer with significant complexity both in and outside the United States.

The Report also addresses cyber security and cyber risk insurance. State insurance regulators only recently have begun addressing the difficult and important subject of cyber security. In 2014, state insurance regulators established a Cyber Security Task Force to coordinate insurance regulatory activities concerning cyber-related issues. Certain state insurance regulators, such as the New York

Department of Financial Services (NYDFS), also have taken action to analyze insurer cyber security issues. FIO encourages state insurance regulators to develop, adopt, and uniformly implement examination standards for insurer cyber security that are consistent across all states and which comply with best practices for financial institutions. Some market participants have raised concerns regarding the current capacity and scope limitations of cyber risk insurance products. Development of the cyber insurance market is expected to continue as insurers gather information, improve underwriting processes for cyber risks, increase capabilities for pricing all forms of cyber risk coverage, and build relevant subject matter expertise.

In addition, the Report discusses insurance producers (agents and brokers), noting that a lack of efficiency and reciprocity in state regulation has created regulatory redundancies that are costly, restrict economic activity, and harm the interests of consumers. On January 12, 2015, President Obama signed into law the National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II), which reestablished the National Association of Registered Agents and Brokers (Association) to provide a national, standardized licensing process for insurance producers. FIO supports the objective of NARAB II and the effort to establish the Association's Board of Directors and to implement NARAB II, and will monitor the governance and operation of the Association.

The Report next assesses private mortgage insurance, force-placed insurance, and title insurance. The Federal Housing Finance Authority (FHFA) has taken important steps toward the goal of providing improved oversight over the mortgage insurance industry, including putting in place new standards for policy rescissions and for claim adjudication timeframes, and directing Fannie Mae and Freddie Mac to revise and align eligibility requirements for mortgage insurers. An increase in the use of force-placed insurance has led to greater scrutiny of the FPI industry. Federal regulators have helped to ensure uniform consumer protections for borrowers. Although California, Florida, and New York have addressed some concerns regarding rate-making by FPI insurers, questions remain regarding the kind of data used by FPI insurers in developing rates. In April 2015, following an investigation into title insurers in New York, the NYDFS proposed regulations that would curtail the practice of including in ratemaking the millions of dollars that title insurers spend to induce attorneys and real estate professionals to order title insurance for clients. Similar practices are the subject of ongoing federal litigation filed by the Consumer Protection Financial Bureau (CFPB) and the Maryland Attorney General.

Next, the Report considers aspects of the workers' compensation insurance system. Every state and the federal government have in place a no-fault workers' compensation system, with mandatory employer participation in all states except for Texas and Oklahoma. In a limited number of states, a state-operated plan is the sole provider legally authorized to provide workers' compensation. In many other states, state-operated plans compete with private insurers in the workers' compensation insurance market. States have launched various efforts to reform the system to address the cost of medical care for injured employees and the insurance cost borne by employers, and to improve employee benefits and medical treatment. These reform efforts include the introduction of standards that require an injured employee to show that he or she did not have a preexisting condition in order to be eligible for workers' compensation benefits – standards that may place workers with disabilities or chronic illnesses, as well as older workers, at a disadvantage. The Report also describes how the current system of establishing workers' compensation benefits results in uneven compensation to injured workers from different states who suffer the same permanent injury.

D. International Developments

The Report covers international standard-setting developments of increasing importance to U.S. insurers, with continued revenue growth in markets outside of North America. The Report discusses key international activities and accomplishments during 2014 and early 2015.

The IAIS is the international standard-setting body for supervisors of the insurance sector. Organizational reforms implemented in 2014 by the IAIS improved its financial independence, efficiency, and transparency. Stakeholders are no longer required to pay to receive access to the IAIS, its members and staff, and its information. Rather, all stakeholders now have equal access to increased benefits from the IAIS, without any fees. The IAIS has improved public communications and information dissemination through stakeholder meetings and calls, newsletters, the IAIS public website, public consultation documents, publication of comments, and publications of replies to comments.[18]

U.S.-based members of the IAIS include FIO, the Federal Reserve, and the lead insurance regulators from the U.S. states, territories, and the District of Columbia. In early 2014, FIO convened a joint Steering Committee comprised of FIO, the Federal Reserve, and the leading state insurance regulators, a group that has held monthly and ad hoc calls to discuss pending and anticipated IAIS issues. FIO also convenes at Treasury meetings for U.S. stakeholders to meet collectively with leaders of FIO, the Federal Reserve, and state insurance regulators to discuss standards development by the IAIS.

Beginning in 2009, the IAIS has continued to develop the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which will include qualitative standards for group-wide supervision, governance, risk management, and recovery and resolution, as well as a quantitative ICS. In 2014, the IAIS began field testing ComFrame's proposed standards relating to corporate governance and risk management, based on data submitted by both volunteer insurance groups and insurance supervisors.

A significant achievement in late 2014 was the adoption by the IAIS of an approach to a Basic Capital Requirement (BCR), the first global group capital standard for the insurance sector. The IAIS has also been working on a higher loss absorbency (HLA) requirement, which is scheduled to be finalized in late 2015. The BCR and HLA form a combined capital requirement that will apply to global systemically important insurers (G-SIIs). A consultation paper on HLA was released, and responses thereto, together with data of volunteer Internationally Active Insurance Groups (IAIGs) in field testing, will inform further efforts to finalize and adopt an initial iteration of the HLA standard in 2015.

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[18] The IAIS Policy for Consultation of stakeholders is *available at* http://iaisweb.org/index.cfm?event=getPage&nodeId=46842.

The IAIS is also working on the insurance capital standard (ICS), which will be more risk-sensitive than the BCR. Once developed, the ICS will replace the BCR as the basis on which HLA would be added to comprise a global, quantifiable group capital standard applicable to G-SIIs. By itself, the ICS will also serve as a global, quantifiable group capital standard applicable to the broader population of IAIGs. The IAIS released a consultation paper on the ICS in December 2014 and has subjected aspects of the ICS, based on specifications proposed to date, to field testing.

In March 2015, IAIS members agreed on the "ultimate goal" of the ICS which "will include a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions. Ongoing work is intended to lead to improved convergence over time on the key elements of the ICS towards the ultimate goal. Not prejudging the substance, the key elements include valuation, capital resources and capital requirements."[19]

The Project began in early 2012 as a joint effort to increase mutual understanding and enhance cooperation between the EU and the United States on insurance issues to promote business opportunity, consumer protection, and effective supervision. The Project has focused on topics that are fundamentally important to a sound regulatory regime, the protection of policyholders, and financial stability. Such areas, which were the focus of information exchange between the sides in 2014 and early 2015 include: professional secrecy/confidentiality, group supervision, solvency and capital requirements, reinsurance and collateral requirements, and supervisory reporting, data collection and analysis.

In October 2014, the Project's Steering Committee, comprised of leaders from FIO, state insurance regulators, the European Commission and the European Insurance and Occupational Pensions Authority (EIOPA) held its second public forum in Amsterdam, entitled "Evolution in Group Supervision." Topics included the practical applications of recent enhancements to group supervisory systems, as well as future challenges, and the potential for using common elements in Own Risk and Solvency Assessment (ORSA) frameworks for insurance groups operating on a transatlantic basis.

With respect to reinsurance and collateral requirements, the agreed-upon initiatives for the Project provide that FIO would respond to suggestions regarding its authority under the Wall Street Reform Act relating to covered agreements. In that regard, the Modernization Report includes the following recommendation: "To afford nationally uniform treatment of reinsurers, FIO recommends that Treasury and the United States Trade Representative (USTR) pursue a covered agreement for reinsurance collateral requirements based on the National Association of Insurance Commissioners Credit for Reinsurance Model Law and Regulation." The United States and the EU have continued progress on procedural prerequisites defined by each jurisdiction's processes towards commencing negotiations on a covered agreement. By statute, USTR and FIO must give notice to Congress of the intent to commence negotiations. That notice is expected in the coming weeks.

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[19] The ultimate goal of the ICS is addressed in the March 2015 IAIS Newsletter, *available at* http://iaisweb.org/index.cfm?event=getPage&nodeId=25303.

III. U.S. INSURANCE INDUSTRY FINANCIAL OVERVIEW

In the aggregate, the U.S. insurance industry continued to report consecutive years of good financial performance following the financial crisis and remained in sound financial condition through 2014.[20] L/H insurance sector premiums rebounded after a modest decrease in 2013 on the strength of increased sales across all major product lines (annuities, traditional life insurance, and accident and health policies). Investment yield continued to suffer from the current low interest rate environment, but net investment income nevertheless showed a small increase on a higher base of invested assets. Growth in expenses, however, outpaced the increase in total revenues, leading to a decline in operating income as compared to 2013. Correspondingly, while the sector was profitable, net income and return on average equity were below last year's levels. Taking into account retained earnings, the sector's capital and surplus reached a record-high level at the end of 2014.

Property and casualty (P/C) sector premiums continued to grow in 2014, reaching a record-high level of total volume. The combined ratio is an accepted industry metric used to compare underwriting performance in the P/C sector; it is the sum of the loss ratio (incurred losses divided by earned premiums) and the expense ratio (incurred expenses divided by written premiums). The sector's combined ratio remained below 100 for the second consecutive year, but increased slightly compared to 2013, as losses incurred during the year increased at a more typical annual rate. Reported net investment income and investment yield both increased from the 2013 levels and would have remained relatively flat but for a large, one-time, extraordinary dividend between two affiliated companies (reported as investment income by its recipient).[21] Net income decreased in 2014 as compared to 2013, the result of lower underwriting gains and a $4 billion, one-time loss reported by a large industry participant.[22] With the sector remaining profitable, its surplus again reached a new, record-high level at the end of 2014.

In 2014, total direct premiums written in the Life and P/C sectors were $1.23 trillion, or 7 percent of the United States Gross Domestic Product (GDP).[23]

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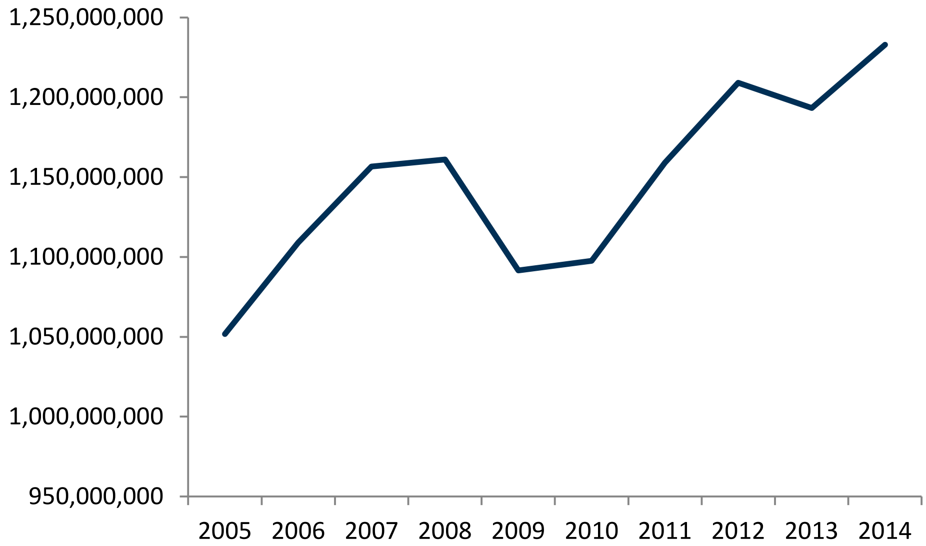
[20] Except as otherwise indicated, data cited in this section of the Report are as of December 31, 2014, as derived from SNL Financial, LC (SNL Financial) on April 20, 2015. These data are on statutory accounting basis. SNL Financial continuously updates its data for corrections in filings; 2013 data in this report are based on the updated data available as of April 20, 2015, and thus may be different in some respects from corresponding figures reported in FIO's 2014 Annual Report on the Insurance Industry. Due to certain conventions used by SNL Financial for aggregation of industry data, some columns in the accompanying tables may not sum to the totals which have been separately accumulated by SNL Financial from individual legal entity data. Some figures may not add to 100 percent due to rounding.

[21] The subject data is based on an aggregation of amounts reported by insurance legal entities, rather than an aggregation of fully consolidated group data. Some intercompany transactions, such as dividends, are therefore not eliminated as would be the case in a full group-wide consolidation. As a result, the amounts reported herein for sector surplus are larger than would be the case using a full consolidation approach.

[22] Jennifer Marshall, "Profits Continue for U.S. P/C Industry, Supporting Record Policyholders' Surplus Level," A.M. Best Company, Inc. (April 30, 2015). For details on the noted one-time loss, refer to section III.A.2.a.iv of this Report.

[23] U.S. Gross Domestic Product data source: Bureau of Economic Analysis.

Figure 1: Total Direct Premiums Written for Life and Property and Casualty ($ thousands)



Source: SNL Financial

A. Financial Performance and Condition

This section focuses on the financial performance and condition of the 1,031 L/H insurance entities, the 2,718 P/C insurance entities, and the 1,060 Health insurance entities licensed in the United States.[24] Companies in the L/H sector offer products in two segments: (1) life insurance and annuities, which generally protect against the risk of financial loss associated with an individual's death and provide income streams for retirement, respectively; and (2) accident and health (A&H) products, which generally cover expenses for health and long-term care or provide income in the event of disability. Companies in the P/C sector offer products that generally protect against the risk of financial loss associated with damage to property or exposure to liability for individuals and families (personal lines) or for businesses (commercial lines). Health insurers (including Health Maintenance Organizations) are licensed to offer health insurance products only.

Net written premiums for the L/H sector were approximately $648 billion in 2014, or 39 percent of net written premiums for the combined L/H, P/C, and Health sectors.[25] For the P/C sector, net written premiums were approximately $502 billion, or 30 percent of net written premiums for the combined L/H, P/C, and Health sectors. The Health sector reported $527 billion of net written premiums for 2014, or 31 percent of the combined total for the same three sectors. At the end of 2014, the L/H sector held approximately $6.3 trillion of total assets (including $2.4 trillion in separate accounts), the P/C sector held approximately $1.8 trillion, and the Health sector held $248 billion. Capital and surplus in the L/H,

[24] Source: A.M. Best Aggregates and Averages (2014) and SNL Financial, LC. The L/H and P/C sectors are the primary insurance industry sectors in the United States. The Health sector includes companies licensed solely as health insurers or as Health Maintenance Organizations, but is not the focus of this report.

[25] Net written premiums means direct written premiums less net ceded reinsurance premiums.

P/C and Health sectors stood at approximately $354 billion, $685 billion and $112 billion, respectively, as of December 31, 2014.

Figures 2 and 3 present snapshots of the L/H sector market, showing the ten largest L/H insurance groups and market share for life insurance (including annuities and other deposit-type contracts) and for A&H lines of business, respectively, measured by 2014 direct written premiums. Premiums shown in Figures 2 and 3, together, aggregate the L/H sector countrywide for the United States.

Figure 2: L/H Insurance Groups by 2014 U.S. Life Insurance Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
1	1	MetLife Inc.	$ 85,001,696	14.91	$ 95,331,132	16.14
2	2	Prudential Financial Inc.	41,407,447	7.26	44,720,129	7.57
6	3	New York Life Insurance Group	24,223,396	4.25	28,393,849	4.81
3	4	Jackson National Life Group	25,728,116	4.51	26,708,218	4.52
4	5	AEGON	24,499,916	4.30	25,339,180	4.29
5	6	Lincoln National Corp.	24,274,104	4.26	24,329,107	4.12
7	7	American International Group	21,698,620	3.81	23,279,901	3.94
10	8	Principal Financial Group Inc.	18,909,411	3.32	18,891,511	3.20
9	9	Manulife Financial Corp.	19,263,216	3.38	18,513,758	3.13
NR	10	Massachusetts Mutual Life Insurance Co	18,803,857	3.30	16,818,431	2.85
		Combined Top 10	$ 305,234,521	53.54	$ 322,325,216	54.58
		Combined Top 25	$456,565,190	80.09	$ 469,352,064	79.47
		Combined Top 100	$562,770,115	98.72	$ 579,129,131	98.06
		Total U.S. Life Insurance Lines	$ 570,052,825		$ 590,581,992	

Source: SNL Financial (includes Life Insurance (No Annuity), Annuity Considerations, Deposit-type Contracts (State Page), Other Considerations (State Page))

The data presented in Figure 2 for life and annuity business, and in the tables that follow for other lines of business, are aggregated at the group level from filings made to state insurance regulators by legal entity insurers. For example, premiums shown for MetLife, Inc. include premiums written by all of its insurance subsidiaries in the United States, but exclude business written by affiliated entities in non-U.S. jurisdictions.

During 2014, MetLife, Inc. grew more rapidly than the overall market, gaining nearly two percentage points of market share and remaining the largest writer of life insurance products in the United States. New York Life Insurance Group's growth in life insurance premiums lifted it to the third largest writer of life insurance products from its sixth-place position in 2013. Massachusetts Mutual Life Insurance Company entered the top ten writers of life insurance products despite a $2 billion decrease in direct premiums written, displacing Voya Financial, Inc. The top ten insurers, measured by direct written premiums, gained one percentage point of market share in 2014, rising to approximately 55 percent.

Figure 3: L/H Insurance Groups by 2014 U.S. A&H Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
1	1	UnitedHealth Group Inc.	$ 41,801,793	23.13	$ 43,507,881	26.19
2	2	Aetna Inc.	20,451,510	11.32	23,151,559	13.94
4	3	Aflac Inc.	15,371,911	8.51	14,601,368	8.79
5	4	Cigna Corp.	12,574,953	6.96	13,410,940	8.07
6	5	MetLife Inc.	6,285,051	3.48	6,657,580	4.01
7	6	Unum Group	5,236,873	2.90	5,259,763	3.17
8	7	Mutual of Omaha Insurance Co.	3,092,753	1.71	3,262,797	1.96
9	8	Guardian Life Ins Co. of America	3,029,428	1.68	3,214,961	1.94
10	9	Assurant Inc.	2,638,169	1.46	2,843,114	1.72
NR	10	Genworth Financial, Inc.	2,505,476	1.39	2,605,503	1.57
		Combined Top 10	$ 130,874,717	72.42	$ 118,521,467	71.34
		Combined Top 25	$ 156,048,648	86.35	$ 142,157,081	85.57
		Combined Top 100	$ 178,888,871	98.99	$ 164,277,711	98.89
		Total U.S. A&H Lines	$ 180,720,128		$ 166,128,398	

Source: SNL Financial

Figure 3 shows A&H premiums written by insurers authorized to offer both life and health insurance; it excludes A&H premiums written by insurers authorized to write only health insurance (see Figure 7). For example, the data presented in Figure 3 for UnitedHealth Group does not reflect that group's total health insurance premiums in the United States on a consolidated basis, rather only the premiums written by its subsidiaries licensed to offer both life and health insurance.

The A&H market contracted in 2014 from approximately $181 billion to approximately $166 billion, and several companies gained notable market share during this period. For example, UnitedHealth Group, Inc. gained three points of market share, while Aetna Inc. added over two-and-a-half points, and Cigna Corp. gained one point of market share. Humana, Inc.'s absence from the 2014 rankings in Figure 3 was the result of an internal reorganization through statutory mergers that in 2014 moved its Medicare business from a subsidiary licensed to write life and A&H business to a subsidiary licensed to write only health business; this increased its health lines market share as can been in Figure 7.

As noted above, P/C insurers underwrite a variety of products, generally categorized as either personal lines or commercial lines. Figure 4 depicts market share information on a combined P/C sector basis, which is then detailed for commercial lines (Figure 5) and personal lines (Figure 6).

Figure 4: P/C Insurance Groups by 2014 U.S. Combined Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
1	1	State Farm Mutual Automobile Insurance Company	$ 55,994,246	10.29	$ 58,508,587	10.34
2	2	Liberty Mutual Insurance	28,906,283	5.31	29,364,559	5.19
3	3	Allstate Corp.	27,583,581	5.07	28,892,088	5.11
4	4	Berkshire Hathaway Inc.	23,169,106	4.26	26,395,906	4.66
5	5	Travelers Companies Inc.	22,842,941	4.20	22,790,776	4.03
7	6	Nationwide Mutual Group	18,079,537	3.32	18,935,862	3.35
9	7	Progressive Corp.	17,562,610	3.23	18,914,866	3.34
8	8	American International Group	17,802,678	3.27	18,653,981	3.30
6	9	Farmers Insurance Group of Companies	18,284,148	3.36	18,611,695	3.29
10	10	USAA Insurance Group	14,562,012	2.67	15,678,176	2.77
		Combined Top 10	$ 244,787,141	44.97	$ 256,746,495	45.37
		Combined Top 25	$ 344,342,667	63.25	$ 359,592,856	63.54
		Combined Top 100	$ 462,354,340	84.93	$ 482,038,028	85.18
		Total U.S. P/C Sector	$ 544,386,565		$ 565,933,448	

Source: SNL Financial (including all lines of business)

Figure 5: P/C Insurance Groups by 2014 Commercial Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
1	1	American International Group	$ 16,503,438	6.09	$ 17,116,239	6.13
2	2	Travelers Companies Inc.	16,126,917	5.95	16,164,807	5.79
3	3	Liberty Mutual Insurance	14,535,081	5.37	14,047,958	5.03
4	4	Zurich Insurance Group	10,816,040	3.99	10,961,490	3.93
5	5	ACE Ltd.	8,691,889	3.21	8,892,619	3.19
6	6	CNA Financial Corp.	8,440,261	3.12	8,633,944	3.09
9	7	Nationwide Mutual Group	7,370,550	2.72	7,978,557	2.86
8	8	Chubb Corp.	7,343,526	2.71	7,475,185	2.68
7	9	Hartford Financial Services	7,338,123	2.71	7,265,273	2.60
NR	10	Berkshire Hathaway Inc.	4,392,498	1.62	5,800,071	2.08
		Combined Top 10	$ 101,985,561	37.66	$ 104,336,143	37.38
		Combined Top 25	$ 155,383,266	57.37	$ 161,661,472	57.92
		Combined Top 100	$ 228,501,508	84.37	$ 236,776,377	84.83
		Total U.S. P/C Commercial Lines	$ 270,826,865		$ 279,115,524	

Source: SNL Financial

Figure 6: P/C Insurance Groups by 2014 Personal Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
1	1	State Farm Mutual Automobile Insurance Company	$ 50,916,278	19.07	$ 53,481,180	19.03
2	2	Allstate Corp.	25,496,146	9.55	26,713,088	9.50
3	3	Berkshire Hathaway Inc.	18,623,188	6.98	20,525,245	7.30
4	4	Progressive Corp.	15,407,391	5.77	16,604,607	5.91
6	5	Liberty Mutual Insurance	14,369,723	5.38	15,312,058	5.45
5	6	Farmers Insurance Group of Companies	14,910,460	5.58	14,854,795	5.29
7	7	USAA Insurance Group	13,495,247	5.05	14,540,246	5.17
8	8	Nationwide Mutual Group	10,731,733	4.02	10,948,729	3.90
9	9	Travelers Companies Inc.	6,714,829	2.52	6,624,648	2.36
10	10	American Family Mutual	5,820,136	2.18	6,071,432	2.16
		Combined Top 10	$ 176,485,132	66.10	$ 185,676,027	66.06
		Combined Top 25	$ 211,837,110	79.34	$ 222,650,994	79.22
		Combined Top 100	$ 251,246,671	94.10	$ 263,478,825	93.74
		Total U.S. P/C Personal Lines	$ 266,987,275		$ 281,069,362	

Source: SNL Financial

Figure 7 presents market share data for the Health sector, which includes HMOs and other insurers licensed to write only health insurance. As noted above, the increase in Humana, Inc.'s premiums and market share was the result of the internal reorganization that occurred in 2014.

Figure 7: Health Insurance Groups by 2014 U.S. Health Lines Direct Premiums Written

2013 Rank	**2014 Rank**	**Insurance Group**	2013 Direct Premiums Written ($000)	Share of Total (%)	**2014 Direct Premiums Written ($000)**	**Share of Total (%)**
2	1	UnitedHealth Group Inc.	$ 51,269,926	19.20	$ 54,968,422	19.56
1	2	Anthem Inc.	51,780,407	19.39	52,217,860	18.58
5	3	Humana Inc.	17,836,173	6.68	45,598,914	16.22
3	4	HealthCare Service Corp. a Mutual	23,682,045	8.87	28,933,352	10.29
4	5	Aetna Inc.	20,634,687	7.73	23,099,513	8.22
8	6	Centene Corp.	9,928,499	3.72	13,499,981	4.80
7	7	Independence Health Group Inc.	10,322,387	3.87	12,249,432	4.36
6	8	Highmark Insurance Group	11,600,299	4.34	11,649,152	4.14
9	9	WellCare Health Plans Inc.	8,996,239	3.37	11,161,715	3.97
10	10	GuideWell Mutual Holding Corp.	8,915,044	3.34	10,673,671	3.80
		Combined Top 10	$ 214,965,706	46.88	$ 264,052,013	51.76
		Combined Top 25	$ 308,329,182	67.24	$ 362,434,540	71.05
		Combined Top 100	$ 416,234,032	90.78	$ 482,216,927	94.53
		Total U.S. Health Lines	$ 458,522,532		$ 510,136,609	

Source: SNL Financial

1. Life and Health Sector

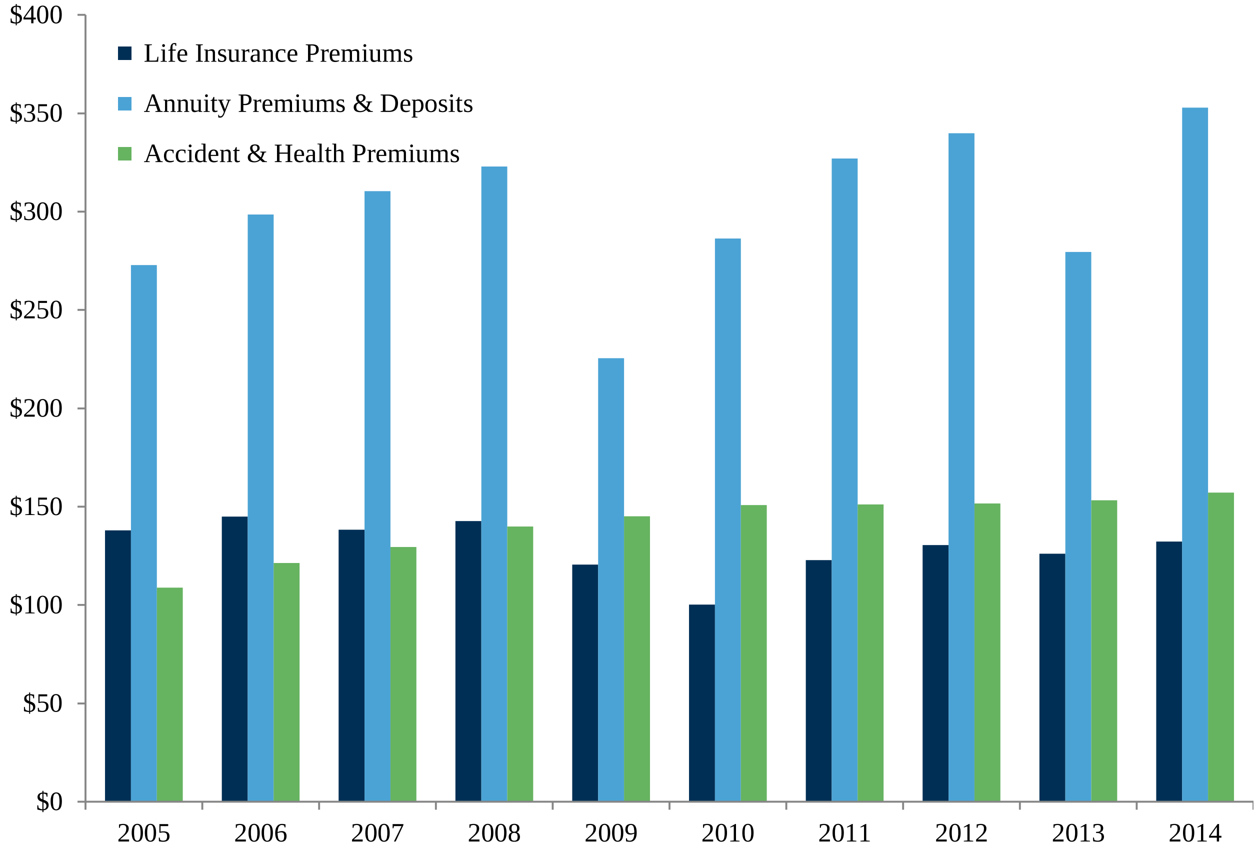
a. Performance

This section presents additional analysis of the financial performance of the L/H sector in 2014 and is followed by a section that analyzes the sector's overall financial condition.

i. L/H Sector Net Written Premiums

Net written premiums (i.e., direct written premiums less net reinsurance premiums ceded) is a principal measure of size and growth in the insurance industry. Net written premiums accounted for 74 percent of total L/H sector revenues in 2014, a mark slightly higher than the historical average of 72 percent. L/H sector net written premiums of $648 billion in 2014 marked a 15 percent increase over the $563 billion reported in 2013. The solid growth in sector net written premiums was driven by a 26 percent gain in annuity premiums and deposits, which also represented the majority (55 percent) of total net written premiums for the L/H sector. Large pension risk transfer transactions reported by Prudential Financial, Inc. in 2012 skewed year-to-year comparisons with 2013 for annuity premiums and deposits, as shown in Figures 8 and 9. Sales of traditional life insurance products represented 21 percent of 2014 L/H sector net written premiums, with the remaining 24 percent comprised of A&H and other premiums. By ceding a smaller amount of business to reinsurers in 2014, life insurers reported a corresponding increase in net premiums.

Figure 8: L/H Sector Net Premiums ($ billions)



Source: SNL Financial

Figure 9: L/H Sector Net Premiums, Considerations, and Deposits ($ thousands)

	2010	2011	2012	2013	2014
Life Insurance Premiums	$ 100,267,921	$ 122,814,093	$ 130,547,655	$ 126,058,613	$ 132,239,683
Annuity Premiums & Deposits	286,318,850	326,985,000	339,914,846	279,434,360	352,823,672
Accident & Health Premiums	150,804,074	151,192,992	151,574,317	153,306,115	157,115,608
Credit Life & Credit A&H Premiums	1,566,013	1,582,995	1,556,674	1,445,214	1,388,591
Other Premiums & Considerations	23,116,619	2,071,361	2,247,325	2,345,598	2,554,797
Total	**$ 562,072,490**	**$ 604,630,732**	**$ 625,844,137**	**$ 562,589,899**	**$ 647,775,436**

	2010	2011	2012	2013	2014
Life Insurance Premiums	**19%**	**20%**	**21%**	**23%**	**21%**
Annuity Premiums & Deposits	**53%**	**54%**	**55%**	**50%**	**55%**
Accident & Health Premiums	**28%**	**25%**	**24%**	**27%**	**24%**
	100%	**100%**	**100%**	**100%**	**100%**

Source: SNL Financial

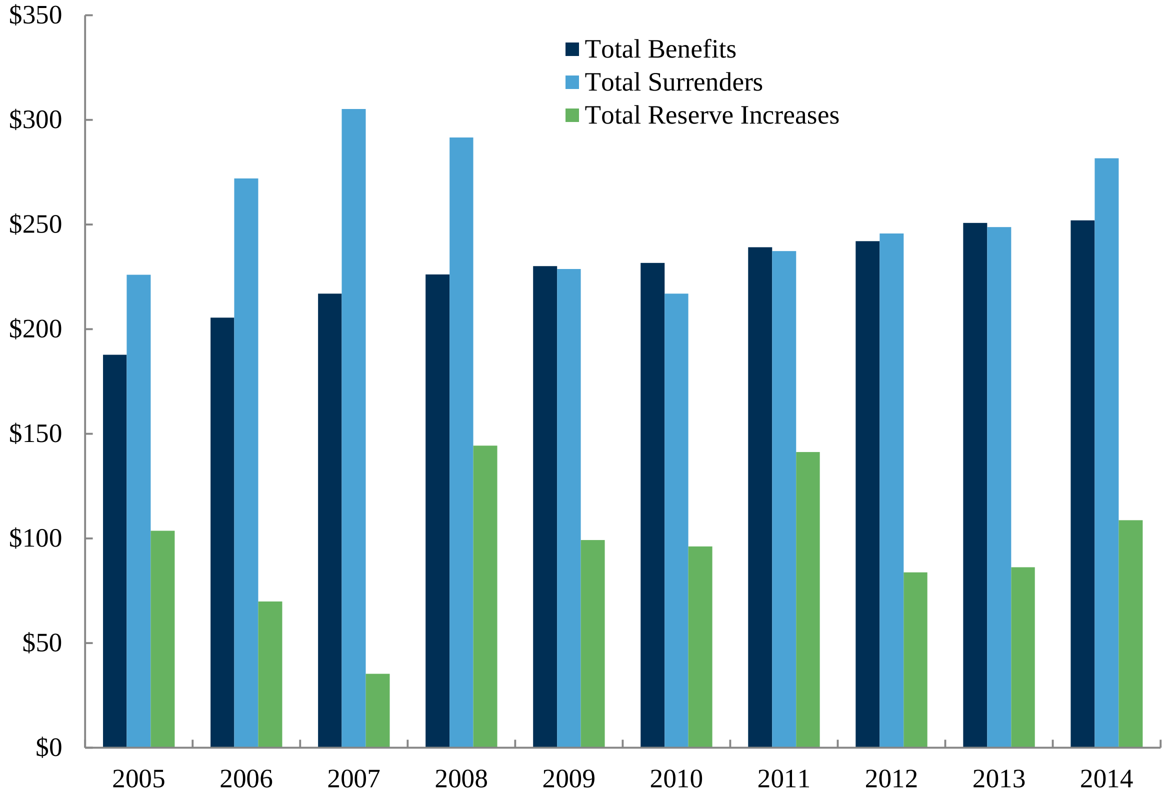
A single large transaction in 2014 skewed the gain in industry net written premiums. Hartford Life and Annuity Insurance Company (a subsidiary of Hartford Financial Services Group, Inc.) terminated a reinsurance arrangement with an affiliated captive insurer, receiving approximately $41 billion of return ceded premiums.[26] This had the effect of increasing Hartford Life and Annuity Insurance Company's—and the industry's—aggregate net written premiums in 2014.

ii. L/H Sector Policyholder Contract Benefits, Surrenders, and Other Expenses

Policyholder contract benefits are claims or obligations of L/H insurers under life insurance, annuity, and other contracts and policies. Contract surrenders occur when a policyholder or contract holder elects to cancel a policy or contract before the end of its contractual term for its accumulated cash value (if any). Contract benefits payments and contract surrenders make up the majority of total expenses for L/H insurers. Non-benefit-related expenses include general administrative and overhead expenses, expenses incurred in acquiring business (particularly producer commissions), and expenses related to payments made under contractual provisions of polices, including loss verification and adjustment expenses. Figures 10 and 11 show aggregate L/H sector benefit payments, surrenders, reserve increases, and all other expenses for recent years.

[26] Tim Zawacki, "Many Moving Parts in Lower 2014 Life Profits," SNL Financial LC (May 5, 2015).

Figure 10: L/H Sector Expenses ($ billions)



Source: SNL Financial

Figure 11: L/H Sector Expenses ($ thousands)

	2010	2011	2012	2013	2014
Total Benefits Payments	$ 231,621,733	$ 239,050,652	$ 241,946,223	$ 250,776,609	$ 251,864,630
Total Surrenders Payments	216,846,768	237,281,879	245,728,482	248,702,238	281,532,892
Total Increase in Reserves	96,164,734	141,164,954	83,758,562	86,219,588	108,721,205
Total Transfers to Separate Accounts	29,272,994	32,427,424	61,550,446	(771,523)	(16,464,689)
Commissions	48,862,077	51,378,693	52,625,458	53,021,993	52,059,871
General & Administrative Expenses	54,662,448	56,432,154	57,233,255	58,488,530	58,983,809
Insurance Taxes, Licenses and Fees	7,544,425	7,807,527	8,044,324	8,198,739	9,986,785
Other Expenses	2,204,698	8,135,096	6,684,742	(371,152)	65,826,306
Total	**$ 687,179,877**	**$ 773,678,380**	**$ 757,571,492**	**$ 704,265,022**	**$ 812,510,810**

Source: SNL Financial

In 2014, the growth in total expenses for the L/H sector kept pace with growth in revenues; total expenses increased 15 percent to $813 billion, led by a 26 percent increase in additions to reserves. Contract surrenders increased 13 percent but remained below the all-time high levels experienced during the financial crisis. For a second consecutive year, a net transfer occurred from separate accounts to general accounts in 2014, but at a significantly higher level ($16 billion compared to $771 million in 2013).[27] Such transfers can be significantly affected by policy surrenders and withdrawals as contract holders react to changes in the macroeconomic environment from year-to-year. Policyholder benefits expenses were essentially flat compared to 2013. The large reinsurance termination by Hartford Life and Annuity Insurance Company (noted above) also inflated aggregate expense figures for 2014. SNL Financial estimated that absent this transaction, aggregate L/H sector expenses would have increased by only 6 percent as compared to the 15 percent indicated in Figure 11.[28]

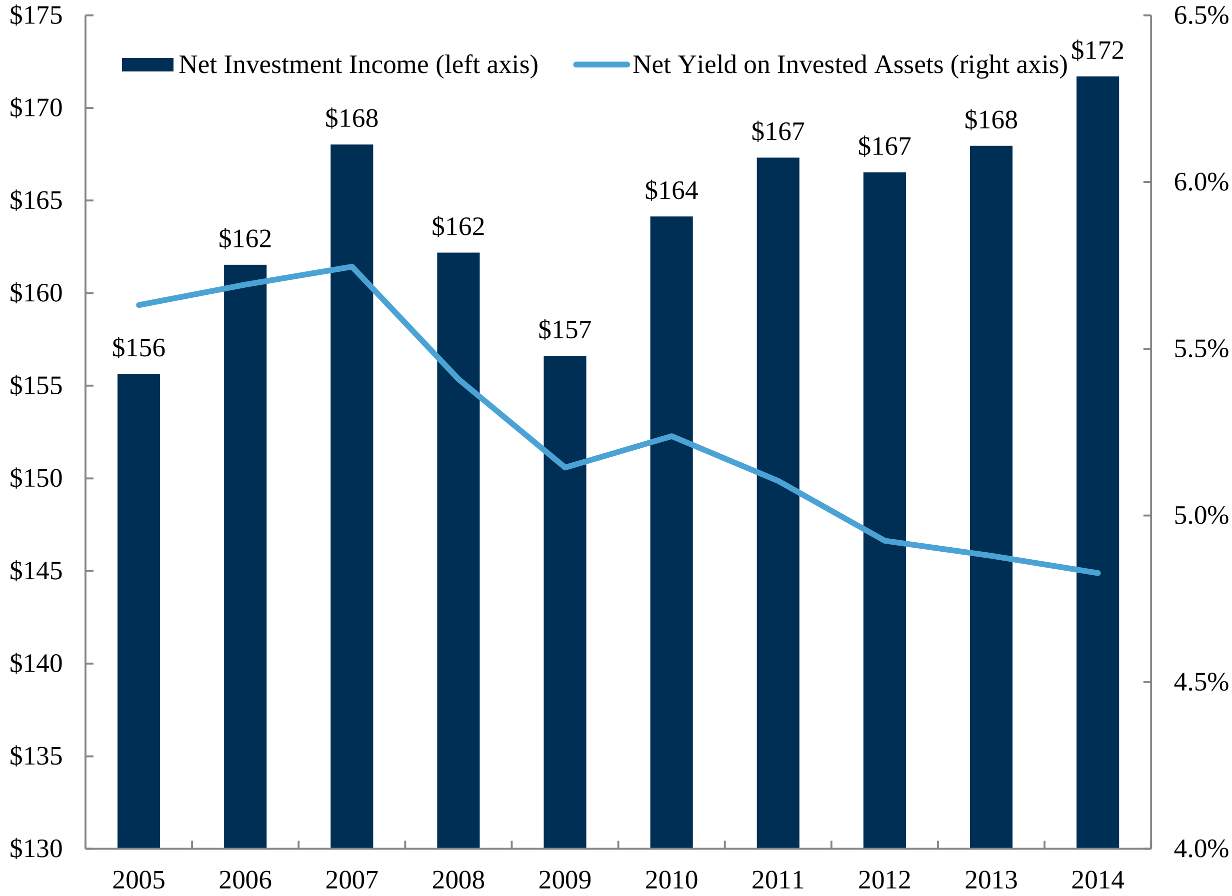
iii. L/H Sector Investment Income

Net investment income represented about 20 percent of aggregate L/H sector revenues in 2014, at the low end of the range over the past ten years. Nonetheless, total net investment income is at record levels; despite steadily declining investment yields since 2007, the sector now has a much larger base of invested assets. Figures 12 and 13 show L/H sector net investment income from invested assets (excluding net realized gains and losses on the disposition of assets) and the net investment yield for recent years.

[27] Separate accounts, as the name implies, are held apart from the general investment account of an insurer and hold and invest proceeds from the sales of products for which contract-holders retain the investment risks. For statutory accounting in the U.S., a transfer from a firm's general account to a separate account is not eliminated as an intra-company transaction, because the separate account is viewed as a separate entity for reporting purposes.

[28] Tim Zawacki, "Many Moving Parts in Lower 2014 Life Profits," SNL Financial LC (May 5, 2015).

Figure 12: L/H Sector Annual Net Investment Income ($ billions) and Net Yield on Invested Assets



Source: SNL Financial (Net Yield based on Average Net Admitted Invested Assets)

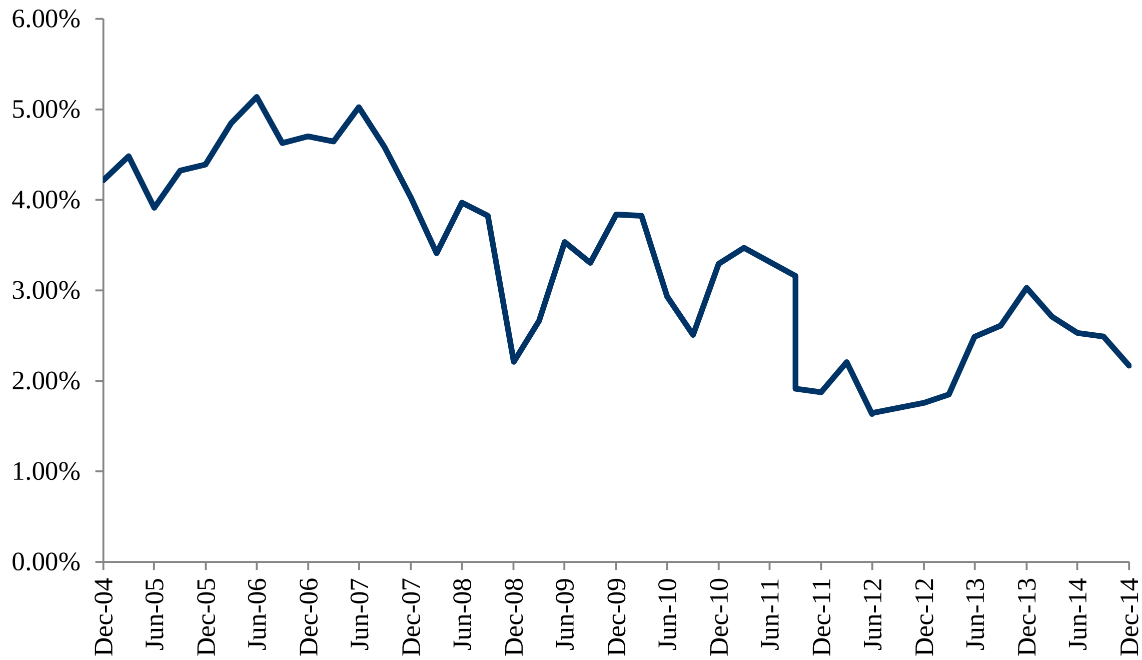
Figure 13: L/H Sector Investment Income ($ thousands) and Net Yield

	2010	**2011**	**2012**	**2013**	**2014**
Net Investment Income	$ 164,137,870	$ 167,322,081	$ 166,522,938	$ 167,951,243	$ 171,701,615
Total Cash & Investments	3,196,195,125	3,360,535,194	3,403,292,657	3,482,219,891	3,631,542,443
Net Yield on Invested Assets	**5.24%**	**5.10%**	**4.92%**	**4.88%**	**4.83%**

Source**:** SNL Financial (Net Yield based on Average Net Admitted Investment Assets)

Following a significant upward trend in 2013, longer-term interest rates generally declined over 2014 (see Figure 14), leading the L/H sector to its lowest investment yield (4.83 percent) in the past ten years. Net investment income did increase slightly, rising just over 2 percent. The low interest rate environment continues to present challenges to the L/H sector, as noted in FIO's previous annual reports. Additional discussion of these risks can be found in section III.D of this Report.

Figure 14: Percentage Yield on 10-year U.S. Treasury Bonds



Source: Bloomberg LP

As shown in Figure 15, growth of life insurer investments in higher-yielding, non-traditional asset classes outpaced growth in traditional bond investments in 2014, continuing a trend over the past several years. Of particular note were the 9 percent increase in "Other Assets," which includes "alternative" investments such as private equity and hedge funds, and the 6 percent growth in mortgage loans (primarily commercial mortgage loans).[29] These assets tend to be less liquid than investment-grade fixed income investments. If confronted with a need to rapidly liquidate assets to meet policyholder obligations (particularly surrenders and withdrawals), a higher concentration in less-liquid assets could cause additional realized losses resulting from the sale of such assets.

[29] The "other investments" entry includes, but is not limited to, assets such as surplus notes, limited partnerships, joint ventures, hedge funds, and private equity funds and direct investments. Figure 15 excludes $2.4 trillion held in separate accounts.

Figure 15: L/H Sector Invested Asset Compositions ($ thousands)

	2010	2011	2012	2013	2014
Bonds	$ 2,422,285,556	$ 2,531,840,835	$ 2,543,254,841	$ 2,601,161,686	$ 2,684,885,766
Preferred Stocks	9,116,406	8,082,049	7,781,708	8,259,459	9,140,252
Common Stocks	68,737,147	70,349,507	70,327,976	72,148,649	76,776,124
Mortgage Loans	307,367,978	323,074,554	335,592,215	353,149,725	373,011,956
Real Estate	19,674,202	20,576,284	21,369,248	22,352,892	21,887,019
Contract Loans	123,488,426	125,976,873	127,480,723	128,437,758	130,133,863
Derivatives	21,575,963	44,356,616	41,576,588	37,806,864	56,487,932
Cash & Short Term Investments	94,995,431	96,500,859	106,614,954	94,787,649	100,065,862
Other Investments	128,954,018	139,777,617	149,294,405	164,115,210	179,153,669
Total Cash & Investments	**$ 3,196,195,125**	**$ 3,360,535,194**	**$ 3,403,292,657**	**$ 3,482,219,891**	**$ 3,631,542,443**

Source: SNL Financial

In 2014, the L/H sector recorded net capital losses of $1.3 billion, nearly a 90 percent decrease from the $12 billion in realized capital losses reported in 2013. Considerably lower realized losses on derivative securities resulting from fairly modest capital markets' performance were the main reason for the decrease.

iv. L/H Sector Net Income and Return on Equity

Figure 16 presents a summary income statement for the L/H sector. Total revenues in the L/H sector increased 12 percent in 2014 to a new record of $878 billion. As discussed above, slight gains in net investment income slowed the overall growth in revenues, which was positively influenced by the 15 percent increase in net written premiums and lower use of reinsurance. Total expenses in 2014 increased at a faster (15 percent) pace as compared to 2013, reaching $813 billion and leading to a 23 percent decline in pretax income.[30] Net income decreased only 13 percent to $38 billion in 2014, largely due to the drop in net realized capital losses, following a record $43 billion of profits in 2013.

[30] The high increase in expenses is in part due to the Hartford Life and Annuity Insurance Company transaction discussed in section III.A.1.a.i of this Report.

Figure 16: L/H Sector Net Income ($ thousands)

	2010	2011	2012	2013	2014
Premiums, Consideration & Deposits	$ 562,072,490	$ 604,630,732	$ 625,844,137	$ 562,589,899	$ 647,775,436
Net Investment Income	164,137,870	167,322,081	166,522,938	167,951,243	171,701,615
Reinsurance Allowance	(29,286,964)	(16,268,042)	(30,779,711)	(21,247,568)	(14,987,927)
Separate Accounts Revenue	23,360,655	26,085,975	29,516,587	31,425,593	34,270,975
Other Income	53,038,453	53,200,471	41,367,790	42,960,169	39,161,577
Total Revenue	**773,322,505**	**834,971,218**	**832,471,742**	**783,679,335**	**877,921,676**
Total Expenses	687,179,877	773,678,380	757,571,492	704,265,022	812,510,810
Policyholder Dividends	14,985,542	15,099,874	15,211,990	15,660,306	16,430,515
Net Gain from Operations before Tax	53,084,270	28,002,719	59,568,028	63,754,009	48,980,351
Federal Income Tax	8,552,757	4,674,861	9,856,787	8,551,209	10,096,974
Net Income before Capital Gains	44,075,051	22,895,712	49,709,026	55,202,800	38,883,377
Net Realized Capital Gains (Losses)	(16,021,249)	(8,535,438)	(9,448,423)	(12,026,062)	(1,306,541)
Net Income	**$ 28,049,199**	**$ 14,364,501**	**$ 40,260,418**	**$ 43,176,737**	**$ 37,576,836**

Source: SNL Financial

Figure 17 shows key operating ratios for the L/H sector. The L/H sector's 2014 pretax operating margin declined to less than 6 percent from a record 8 percent in 2013. The decline in operating and net income resulted in a decrease in the sector's return on average equity (ROAE) to 11 percent from the 13 percent recorded in 2013.

Figure 17: L/H Sector Operating Ratios (%)

	2010	2011	2012	2013	2014
Pre-Tax Operating Margin	6.86	3.35	7.16	8.14	5.58
Return on Average Equity	9.39	4.66	12.64	13.11	10.96
Pre-Tax Operating Return On Average Equity	17.78	9.08	18.70	19.36	14.29
Return on Average Assets	0.56	0.27	0.73	0.74	0.61

Source: SNL Financial

b. Condition

This section presents information on the financial condition of the L/H sector, highlighting industry metrics associated with solvency and financial stability.

i. L/H Sector Assets, Capital and Surplus, and Leverage

Figure 18 shows the financial condition of the L/H sector as represented by its assets, capital and surplus, and leverage ratios.

Figure 18: L/H Sector Financial Leverage ($ thousands)

	2010	2011	2012	2013	2014
Capital & Surplus	$ 306,430,238	$ 310,372,997	$ 326,647,273	$ 331,828,320	$ 353,882,911
General Account Assets	3,356,501,480	3,534,370,609	3,587,753,293	3,675,810,891	3,835,979,315
General Account Assets-to-Surplus Ratio	**10.95**	**11.39**	**10.98**	**11.08**	**10.84**

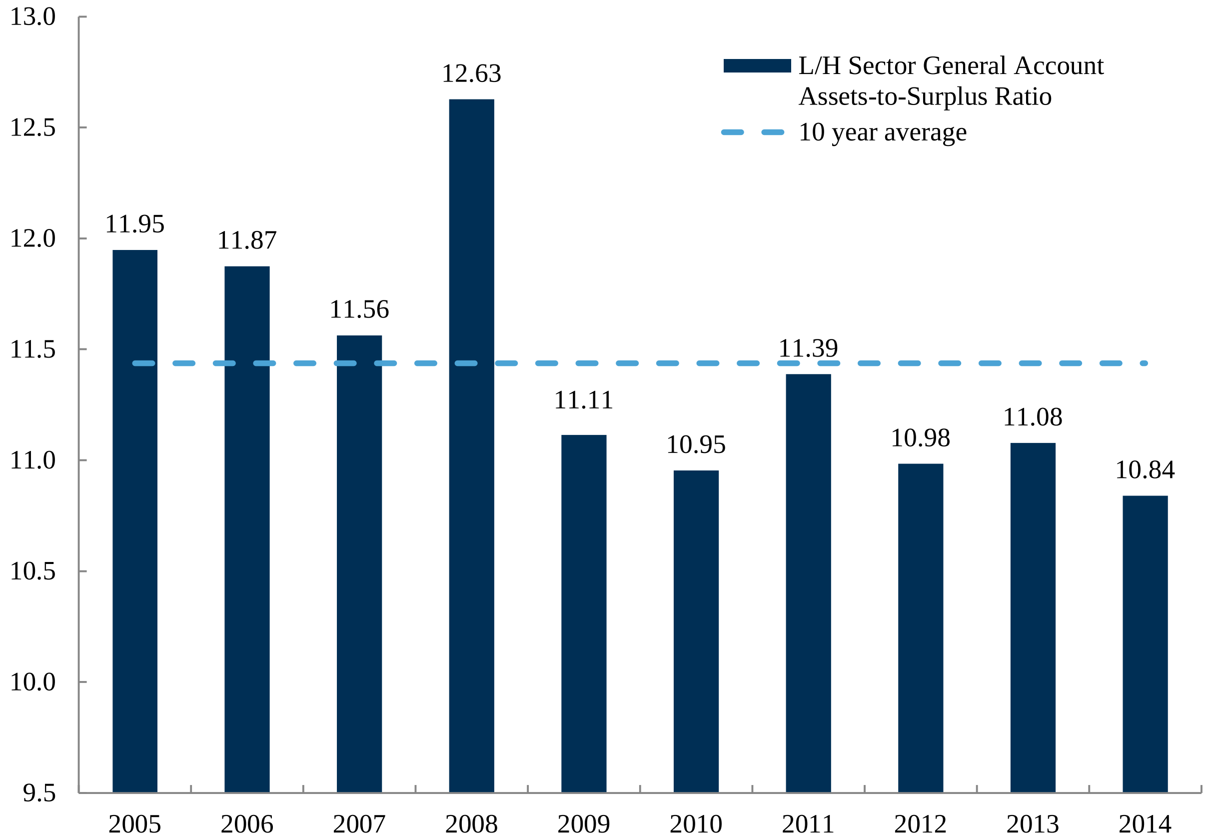
Source: SNL Financial

Capital and surplus is the excess of reported assets of an insurer over its reported liabilities, based on valuations prescribed by state insurance regulators. Capital and surplus is an important measure of financial health because it reflects the ability of an insurer to satisfy obligations to policyholders (particularly in the event of unexpectedly large or catastrophic losses). Surplus is also indicative of the capacity of an insurer to write new business (i.e., to make insurance products more available to consumers).

For 2014, general account assets of the L/H sector increased by slightly more than 4 percent, but capital and surplus increased by nearly 7 percent. Capital and surplus reached a record $354 billion due to the contribution of net income after dividends, lower net realized capital losses, and substantially higher net unrealized capital gains as compared to 2013. The L/H sector's leverage ratio (i.e., assets-to-surplus) decreased to its lowest level in the past ten years, indicating a stronger aggregate balance sheet. However, due to state-based reporting requirements, this L/H sector data is based on an aggregation of amounts reported by life insurance legal entities and does not reflect an aggregation of fully consolidated group data. Some intercompany transactions, such as amounts that some large life insurers cede to affiliated captive reinsurers, are therefore reported in a manner identical to cessions to non-affiliated reinsurers. Group-wide consolidated reporting would eliminate the benefits of these intra-company transactions. As a result, due to the limits of state reporting requirements the amounts reported herein for L/H sector surplus are larger than would be the case using a full consolidation approach.

Figure 19 presents a longer-term illustration of the L/H sector's financial leverage. Improvements in capital and surplus that occurred after the financial crisis contributed to the maintenance of relatively lower leverage ratios as compared to pre-crisis years.

Figure 19: L/H Sector General Account Assets-to-Surplus Ratio



Source: SNL Financial

ii. L/H Sector Reserves

In the United States, life insurance reserves generally represent the net present value of expected future obligations of a life insurer. Estimates of an insurer's long-term liabilities are dependent on a number of key assumptions (e.g., mortality and interest rates) and actuarial judgment. For interest-rate sensitive life and annuity business, reserve increases can be attributed in part to actuarial cash flow testing, which considers the changes in assets and liabilities under a variety of scenarios.

As shown in Figure 20, in 2014 total L/H sector reserves reached a new record level and increased by more than 3 percent from 2013 to almost $3 trillion. A nearly 4 percent increase in reserves for life insurance policies and contracts (including annuities) drove the overall increase in reserves.

Figure 20: L/H Sector Reserves ($ thousands)

	2010	2011	2012	2013	2014
Net Policy Reserves - Life	$ 2,191,727,721	$ 2,313,653,676	$ 2,305,705,102	$ 2,375,628,530	$ 2,467,612,434
Net Policy Reserves – A/H	206,872,867	222,235,744	219,118,177	218,826,440	223,483,213
Liability for Deposit-Type Contracts	273,171,733	266,873,754	270,573,877	264,312,909	267,690,525
Total Policy Reserves plus Deposits	**$ 2,671,772,321**	**$ 2,802,763,174**	**$ 2,795,397,156**	**$ 2,858,767,878**	**$ 2,958,786,172**
Growth - Total Reserves & Deposits	**3.39%**	**4.90%**	**-0.26%**	**2.27%**	**3.50%**

Source: SNL Financial

2. Property and Casualty Sector

a. Performance

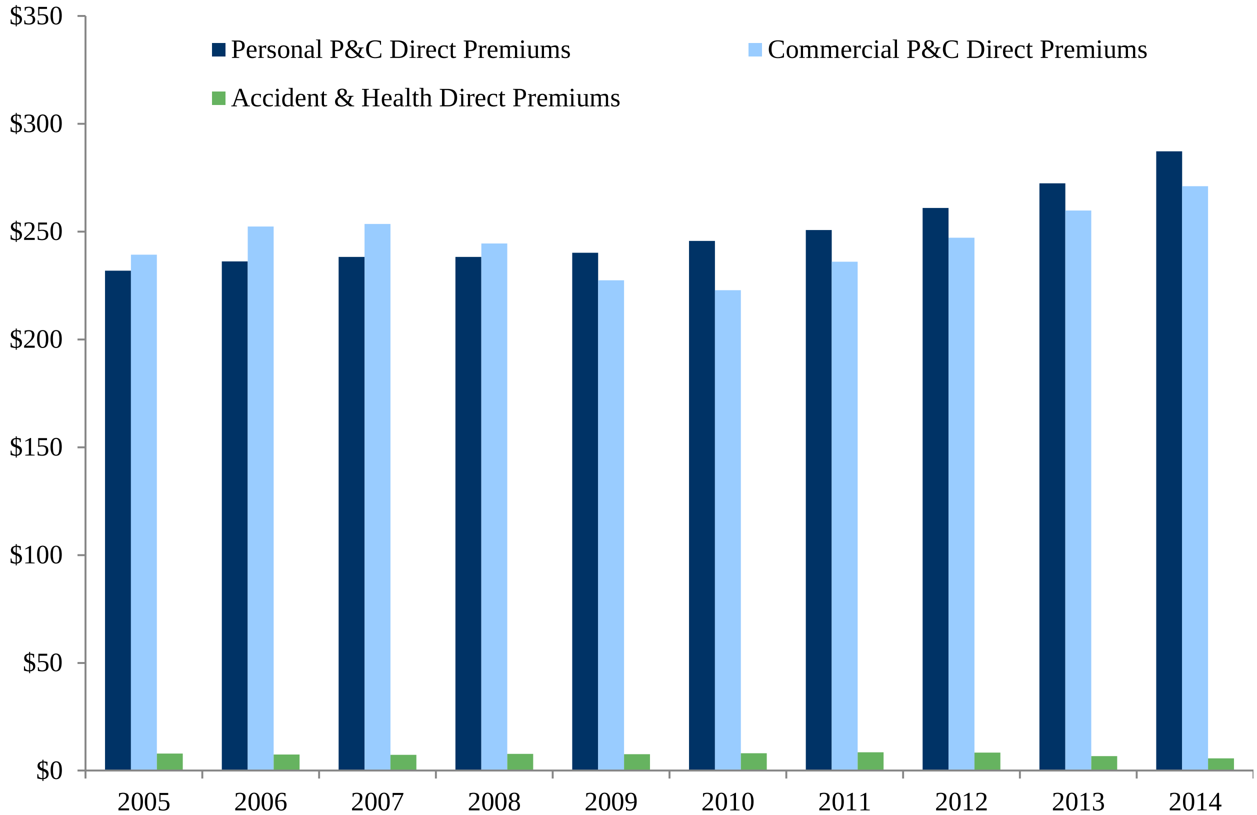
This section presents additional analysis of the financial performance of the P/C sector, followed by a section that analyzes the financial condition of the sector.

i. P/C Sector Net Written Premiums

Figure 21 shows the level and composition of P/C sector direct written premiums by major lines of business, and Figure 22 shows the corresponding dollar values and a reconciliation to net premiums earned (i.e., direct premiums written less net reinsurance premiums ceded and the change in unearned premiums reserve). For 2014, total P/C sector net written premiums reached another record level at $503 billion, marking an increase of more than 4 percent over the 2013 result. Direct written premiums for personal lines of business grew by more than 5 percent, while direct written premiums for commercial lines of business increased slightly more than 4 percent. Premiums ceded to reinsurers also increased by nearly 5 percent, leading to the growth in net written premiums. Rate increases and continued improvement in the U.S. economy drove growth in aggregate premiums in 2014.[31]

[31] Jennifer Marshall, “Profits Continue for U.S. P/C Industry, Supporting Record Policyholders’ Surplus Level,” A.M. Best Company, Inc. (April 30, 2015) (hereinafter, “Profits Continue for U.S. P/C Industry”).

Figure 21: P/C Sector Direct Premiums Written ($ billions)



Source: SNL Financial

Figure 22: P/C Sector Premiums ($ thousands)

	2010	2011	2012	2013	2014
Personal P&C Direct Premiums	$ 245,730,464	$ 250,663,210	$ 260,935,657	$ 272,367,403	$ 287,265,939
Commercial P&C Direct Premiums	222,868,720	235,984,214	247,129,459	259,724,199	270,986,770
Accident & Health Direct Premiums	8,037,142	8,557,416	8,412,897	6,684,794	5,764,967
Direct Premiums Written	**484,429,036**	**502,033,845**	**523,932,157**	**546,338,848**	**570,424,137**
Net Reinsurance Premiums	(58,176,409)	(60,035,881)	(62,963,530)	(64,633,403)	(67,814,643)
Net Premiums Written	**426,252,627**	**441,997,964**	**460,968,626**	**481,705,445**	**502,609,494**
Change in Unearned Premiums Reserve	1,569,806	3,642,303	7,913,565	9,841,148	9,096,537
Net Premiums Earned	**$ 424,682,821**	**$ 438,355,661**	**$ 453,055,061**	**$ 471,864,297**	**$ 493,512,957**

Source: SNL Financial

ii. P/C Sector Underwriting Results

The combined ratio is an accepted insurance sector metric used to compare underwriting performance in the P/C sector; it is the sum of the loss ratio (incurred losses divided by earned premiums) and the expense ratio (incurred expenses divided by written premiums). A combined ratio less than 100 percent indicates that premiums covered losses and expenses in a given period (i.e., underwriting operations made a positive contribution to net income). Figure 23 shows the P/C combined ratio and its component ratios for the past several years.[32] While the combined ratio for the P/C sector increased slightly to approximately 97 percent in 2014, it remained below 100 percent for the second consecutive year. Investment income, realized capital gains/losses, and income taxes are not considered in the combined ratio. Following a relatively modest cumulative level of natural catastrophe and other weather-related non-catastrophe losses in 2013, the sector incurred a more typical level of such losses in 2014, leading to an increase in the loss ratio.[33] Operating expenses were kept in check, and allowed the expense ratio to decline slightly.

Figure 23: P/C Sector Operating Ratios (%)

	2010	2011	2012	2013	2014
Loss Ratio	61.06	66.87	61.95	55.59	57.20
Loss Adjustment Expense Ratio	12.54	12.58	12.39	11.94	11.82
Loss and Loss Adjustment Expense Ratio	**73.59**	**79.45**	**74.34**	**67.53**	**69.02**
Net Commission Ratio	10.39	10.22	10.20	10.24	10.38
Salaries & Benefits Ratio	8.33	8.30	8.41	8.54	8.14
Tax, License & Fees Ratio	2.60	2.60	2.62	2.60	2.51
Administrative & Other Expense Ratio	6.94	7.25	6.99	6.78	6.55
Expense Ratio	**28.26**	**28.37**	**28.22**	**28.17**	**27.58**
Policyholder Dividend Ratio	0.64	0.53	0.59	0.64	0.59
Combined Ratio	**102.49**	**108.35**	**103.15**	**96.34**	**97.20**

Source: SNL Financial

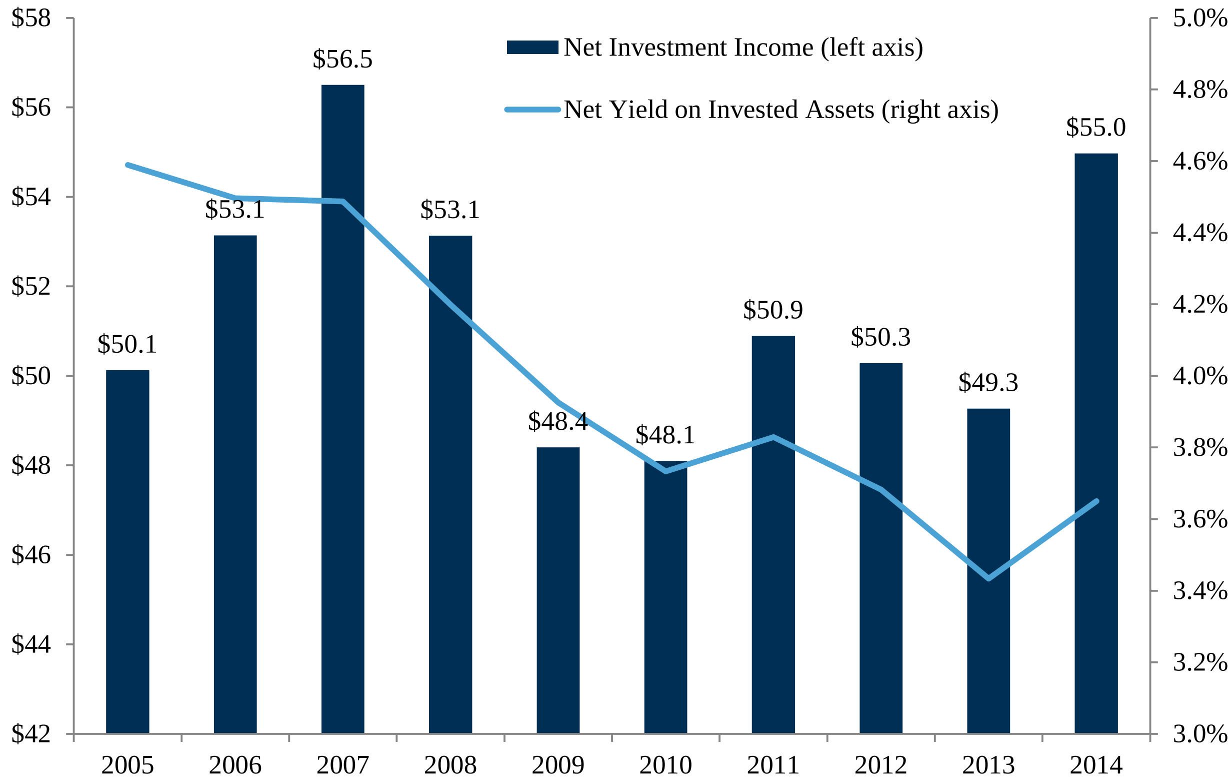
iii. P/C Sector Investment Income

Reported net investment income for the P/C sector increased by nearly 12 percent to $55 billion in 2014, reversing a several years-long declining trend. Commensurately, the net yield on invested assets rose 22 basis points to 3.65 percent, marking the first increase in net yield since 2011. Notably, though, these measures were inflated by a one-time extraordinary dividend of approximately $7 billion between subsidiaries of Berkshire Hathaway, Inc.[34] A.M. Best Company, Inc. estimates that absent this extraordinary dividend, net investment income would have declined slightly from the 2013 level to approximately $48 billion, continuing the decreasing trend.[35] Likewise, the adjusted net yield on invested assets would have been slightly below the 2013 level. Figure 24 depicts a longer-term historical view of the trend in net investment income and net yield on invested assets for the P/C sector,

[32] For transparency, SNL Financial ratios include the policyholder dividend ratio because dividends represent a cash outlay.
[33] Profits Continue for U.S. P/C Industry.
[34] Government Employees Insurance Company paid to National Indemnity Company, as a dividend, shares of nonfinancial affiliates worth approximately $7 billion.
[35] Profits Continue for U.S. P/C Industry.

and Figure 25 provides this data for the past five years. Realized capital gains and losses are excluded from net investment income.

Figure 24: P/C Sector Annual Net Investment Income ($ billions) and Net Yield on Invested Assets



Source: SNL Financial (Net Yield based on Average Net Admitted Invested Assets)

Figure 25: P/C Sector Investment Income ($ thousands) and Net Yield

	2010	2011	2012	2013	2014
Net Investment Income	$ 48,099,454	$ 50,890,625	$ 50,284,734	$ 49,270,139	$ 54,973,977
Total Cash & Investments	1,316,192,292	1,341,904,107	1,389,359,572	1,480,597,434	1,531,873,037
Net Yield on Invested Assets	**3.73%**	**3.83%**	**3.68%**	**3.43%**	**3.65%**

Source: SNL Financial

P/C insurers are less dependent on net investment income to fund losses and expenses than are L/H insurers, and, therefore net investment income accounted for 9 percent of total sector revenues in 2014 (compared to about 20 percent in the L/H sector). Nonetheless, historically low interest rates have caused P/C insurers to look to investments in mortgage loans and “alternative” investments for higher rates of return. Figure 26 shows the composition of the P/C sector’s invested assets over the past five years. Although bonds comprise the largest allocation of the P/C sector’s assets, the less than 2 percent growth in total bonds from 2013 to 2014 was the lowest increase of any asset class and less than the growth of more than 3 percent in total cash and invested assets. Exposure to common equities increased 5 percent, and other investments increased 7 percent. Preferred stocks and mortgage loans, although still relatively small components of invested assets (1 percent or less each), increased 26 percent and 25 percent, respectively. The growth in mortgage loans followed exceptionally strong growth (up 41 percent) in 2013. Also notable was a nearly 9 percent increase in cash and short-term investments, which may have been the result of building liquidity out of concern for an upward spike in interest rates.[36]

Figure 26: P/C Sector Invested Assets ($ thousands)

	2010	2011	2012	2013	2014
Bonds	$ 873,861,414	$ 902,533,003	$ 907,509,046	$ 926,333,477	$ 942,396,140
Preferred Stocks	17,574,224	11,619,100	11,929,781	11,541,934	14,585,378
Common Stocks	208,460,881	227,253,516	254,465,023	315,950,953	330,046,819
Mortgage Loans	4,171,188	4,969,359	5,682,044	7,985,242	10,020,467
Real Estate	9,772,963	10,373,603	10,386,643	9,953,091	10,153,163
Derivatives	643,393	648,785	591,755	577,504	636,629
Cash & Short Term Investments	85,977,934	72,607,938	82,611,910	83,611,616	90,776,318
Other Investments	115,730,293	111,898,803	116,183,370	124,643,617	133,258,123
Total Cash & Investments	**$ 1,316,192,292**	**$ 1,341,904,107**	**$ 1,389,359,572**	**$ 1,480,597,434**	**$ 1,531,873,037**

Source: SNL Financial

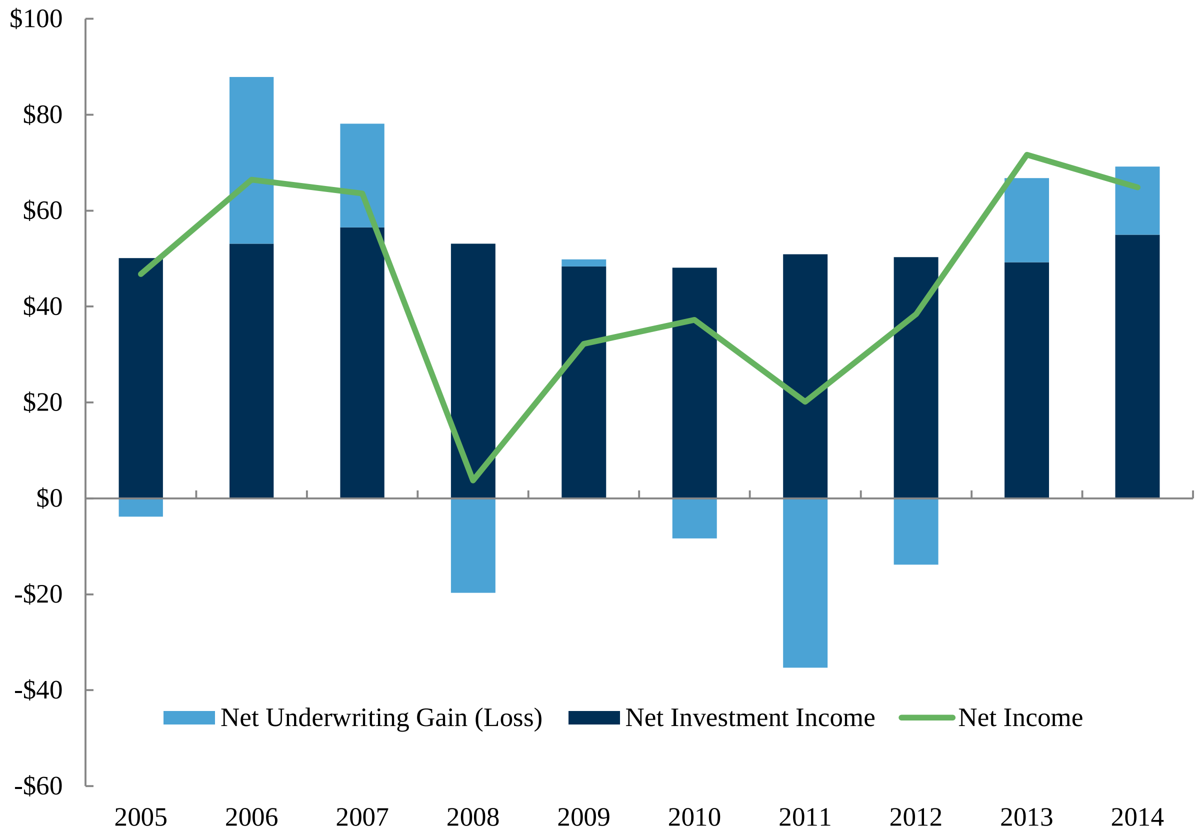
Realized capital gains on investments also contributed to the P/C sector's profitability; over 2014, the P/C sector recorded net realized capital gains of $12 billion, which was 36 percent less than the 2013 level. Considerably lower realized gains on the disposition of affiliated common stocks were the main reason for the decrease in realized gains in 2014.

iv. P/C Sector Net Income

The P/C sector's net income decreased by 9 percent in 2014 to $65 billion, as shown in Figure 27. A 19 percent decline in the underwriting gain was the main reason for the decrease in net income. The increase in net investment income was more than offset by the decrease in net realized capital gains. A $4 billion, one-time loss on assumed retroactive reinsurance by a Berkshire Hathaway, Inc. subsidiary was responsible for a significant increase in other expenses.[37] These factors led to a 10 percent decrease in pretax operating income. With lower profitability came lower income taxes, which decreased 14 percent in 2014, leaving net income down by 9 percent for the year. Figure 28 provides a summary income statement for the P/C sector.

[36] *Id.*
[37] *Id.*

Figure 27: P/C Sector Net Income ($ billions)



Source: SNL Financial

Figure 28: P/C Sector Net Income ($ thousands)

	2010	2011	2012	2013	2014
Net Premiums Earned	$ 424,682,821	$ 438,355,661	$ 453,055,061	$ 471,864,297	$ 493,512,957
Losses and Loss Adjustment Expense Incurred	312,544,989	348,268,077	336,799,291	318,657,814	340,636,716
Other Underwriting Expense Incurred	121,271,162	123,919,420	129,777,721	136,164,953	139,101,706
Other Underwriting Deductions	(808,897)	1,475,530	322,517	(471,495)	(475,077)
Net Underwriting Gain (Loss)	**(8,322,053)**	**(35,308,154)**	**(13,842,550)**	**17,511,086**	**14,249,687**
Policyholder Dividends	2,701,811	2,315,009	2,656,168	3,018,374	2,932,599
Net Investment Income	48,099,454	50,890,625	50,284,734	49,270,139	54,973,977
Net Realized Capital Gains (Losses)	7,829,338	7,577,531	8,659,260	18,383,109	11,777,785
Finance Service Charges	3,182,086	3,179,564	3,287,910	3,403,168	3,271,070
All Other Income	(2,039,896)	(868,718)	(1,062,516)	(1,874,717)	(6,157,994)
Net Income after capital gain (loss) before tax	**46,052,998**	**23,155,391**	**44,670,672**	**83,674,412**	**75,181,851**
Federal Income Tax	8,834,290	3,026,943	6,254,790	12,035,959	10,325,601
Net Income	**$ 37,217,759**	**$ 20,124,876**	**$ 38,415,881**	**$ 71,638,452**	**$ 64,856,316**

Source: SNL Financial

Figure 29 displays key measures of returns for the P/C sector. While each of these metrics declined compared to 2013 levels, each also remained higher than those recorded in other post-crisis years. The 2014 return on average equity of 9.6 percent was slightly higher than the long-term average of 9 percent.

Figure 29: P/C Sector Operating Ratios (%)

	2010	2011	2012	2013	2014
Pre-Tax Operating Margin	8.06	3.17	7.12	12.49	11.62
Return on Average Equity (Capital & Surplus)	6.89	3.59	6.65	11.37	9.58
Pre-Tax Operating Return on Average Equity	7.08	2.78	6.23	10.36	9.37
Return on Average Assets	2.45	1.28	2.37	4.23	3.67

Source: SNL Financial

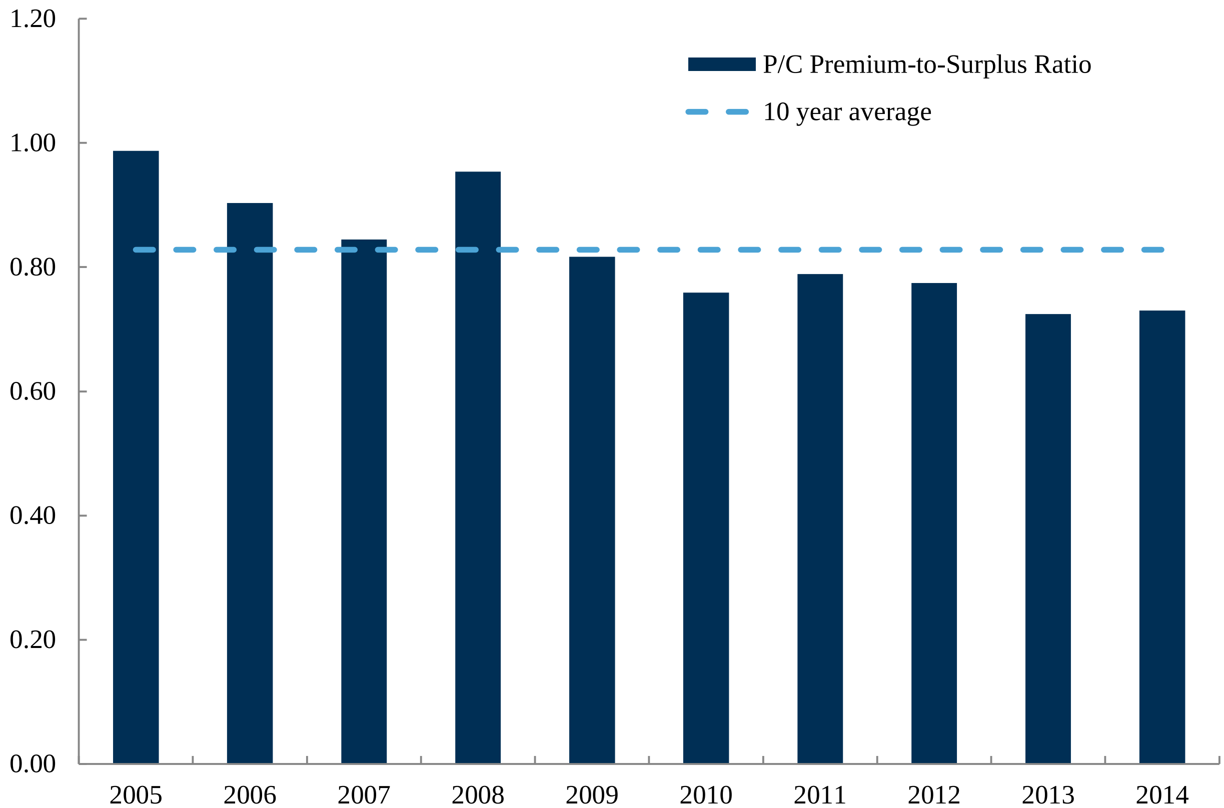
b. Condition

This section presents additional information on the financial condition of the P/C sector, highlighting industry metrics associated with solvency and financial stability.

i. P/C Sector Policyholders' Surplus

The P/C sector's policyholders' surplus continued to increase in 2014, rising nearly 4 percent to a record-high $689 billion, driven by the sector's profitability. Policyholders' surplus has increased in each of the past four years, enhancing the P/C sector's claims-paying resources and loss-absorption capacity. Figure 30 provides a longer-term perspective on the sector's leverage, with corresponding dollar values for periods since 2010 shown in Figure 31. The ratio of net premiums written to policyholders' surplus is the standard measure of leverage in the P/C sector, as contrasted with the assets-to-surplus ratio used in the L/H sector; this is reflective of the shorter duration and higher volatility of P/C sector liabilities relative to L/H sector liabilities. Since the financial crisis, the P/C sector (like the L/H sector, as well) has been deleveraging, which increases capacity to write new business and absorb losses. The 2014 premiums-to-surplus ratio of 73 percent was well below the ten-year average, although a slight increase from the 2013 mark as surplus growth was slowed by lower profitability.

Figure 30: P/C Sector Annual Net Premiums-to-Surplus Ratio



Source: SNL Financial

Figure 31: P/C Sector Financial Leverage ($ thousands)

	2010	2011	2012	2013	2014
Policyholders' Surplus	$ 561,776,605	$ 560,322,549	$ 595,162,557	$ 664,818,600	$ 688,588,315
Net Premiums Written	426,252,627	441,997,964	460,968,626	481,705,445	502,609,494
Net Premiums Written/Average Policyholders' Surplus	**87.3**	**86.35**	**78.95**	**78.65**	**79.47**

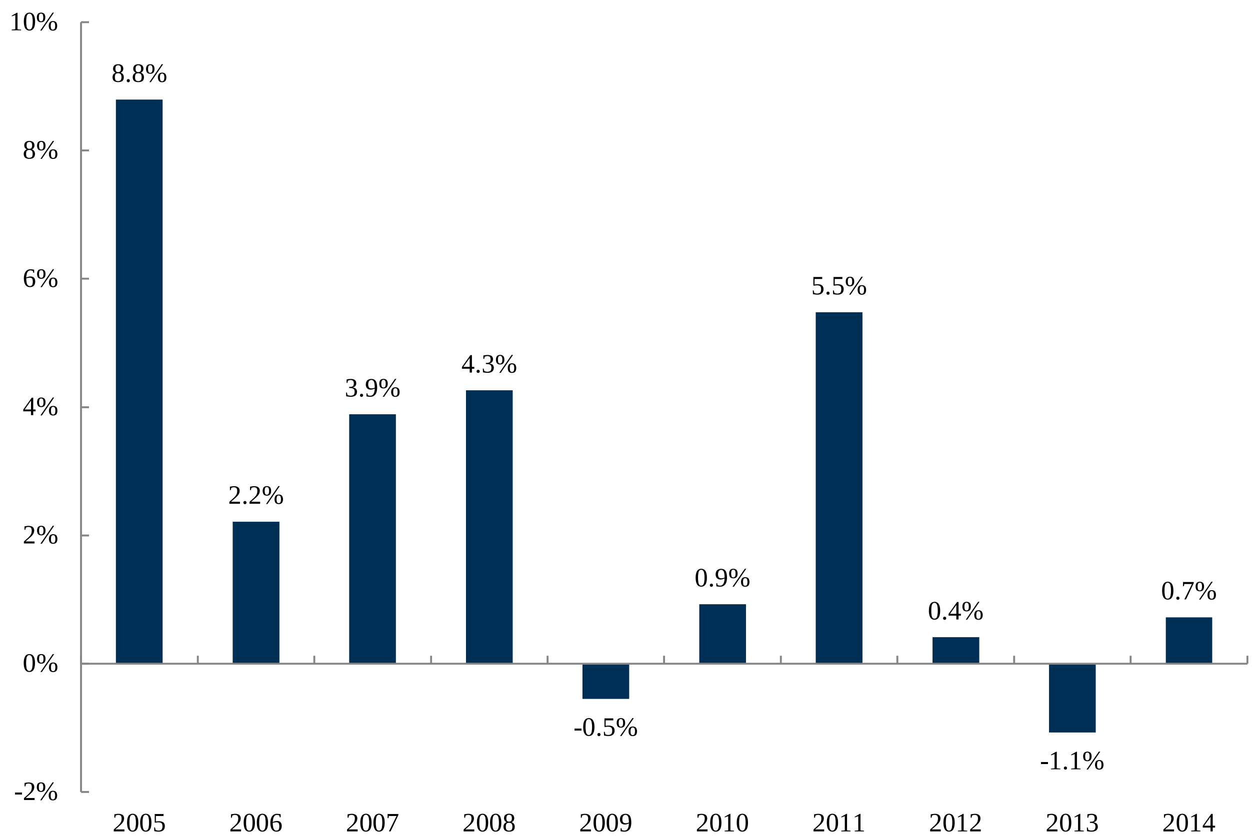
Source: SNL Financial

ii. P/C Sector Reserves

P/C sector reserves represent estimates for losses of the ultimate incurred losses and loss adjustment expenses for events that have already occurred, but that remain unpaid as of the balance sheet date. Subject to non-uniform but generally applicable state-by-state regulations, P/C reserves are set based on both actuarial judgement and insurer discretion.

Total P/C sector reserves increased by less than 1 percent in 2014, as shown in Figure 32. The limited increase in total reserves was mainly the result of an essentially flat development of 2014 commercial lines reserves as compared with the 2013 level (Figure 33). Sector reserves for personal lines of business increased 3 percent in 2014; this increase was the main contributor to the overall growth in reserves.

Figure 32: P/C Sector Change in Loss and LAE Reserves



Source: SNL Financial

Figure 33: P/C Sector Reserves ($ thousands)

	2010	2011	2012	2013	2014
Major Segment - Personal	$ 120,673,876	$ 123,951,475	$ 124,846,974	$ 125,436,080	$ 128,972,564
Major Segment - Commercial	444,089,022	471,815,067	473,386,905	466,146,476	466,377,372
Major Segment - Accident & Health	4,754,119	5,011,683	5,210,754	5,391,795	5,924,228
Total Loss and Loss Adjustment Expense Reserves	**$ 569,505,045**	**$ 600,707,917**	**$ 603,179,216**	**$ 596,711,138**	**$ 601,031,537**
Change in Loss & Loss Adjustment Expense Reserves	**0.93%**	**5.48%**	**0.41%**	**-1.07%**	**0.72%**

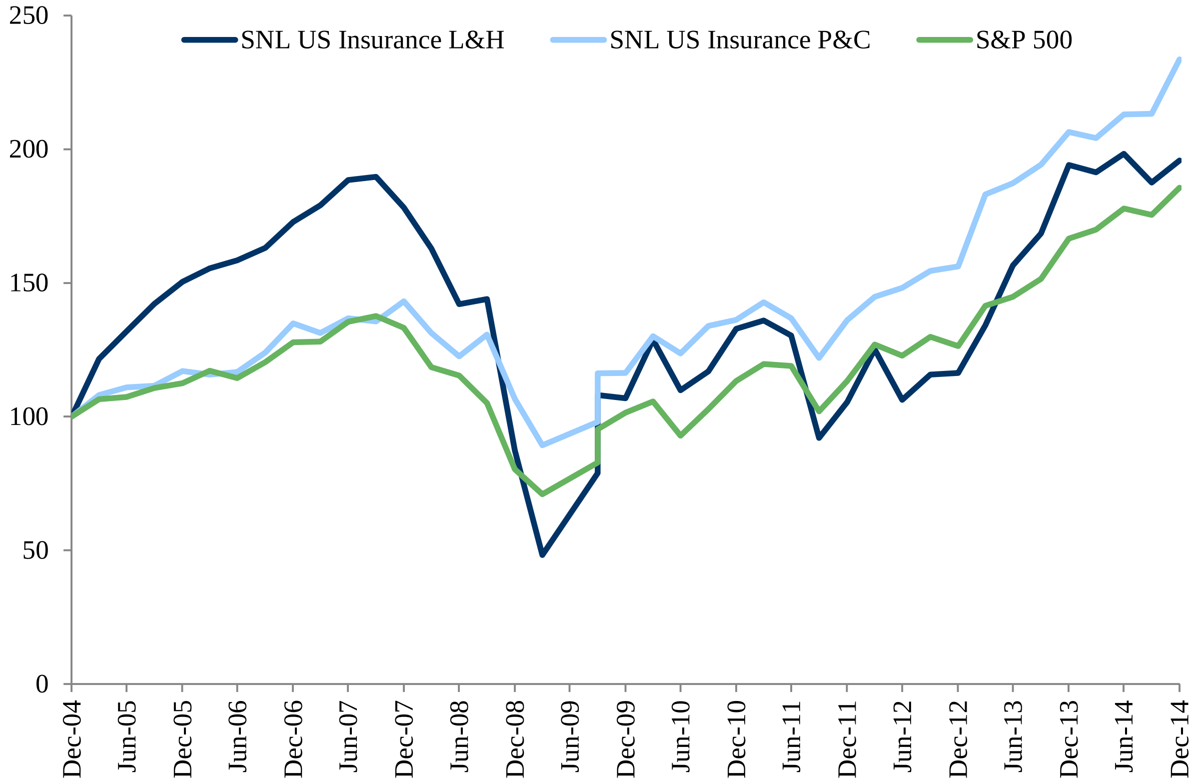
Source: SNL Financial

B. Market Performance

Stock price movements are indicators of investors' perceptions about the recent financial results and future financial prospects of a firm, an industry sector or, in a broader context, the national economy. The discussion that follows considers the price performance of stock indices for the L/H and P/C sectors, as compared to the performance of the Standard and Poor's 500 Index (S&P 500).

Over the past ten years, the SNL Stock Price Indices for both the U.S. L/H and P/C sectors have outperformed the S&P 500, as shown in Figure 34. The L/H sector stock index outperformed the S&P 500 prior to and following the financial crisis, but underperformed during the crisis. The P/C sector was on balance a market performer leading up to the crisis, but has outperformed the S&P 500 during and subsequent to the crisis. Since the end of 2004, the P/C stock index gained 134 percent and the L/H stock index increased 96 percent; over the same period, the S&P 500 gained 86 percent. In the short-term, for 2014, the P/C stock index increased 13 percent, outperforming the S&P 500's 11 percent gain, but the L/H sector stock index significantly underperformed, appreciating slightly less than 1percent, as shown in Figure 35.

Figure 34: Insurance Sector Stock Prices vs. S&P 5000



December 31, 2004 = 100
Source: SNL Financial, LC

Figure 35: Insurance Sector Indexed Stock Prices vs. S&P 5000

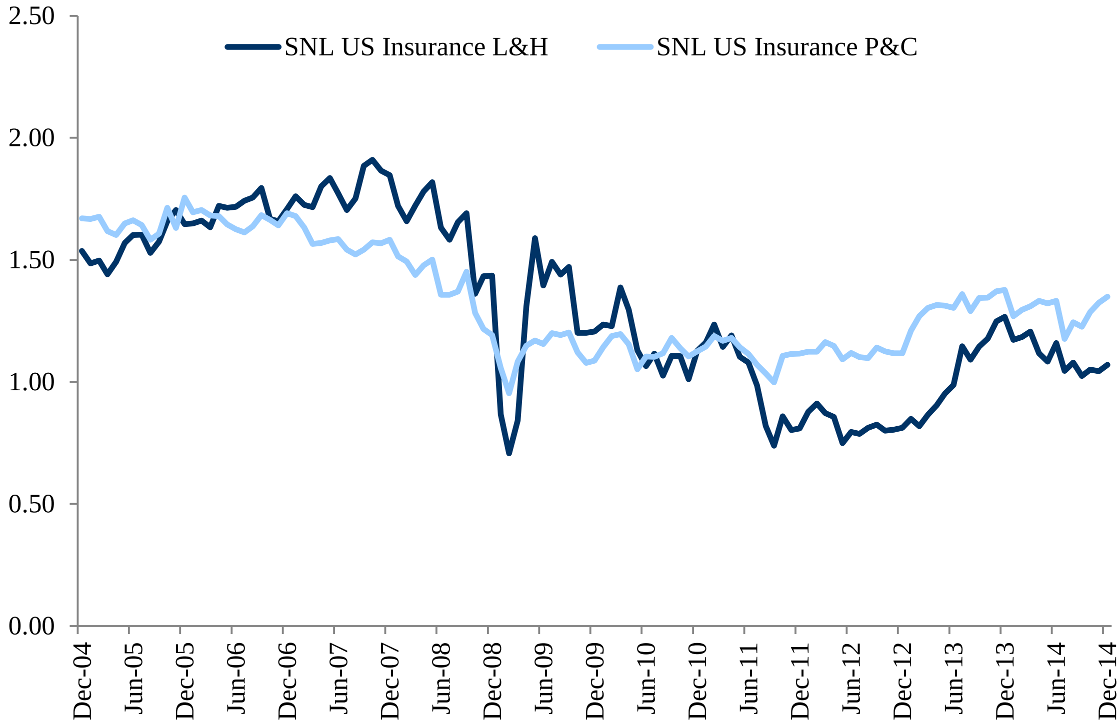
	Dec - 13	Mar -14	Jun - 14	Sep - 14	Dec - 14	Qtr/Qtr	Yr/Yr
SNL Life	194	191	198	187	196	4.4%	.08%
SNL P&C	206	204	213	213	234	9.5%	13.2%
S&P 500	167	170	178	175	186	5.8%	11.4%

December 31, 2004 = 100
Source: SNL Financial, LC

The price-to-book value ratio, which compares on a per share basis the market value of a firm to its book value (i.e., reported equity on its balance sheet) is a common and popular metric by which to measure market valuation of a company. If a share of a company's stock is selling for less than its book value per share, the market is valuing the company at less than its assets minus its liabilities (net worth); the opposite is true if the stock is trading at a premium to its book value. Figure 36 compares L/H and P/C sector price-to-book value ratios from year-end 2004 through year-end 2014. Following a strong price recovery in 2013, the premium of L/H sector stocks to book value narrowed over 2014, settling at a multiple of 1.07 times book value at the end of the year, down from the 1.27 multiple at the end of 2013.

P/C sector stocks also saw slight erosion in premium over book value, slipping to a multiple of 1.35 times book value at the end of 2014 compared to a multiple of 1.38 times book value at the end of 2013.

Figure 36: Insurer Price/Book Value Ratios



Source: SNL Financial

C. Capital Markets Activity

In terms of the number of transactions, merger and acquisition (M&A) activity was slower in 2014 compared to 2013, but the aggregate value of those transactions was considerably greater.[38] In 2014, a total of 76 transactions with an aggregate value of $14.0 billion were announced, compared to 85 transactions with an aggregate value of $7.8 billion in 2013. The number of transactions decreased 11 percent, while the aggregate value increased by 79 percent. Most of the activity occurred in the P/C sector (49 transactions, or 65 percent), but these deals accounted for only 48 percent of the aggregate value.

A few large transactions were the drivers of the increase in the aggregate transaction value for the industry. The largest transaction in 2014 was the June acquisition by Dai-ichi Life Insurance Company, Ltd. (Japan) of Protective Life Corporation, valued at $5.6 billion. The acquisition of Wilton Re

[38] All data in this section sourced from SNL Financial, LC, as collated and calculated by FIO.

Holdings, Ltd. by a private investor group was the second-largest deal in 2014, valued at $1.8 billion, followed by RenaissanceRe Holdings, Ltd.'s $1.7 billion acquisition of Platinum Underwriters Holdings, Ltd. These top three transactions constituted 65 percent of the industry aggregate deal value for the year.

Following a fairly uneventful year for mergers and acquisitions in 2014, activity picked up significantly in the middle of 2015 as a number of large, high-value mergers were announced. In early June 2015, Tokio Marine Holdings, Inc., a Japan-domiciled insurer, announced it had reached an agreement to acquire Houston, Texas-based HCC Insurance Holdings, Inc. for approximately $7.5 billion; this one transaction was valued at more than half of the total value of all transactions announced in 2014. Three more significant deals were announced in the first few days of July 2015. First, ACE, Limited of Switzerland announced its agreement to acquire Chubb Corporation for approximately $28.2 billion.[39] This was followed by Centene Corporation's announcement of a $6.3 billion acquisition of Health Net, Inc. On the next day, Aetna Inc. announced an agreement to acquire Humana Inc. for approximately $35.5 billion. Later in July, Anthem Inc. announced an agreement to acquire Cigna Corp. in a cash and stock deal valued at $54.2 billion. In the aggregate, these five deals were valued at $131.7 billion, more than nine times the aggregate value of the 76 transactions announced in all of 2014.

The transactions in 2015 also are noteworthy because of the resulting market consolidation. The combination of ACE and Chubb will create the second-largest commercial lines insurer operating in the U.S., as well as adding exposure to markets in which neither company was active.[40] Centene and HealthNet together will be a significant player in the Medicaid market.[41] Notably, the merged operations of Aetna and Humana will have more members than the current largest U.S. health insurer, UnitedHealth Group, Inc.[42] The combination of Anthem and Cigna is expected to create an insurer with over 53 million members, or roughly 17 percent of the U.S. population.[43] A.M. Best Company, Inc. expects merger and acquisition activity to continue for the next several months as managers expand the geographic reach of insurers, seek opportunities to save costs, and take advantage to low (debt) financing cost which remain in place to facilitate consolidation.[44]

The insurance industry continued to actively access the equity markets for new and/or additional capital in 2014. During the year, 36 equity offerings were announced, with an aggregate value of $8.0 billion. This activity marked an increase in both the number and aggregate value of transactions as compared to 2013 levels (22 offerings valued at $5 billion). Of the total offerings, six transactions valued at $604 million in all were initial public offerings (IPOs); the number of IPOs increased by one compared to

[39] In December 2014, ACE Ltd announced the acquisition of the high net worth personal lines business of Fireman's Fund Insurance Company for approximately $365 million.
[40] Thomas Mason, "Landmark ACE/Chubb Deal Will Rock Market Share Rankings," SNL Financial, LC (July 1, 2015).
[41] Matt MacFarland, "Aetna/Humana Combination May Push Anthem to Quickly Ink Deal with Cigna," SNL Financial, LC (July 6, 2015).
[42] *Id*.
[43] Dennis Gorski, "Anthem CEO: $54 Billion Buy of Cigna Creates New Company that Will Cover 17% of U.S. Population," A.M. Best Company, Inc. (July 24, 2015).
[44] John Andre, "Insurance and Reinsurance Market Conditions Set the Scene for Further Takeover Activity," A.M. Best Company, Inc. (July 17, 2015).

2013, but the aggregate value decreased from the $1 billion issued in 2013. Private equity investors also continued to take profits on investments in the insurance industry by selling all or part of their stakes to the public; three of the equity offerings in 2014 were made by selling stockholders in which the subject insurers received none of the proceeds, as compared to four such transactions in 2013.

Debt markets were also a significant source of additional capital for the insurance industry in 2014. During the year, insurers raised an aggregate $37.3 billion in 86 separate debt offerings, thus continuing to benefit, at least in one respect, from the low interest rate environment. Debt issuance slowed, however, as compared to the $41.8 billion raised in 88 offerings in 2013. Through a combination of 21 separate offerings, MetLife, Inc. and its largest operating subsidiary, Metropolitan Life Insurance Company, raised an aggregate $12.1 billion, or 32 percent of the total for the industry. The next largest insurer issuer of debt was AIG, which raised an aggregate $3.3 billion through three separate offerings. The remainder of the top five issuers of debt included Prudential Financial ($1.9 billion), Berkshire Hathaway, Inc. ($1.9 billion), and Anthem, Inc. ($1.8 billion). Together, the funds raised by the top five issuers of debt accounted for 56 percent of the 2014 industry total. The largest single offerings were $1.5 billion issues sold (separately) by MetLife, Inc. and AIG.

D. Alternative Risk Transfer Capital

Reinsurance markets remained "soft" during 2014. Reinsurance broker Willis Re reported that "after three years of relentless rate reductions, the January 1, 2015, renewal season has not offered reinsurers any respite."[45] Similarly, reinsurance broker Guy Carpenter & Company, LLC reported that renewal premiums for catastrophe reinsurance declined by 11 percent year-over-year as of January 2015.[46]

These persistently lower premiums are a product of at least two main factors. One factor is weaker demand from primary insurers, some of which are retaining more (i.e., ceding less) of the risks. The second factor is the continued growth in reinsurance market capacity. Industry observers have noted that "the continued lack of demand and oversupply of capital can only keep driving pricing down."[47]

This oversupply of capital consists, in small part, of an increase in capital at traditional reinsurance companies. Aon Benfield measures such growth at 6 percent in 2014, following a 7 percent increase in 2013.[48] Another part is the $14 billion growth (28 percent annual growth rate) in alternative risk transfer transactions (ART). Although ART is growing quickly, the total amount of ART capital (approximately $64 billion) is small in comparison to the $575 billion of capital in reinsurance companies.[49] ART instruments include insurance-linked securities, industry-loss warranties,

[45] Willis Re Inc., "1st View: Market Reshaping A Reality," 3 (January 1, 2015), *available at* http://www.willisre.com/Documents/Media_Room/Press_Releases/2015/Willis_Re_1st_View_January_2015.pdf.
[46] Guy Carpenter & Company, LLC, "Shaping the Future: Positive Results, Excess Capital and Diversification"(January 1, 2015).
[47] Willis Re Inc., "1st View: Market Reshaping A Reality," 3 (January 1, 2015), *available at* http://www.willisre.com/Documents/Media_Room/Press_Releases/2015/Willis_Re_1st_View_January_2015.pdf.
[48] Aon Benfield, "Reinsurance Market Outlook – April 2015," 4 (April 1, 2015), *available at* http://thoughtleadership.aonbenfield.com/sitepages/display.aspx?tl=485.
[49] *Id*. at 4 and 6 (measured on a consolidated basis and thus not all amounts are available to write reinsurance premiums).

collateralized reinsurance, and "sidecars" (see Box 1 for a description of the various forms of ART transactions).[50] These financial instruments allow capital market investors (e.g., pension funds) to diversify and to seek higher yield than may otherwise be available by participating in risks that are conventionally underwritten by reinsurance companies.

Box 1: Forms of Alternative Risk Transfer Instruments

Insurance-Linked Securities transfer insurance risk from an insurance company to investors in the capital markets. They are structured in a manner that links their yield to the magnitude of insurable events or the amount of insurance (or reinsurance) claims that arise from specific insured events over a specific period. The structure consists of using the principal from the securities to fully collateralize a special purpose vehicle that sells an equivalent amount of protection to an insurer (or reinsurer) in exchange for premiums that serve to pay the coupons on the securities. The yield is reduced to the extent the specific insurable event exceeds a specific threshold or amount.

Industry-Loss Warranties offer payouts similar to options, with the payment determined by whether the industry-wide claims or related index breach a specified threshold or 'strike price' in the contract.

Collateralized Reinsurance is provided through a special purpose vehicle that posts collateral, typically using a trust account, equal to the maximum loss on the reinsurance contract.

Sidecar is the term for a fully-collateralized structure in which investors provide capital and take on insurance risk in exchange for the benefit from the returns on the invested assets and underwriting gains from a specific book of insurance or reinsurance business.

In 2014, of the $64 billion of capital presently deployed in ART, collateralized reinsurance grew by 25 percent to comprise $29 billion or almost half of the alternative capital.[51] Insurance-linked securities, often referred to as Catastrophe Bonds, grew more slowly in 2014 than the previous year, and now account for $24 billion of the market segment. The coupons on these bonds, which are the maximum possible payout to investors before adjustments for insured losses, have continued to fall and this has put further downward pressure on reinsurance premiums. Willis Re reports that "[c]atastrophe bond spreads have declined 15 [percent] to 20 [percent] year over year."[52] Capital deployed as industry-loss warranties doubled in 2014 over the previous year.[53] Recent reports suggest that ART has become a

[50] The growth of the alternative risk transfer market is addressed in FIO's Reinsurance Report at 38-42 ("Increasing Capital Markets Convergence with Reinsurance"), *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/.
[51] Aon Benfield, "Reinsurance Market Outlook – April 2015," 6 (April 1, 2015), *available at* . http://thoughtleadership.aonbenfield.com/sitepages/display.aspx?tl=485.
[52] Willis Re Inc., "1st View: Market Reshaping A Reality," 19 (January 1, 2015), *available at* . http://www.willisre.com/Documents/Media_Room/Press_Releases/2015/Willis_Re_1st_View_January_2015.pdf.
[53] Aon Benfield, "Reinsurance Market Outlook -- April 2015," 6 (April 1, 2015), *available at* . http://thoughtleadership.aonbenfield.com/sitepages/display.aspx?tl=485.

permanent part of the risk transfer market,[54] with various stakeholders suggesting that its deployment will permit the insurance industry to devote increased attention to risk categories and locations that are currently underinsured.[55]

E. Interest Rate Risk for Life Insurers

While life insurers engage in a variety of financial activities, the core business of life insurers is to supply insurance and annuity products that guarantee future payments that guard against risks of mortality, morbidity, and longevity. These are often long-term contracts that cover risks that can persist for decades into the future. Life insurers use long-term assets and derivatives in order to generate future cash flows to meet these obligations.

Life insurers' liabilities include the present value of future payments of policyholder benefits. To meet these obligations, life insurers invest the premiums and deposits received from policyholders in long-term assets that are expected to generate a stream of cash flows that will more than cover the related claims, expenses and taxes, thereby resulting in a net profit.

Changes in interest rates affect the values of both an insurer's assets and its liabilities. As interest rates rise, the market value of an insurer's existing fixed income investments declines, as will the present value of future benefit obligations on the liability side of the insurer's balance sheet. If the discount rate applied in determining the present value of liabilities approximates the net yield on the investment portfolio, then when interest rates change over time, the valuation of the corresponding assets and liabilities would theoretically move in the same direction and in comparable amounts. Practically, however, this may not always be the case; for example, regulatory requirements may impose limitations on discount rates in determining reserves for benefit obligations. To the extent a life insurer's asset-liability management program is unable to match liabilities with assets of comparable durations, its exposure to interest rate risk will be increased.

Life insurance policies may result in cash flows that extend beyond the longest maturity of available bonds or derivatives, leaving insurers with mismatched risk and increased vulnerability to adverse changes in interest rates. For example, a life insurance policy can be in force for as long as 50 years or more, whereas few available fixed income investments exist that have a correspondingly long maturity. Investing in bonds that are shorter in maturity than the covered liabilities means that when the bonds mature, the proceeds may have to be reinvested at lower interest rates, reducing the insurer's profitability.

[54] Artemis, "Alternative Capital Helps Re/insurance Stay Relevant to Society" (June 11, 2015) *available at* http://www.artemis.bm/blog/2015/06/10/alternative-capital-helps-reinsurance-stay-relevant-to-society-mcgavick (reporting on comments of XL Catlin CEO Mike McGavick).
[55] "Capacity affords us the opportunity to develop new solutions for new risks and consequently, drive growth, enabling the industry to provide cover for risks that are currently uninsured." Guy Carpenter LLC, "The (Re)insurance Landscape," 3 (July 2015), *available at* http://www.guycarp.com/content/dam/guycarp/en/documents/thought-leadership/The_Reinsurance_Landscape.pdf.

Interest rates have been trending lower since the early 1980s. More importantly, short-term interest rates at virtually 0 percent is a market phenomenon that most insurers had likely not included in their interest rate risk scenarios. Sustained low interest rates also mean lower yields on invested assets, resulting in increased pressure to invest in riskier assets for a higher yield, greater exposure to swings in the value of interest rate-related derivatives, less attractive policy benefits, and higher hedging costs. Other factors that impact an insurer's exposure to interest rate risk include the nature and complexity of any long-term interest rate-sensitive policies, and complexity and efficacy of related investment and risk management strategies.

Low interest rates are not just a concern for U.S. insurers, but for insurers globally. In a recent study of the impact of low interest rates on international insurance markets, Moody's Investors' Services reported that life insurers were both shifting the mix of offerings of insurance products and using derivatives to reduce the difference in interest rates exposures of assets and liabilities.[56]

F. Infrastructure Investments

Life insurers seek investment options that offer high yields and long maturities to back long-duration life insurance obligations. One such option involves investments in infrastructure systems, such as transportation, communication, water, sewer, and the generation and distribution of electric power. Such systems are generally capital-intensive and tend to have high costs, but are vital to a nation's economic prosperity and development, thus requiring long-term funding. In addition, infrastructure systems often provide stable cash flows to investors because of high barriers to entry. Insurers may have opportunities to become a more prominent source of funding to benefit needed improvements in infrastructure, while at the same time improving the efficiency of asset-liability management programs.

Infrastructure projects may be funded publicly, privately, or through public-private partnerships. In the United States, the main funding vehicle for infrastructure projects historically has been the traditional municipal bond market. More recently, and particularly for transportation and energy projects, as well as for some water projects, private equity investment in infrastructure projects has increased.

Beginning with the Build America Bonds program in 2009, encouragement and incentives for investment in infrastructure have been significant parts of the Obama Administration's economic growth plan for the United States.[57] In this context, the Administration introduced the Build America Investment Initiative in July 2014, which calls for federal agencies to find new ways to spur infrastructure investments in transportation, ports, water, energy, and broadband by facilitating increased collaboration between federal, state and local governments, and private sector investors.[58] Additionally, President Obama has repeatedly called on Congress to increase public funding for infrastructure

[56] Moody's Investor Service, "Low Interest Rates are Credit Negative for Insurers Globally, but Risks Vary by Country" (March 26, 2015).
[57] The Build America Bonds program, which expired on December 31, 2010, gave municipalities subsidies on interest costs for issuing taxable debt to finance infrastructure work. Approximately $181 billion in bonds were issued under the program.
[58] Fact Sheet, "Increasing Investment in U.S. Roads, Ports and Drinking Water Systems Through Innovative Financing" (January 16, 2015), *available at* https://www.whitehouse.gov/the-press-office/2015/01/16/fact-sheet-increasing-investment-us-roads-ports-and-drinking-water-syste.

projects, and the Administration has advanced a number of additional initiatives aimed at stimulating investments in the nation's infrastructure.

Investing in infrastructure projects has also received attention from international bodies. In recent years, the G20 Finance Ministers and Central Bank Governors have noted the importance of infrastructure financing in fostering long-term economic growth and productivity. At the Brisbane Summit in November 2014, the G20 leaders endorsed the Global Infrastructure Initiative – a multi-year program to support public and private investment in quality infrastructure.[59] In collaboration with the Organization for Economic Development, the G20 is developing an approach to implement principles to facilitate and promote long-term investment by institutional investors.[60]

Collectively, the insurance industry has been a meaningful institutional investor in the U.S. municipal bond market for many years, and many of its investments in the market are project finance bonds. At the end of 2014, the Federal Reserve Board estimated the total U.S. municipal finance market to be $3.7 trillion,[61] of which the insurance industry (L/H and P/C sectors combined) held approximately $500 billion.[62] The P/C sector has historically allocated a much larger percentage of its bond investments to municipal bonds than has the L/H sector, largely due to federal income tax considerations.

Currently, the state-based capital assessment formula, or risk-based capital (RBC), does not distinguish among the uses of funds by the issuer of a security.[63] RBC charges against an insurer for assets are determined by the asset class of an investment and credit quality for bonds. In this light, the RBC framework does not provide incentives, and may provide disincentives, for infrastructure investments. Due to the typically long maturity of infrastructure investments, these types of assets could aid an insurer seeking to mitigate interest rate risk while also promoting insurer investment in essential public works. The NAIC's Investment Risk-Based Capital Working Group is developing recommendations for revisions to the current asset risk structure and factors in the RBC Formula. FIO encourages state insurance regulators to assess the current RBC approach and explore appropriate ways to increase incentives for infrastructure investments by insurers.

[59] Brisbane Summit, G20 Leaders' Communique (November 15-16, 2015), *available at* https://g20.org/wp-content/uploads/2014/12/brisbane_g20_leaders_summit_communique1.pdf.
[60] G20/OECD Task Force on Institutional Investors and Long-Term Financing, "Report on Effective Approaches to Support Implementation of the G20/OECD High-Level Principles on Long-Term Investment Financing by Institutional Investors" (November 2014), *available at* http://www.oecd.org/daf/fin/private-pensions/G20-OECD-Report-Effective-Approaches-LTI-Financing-Sept-2014.pdf.
[61] Source: Federal Reserve Board and Haver Analytics, LLC.
[62] Source: SNL Financial, LC and National Association of Insurance Commissioners.
[63] NAIC, "Risk-Based Capital Forecasting and Instructions – Life" (2015); NAIC, "Risk-Based Capital Forecasting and Instructions – Property/Casualty" (2015).

IV. CONSUMER PROTECTION AND ACCESS TO INSURANCE

A. Underwriting Fairness

1. Sex and Gender Identity

A competitive insurance market rests in part on "the statutory authority to use all appropriate tools at [an insurers'] disposal to accurately assess and classify risks" and recognition that "[l]imitations on this freedom should only be applied to those fundamental elements that society has agreed are inappropriate, such as race, color, religion, or national origin."[64] Sex is commonly used in insurance risk classification for non-health insurance products. The use of sex to classify risks may inappropriately disadvantage some policyholders, however, and in some instances has already been prohibited.

For instance, in 1983 the Supreme Court held that Title VII of the Civil Rights Act of 1964 "prohibits an employer from offering its employees the option of receiving retirement benefits from one of several companies selected by the employer, all of which pay a woman lower monthly retirement benefits than a man who has made the same contributions," even though women at typical retirement ages on average live about three years longer than men.[65] As a result, employers have "convert[ed] to sex-neutral systems for payment of employee retirement annuity and pension benefits."[66]

In addition, a limited number of states have prohibited the use of sex in automobile risk rating.[67] Those states that have barred the use of sex as a rating factor for auto business have done so in furtherance of the policy goal of fair treatment of a policyholder's sex in insurance underwriting and rating.[68]

Gender identity should be considered in this context. An individual could identify as transgender "[w]hen one's gender identity and biological sex are not congruent."[69] Identity documents, such as a driver's license or birth certificate, may have a different gender marker than the individual's gender identity. Most states require proof of surgical, or in some cases clinical, treatment to change the gender

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[64] Comment of the American Insurance Association (June 9, 2014) in response to Monitoring Availability and Affordability of Auto Insurance, 79 Fed. Reg. 19, 969 (Apr. 10, 2014), *available at* http://www.regulations.gov/#!docketBrowser;rpp=25;po=0;dct=PS;D=TREAS-DO-2014-0001.

[65] *Arizona Governing Committee v. Norris*, 460 U.S. 1073 (1983).

[66] Mary L. Heen, "Sex Discrimination in Pension and Retirement Annuity Plans after Arizona Governing Committee v. Norris: Recognizing and Remedying Employer Non-Compliance," 8 Women's Rts. L. Rep. 155, 156 (1985) *available at* http://scholarship.richmond.edu/cgi/viewcontent.cgi?article=1260&context=law-faculty-publications.

[67] For example, in 1985 Montana banned the use of gender as a factor in setting premium rates, including under automobile policies. Mont. Code Ann. § 49-2-309. *See also* Massachusetts Office of Consumer Affairs and Business Regulation, "Massachusetts Bill of Rights for Automobile Insurance," *available at* http://www.mass.gov/ocabr/insurance/vehicle/auto-insurance/massachusetts-consumer-bill-of-rights-for.html; Michigan Department of Insurance and Financial Services, "Information on Purchasing Auto Insurance," *available at* http://www.michigan.gov/difs/0,5269,7-303-13222_13224-66774--,00.html#q5; Pennsylvania Department of Insurance, "Automobile Insurance Guide," *available at* http://www.portal.state.pa.us/portal/server.pt/community/auto_insurance/9187/auto_insurance_guide/536522.

[68] Note, "Elimination of Gender Discrimination in Insurance Pricing: Does Automobile Insurance Rate Without Sex," 61 Notre Dame L. Rev. 748, 751 (1986), *available at* http://scholarship.law.nd.edu/ndlr/vol61/iss4/4/.

[69] American Psychological Association, "Definition of Terms: Sex, Gender, Gender Identity, Sexual Orientation" (2011), *available at* http://www.apa.org/pi/lgbt/resources/sexuality-definitions.pdf.

marker on a birth certificate. Some states, however, will not allow a change in the gender marker on a birth certificate under any circumstances.[70] Insurance applications do not indicate whether a person's answer to questions about sex should be based on the individual's gender identity or his/her gender marker on legal documents. For example, Oregon advised that insurers "cannot require an applicant to produce a birth certificate indicating sex unless this requirement is imposed on all applicants for insurance" and "if the insurer always requires an applicant to show a driver license [sic], the insurer could use the sex as indicated on the driver license [sic] for rating purposes."[71]

Based on considerations of fairness and other factors, states should continue to assess whether sex is an appropriate underwriting or rating consideration.

2. Marital Status

In its Modernization Report, FIO noted in 2013 the impact on the insurance industry resulting from the decision of the Supreme Court in *United States v. Windsor*, which ruled that a provision of the Defense of Marriage Act (DOMA) was unconstitutional.[72] That provision provided federal definitions for "marriage" and "spouse" that had been used in reference to federal laws and regulations, defining marriage as a legal union between one man and one woman, and spouse as referring only to a person of the opposite sex who is a husband or a wife. The Modernization Report called on states to assess whether or in what manner marital status is an appropriate insurance underwriting or rating consideration.

On June 26, 2015, in *Obergefell v. Hodges,*[73] the Supreme Court held that, under the Fourteenth Amendment, same-sex couples may exercise the fundamental right to marry and that the Constitution requires a state to recognize the marriage of a same-sex couple who is validly married in another state. Whether marital status should remain an appropriate factor for underwriting and rating insurance remains an important question of public policy. Some recent studies (apparently initiated after the publication of FIO's Modernization Report*)* show that marital status can contribute significantly to a consumer's premium. One study found that after the death of a spouse a widower may pay as much as 20 percent more for personal auto insurance after the death of a spouse.[74] Many consumers opt not to marry, or are divorced or widowed; such consumers should not, as a consequence of that status alone, be expected to pay higher premiums for personal insurance products than otherwise identically situated individuals. For these reasons, and considerations of fairness and other factors, states should continue to assess whether marital status is an appropriate underwriting or rating consideration.

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[70] American Civil Liberties Union, "Know Your Rights – Transgender People and the Law" (April 24, 2013), *available at* https://www.aclu.org/lgbt-rights/know-your-rights-transgender-people-and-law.
[71] Oregon Department of Consumer and Business Services, "Insurance and Gender Identify Fact Sheet" (January 2013) *available at* http://www.oregon.gov/dcbs/insurance/legal/bulletins/documents/genderidentity-factsheet.pdf.
[72] *United States v. Windsor*, 133 S.Ct. 2675 (2013).
[73] *Obergefell v. Hodges*, 135 S.Ct. 2584 (2015).
[74] Consumer Federation of America, "New Research Shows That Most Major Auto Insurers Vary Prices Considerably Depending on Marital Status" (July 27, 2015), *available at* http://www.consumerfed.org/news/1106.

B. Natural Catastrophe Insurance

Natural catastrophes are events caused by natural hazards (i.e., geological, meteorological, hydrological) that cause serious disruption of the functioning of a community and involve widespread economic and human losses. Every region of the United States is vulnerable to natural catastrophes. Further, both the total number of natural catastrophes and the associated economic losses for the United States are increasing. When the impact of a natural catastrophe exceeds the capacity of the affected area to recover within the limits of its own resources, governments and insurers may provide the resources needed to assist the affected area in recovering and rebuilding.

In the consumer context, the demand for natural catastrophe insurance may be driven by both consumers' perceptions of natural catastrophe risk and by mortgage loan requirements. Generally, the requirement by mortgage lenders that borrowers maintain hazard insurance may be satisfied by a homeowner insurance policy. For some properties, mortgage lenders also require borrowers to maintain flood insurance, but this does not apply to residential properties located outside the geographic areas at greatest risk for flooding as identified in the latest Flood Insurance Rate Maps (FIRMs) issued by the Federal Emergency Management Agency (FEMA). Mortgage lenders do not require earthquake insurance in any state or the District of Columbia.

Natural catastrophes present operational and financial challenges for insurers. Following a natural catastrophe event, insurers must address a large number of claims, with individuals and communities reasonably expecting an efficient and fair claims resolution process. Moreover, because a natural catastrophe causes widespread losses, with many policyholders simultaneously suffering losses (a circumstance referred to as "correlated losses") natural catastrophes are "difficult to insure, since they imply a larger risk of insolvency for the insurer."[75]

In part, insurers manage natural catastrophe risk by increasing premiums and by applying restrictive underwriting standards, thereby potentially limiting the availability of insurance in geographic areas with correlated exposures to events such as flooding and earthquakes. In response to such approaches, states along the Atlantic and Gulf coasts have established government administered residual markets for homeowner insurance. Similarly, the State of California established the California Earthquake Authority to offer earthquake insurance. To address affordability and availability of flood insurance, the United States Congress established the National Flood Insurance Program (NFIP) in 1968.

In March of 2015, the National Research Council of the National Academies issued the *Affordability of National Flood Insurance Program Premiums: Report 1* (NFIP Affordability Report), as part of the study on affordability required by the Biggert-Waters Flood Insurance Reform Act of 2012.[76] The NFIP Affordability Report notes the importance of establishing a clear and measurable definition of

[75] Carolyn Kousky, Resources for the Future Discussion Paper, "Managing the Risk of Natural Catastrophes: The Role and Functioning of State Insurance Programs" at 2 (2010), *available at* http://www.rff.org/research/publications/managing-risk-natural-catastrophes-role-and-functioning-state-insurance.
[76] The NFIP Affordability Report is *available at* http://www.nap.edu/catalog/21709/affordability-of-national-flood-insurance-program-premiums-report-1.

"affordability," in order to design a program to provide more targeted assistance to NFIP policyholders with the greatest need. Additionally, the NFIP Affordability Report describes a number of options to enhance flood insurance affordability. These options include: increasing the availability of mitigation efforts through loans and means-tested grants; promoting higher premium deductibles; and implementing a voucher program to administer direct payments to cost-burdened policyholders. The National Research Council of the National Academies is scheduled to release a second report in 2015, which will propose analytical procedures that FEMA may use to conduct an analysis of different policy options. Following the release of the second report, FEMA is required to submit to Congress an affordability framework to "address, via programmatic and regulatory changes, the issues of affordability of flood insurance [sold under the NFIP], including issues identified in the affordability study required [to be completed by the National Academy of Sciences]."[77]

Box 2: Insuring Man-made Earthquakes

Most property insurance policies exclude coverage for damage caused by earthquakes. Homeowners or business owners who wish to protect against damages caused by earthquakes must separately purchase either an endorsement to a property insurance policy, if available from the insurer, or an earthquake insurance policy. Earthquake insurance "provides protection from the shaking and cracking that can destroy buildings and personal possessions"[78] caused by natural earthquakes, pays for the cost of living expenses if a policyholder cannot live in the insured property while the property is being repaired, and pays for the cost of removing debris.[79]

Unlike the traditional dollar amount deductible generally associated with property insurance policies, earthquake insurance policyholders are subject to a deductible ranging from two percent to 25 percent of the replacement value of the insured structure.[80] In high-risk states, insurers may require a deductible of at least 10 percent.[81] The California Earthquake Authority, the largest writer of earthquake insurance in the United States, requires deductibles of either 10 or 15 percent.

Earthquake insurance is generally available throughout the United States, although as noted by the Utah Insurance Department, "few [insurers] actively market the coverage."[82] A 2014 survey found that the take-up rate for the voluntary purchase of earthquake insurance is seven percent, down from 10 percent in 2013 and 13 percent in 2012.[83] However, increased earthquake activity in the central and eastern

[77] Public Law 113-89 § 9(a), 128 Stat. 1024 (2014).
[78] Insurance Information Institute, "Earthquakes: Risk and Insurance Issues" (May 2015), *available at* http://www.iii.org/issue-update/earthquakes-risk-and-insurance-issues (hereinafter, "Earthquakes: Risk and Insurance Issues").
[79] NAIC, "A Consumer's Guide to Earthquake Insurance," 3 (October 2011), *available at* http://www.naic.org/documents/consumer_guide_earthquake.pdf.
[80] Earthquakes: Risk and Insurance Issues. *See also* Washington State Office of the Insurance Commissioner, "Earthquake Insurance," *available at* http://www.insurance.wa.gov/your-insurance/home-insurance/earthquake/.
[81] Earthquakes: Risk and Insurance Issues.
[82] Utah Department of Insurance, "Earthquake Insurance in Utah," *available at* https://insurance.utah.gov/auto-home/home/earthquake.php.
[83] Earthquakes: Risk and Insurance Issues.

United States has led to an increase in the take-up rate for earthquake insurance in certain states. For example, the take-up rate for earthquake insurance in Oklahoma has risen from two percent in 2011 to 15 percent in 2014, which is higher than the 10 percent take-up rate in California.[84]

One evolving issue concerns whether an earthquake is natural or man-made. The issue relates to the increasing prevalence in the energy sector of hydraulic fracturing, also known as fracking, and the related use of waste water disposal wells. Fracking is an "oil and gas well development process that involves injecting water under high pressure into a bedrock formation via the well and is used to increase oil or gas flow to a well from petroleum-bearing rock formations."[85] The waste water that is a byproduct of fracking is routinely disposed of by injection into wells specifically designed and approved for this purpose.[86] Scientists from the U.S. Geological Survey (USGS) analyzing the increased incidence of earthquakes reported that the increasing rates of earthquakes coincide with the injection of wastewater in disposal wells.[87]

Some state insurance regulators have questioned whether fracking or waste water disposal wells are or can be the cause of the increased incidence of earthquakes. In March 2015, the Oklahoma Insurance Department issued a bulletin to insurers operating in Oklahoma stating: "At present, there is no agreement at a scientific or governmental level concerning any connection between injection wells or fracking and 'earthquakes.'"[88] The bulletin expressed concern that insurers might be denying earthquake claims based on insufficient evidence that the earthquakes were caused by fracking.

In April 2015, then Acting Commissioner Teresa Miller of the Pennsylvania Insurance Department issued a bulletin to insurers writing homeowner insurance policies in Pennsylvania instructing that Pennsylvania earthquake endorsements "should cover all earthquakes, whether believed to be 'naturally occurring' or caused by 'human activity.'"[89] Acting Commissioner Miller's bulletin followed an increase of earthquakes in areas where earthquakes were previously unobserved.

The USGS continues to examine the cause(s) of the increased incidence of earthquakes in certain regions of the country. FIO will continue to monitor USGS activities on this issue, the actions of state insurance regulators concerning naturally occurring earthquakes or earthquakes caused by human activity, and the overall earthquake insurance market.

[84] Miguel Bustillo & Daniel Gilbert, "Energy's New Legal Threat: Earthquake Suits," The Wall Street Journal (March 30, 2015).
[85] U.S. Geological Survey, "Introduction to Hydraulic Fracturing," *available at* http://www.usgs.gov/hydraulic_fracturing/.
[86] U.S. Geological Survey, "Induced Earthquakes," *available at* http://earthquake.usgs.gov/research/induced/.
[87] U.S. Geological Survey, "Man-Made Earthquakes Update" (January 17, 2014), *available at* http://www.usgs.gov/blogs/features/usgs_top_story/man-made-earthquakes/.
[88] Oklahoma Insurance Department, Earthquake Insurance Bulletin No. PC 2015-02 (March 3, 2015), *available at* http://www.ok.gov/oid/documents/030415_Earthquake%20Bulletin%203-3-15.pdf.
[89] Pennsylvania Insurance Department, Insurance Department Notice No. 2015-04, (April 11, 2015), *available at* http://www.portal.state.pa.us/portal/server.pt/document/1493558/Department%20Notice%202015-04.pdf.

C. Retirement Security

1. Standard of Care for Retirement Investment Advice

The retirement savings landscape in the United States is rapidly evolving. As the baby boomer generation retires, and life expectancies and retirement periods lengthen, Americans are increasingly confronting the risk of outliving assets and are seeking sources of guaranteed retirement income to address this "longevity risk." Historically, a common solution to the challenge of achieving retirement security has been a lifetime income payout, or pension, under a defined benefit plan. However, far fewer employers now offer defined benefit plans than in prior eras. The increased prevalence of defined contribution plans, by contrast, has shifted greater responsibility to employees for building and managing their own retirement savings.

Life insurers are important providers of guaranteed retirement income in the United States, primarily through annuity products which fund payouts from employer-based plans or enable individuals to purchase guaranteed lifetime income streams. However, the role of annuities and guaranteed lifetime income in retirement planning has shifted as defined contribution plans (such as 401(k) plans) offering lump sum cash payments have become increasingly common in the workplace.[90] In response to this development, Treasury and the U.S. Department of Labor (DOL) in 2010 announced a joint initiative to encourage access to, and use of, products designed to provide a lifetime stream of income during retirement. As part of that initiative, in July 2014, Treasury and the Internal Revenue Service issued final regulations clarifying the tax treatment of a type of annuity known as a longevity annuity, which protects against the risk that individuals will outlive retirement savings.[91]

In April 2015, following several years of development, DOL re-proposed a rule that would expand the types of retirement investment advice covered by ERISA's fiduciary protections. Under DOL's proposed definition, the term "fiduciary" covers any individual receiving compensation for advice that is individualized or specifically directed to an employer with a retirement plan, a plan participant, or IRA owner regarding a retirement investment decision. Status as a fiduciary means that the adviser must provide impartial advice in the client's best interest, and cannot accept any payments creating a conflict of interest unless the adviser qualifies for an exemption. As proposed, the rule would generally apply to retail sales of annuities to retirement plans, plan participants, and IRA owners, unless the sale met specified conditions designed to protect the purchaser from the harmful impacts of conflicts of interest. The public comment period for the proposed rule ended on July 21, 2015, and was followed in August 2015 by four days of public hearings hosted by DOL.

[90] Treasury Fact Sheet, "Helping American Families Achieve Retirement Security by Expanding Lifetime Income Choices," *available at* http://www.treasury.govfe/press-center/press-releases/Documents/020212%20Retirement%20Security%20Factsheet.pdf.
[91] Longevity Annuity Contracts, 79 Fed. Reg. 37, 633 (July 2, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-07-02/pdf/2014-15524.pdf.

2. Product Suitability and Disclosure

a. Annuity Products

Following several state-based market conduct examinations and investigations that revealed unsupervised sales of annuities that were not appropriate for the consumer's profile, the NAIC adopted a strengthened Suitability in Annuity Transactions Model Regulation (Model Suitability Regulation) in 2010. The Model Suitability Regulation: (i) expressly defines suitability information and requires insurance producers to make reasonable efforts to obtain this information and take it into consideration before recommending any annuity purchase; (ii) requires insurers to provide both general and product-specific training to producers; and (iii) requires insurers to review the suitability of an annuity for a particular consumer prior to issuing the annuity. In both the Modernization Report[92] and the 2014 Annual Report on the Insurance Industry,[93] FIO urges the states to adopt the Model Suitability Regulation so that prospective annuity owners nationwide receive sufficiently rigorous protections. FIO also has noted that the Wall Street Reform Act provides incentives for state insurance regulators to enact national suitability standards.[94]

According to a recent benchmarking survey of 82 life insurers in the annuity market, 93 percent of respondents report that the insurer maintains its own annuity suitability review practices, and 91 percent have a heightened review process for transactions that do not pass the standard review process.[95]

Despite industry's pursuit of appropriate suitability standards, however, states have not uniformly adopted or implemented the Model Suitability Regulation. In 2014, only two additional states (compared to seven in 2013) adopted some version of the Model Suitability Regulation; one additional state acted in 2015, bringing the number to 35, plus the District of Columbia.[96] Among the 35 states and the District of Columbia, suitability standards for annuities sales are not uniform. At the same time, annuities subject to state oversight are becoming both more complex and more popular. One such annuity, known as a fixed indexed annuity, achieved a record sales total of $48 billion in 2014, up 23 percent from 2013, [97] and is now the second leading annuity product by premium volume behind

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[92] Modernization Report, 51-52.
[93] 2014 Annual Report on the Insurance Industry, 35.
[94] Modernization Report, 52. For example, a state insurance regulator could apply to the Office of Financial Literacy in the CFPB for grants to enhance the protection of seniors from misleading and fraudulent sales of financial products if, among other requirements, the state has adopted rules with respect to fiduciary or suitability standards that meet or exceed the minimum requirements established by the Model Suitability Regulation. *See* 12 U.S.C. § 5537. The Wall Street Reform Act also directs the SEC to treat indexed annuities as exempt securities subject to certain conditions, including issuance of the indexed annuity in a state that has adopted the Model Suitability Regulation or by an insurer that adopts and implements practices for the nationwide sale of annuities that meet or exceed the Model Suitability Regulation. *See* 15 U.S.C. § 77c note.
[95] The Compliance & Ethics Forum for Life Insurers, "2015 CEFLI Annuity Suitability Benchmarking Survey Report."
[96] Pam Heinrich, "State of the States: A Mid-Year Review," NAFA Annuity Outlook (July/August 2015), *available at* http://annuityoutlookmagazine.com/2015/07/state-roundup-12/. States that have not adopted the Model Suitability Regulation represented approximately 20 percent of annuity considerations in 2014, based on SNL data.
[97] Life Insurance Marketing Research Association (LIMRA), "Total U.S. Annuity Sales Improve Three Percent in 2014" (March 12, 2015), *available at* http://www.limra.com/Posts/PR/News_Releases/Total_U_S__Annuity_Sales_Improve_Three_Percent_in_2014.aspx?LangType=1033.

variable annuities.[98] As unprecedented numbers of seniors reach retirement age with increased longevity, and as life insurers continue to introduce more complex products tailored to consumer demand, the absence of national annuity suitability standards is increasingly problematic. FIO recommends that all states adopt a suitability standard at least as rigorous as the NAIC model. In the absence of more uniform adoption and implementation of the Model Suitability Regulation, federal authorities should consider appropriate action.

b. Life Insurance Products

Sales of indexed universal life (IUL) insurance have accelerated in recent years. The distinguishing feature of IUL is that growth in the value of the policy is linked to the performance of an external market index such as the Standard & Poor's 500. In 2014, annualized IUL sales were approximately $2 billion, a 23 percent increase over the prior year, and IUL generated 52 percent of all universal life premium and 20 percent of all individual life premiums. Like other types of universal life insurance, IUL policies are typically sold with illustrations of guaranteed and non-guaranteed values. During 2014, the industry and state insurance regulators discussed the differing practices of insurers and producers when illustrating rates of return on various indices used in IUL policies. These discussions resulted in development of Actuarial Guideline 49 in June 2015. If adopted by the states, Actuarial Guideline 49 would provide uniform guidance, including maximum rates, in determining index-based crediting rates for IUL policy illustrations. FIO encourages life insurers and the states to continue to work cooperatively, and promptly, to adopt and implement a uniform framework for appropriate IUL illustrations.

With the exception of certain life insurance products that are registered as securities with the SEC, such as variable annuities, most life insurance products, including IUL, are generally not subject to suitability standards of either federal or state securities laws. This is true even though a key feature of IUL— values linked to the performance of one or more market indices— has investment characteristics and is essentially the same feature offered by fixed indexed annuities, which are subject to certain suitability standards under insurance laws in most states. Also, the target market for IUL consists of pre-retirees and retirees, many of whom would benefit from the protection provided by appropriate suitability standards. Therefore, FIO recommends that state insurance regulators consider whether uniform, national consumer protection standards should be adopted for IUL.

[98] Variable annuities are registered as securities with the SEC. They may be sold only by sales representatives registered with the Financial Industry Regulatory Authority (FINRA) and are therefore subject to FINRA's suitability standards.

V. U.S. REGULATORY DEVELOPMENTS

A. Financial Stability Oversight Council

The Council was established by Title I of the Wall Street Reform Act and, among other functions, is charged with: (1) identifying risks to the financial stability of the United States; (2) promoting market discipline; and (3) responding to emerging risks to the stability of the United States' financial system.[99] The Council is also charged with identifying risks to the financial stability of the United States that could arise from the material distress or failure, or ongoing activities, of nonbank financial companies.[100] The Wall Street Reform Act authorizes the Council to designate a nonbank financial company to be subject to consolidated supervision by the Federal Reserve and enhanced prudential standards if the company's material financial distress—or the nature, scope, size, scale, interconnectedness, or mix of its activities—could pose a threat to U.S. financial stability.[101] The Wall Street Reform Act sets forth statutory standards for the Council's determinations regarding nonbank financial companies and requires the Council to take into account ten specific considerations when evaluating those companies.[102] In April 2012, the Council voluntarily issued a rule and interpretative guidance that provides transparency into the Council's detailed framework and process for evaluating nonbank financial companies for designations.[103]

1. Designations

In December 2014, the Council voted to make a final determination to subject MetLife to supervision by the Federal Reserve and enhanced prudential standards.[104] MetLife is the fourth nonbank financial company to be designated by the Council. Previously, the Council had made final determinations regarding AIG, GECC, and Prudential.

2. Supplemental Procedures Relating to Nonbank Financial Company Determinations

The Council's designation authority under Title I of the Wall Street Reform Act enables the Council to identify and respond to risks that individual nonbank financial companies could pose to U.S. financial stability.[105] As part of the Council's ongoing evaluation of how it conducts its work, the Council engaged with financial companies, trade associations, public interest groups, and Congressional stakeholders to review its practices related to the evaluation of nonbank financial companies under Section 113 of the Wall Street Reform Act. Based on this review, in February of 2015 the Council

[99] 12 U.S.C. § 5321(a).
[100] 12 U.S.C. § 5322(a)(1)(A).
[101] 12 U.S.C. § 5323(a)(1).
[102] 12 U.S.C. § 5323(a)(2).
[103] *See* 12 C.F.R. pt. 1310.
[104] The public basis for the final determination regarding MetLife is *available at* http://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf.
[105] *See* 12 C.F.R. pt. 1310.

adopted certain changes and formalized certain practices relating to its process for reviewing nonbank financial companies for potential designation.[106]

The changes fall into three categories:

(1) Engagement with companies under consideration by the Council. The Council will inform a nonbank financial company earlier when that company comes under review, and provide additional opportunities for the company and its regulator(s) to engage with the Council and staff, without compromising the Council's ability to conduct its work.

(2) Transparency to the broader public regarding the determinations process. The Council will make available to the public more information about its designations work, while continuing to protect sensitive, nonpublic information.

(3) Engagement during the Council's annual reevaluations of designations. These changes create a clearer and more robust process for the Council's annual reviews of its designations. This process will enable more engagement between designated companies and the Council and staff, with ample opportunity for companies to present information and to understand the Council's analysis.

3. Annual Review of Designated Nonbank Financial Companies

Under Section 113 of the Wall Street Reform Act, the Council is required at least annually to reevaluate each previous determination and rescind any determination if the company no longer meets the statutory standards. Among other things, the Council's reevaluation process considers whether any material changes at the company justify a rescission of the designation.

The Council provides designated nonbank financial companies the opportunity to meet with the Council's Nonbank Designations Committee, which includes representatives of all Council members, including FIO, to discuss the scope and process for the annual review and to present information regarding any change that may be relevant to the threat the company could pose to U.S. financial stability. If the company contests its determination during the Council's annual reevaluation, the Council will vote on whether to rescind the determination and provide the company a notice that explains the primary basis for any decision not to rescind the determination. Additionally, the Council will provide each company subject to a determination an opportunity for an oral hearing before the Council once every five years.

In 2014, the Council completed its first reevaluations of AIG, GECC, and Prudential. Based on the analytical work done in these reevaluations, the Council did not rescind any of its determinations.

[106] The Council's "Supplemental Procedures relating to Nonbank Financial Company Determinations" is *available at* http://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf (February 4, 2015).

B. Supervision of Insurance Companies by the Federal Reserve

As a result of the Wall Street Reform Act, the Federal Reserve has expanded responsibility as the consolidated supervisor for a number of insurance holding companies, including insurance holding companies that own an insured bank or thrift, as well as insurers designated by the Council for Federal Reserve supervision. The insurers for which the Federal Reserve is the consolidated supervisor vary in size and collectively hold approximately one-third of the U.S. insurance industry assets.[107] The principal supervisory objectives for the Federal Reserve are protecting the safety and soundness of the consolidated firms and subsidiary depository institutions, while mitigating risks to financial stability.[108]

In December 2014, Congress passed, and the President signed into law, the Insurance Capital Standards Clarification Act of 2014,[109] which provides the Federal Reserve with flexibility to tailor its capital framework to firms that are substantially engaged in insurance underwriting activity. Following the passage of this amendment to the Wall Street Reform Act, the Federal Reserve is now "constructing a domestic regulatory capital framework for its supervised insurance holding companies that is well tailored to the business of insurance."[110] As required by the Wall Street Reform Act, FIO will coordinate with the Federal Reserve in conducting annual analyses of nonbank financial holding companies supervised by the Federal Reserve to evaluate whether such companies have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.[111]

C. Capital Developments at the State Level

Capital regulation is one of the most important elements of prudential financial regulation. Since the financial crisis of 2007-08, domestic and international regulators have undertaken significant efforts to develop strengthened standards for both the quantity and quality of capital that must be held by insurers. These standards build upon certain aspects of the existing state- and entity-based capital regime for insurers in order to construct a more risk-sensitive approach for group capital. In the United States, various government bodies and industry stakeholders (including FIO, the Federal Reserve, state legislatures and insurance regulators, and the NAIC) are devoting significant resources to developing a more risk-sensitive standard for setting minimum capital requirements for insurers.

1. Risk-Based Capital

Risk-based capital (RBC) is a capital measurement framework designed to help state insurance regulators detect when progressively more intense levels of intervention may be appropriate and necessary. Development and implementation of the RBC framework began in the early 1990s as an

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[107] Testimony of Mark E. Van Der Weide, Deputy Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System before the Senate Committee on Banking, Housing, and Urban Affairs, 1 (April 28, 2015), *available at* http://www.federalreserve.gov/newsevents/testimony/vanderweide20150428a.pdf.
[108] *Id*. at 2.
[109] The bill was signed by the President on December 18, 2014. Public Law 113–279, 128 Stat. 3017 (2014).
[110] Testimony of Mark E. Van Der Weide, 2 (April 28, 2015).
[111] 12 U.S.C. § 5365(i)(1)(A).

early warning system for state insurance regulators, following several insurer insolvencies that occurred in late 1980s and early 1990s.[112]

The RBC framework applies only to a legal entity, rather than a group, and establishes a calculation of a ratio defined as qualifying capital over minimal required regulatory capital (RBC ratio) of a legal entity-level capital position. Using data and information specific to the insurance sector within which an insurer operates, the RBC framework yields the minimum capital standard for an insurance entity.[113] Insurers generally hold capital amounts that are significantly higher than the minimum RBC capital standard. In this sense, the RBC framework sets forth an objective standard for triggering regulatory action when an insurer's RBC ratio is reported below certain levels.

An insurer is required to report its RBC ratio to its domiciliary state insurance regulator on an annual basis. Although reported RBC ratios can be used by insurance regulators as a reference point for identifying potentially weakly-capitalized insurers, RBC is not a total balance sheet framework, or a framework based on an integrated view of risk for an insurance organization. For example, the current RBC framework for life insurers excludes certain risks that are relevant for this analysis, including legal risks, tail risks, and risks that cannot be pre-funded by capital, such as liquidity or specific operational risks like cyber risk.

2. Principles-Based Reserving

For decades, life insurers have followed a standardized formula prescribed under state insurance laws to calculate reserves for products. Critics of this approach contend that it is too static and conservative; that it fails to capture the risks associated with increasingly complex products and product features favored by consumers; and that it does not reflect life insurers' risk management practices. According to these critics, the RBC approach results in reserve requirements that are too high for some products and too low for others. In addition, many industry participants state that redundant reserve requirements have forced the development and expansion of captive reinsurance in order to allow life insurers to more efficiently use capital (captive reinsurance is further addressed in section V. D. of this Report).

In order to address these concerns, including limiting the use of reinsurance captives, states have been moving forward with a new method referred to as principles-based reserving (PBR). This method reflects general consensus among stakeholders that reserving requirements should properly reflect current mortality rates, the life insurer's particular business model, and the insurer's unique risk profile. Whereas the formula-based approach to quantifying reserves incorporates standardized calculations, PBR relies upon an insurer's individualized risk modeling and analysis techniques, including the use of insurer-specific claims experience with specific portfolio(s) of business, to incorporate consideration of particularized risks and, thereby, more closely tailor calculations to the actual attributes of an insurer's portfolio.

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[112] NAIC, "Risk-Based Capital," *available at* http://www.naic.org/cipr_topics/topic_risk_based_capital.htm.
[113] *Id*.

In December 2012, the NAIC adopted a Valuation Manual which contains details of the principles-based approach and defines the methods for calculating reserves under PBR. When at least 42 states representing 75 percent of total U.S. premium adopt the revised reserving principles, a three-year PBR implementation period will begin and will apply only for new business. As of June 1, 2015, 29 states, representing 45 percent of premium, had adopted PBR. The NAIC has developed a written plan targeting a January 1, 2017 effective date to begin the implementation period. Key elements of the plan include: (1) hiring of actuaries by the NAIC to support the states in preparing for PBR; (2) establishing a framework for development of risk-focused PBR examination procedures; (3) changing the schedules used to report reserves and enhancing automated financial analysis and prioritization tools; (4) training state insurance department staff; and (5) determining a specific date to require PBR as an accreditation standard.

Notwithstanding the potential advantages of PBR, its wholesale adoption by the states continues to raise concerns. PBR relies heavily on each insurer's application of internal models to complex data sets, which are unique to each insurer, and necessarily demanding of expertise and resources. This approach makes sense from the industry perspective, but raises questions about the limitation of state regulatory capacity. The lack of sufficiently trained and expert actuaries and examiners on staff at state insurance departments raises questions regarding uniformity and consistency of adoption across the states. The propriety of contracting these essential regulatory responsibilities to the NAIC, or to vendors or consultants hired by the NAIC, a non-public entity, also raises concerns about the delegation of central regulatory functions. Some state insurance regulators and other stakeholders have also expressed concern that adoption, implementation, and enforcement of PBR will not be uniform and will increase state-by-state disparities.

D. Reinsurance Captives

The Modernization Report recommends that states "develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives."[114] FIO's recommendation concerns those captive insurance companies (referred to herein as "reinsurance captives") which provide reinsurance to an affiliated or parent life insurer. This subject continued to receive attention and scrutiny in 2014 and 2015, including from Congress, state insurance regulators, and news media.

State insurance laws generally apply less stringent regulatory requirements to captive insurance companies (including reinsurance captives) than those applicable to commercial insurers. For example, when compared to other commercial insurers, captive insurers are subject to lower requirements on the amount and quality of assets or capital that must be held. This fact, when combined with the dramatic increase in the reliance upon reinsurance captives over the past 10-plus years, means that life insurers may be less well capitalized, and consumers more vulnerable, than would be the case without the use of reinsurance captives.

State regulation of insurers focuses on individual legal entities within a group rather than on the group as a whole, which allows life insurers to shift capital among affiliates to take advantage of state-by-state

[114] Modernization Report, 32.

regulatory inconsistencies. One of the benefits of group supervision for the regulation of insurers, and of consolidated capital assessment, is that it provides a greater focus on the consolidated financial condition of the group as a whole. Under group supervision, the benefits of reinsurance captive transactions would be eliminated through consolidation without a net effect at the group level.

State insurance regulators are developing a framework (Captive Framework) which aims to enhance the regulation of reserve financing transactions between life insurers and reinsurance captives for certain term life and universal life with secondary guarantee products. The Captive Framework follows years of study and deliberation and proposes standards that a ceding insurer would be required to satisfy in order to receive credit for reinsurance ceded to reinsurance captives.[115] In brief, the proposal would require the insurer to receive collateral from the reinsurance captive in an amount and quality sufficient to assure recovery of the so-called "economic" portion of the ceded statutory reserves. Any excess statutory reserve amount over the economic portion, which has been referred to by some life insurers as the "redundant reserve," could be collateralized by lower quality security acceptable to the ceding insurer's regulator. Ceding insurers would be subject to increased disclosure requirements. If implemented by the states, however, the Captive Framework would not apply regulatory requirements directly to reinsurance captives. In May of 2015, state insurance regulators included certain provisions of the Captive Framework into the preamble of Part A (Laws and Regulations) of the Financial Regulation Standards and Accreditation Program.

The Captive Framework does not address all transactions between life insurers and reinsurance captives, but rather only transactions involving cessions of reserves for term life and universal life with secondary guarantees. As measured by life insurance in force, such transactions accounted for approximately 63 percent of all reinsurance-related transactions between life insurers and reinsurance captives in 2014.[116] Due to its limited scope and its exclusive focus on ceding insurers, the Captive Framework does not fully address concerns about the non-uniform prudential regulation of reinsurance captives. Therefore, reinsurance captives would continue to be subject to a wide variety of less stringent requirements across the states with regard to minimum capital,[117] risk-based capital,[118] allowable assets,[119] and accounting practices.[120]

While disclosure requirements of life insurers pertaining to cessions to reinsurance captives of reserves related to term life and universal life with secondary guarantee products has improved, state insurance regulators do not require public disclosure of the financial statements of reinsurance captives.

[115] The reports of the industry consultant, Rector & Associates, Inc., released in September 2013, February 2014, and June 2014 are *available at* http://www.naic.org/committees_ex_pbr_implementation_tf.htm.
[116] SNL Financial, data extracted on July 24, 2015.
[117] While many states allow captives to be established with only $250,000 in capital, one state required $10 million in capital while the requirement of another state was based on the transaction. NAIC White Paper, "Captives and Special Purpose Vehicles," 12 (July 2013), *available at* http://www.naic.org/store/free/SPV-OP-13-ELS.pdf.
[118] Certain states—in the case of Special Purpose Vehicles—required risk-based capital filings while other states did not. *Id*.
[119] Allowable assets varied by state, including letters of credit, parental guarantees, surety bonds, and other assets. *Id*.
[120] Allowable accounting standards included Statutory Accounting Practices, Generally Accepted Accounting Practices, and other standards. *Id*.

Reinsurance captives would continue to be exempt from public disclosure requirements under the Captive Framework.

The uncertain timeframe for implementation of the Captive Framework raises additional concerns. The framework is expected to be implemented in phases, including the development of a new reinsurance standard pertaining to term life and universal life with secondary guarantee products – thereby requiring state-by-state adoption over the course of an uncertain number of years.[121] The NAIC expects that the incentives to create reinsurance captive transactions will "be almost, if not fully, eliminated"[122] once PBR becomes effective, although insurers have not conceded that expectation. A.M. Best has noted that "given the uncertain timeframe for adoption of PBR," the "stopgap" measures established in the Captive Framework may become the new regulatory reality and, thereby, not eliminate the use of reinsurance captives.[123]

E. Terrorism Risk Insurance Program

The September 11, 2001 terrorist attacks resulted in an insurance industry loss of about $32.5 billion (in 2001 dollars), which at the time was the largest global insurance loss in history.[124] Following those attacks, insurers and reinsurers largely withdrew from the terrorism risk insurance market, potentially threatening planned construction, property acquisition, business projects, and other economic activity.[125] In response, the Terrorism Risk Insurance Act of 2002 (TRIA) was enacted, which created the Terrorism Risk Insurance Program (TRIP) within Treasury.[126] TRIP was established to incentivize the private market to offer insurance for terrorism risk, while providing a transitional period for the private market to resume pricing terrorism risk and build capacity to absorb future insurance losses.[127] The Wall Street Reform Act authorizes FIO to assist the Secretary in administering TRIP.[128]

In general, TRIA requires each commercial P/C insurer to participate in TRIP and to make coverage available for terrorism risk insurance.[129] In addition, an insurer may be reimbursed by TRIP for "insured losses" resulting from one or more certified acts of terrorism. In this regard, when industry losses exceed a specified trigger amount, TRIA authorizes the Secretary to make federal payments to an insurer as reimbursement for a portion of insured losses resulting from a certified act of terrorism exceeding the insurer's deductible as determined under TRIA. Insurers co-participate with federal

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[121] Actuarial Guideline 48 (AG-48), which is a component of the Captive Framework, was developed as an interim step until the new model law is completed, which would replace AG-48 once adopted by the states.
[122] NAIC Press Release, "NAIC Adopts XXX/AXXX Reinsurance Framework" (August 17, 2014), *available at* http://www.naic.org/Releases/2014_docs/naic_adopts_xxx_axxx_reinsurance_framework.htm.
[123] A.M. Best, "New Reserve Financing Rules Unlikely to Eliminate XXX, AXXX Captives," 1 (February 2, 2015).
[124] President's Working Group on Financial Markets, "The Long-Term Availability and Affordability of Insurance for Terrorism Risk" (April 2014), *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/PWG_TerrorismRiskInsuranceReport_2014.pdf.
[125] TRIA § 101(a)(5). Because the provisions of TRIA appear in a note, i.e., 15 U.S.C. § 6701 note, instead of particular sections, of the United States Code, references to its provisions in this Report are identified by the sections of the Act.
[126] For purposes of this Report, TRIP refers to the program, as it is administered through regulations found in 31 CFR 50.
[127] TRIA § 101(b).
[128] 31 U.S.C. § 313(c)(1)(D).
[129] TRIA § 103(a)(3).

funding with respect to payments for losses above the deductible, and would be required to impose a surcharge on policyholders in order to fund any recoupment payments to Treasury. TRIA was originally scheduled to expire on December 31, 2005, was reauthorized in 2005 and again in 2007, with expiration scheduled for December 31, 2014.

On January 12, 2015, President Obama signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2015 (Reauthorization Act), which amended the termination date of TRIA to December 31, 2020 and reformed several provisions of TRIA. In addition, Treasury is required to issue certain new reports and to engage in rulemaking.

Reforms to TRIP under the Reauthorization Act include the following:

(1) Gradually increasing the minimum amount of aggregate insured losses from one or more certified acts of terrorism before payments can be made under TRIP (i.e., the "Program Trigger") from $100 million to $200 million.

(2) Phasing-down the federal share, which is the amount of reimbursement paid to an insurer for insured losses from a certified act of terrorism exceeding that insurer's deductible during a calendar year (provided the aggregate insured losses exceed the Program Trigger), from 85 percent to 80 percent.

(3) Slowly raising the minimum amount of insured losses from one or more acts of terrorism during a calendar year that must ultimately be borne by the private market (i.e., the insurance marketplace aggregate retention) from $29.5 billion to $37.5 billion.

On February 6, 2015, Treasury released interim guidance to reflect the immediate changes to requirements under the TRIP regulations arising under the Reauthorization Act.[130] Treasury continues to update the TRIP regulations and implement the Reauthorization Act, including:

(1) Certification Improvement. On February 9, 2015, Treasury published a notice in the Federal Register seeking comment for a study examining the process by which an event may be certified as an act of terrorism.[131] Upon the completion of the study, Treasury must issue a report (Certification Process Report) on the results of the study.[132] Following issuing the Certification Process Report, Treasury will issue final rules addressing the certification process.[133]

[130] Interim Guidance Concerning the Terrorism Risk Insurance Program Reauthorization Act of 2015, 80 Fed. Reg. 6, 656 (Feb. 6, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-02-06/pdf/2015-02556.pdf.
[131] Study on Improving the Certification Process for the Terrorism Risk Insurance Program, 80 Fed. Reg. 7, 075 (Feb. 9, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-02-09/pdf/2015-02563.pdf.
[132] Reauthorization Act § 107(d), Pub. L. No. 114-1; 129 Stat. 7 (2015).
[133] Reauthorization Act § 107(e), Pub. L. No. 114-1; 129 Stat. 8 (2015).

(2) Data Collection and Reporting. Beginning in 2016, Treasury must collect terrorism risk insurance information from insurers as part of an effort to analyze the effectiveness of TRIP.[134] Not later than June 30, 2016, and every other June 30 thereafter, Treasury is required to submit a report that evaluates the effectiveness of TRIP, any changes or trends of data collected by Treasury, and whether aspects of TRIP discourage insurers from providing terrorism risk insurance.[135] Treasury must also conduct a study and submit a report not later than June 30, 2017, and every other June 30 thereafter, on competitive challenges small insurers face in the terrorism risk insurance marketplace.

(3) Advisory Committee. The Reauthorization Act requires establishment of an advisory committee on risk-sharing mechanisms (Advisory Committee) to provide advice and recommendations with respect to the creation and development of non-governmental risk-sharing mechanisms for protection against losses arising from acts of terrorism.[136] On April 8, 2015, Treasury officially formed the Advisory Committee; on April 20, 2015, Treasury published a notice in the Federal Register seeking applications by May 20, 2015 from interested individuals to serve as members on the Advisory Committee; and on September 23, 2015 Treasury announced the appointment of nine individuals to serve on the Advisory Committee.[137] The first meeting will occur in the fourth quarter of 2015.

The Reauthorization Act does not alter the basic framework and functions of TRIP that have contributed to development of the terrorism risk insurance market for the past 14 years. According to the 2014 report by the President's Working Group on Financial Markets, terrorism risk insurance would be less available and more costly in the absence of TRIP.[138] FIO continues to assist the Secretary and to further implement the Reauthorization Act as required by statute.

F. State Guaranty Funds

State guaranty funds provide benefits and payments to policyholders, up to specified statutory limits set by the states, when insolvent insurers are unable to pay policyholder claims in a timely manner. Insurers operating in a state are required to participate in that state's guaranty fund. The guaranty funds are administered by state guaranty associations, which are created by state law typically as nonprofit entities subject to the oversight and direction of insurers licensed in the states. Most states have established separate guaranty funds for P/C and L/H lines of insurance.

[134] Reauthorization Act § 111, Pub. L. No. 114-1; 129 Stat. 10 (2015).
[135] Reauthorization Act § 111, Pub. L. No. 114-1; 129 Stat. 10 (2015).
[136] Reauthorization Act § 110, Pub. L. No. 114-1; 129 Stat. 9 (2015).
[137] Advisory Committee on Risk-Sharing Mechanisms to Voluntarily Reinsure Against Losses From Acts of Terrorism, 80 Fed. Reg. 21,802 (April 20, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08978.pdf.; Press Release, "Treasury Announces Appointments to Advisory Committee on Risk-Sharing Mechanisms" (Sept. 23, 2015), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl0176.aspx.
[138] Note 125, above.

The National Conference of Insurance Guaranty Funds (NCIGF) has reported that its member guaranty funds have paid more than $27 billion to claimants since 1976.[139] With respect to life and health insurers, the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA) states that its members have made claims payments to more than 2.5 million consumers in roughly 100 multi-state insolvency cases.[140] NOLHGA reported that no new insolvencies requiring guaranty fund obligations were triggered in 2014. As noted in the Modernization Report,[141] despite the apparent capacity of the state guaranty funds, it is unclear how the funds would fare in the event of the failure of a large complex insurer with multiple insurance and non-insurance subsidiaries operating around the world.

Coverage limits under state guaranty fund laws are not consistent across states. This lack of uniformity places some consumers at a financial disadvantage and increased financial risk based solely on geography. For example, in the event an insurer is placed into receivership, the owner of an annuity contract residing in Connecticut is eligible for up to $500,000 in guaranty fund protection, whereas the same person with the same contract from the same company would be eligible for only $100,000 in protection if that person were to reside in New Hampshire. Coverage limits for structured settlement annuities and P/C products are even less uniform.

In 2009 the NAIC adopted significant revisions to its Life and Health Insurance Guaranty Association Model Act (Model Life Guaranty Act).[142] These revisions expanded the list of covered products to specifically include disability and long term care insurance, and either reconfirmed existing coverage limits or established new limits for each line of business.[143] Nevertheless, significant variations among states remain for two reasons: a number of states have not adopted Model Life Guaranty Act updates, and other states have enacted coverage limits higher than specified in the Model Life Guaranty Act.

The Modernization Report notes this lack of uniformity in coverage limits from state to state, and recommends that the states adopt and implement uniform policyholder recovery rules so that policyholders, regardless of the state in which they reside, receive the same guaranty fund benefits. Since publication of the Modernization Report in 2013, state law revisions have not addressed coverage limits under state guaranty funds for P/C insurers. In the case of life insurers, two states and the District of Columbia have adopted the key revisions to the Model Life Guaranty Act, increasing the number of jurisdictions that have adopted the revisions to 42,[144] although these actions do not resolve concerns about the national lack of uniformity of benefits.

[139] NCIGF, "Insolvency Trends," 2, *available at* http://ncigf.org/media/files/NCIGF_Trends_Summer_2014.pdf.
[140] NOLHGA, "Facts & Figures," *available at* http://www.nolhga.com/factsandfigures/main.cfm.
[141] Modernization Report, 44-45.
[142] The Model Life Guaranty Act is *available at* http://www.naic.org/store/free/MDL-520.pdf.
[143] The limits are $100,000 for health claims, $300,000 for life claims, $100,000 for cash surrender/withdrawal values, $300,000 for both disability and long term care claims, $500,000 for basic or major medical claims, and $250,000 in the present value of annuity benefits. *See* Model Life Guaranty Act, Section 3.
[144] American Council of Life Insurers, "Issue Status Chart: 2009-2015 Guaranty Association Legislation (As of April 29, 2015)."

G. Cyber Security and the Insurance Sector

1. Regulatory Standards

The recently reported cyber-attacks on Anthem Inc.,[145] Premera Blue Cross,[146] and CareFirst BlueCross BlueShield[147] illustrate that all aspects of the financial sector are targets and potentially vulnerable to cyber-attack. Insurers, in particular, are data-rich targets for cyber attackers. For this reason, insurers should be examined and held to the same nationally rigorous regulatory standards for cyber security as other financial institutions.

Insurers have been subject to some level of privacy regulation for approximately 15 years. The Financial Services Modernization Act of 1999, also known as Gramm-Leach-Bliley, includes provisions for state insurance authorities to establish appropriate standards "relating to administrative, technical, and physical safeguards – (1) to insure the security and confidentiality of customer records and information; (2) to protect against any anticipated threats or hazards to the security and integrity of such records; and (3) to protect against unauthorized access to or use of such records or information which could result in substantial harm or inconvenience to any customer."[148] In response, the NAIC developed two model regulations: (1) the Privacy of Consumer Financial and Health Information Regulation, which governs treatment of nonpublic personal health information (NPHI) and nonpublic personal financial information (NPFI) by licensees; and (2) Standards for Safeguarding Consumer Information Model Regulation, which establishes standards for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information. All 50 states and the District of Columbia have adopted the Privacy of Consumer Financial and Health Information Regulation or a substantially similar regulation. Only 36 states have adopted some version of the Standards for Safeguarding Consumer Information Model Regulation or a substantially similar regulation.

In late 2014, state insurance regulators established a Cyber Security Task Force to coordinate insurance regulatory activities relating to cyber security issues, including analyzing information regarding the cyber insurance market and discussing potential regulatory standards relating to cyber security. On April 16, 2015, state insurance regulators released *Principles for Effective Cybersecurity Insurance Regulatory Guidelines*—12 guiding principles to assist states in developing regulatory regimes intended to protect consumers and the insurance industry from cyber threats.[149] Additionally, state insurance regulators on the NAIC's Property and Casualty (C) Committee has exposed its Cybersecurity Blanks

[145] Anthem, Inc., "Statement regarding cyber attack against Anthem," *available at* https://www.anthem.com/health-insurance/about-us/pressreleasedetails/WI/2015/1813/statement-regarding-cyber-attack-against-anthem.
[146] Premera Blue Cross, "Premera Targeted by Cyberattack" (March 17, 2015), *available at* https://www.premera.com/wa/provider/provider-update/.
[147] Kate Vinton, "Data Belonging to 1.1 Million CareFirst Customers Stolen in Cyber Attack," Forbes (May 20, 2015), *available at* http://www.forbes.com/sites/katevinton/2015/05/20/data-belonging-to-1-1-million-carefirst-customers-stolen-in-cyber-attack/.
[148] 15 U.S.C. § 6801(b).
[149] NAIC, "Principles for Effective Cybersecurity: Insurance Regulatory Guidance" (April 2015), *available at* http://www.naic.org/documents/committees_ex_cybersecurity_tf_final_principles_for_cybersecurity_guidance.pdf.

proposal, which would require submission of additional Annual Statement information regarding cyber insurance issued as stand-alone coverage or as part of commercial multi-peril policies, including premiums, losses, direct defense and cost containment, and number of policies in force.[150]

In February 2015, the New York Department of Financial Services (NYDFS) issued the *Report on Cyber Security in the Insurance Sector*, following a survey of a cross-section of regulated insurance companies (21 health insurers, 12 P&C companies, and 10 life insurers).[151] The NYDFS, leading the national effort among state insurance regulators, determined that enhanced supervisory cyber security examinations are necessary in order to identify vulnerabilities in insurers and to identify appropriate solutions. Insurance regulators from other states, including Alaska, California, Indiana, Maine, Missouri, New Hampshire, North Dakota, Oregon, South Carolina, and Washington, are conducting multi-state market conduct examinations of Anthem and Premera.[152] These examinations will focus on the events affecting Anthem and Premera, the insurers' cyber security protections that had been in place, the impact of the security breaches on consumers, and the measures the insurers have taken to prevent unauthorized access to or losses of data that could result from future attacks.[153]

Insurers often collect and retain vast amounts of personal data, including health, financial, property, and family interests. For this reason, among others, state insurance regulators should prioritize and embrace the opportunity to work with and learn from the supervisors of other financial sectors in support of a nationally rigorous approach to cyber security. Treasury, through both FIO and more broadly, encourages state insurance regulators to work in a coordinated manner with the federal and state supervisors of other sectors, including through Treasury's role as lead coordinator for cyber risk in the U.S. financial sector.

Cyber security for the insurance sector is an issue of national interest. Accordingly, FIO encourages state insurance regulators to develop, adopt and uniformly implement examination standards for insurer cyber security that are consistent across all states and which comply with best practices for oversight of financial institutions. For example, the Federal Financial Institutions Examination Council (FFIEC) recently released the Cybersecurity Assessment Tool (Assessment). The Assessment, developed for primary use a financial institution's senior management and board of directors, provides a sound, graduated approach to cyber security oversight. In addition to internal use by financial institutions, the

[150] NAIC, "Cybersecurity Insurance Coverage Supplement," *available at* http://www.naic.org/documents/committees_c_exposure_cybersecurity_blanks_proposal.pdf.
[151] New York Department of Financial Services, "Report on Cyber Security in the Insurance Sector" (February 2015), *available at* http://www.dfs.ny.gov/reportpub/dfs_cyber_insurance_report_022015.pdf.
[152] NAIC, "State Insurance Regulators Call for Multi-State Examination of Anthem" (February 6, 2015), *available at* http://www.naic.org/Releases/2015_docs/state_regulators_call_for_multi-state_exam_of_anthem.htm; Washington State Office of the Insurance Commissioner, "Washington to lead multistate investigation of Premera" (March 24, 2015), *available at* http://www.insurance.wa.gov/about-oic/newsroom/news/2015/03-24-2015.html.
[153] California Department of Insurance, "Insurance Commissioner Jones to conduct financial and market conduct examination of Anthem data breach" (February 6, 2015), *available at* http://www.insurance.ca.gov/0400-news/0100-press-releases/2015/release017-15.cfm; Washington State Office if the Insurance Commissioner, "Washington to lead multistate investigation of Premera" (March 24, 2015), *available at* http://www.insurance.wa.gov/about-oic/newsroom/news/2015/03-24-2015.html.

Assessment also could be used as a valuable tool for regulatory oversight, including by state insurance regulators. For cyber security, state insurance regulators should pursue oversight practices consistent with, and at least as rigorous as, those used in other sectors.

The National Institute for Standards and Technology *Framework for Improving Critical Infrastructure Cybersecurity* (NIST Cybersecurity Framework) provides a voluntary blueprint that firms of all sizes can use to evaluate, maintain, and improve the resiliency of computer systems and reduce cyber risk. Treasury encourages insurers and other financial services firms to implement the NIST Cybersecurity Framework, including holding business partners, suppliers, and customers accountable to its approach to risk management.

The IAIS is monitoring the emergence of cyber threats and contemplating the potential need for globally consistent cybersecurity standards for insurers. At the direction of the IAIS Technical Committee, FIO is leading an IAIS task force is considering the impact that cyber incidents pose to insurers' businesses, to consumer confidence, and to the overall financial sector.

2. Cyber Insurance Market

Cyber risk insurance is a broad term referring to insurance products that cover risks that emanate from the use of electronic data and its transmission, including technology tools such as the internet and telecommunications networks, as well as physical damage that can be caused by cyber-attacks, fraud committed by misuse of data, liability arising from data storage, and the availability, integrity, and confidentiality of electronic information.[154] The U.S. cyber risk insurance market is growing, with most industry analysts estimating that the market reached $2 billion in annual premiums in 2014, and at least one analyst estimating $2.75 billion as of June 2015.[155] Due to recent paid claim activity, cyber risk insurance policies generally have grown more expensive, although this increase depends upon the particular coverage. Notably, retailers with point-of-sale exposure have seen 10 to 100 percent increases in primary cyber risk premiums and additional increases in excess layers upon renewal.[156]

Recently, concerns have been raised regarding the capacity and scope limitations of the cyber risk insurance market, with some market participants describing market capacity for cyber risks as "very small"[157] and observing that billion dollar coverage limits are needed to adequately address the losses posed by cyber risks.[158] Insurers should continue improving underwriting processes for cyber risks by pooling insurance data; increasing capabilities for pricing non-data breach cyber risks, such as adopting

[154] CRO Forum, "Cyber Resilience: The Cyber Risk Challenge and the Role of Insurance" (December 2014), *available at* http://www.thecroforum.org/cyber-resilience-cyber-risk-challenge-role-insurance/.
[155] Dan Schutzer, "An Assessment of Cyber Insurance," Financial Services Roundtable (February 2015), *available at* http://fsroundtable.org/cto-corner-assessment-cyber-insurance/; The Betterley Report, "Cyber/Privacy Insurance Market Survey-2014" (June 2014); The Betterley Report, "Cyber/Privacy Insurance Market Survey-2015" (June 2015).
[156] Willis Re, "Marketplace Realities 2015: Spring Update" (April 2015), *available at* http://www.willis.com/documents/publications/Marketplace_Realities/20150414Marketplace_Realities_2015_Spring_Update-v1.pdf.
[157] Rachel King, "Cyber Insurance Capacity is 'Very Small': AIG CEO," Wall Street Journal (April 2, 2015).
[158] Gina Chon, "Cyber-attack risk requires $1bn of insurance cover, companies warned," Financial Times (February 18, 2015).

the NIST Cybersecurity Framework into the underwriting process; and continuing to build subject matter expertise on cyber risks by engaging cyber security professionals to assist in the underwriting process. FIO will continue to monitor the development of the cyber insurance market.

H. Insurance Producers

Under state laws, insurance producers (agents or brokers) operating in more than one state must complete separate applications, pay multiple licensing fees, and meet different pre-licensing and continuing education requirements established by each state in which they seek to be licensed. These often redundant regulatory burdens are prohibitive for many producers, agents, and brokers, restrict economic activity, and are detrimental to the interest of consumers. Previous steps to promote greater uniformity and reciprocity in state producer licensing requirements have included the state insurance regulators' development of the National Insurance Producer Registry (NIPR) in 1996 as a centralized producer database.

On January 12, 2015, as Title II of the Reauthorization Act, President Obama signed into law the National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II).[159] NARAB II reestablished the National Association of Registered Agents and Brokers (the Association), which was originally authorized by the Gramm-Leach-Bliley Act in 1999 but never established.[160]

The purpose of the Association is to provide a national, standardized licensing process, i.e., "a mechanism through which licensing, continuing education, and other nonresident insurance producer qualification requirements and conditions may be adopted and applied on a multi-state basis."[161] NARAB II establishes a 13-member Board of Directors to govern and supervise all activities of the Association. Members of the Board of Directors are appointed by the President, with the advice and consent of the United States Senate.[162] Once confirmed, the Board of Directors will consist of eight state insurance commissioner members, three industry members with expertise and experience in property and casualty insurance producer licensing, and two industry members with expertise and experience in life or health insurance producer licensing.[163]

In its role as advisor to the Secretary on major domestic insurance policy issues, FIO supports the effort to establish the Association's Board of Directors, implement NARAB II, and will monitor the governance and operation of the Association to ensure that it meets the objectives of the law.

[159] Pub. L. 114-1, Title II, 129 Stat. 12.
[160] The Gramm-Leach-Bliley Act provided that unless a majority of the states enacted uniform producer licensing laws or reciprocal frameworks by a specified date, the original National Association of Registered Agents and Brokers would be established by operation of law. The NAIC subsequently certified that a majority of states had adopted uniform laws or reciprocity, thus halting establishment of the original NARAB.
[161] 15 U.S.C. § 6752.
[162] 15 U.S.C. § 6754.
[163] *Id*.

I. Housing Finance Insurance

1. Private Mortgage Insurance

The dramatic decline in housing prices during the financial crisis placed significant stress on mortgage insurers (MIs). Faced with growing losses from an increasing number of foreclosures, MIs' capital was significantly diminished and they took steps to minimize losses, including rescinding private mortgage insurance (PMI) policies. This shifted losses from the MIs to lenders and investors. Following the financial crisis, MIs insured 4.3 percent of total new mortgage loans in 2010. Market penetration rebounded to 18 percent in 2014.[164] Although MIs are on sounder footing in 2015 than at any time since the crisis, industry participants may remain susceptible to an economic downturn. The financial crisis demonstrated the need for vigilant oversight of the industry as approximately 40 percent of the industry participants failed, thereby leading to greater taxpayer exposure. State-by-state differences can lead to inconsistent oversight and regulatory arbitrage. For this reason, federal enforcement of federal standards remains the recommended solution to improve both the performance and prominence of MIs in the housing finance system.

The Federal Housing Finance Authority (FHFA), in its capacity as the conservator of Fannie Mae and Freddie Mac, has taken important steps to ensure that MIs maintain sufficient resilience. The FHFA put in place new standards for policy rescissions and for claim adjudication timeframes, and items incorporated in the MI master policies issued to lenders. The FHFA also directed Fannie Mae and Freddie Mac to revise and align eligibility requirements for MIs to ensure that MIs approved to assume risk with Fannie Mae and Freddie Mac possess the financial and operational capacity to withstand a financial crisis. After consulting with a range of stakeholders, the FHFA adopted new private mortgage insurer eligibility requirements (PMIERs) and capital standards for MIs, effective December 31, 2015.[165]

2. Force-Placed Insurance

Force-placed insurance (FPI) protects investors in loans that are collateralized with real property when the borrower fails to maintain adequate property insurance.[166] FPI is generally far more expensive than normal home hazard insurance, and it does not provide the full range of coverage to the homeowner such as for furnishings and other personal possessions. During the financial crisis, personal financial issues of many borrowers resulted in increased lapses in homeowner property insurance coverage thereby resulting in higher usage of FPI.

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[164] U.S. Mortgage Insurers, "Key Facts About Mortgage Insurance," *available at* http://www.usmi.org/mi-resources/mortgage-insurance-factsheet/.

[165] Fannie Mae, "Private Mortgage Insurer Eligibility Requirements" (June 30, 2015), *available at* https://www.fanniemae.com/content/eligibility_information/private-mortgage-insurer-eligibility-requirements.pdf. *See also* Freddie Mac, "Private Mortgage Insurer Eligibility Requirements" (June 30, 2015), *available at* http://www.freddiemac.com/singlefamily/pdf/PMIERs.pdf.

[166] FPI is sometimes referred to as "lender-placed insurance" or "creditor-placed home insurance."

Responding to concerns about the increased usage of FPI during the financial crisis, federal and state regulators began to examine more closely FPI industry practices. In 2012, the Consumer Financial Protection Bureau (CFPB) amended Regulation X, which implements the Real Estate Settlement Procedures Act of 1974, requiring: (1) mortgage servicers to give borrowers information about FPI and how to avoid FPI by sending notices to borrowers before charging FPI premiums, (2) the cancellation of FPI and that unearned premiums be refunded to borrowers upon the provision of proof of insurance by the borrower; and (3) mortgage servicers to continue to pay for the borrower's property coverage if the borrower has established an escrow account. In 2013, FHFA directed Fannie Mae and Freddie Mac to prohibit mortgage services from receiving FPI commissions and using affiliated entities to insure or reinsure FPI. Three states – California, Florida, and New York – have taken regulatory action requiring, among other things, FPI insurers to submit new rate filings for review, be subject to rate review each year, and annually report FPI loss ratios.

The CFPB's amendments to Regulation X provide uniform consumer protections to ensure consumers understand the consequences of having FPI, provide for the full refund of unearned FPI premiums, and reduce the prevalence of FPI. Despite enforcement actions of state insurance regulators in California, Florida, and New York, data required to fully evaluate the FPI industry is limited.

In 2013, the FHFA and state insurance regulators held discussions about FPI and strategies for collecting data to better understand the FPI industry, and a working group of state and federal authorities, including FIO, was formed. The working group created a template consisting of approximately 80 industry variables to obtain data regarding the kinds of properties insured by FPI, including whether the mortgage had an escrow account, the property's occupancy status, the reason for coverage lapse, and the premium and coverage amount. In 2014, the state insurance regulators requested that the top three FPI insurers—roughly 90 percent of the market—provide the data. In reply, the insurers failed to provide meaningful information for many of the data elements.

The FPI market serves consumers who may be experiencing personal financial crises. In order to ensure that appropriate protections are in place for consumers served by this market, state insurance regulators should collect accurate and detailed data about the FPI industry. The absence of this important data creates a regulatory gap, to the detriment of consumers, which may warrant federal data collection efforts.

3. Title Insurance

Prior to extending credit for the purchase of real property (and in some instances, loans against home equity), a lender will usually require assurance that title to the property offered as collateral for the loan is free of liens and encumbrances. Title insurance provides protection for lenders and owners against loss resulting from an unknown encumbrance, defective title, invalidity of title, or adverse claim to title that occurred prior to the issuance of the title insurance policy.[167] Two types of title insurance policies are available – the lender's policy and the owner's policy. The lender's policy is issued to the lender and (subject to the terms and conditions of the policy) will pay the lender the remaining principal of the

[167] Insurance Information Institute, "Title Insurance," *available at* http://www.iii.org/article/title-insurance. .

loan if there is a problem with the title that cannot be resolved. The owner's policy is issued to the buyer of the real property and typically provides coverage for up to the full purchase price of the property. Both the lender's policy and owner's policy are typically paid for by the buyer of the real property. Although a single premium for the title insurance policy is paid at the time of closing, the lender's policy remains effective until the associated mortgage loan has been satisfied and the owner's policy remains effective as long as the homeowner or the homeowner's heirs have an interest in the property.

In 2015, the NYDFS concluded an investigation into the ratemaking practices of title insurers in New York. The NYDFS discovered that title insurers were annually spending "millions of dollars on meals, entertainment, and gifts for attorneys and other real estate professionals who order title insurance on behalf of their clients."[168] This observation echoes similar findings and conclusions from studies in Colorado and other states in the mid-2000s.[169] The NYDFS determined that the inclusion of such expenses in ratemaking for title insurance violates laws prohibiting inducements in the sale of insurance. In April 2015, the NYDFS proposed regulations to curtail the practice.[170]

Similarly, the CFPB and the Maryland Attorney General filed a complaint in federal court against a title insurer and several mortgage loan officers, alleging that the title insurer provided the loan officers with "kickbacks or things of value for referrals of settlement-service business," including cash and marketing services.[171] These practices are alleged by the CFPB and the Maryland Attorney General to violate the Real Estate Settlement Procedures Act (RESPA).[172]

The federal government and a number of states are addressing the issue of inflated title insurance premiums by title insurers through court action and regulatory processes. Iowa has addressed these issues through a unique system of providing title guarantees, becoming the only state provider of public guarantees of title to residential real property. It does this through Iowa Title Guaranty, a division of the Iowa Finance Authority.[173] Iowa Title Guaranty does not charge a premium for an owner's policy if the owner's policy is issued in conjunction with a lender's policy.[174] Notably, the Iowa approach is premised upon the availability and reliability of electronically available information regarding property titles. While Iowa remains the only state to adopt such an approach, its continuing viability warrants increased attention from policymakers in other states.

[168] NYDFS, "New York State Department of Financial Services Financial Frauds and Consumer Protection Report" (March 15, 2015), *available at* http://www.dfs.ny.gov/reportpub/fraud/ffcpd-annualrep-2014.pdf.
[169] Government Accountability Office, "Title Insurance Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers," 27 (April 2007), *available at* http://www.gao.gov/assets/260/259269.pdf.
[170] NYDFS Proposed 11 NYCRR 227 (Insurance Regulation 208), *available at* http://www.dfs.ny.gov/insurance/r_prop/rp208t.pdf (April 29, 2015).
[171] *Consumer Financial Protection Bureau* and *State of Maryland, Office of the Attorney General of Maryland, Consumer Protection Division v. Genuine Title, LLC, et. al.* (Compl. ¶¶ 1 and 3, Case 1:15-cv-01235-JFM) (April 29, 2015).
[172] 12 U.S.C. § 2607(a).
[173] Information about the Iowa Title Guaranty is *available at* http://www.iowafinanceauthority.gov/TitleGuaranty/Aboutus.
[174] *Id.*

J. Workers' Compensation Insurance

1. Overview

Workers' compensation provides medical care, rehabilitation, and wage replacement benefits to workers who are injured or who contract work-related illnesses in the course of employment. Workers' compensation also pays benefits to the dependents of workers who die of work-related injuries or illnesses. If eligible for workers' compensation, such benefits are the exclusive remedy against the employer available to workers and their families for injuries sustained or illnesses contracted in the course of employment.

Workers' compensation benefits are determined by state law and the programs are administered by each state. Employers typically pay for workers' compensation benefits in one of three ways: (1) by purchasing insurance from a private insurer; (2) by purchasing insurance from a state workers' compensation insurance plan (state plan); or (3) through self-insurance.

Workers' compensation insurance purchased from private insurers and state plans provide the benefits required under state law. In four states, the state plan is the sole provider legally authorized to provide workers' compensation insurance in the state.[175] Many other states have state plans that compete with private insurers in the workers' compensation insurance market.[176] As is common with other types of commercial insurance coverage, large employers often elect to self-insure for workers' compensation risks.[177]

Premiums for workers' compensation insurance are generally based on the industry classification of the employer and the employer's payroll.[178] Premiums to cover employees engaged in hazardous occupations, e.g., construction workers and miners, typically are higher than premiums to cover employees engaged in less-hazardous occupations.

The National Council on Compensation Insurance (NCCI) reported net written premium for workers' compensation insurance in 2014 of $44.2 billion, up from $41.8 billion in 2013 and $39.5 billion in 2012.[179] The combined ratio for workers' compensation insurance, as reported by NCCI, was 98 percent in 2014, a 4 percentage point decline from 102 percent in 2013, and an 11 point decline from 109 percent in 2012.[180] These figures show marked improvement for insurers in a market where net

[175] The four states are North Dakota, Ohio, Washington, and Wyoming.
[176] In Arizona, California, Colorado, Hawaii, Idaho, Kentucky, Louisiana, Maryland, Missouri, Montana, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, and Utah, the state plans compete with private market insurers.
[177] However, all employers in North Dakota and Wyoming are required to purchase workers' compensation insurance from the state plan.
[178] Insurance Information Institute, "Workers Compensation Insurance," *available at* http://www.iii.org/publications/insuring-your-business-small-business-owners-guide-to-insurance/specific-coverages/workers-compensation-insurance.
[179] NCCI, "Annual Issues Symposium, State of the Line, Analysis of Workers Compensation Results" (2015), *available at* https://www.ncci.com/Documents/AIS-2015-SOL-Presentation.pdf.
[180] *Id.*

written premium fell from its highest level of $47.8 billion in 2005 to $33.8 billion in 2010 and the combined ratio fluctuated between 93 percent and 115 percent for the same time period.[181]

In order to improve workplace safety, enhance employees' recovery from injury, and decrease workers' compensation costs to employers, states have examined or implemented various reforms to the workers' compensation system. States have established occupational health and safety boards and offices to help ensure safe and healthful working conditions for employees. Increases in medical costs have led many states to establish the reimbursement rate for medical procedures related to workplace injuries through fee schedules. Reflecting the importance of workers' compensation insurance to both employers and employees, many states require the rates to be pre-approved by the state insurance regulator.

2. Reforms

Workers' compensation laws were initially enacted by most states and the federal government in the early part of the 20th century.[182] By 1949, all states and the federal government had in place a no-fault workers' compensation system,[183] with participation mandatory in all states but Texas.[184] One of the principal aims of workers' compensation programs was to provide adequate benefits to injured workers while at the same time eliminating the burden, cost, and variables of a judicial proceeding and, further, imposing limits on an employer's liability to an injured worker.[185] Injured workers promptly receive benefits, thereby reducing the potential strain on local government healthcare operations, and both employees and employers were relieved of the uncertainties surrounding litigation regarding workplace injuries. Since establishment of workers' compensation systems across the country, stakeholders have worked with policymakers to launch various reform efforts.

In 2005, Texas enacted reforms to the state workers' compensation system that, among other things, required the formation of physician networks to reduce the cost of medical care for injured employees to Texas employers.[186] In 2011, Illinois adopted reforms that, among other things, reduced provider reimbursements, reduced maximum payouts for some worker injuries, and led to a significant and increasing reduction in the underlying costs incurred by employers due to an injured employee.[187]
In 2012, California enacted reforms to improve employee benefits and medical treatment and to address the concerns from employers that California had among the highest costs for workers' compensation in

[181] *Id.*
[182] General Accounting Office, "Workers' Compensation, Selected Comparisons of Federal and State Laws" (April 1996), *available at* http://www.gao.gov/assets/230/222346.pdf.
[183] Insurance Information Institute, "Workers Compensation" (April 2015), *available at* http://www.iii.org/issue-update/workers-compensation.
[184] Texas Department of Insurance, "Employer Participation in the Texas Workers' Compensation System" (November 2014), *available at* http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf.
[185] General Accounting Office, "Workers' Compensation, Selected Comparisons of Federal and State Laws," 1 (April 1996), *available at* http://www.gao.gov/assets/230/222346.pdf.
[186] Texas Department of Insurance, "Setting the Standard, An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System, 2014 Results" (December 2014), *available at* http://www.tdi.texas.gov//reports/dwc/documents/2014regbiennialrpt.pdf.
[187] Illinois Public Act 97-0018 (2011).

the country.[188] In 2013, Oklahoma passed workers' compensation reforms that, among other things, reduce some benefits to injured employees and allow employers in the state to opt-out of participation in the state's workers' compensation program.[189]

Also, in 2013, to address the 26 percent increase in average workers' compensation rates over two years in Delaware, the Workers Compensation Task Force was created to review the laws relating to workers' compensation and the reasons for the increases and determine whether additional statutory or regulatory changes were required to control growth in premiums.[190] At the conclusion of its review, the Workers Compensation Task Force recommended changes to the insurance laws designed to provide better scrutiny of the annual rate requests of workers' compensation carriers and of individual carriers' diligence in holding down costs on individual claims. Recommendations included the creation of a rate payer advocate to represent rate-paying businesses during the annual review by the Delaware Department of Insurance of the loss cost ratio, the review of medical losses for Delaware's largest workers' compensation carriers, the creation of a new medical fee schedule using multipliers of medical codes used by the Centers for Medicare and Medicaid Services, and an assessment by the Delaware Department of Insurance of whether a change in the rating organization used by workers' compensation carriers is warranted.[191]

In general, before a covered employee's injury or illness can be considered compensable under a state's workers' compensation law, the injury or illness must have arisen out of and in the course of employment. This has typically meant identifying the most probable cause of a worker's injury or illness and that the injury or illness arose out of work, also referred to as causation.

With respect to causation and compensability under workers' compensation laws, some state laws require an injured worker to prove something more than that the injury occurred during the course of employment. For example, in Kansas and Missouri, a work injury by accident is compensable only if the accident was the "prevailing factor" in causing the resulting medical condition and not another type of disease, such as obesity or diabetes.[192] In Oklahoma, for some illnesses or injuries to be compensable, the injured employee must prove that some unusual or unpredicted incident occurred and is found to have been the "major cause" of the physical harm.[193] These types of reforms may reduce short-term premium costs but also may fundamentally change the workers compensation system. Instead of working through medical issues, recovering and returning to work, workers with disabilities or chronic illnesses, or older workers, may be disadvantaged due to the preexisting condition test implied in the prevailing factor or "major cause" causation standards. This outcome may be

[188] California Department of Industrial Relations, "SB 863: Assessment of Workers' Compensation Reforms" (July 17, 2014), available at https://www.dir.ca.gov/dwc/Reports/SB863-Assessment-WC-Reforms-July-2014.pdf.
[189] 85A Okl. St. § 109.
[190] Delaware House Joint Resolution No. 3, 147th General Assembly.
[191] "Delaware Workers' Compensation Task Force Report to the Governor and General Assembly of the State of Delaware" (May 15, 2014), *available at* http://ltgov.delaware.gov/taskforces/wctf/20140515/Workers_Comp_Report_Presented_May_15_2014.pdf.
[192] K.S.A. § 44-508(d) and RSMo § 287.020.
[193] 85A Okl. St. §§ 14 and 65.

substantially detrimental to the many disabled or older Americans who are working and not yet eligible, or able, to retire.

As discussed earlier in this section, each jurisdiction determines the workers' compensation benefits for its workers, including the amount of compensation for a worker who suffers a permanent injury on the job. Under this system, the average maximum compensation for the loss of a leg nationwide is $153,221 with Alabama compensating an injured worker the least amount of all states, at $44,000, and Nevada compensating the most, at $457,418.[194] As in other areas such as guaranty fund benefit limits, these state-by-state differences raise important questions regarding the propriety of local standards.

Stakeholders in workers' compensation, including states, employers, employees, injured workers and their dependents, insurers, and state plans continue to develop and propose further reforms to the workers' compensation system. FIO will continue to monitor the workers' compensation market, state trends, and the results of recent reforms to determine whether further action is warranted.

[194] Lena Groeger, Michael Grabell, & Cynthia Cotts, "Workers' Comp Benefits: How much is a Limb Worth," ProPublica (March 5, 2015), *available at* http://projects.propublica.org/graphics/workers-compensation-benefits-by-limb#.

VI. INTERNATIONAL REGULATORY DEVELOPMENTS

Over 2014, world insurance market developments were consistent with recent trends. The United States remained the world's largest insurance market as measured by premium volume, but its share as a percentage of world insurance premiums continued to decline (26.8 percent in 2014, compared to 27.5 percent in 2013).[195] Premium growth in emerging markets continued to be strong, presenting opportunities for worldwide expansion by internationally active insurers.

FIO participates in a number of initiatives in various international forums intended to improve the efficacy and consistency of insurance supervisory standards across jurisdictions, to enhance financial stability, and to promote a level playing field for insurers operating globally. Current developments in these areas are highlighted in this section of the Report.

A. International Association of Insurance Supervisors

The IAIS is the international standard-setting body for supervision of the insurance sector. IAIS membership consists of insurance regulators and supervisors of more than 200 jurisdictions in nearly 140 countries, representing 97 percent of global insurance premiums. Its objectives are: (1) to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders; and (2) to contribute to global financial stability.[196] The IAIS also provides a forum for members and stakeholders to share experiences and understanding of insurance supervision and insurance markets, and to develop standards based on best practices.

FIO became a full member of the IAIS in 2012, consistent with its statutory authority to serve as representative of the United States on prudential aspects of international insurance matters and as representative of the United States at the IAIS. FIO serves in leadership roles in the IAIS, including as a member of the Executive and Financial Stability Committees and as Chair of the Technical Committee. The NAIC was among the founding members of the IAIS in 1994, as are each of the 56 U.S. state and territory regulators. At the October 2014 IAIS Annual Meeting, the Federal Reserve became a full member of the IAIS.

1. Organizational Reform

In 2014, the IAIS adopted organizational reforms to improve its financial independence, efficiency, and transparency. Formerly, the IAIS charged stakeholders as much as $20,400 annually to receive the designation of "observer," thereby gaining special access to certain meetings, events, and information. These observer fees constituted approximately 40 percent of IAIS funding, creating the appearance of a quid pro quo arrangement that detracted from the credibility of the IAIS. The IAIS organizational reforms eliminated the "pay-for-play" approach thereby enhancing the opportunities for all stakeholders to engage in a more meaningful manner than was previously possible.

[195] Swiss Re Sigma, "World Insurance Market in 2014: Back to Life" (June 2015), *available at* http://www.swissre.com/sigma/#inline.
[196] About the IAIS, *available at* http://iaisweb.org/index.cfm?event=getPage&nodeId=25181.

Through these reforms, the IAIS also has improved dramatically its engagement with and transparency to stakeholders. Perhaps most importantly, as of January 1, 2015, the IAIS no longer charges stakeholder fees or otherwise discriminates among stakeholders. The following examples illustrate the improvements to the IAIS processes for stakeholder consultation:

(1) In 2014, stakeholder sessions for all IAIS work streams amounted to less than 12 hours; thus far in 2015, IAIS stakeholder sessions have amounted to more than 60 hours.

(2) The IAIS website provides the general public with access to information; special access privileges are not provided to any class of external stakeholders.

(3) The IAIS now hosts public meetings and conference calls so that stakeholders can learn about the substance of issues such as consultation papers, provide comments and ask questions.

(4) The IAIS publishes on its public website comments received on consultation papers, summaries of the comments, and replies to the comments.

(5) Stakeholder contact lists are being developed for various work streams so that interested stakeholders can provide input at multiple stages of a work stream's process.

(6) The IAIS publishes monthly newsletters on its public website to describe developments in the preceding month and events scheduled for the coming month.

While only a few IAIS working groups were open directly to designated observers before 2015, the new governance and transparency practices provide a uniform approach to openness and stakeholder engagement for all IAIS activities.

2. United States Coordination

FIO embraces the imperative for U.S.-based members to collaborate on key matters before the IAIS. To that end, FIO regularly convenes a joint Steering Committee comprised of the leaders of FIO, the Federal Reserve, and representatives of the state insurance regulators. Since early 2014, this Steering Committee routinely has held monthly calls and frequent *ad hoc* calls to discuss pending and anticipated issues. At the working group level, staff of each of the U.S.-based IAIS members also meet or confer frequently, including prior to or in connection with scheduled IAIS working group and work stream meetings, and as necessary in the interim. Interaction between FIO, the Federal Reserve, and the states occurs in multiple ways and on multiple occasions on nearly every work day, including by telephone and in person through meetings in the offices of the respective agencies or as side-meetings held in conjunction with IAIS working group, task force, or committee meetings.

These coordination sessions provide opportunities for FIO and the other U.S.-based IAIS members to preview topics and issues that may arise at IAIS meetings, share and discuss respective views, and increase the possibility of unified positions.

In addition, beginning in August 2014, FIO began hosting at Treasury quarterly sessions for U.S. stakeholders in IAIS activities to meet with FIO, the Federal Reserve, and state insurance regulators. Participating stakeholders have included representatives of the U.S.-based G-SIIs, other U.S.-based IAIGs, foreign-based IAIGs with significant U.S. business operations, U.S.-based non-IAIGs, industry trade groups, and consumer representatives. Topics discussed in these sessions have included the development of global capital standards, resolution, and field testing.

3. Common Framework for the Supervision of Internationally Active Insurance Groups

Beginning in 2009, the IAIS set out to develop the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), an integrated, multilateral and multidisciplinary framework for the heightened supervision of IAIGs. It is estimated that, globally, approximately 50 insurance groups meet ComFrame's proposed criteria for IAIGs based on financial metrics pertaining to size and the extent of cross-border business. ComFrame will include qualitative standards for group-wide supervision, governance, risk management, and recovery and resolution.

The initial development phase of the qualitative standards within ComFrame has been completed, including a public consultation phase. To develop ComFrame and related capital standards (see below), the IAIS established a field testing process through which participating firms provide data and real world perspective that shape the standard setting exercise. In late 2014, the IAIS began field testing ComFrame's proposed standards and parameters relating to corporate governance and risk management in order to determine the existence of gaps between the proposed requirements and current jurisdictional supervisory requirements on the one hand, and actual insurer practices on the other. ComFrame field testing involves data collection from both volunteer insurance groups and insurance supervisors, with the goal of gathering information on the estimated costs and benefits of implementation of the current draft of ComFrame as well as on potential improvements to the text of ComFrame. The IAIS will continue to develop and field test ComFrame through 2019.

4. Global Capital Standards

In 2009, in response to the global financial crisis, G-20 Leaders asked the Financial Stability Board (FSB) to develop a policy framework to address the systemic and moral hazard risks associated with global systemically important financial institutions (G-SIFIs).[197] In response, the FSB, which coordinates financial regulatory initiatives on behalf of the G-20, developed a framework and called on the relevant international standard-setting bodies to, among other things, develop methodologies for identifying G-SIFIs in each financial services industry. In 2013 and 2014, based on the IAIS-developed methodology and recommendations, the FSB identified, with the support of the IAIS and involved supervisors, nine G-SIIs, including three U.S.-based insurance groups.

In July 2013, the FSB called upon the IAIS to develop a backstop capital requirement (now known as Basic Capital Requirement, or BCR) by 2014 for G-SIIs and to develop by 2015 an approach to higher loss absorbency (HLA) for G-SIIs. These policy measures conform to the G-20-endorsed FSB

[197] FSB, "Addressing SIFIs," *available at* http://www.financialstabilityboard.org/what-we-do/policy-development/systematically-important-financial-institutions-sifis/.

framework for systemically important financial institutions, which calls for higher loss absorbency for all G-SIFIs. The FSB also called upon the IAIS to continue development of ComFrame and to include in ComFrame a quantitative insurance capital standard (ICS). This comprehensive work plan and the related deliverables (including ComFrame, BCR, and HLA) have been welcomed by G-20 Leaders.

a. Basic Capital Requirement and Higher Loss Absorbency

At its October 2014 Annual Meeting, after more than 12 months of data analysis, testing and consultation, the IAIS adopted an approach to the BCR. The BCR is the first global group capital standard for the insurance sector and provides a simplistic method to measure capital adequacy within an insurance group across jurisdictions. The BCR, as improved over time, will serve as the foundation for the HLA until replaced by the ICS. The BCR is not a standalone capital requirement; rather, applicable only to G-SIIs, the sum of BCR and HLA will be the capital requirement (or the sum of ICS and HLA once ICS is implemented).

HLA is intended to address the potential systemic risk of G-SIIs; it has the primary purpose of reducing the probability of distress or failure of a G-SII and any related impact on the financial system. Following months of analysis and drafting, the IAIS consultation paper on HLA was released in June 2015 for a period of sixty days. The 2015 field testing exercise, which is currently underway, will collect data from insurers to enable further study of the proposed HLA. The IAIS work plan calls for the HLA to be finalized, submitted for FSB endorsement, and submitted to the G-20 in November 2015. The 2015 version of HLA will be subject to improvement and change as its elements are also improved and changed.

While the BCR represents a significant milestone as the first global group capital standard for the insurance sector, it constitutes only a baseline measure; it does not assess certain key risks of insurers, introduces unnecessary volatility, and is not sufficiently risk-sensitive. Therefore, the IAIS is also working on the ICS, which will both replace the BCR as the foundation for HLA for G-SIIs, and serve as a global, quantifiable capital standard applicable to the broader population of IAIGs.

b. Insurance Capital Standard

The IAIS released a consultation paper on the ICS in December 2014. The consultation paper was highly technical and generated 1500 pages of comments from stakeholders.

As publicly described in March 2015, IAIS members agreed on the “ultimate goal” of the ICS to help steer the technical work that is currently underway and that will continue for some time. IAIS members agreed:

> The ultimate goal of a single ICS will include a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions. Ongoing work is intended to lead to improved convergence over time on the key elements of the

> ICS towards the ultimate goal. Not prejudging the substance, the key elements include valuation, capital resources and capital requirements.[198]

As technical experts from the United States and around the world sort through the many complexities of the key elements, the "ultimate goal" will provide the boundaries to shape and influence those conversations and the day-to-day developments.

Given the enormous amount of technical work and the magnitude of the differences that currently exist in group capital requirements across jurisdictions and regions, achieving this "ultimate goal" is a long-term objective. In the near term, building upon data, analysis and testing, progress will be made and convergence will improve. Work will proceed incrementally toward milestones that are realistic, achievable, and driven by factual analysis and consensus.

Notwithstanding the foregoing efforts at the IAIS, international standard-setting activities with regard to insurance capital standards remain in the early stages of development. Importantly, international standards are not self-executing and are entirely without legal effect in the United States until implemented through a federal or state process. While under development and prior to final adoption, the IAIS standards will be tested for accuracy, value, and impact, both with respect to the U.S. insurance market and individual U.S. firms. Whether at the state or federal level, implementation of an international standard should occur in a manner tailored to the unique features of the U.S. insurance sector, promote competition and consumer choice, and support both policyholder protection and financial stability.

B. EU-U.S. Insurance Project

The EU-U.S. Insurance Project (Project) began in early 2012 as a joint effort to increase mutual understanding and enhance cooperation between the EU and the United States on insurance issues in order to promote business opportunity, consumer protection, and effective supervision. The Project is carried out through collaboration among the European Insurance and Occupational Pensions Authority (EIOPA), the European Commission (EC), and a representative of the Bank of England for the EU; and for the United States, through FIO, a state insurance regulator, and the Federal Reserve.

Since its inception, the Project has focused on topics that are fundamentally important to a sound regulatory regime, the protection of policyholders, and financial stability. The priority topics are: professional secrecy/confidentiality; group supervision; solvency and capital requirements; reinsurance and collateral requirements; supervisory reporting, data collection and analysis; independent third party review of regulatory activities; and supervisory on-site inspections.

Project developments in these areas for 2014 and early 2015 include the following:

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[198] The ultimate goal of the ICS is addressed in the March 2015 IAIS Newsletter, *available at* http://iaisweb.org/index.cfm?event=getPage&nodeId=25303.

- A Technical Committee composed of experts from both the United States and EU surveyed the U.S. states and EU Member States regarding bilateral Memoranda of Understanding (MOUs) in place as well as experience with the IAIS Multilateral Memorandum of Understanding (MMoU). The Technical Committee also studied the viability and necessity of various options to further facilitate the exchange of information between regulators.

- Additional U.S. states and EU Member States have become signatories to the IAIS MMoU; collectively, these jurisdictions are the home supervisors for the majority of the largest insurers operating on a transatlantic basis. Both FIO and EIOPA intend to apply to become signatories to the IAIS MMoU.

- Regarding group supervision, an ongoing exchange between U.S. and EU members has led to increased understanding of enhancements to group supervisory practices, including with respect to group analysis procedures, holding company laws and their implementation by the U.S. states, and the designated tasks and responsibilities of group/lead supervisors, including with respect to supervisory colleges.

- In October 2014, the EU-US Insurance Project Steering Committee held a public forum in Amsterdam entitled "Evolution in Group Supervision." The forum consisted of panels that discussed the practical applications of recent enhancements to group supervisory systems as well as future challenges, and the potential for using common elements in Own Risk and Solvency Assessment (ORSA) frameworks for insurance groups operating on a transatlantic basis. The Steering Committee intends to hold a similar public event each year as a foundation for analyses of emerging best practices in group supervision and to support further initiatives within the Project.

- With regard to the area of capital and solvency, each of the organizations represented on the Steering Committee is actively engaged at the IAIS in efforts to develop group capital standards. The Project recognizes this as a priority endeavor, and provides a means for bilateral information exchange between U.S. and EU members about IAIS capital developments.

With respect to reinsurance and collateral requirements, the agreed-upon initiatives for the Project provide that FIO would respond to suggestions regarding its authority under the Wall Street Reform Act relating to covered agreements. In that regard, the Modernization Report includes the following recommendation: "To afford nationally uniform treatment of reinsurers, FIO recommends that Treasury and the United States Trade Representative (USTR) pursue a covered agreement for reinsurance collateral requirements based on the National Association of Insurance Commissioners Credit for Reinsurance Model Law and Regulation." The United States and the EU have continued progress on procedural prerequisites defined by each jurisdiction's processes towards commencing negotiations on a covered agreement. By statute, USTR and FIO must give notice to Congress of the intent to commence negotiations. That notice is expected in the coming weeks.

APPENDIX

Update on Status of Recommendations Made in Modernization Report

Recommendation	**Status**
For material solvency oversight decisions of a discretionary nature, states should develop and implement a process that obligates the appropriate state regulator to first obtain the consent of regulators from other states in which the subject insurer operates.	While a process that obligates the appropriate state insurance regulator to first obtain the consent of regulators from other states in which an insurer operates may be in place on a state-by-state basis, FIO is unaware of any coordinated initiative that would extend such a process across states and in a consistent manner, or that would assure the continuity of such a process over time. With respect to larger insurers for which supervisory colleges have been established, the NAIC has developed guidance, in its Financial Analysis Handbook, but the guidance does not address the need for regulator consensus on discretionary material solvency oversight decisions. As a result, continued state-by-state differences remain.
To improve consistency of solvency oversight, states should establish an independent, third-party review mechanism for the National Association of Insurance Commissioners Financial Regulation Standards Accreditation Program.	Currently, only state insurance regulators, NAIC staff, and NAIC contractors are charged with evaluating states' compliance with the Accreditation Program. States often consult with the NAIC when considering adoption of model laws and regulations, yet it is the NAIC's legal staff that is solely responsible for assessing compliance of states with adoption of the key elements of model laws and regulations. To improve the reliability of this peer review structure, an additional independent review and audit layer would provide a helpful perspective on the uniformity, adoption, and implementation of capital rules and other standards. This independent review will also help to maintain the incentive for accreditation reviews to be conducted with appropriate and objective rigor. State insurance regulators have not taken action to adopt the recommendation and, as a result, the NAIC Accreditation Program remains lacking in independence.

Recommendation	**Status**
States should develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives.	The NAIC has developed and continues to implement a framework to enhance the regulation of reserve financing transactions associated with captive reinsurers for certain term life and universal life with secondary guarantee products. While this is a meaningful step forward, more work remains to be done. Additional information on reinsurance captives can be found in section V.D of this Report.
State-based solvency oversight and capital adequacy regimes should converge toward best practices and uniform standards.	The IAIS benefits from the experience and best practices of its members across jurisdictions, and aspires to an ultimate goal of a single ICS that will include a common methodology by which one ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions. State insurance regulators have been actively participating with FIO and the Federal Reserve in the activities at the IAIS including at the working group level involving the development and field testing of ComFrame and the proposed capital standards. As state insurance regulators, working through the Capital Development Working Group, evaluate approaches to a group capital assessment, the Federal Reserve continues work to promulgate a group capital standard for the insurers subject to its consolidated supervision. Independently or in tandem, these two developments will mark the first-ever U.S. supervisory group capital perspective. Consistent with past practice, whether at the state or federal level, implementation of an international standard should occur in a manner tailored to the unique features of the U.S. insurance sector, promote competition and consumer choice, safeguard policyholder protection and contribute to financial stability. Additional information on IAIS work related to solvency oversight and capital adequacy can be found in section VI.A.4 of this Report.

Recommendation	**Status**
States should move forward cautiously with the implementation of principles-based reserving and condition it upon: (1) the establishment of consistent, binding guidelines to govern regulatory practices that determine whether a domestic insurer complies with accounting and solvency requirements; and (2) attracting and retaining supervisory resources and developing uniform guidelines to monitor supervisory review of principles-based reserving.	The NAIC has developed a written implementation plan targeting a PBR effective date of January 1, 2017, followed by a three-year transition period before individual companies must comply. In the right circumstances, PBR can lead to more accurate reserve levels for life insurers. Establishing the regulatory framework for PBR by the target date will require significant resource commitment, coordination, and cooperation by the state insurance departments. Questions also remain about the propriety of state insurance regulators using contractors for essential regulatory services, especially basic regulatory functions such as the assessment of sophisticated models on which PBR will be based. Discussion on principles-based reserving can be found in section V.C.2 of this Report.

Recommendation	Status
States should develop corporate governance principles that impose character and fitness expectations on directors and officers appropriate to the size and complexity of the insurer.	On November 18, 2014, the NAIC Executive Committee and Plenary adopted the Corporate Governance Annual Disclosure Model Act (Corporate Governance Model Act) and the Corporate Governance Annual Disclosure Model Regulation (Corporate Governance Model Regulation). The Corporate Governance Model Act and Corporate Governance Model Regulation require an insurer (or group of insurers) to provide information regarding corporate governance practices ("corporate governance annual disclosure") to the lead state and/or domestic regulator annually by June 1. While some insurer discretion is permitted, the Corporate Governance Model Act and Corporate Governance Model Regulation require the insurer to provide information at least on its corporate governance framework and structure; the policies and practices of its Board and significant committees; the policies and practices directing senior management; and governance processes enforcing oversight over critical risk areas.[199] The first annual disclosures are scheduled to be due by June 1, 2016, for those states that adopt the Corporate Governance Model Act and Corporate Governance Model Regulation.[200] As of May 2015, not one state had adopted the model act or regulation. Under the new Corporate Governance Model Act and Corporate Governance Model Regulation, an insurer must describe its suitability standards to determine whether officers and key persons in control functions have the appropriate background, experience, and integrity to fulfill the role they hold. However, the model act and regulation do not impose any character and fitness requirements, on directors and officers.

[199] Commissioner Susan Donegan, "Recommendation for Part A Accreditation Standards and Guidelines for the Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation" (November 18, 2014), *available at* http://www.naic.org/documents/committees_e_isftf_corp_governance_exposure_recommended_accreditation_standards__corporate_gov_models.pdf).
[200] *Id*.

Recommendation	**Status**
In the absence of direct federal authority over an insurance group holding company, states should continue to develop approaches to group supervision and address the shortcomings of solo entity supervision.	In December 2014, the NAIC Executive Committee & Plenary approved amendments to the Model Insurance Company System Regulatory Act (Holding Company Act). These amendments provide for the supervision of certain internationally active insurance group by a group-wide supervisor, outline the process for determining a lead state for these insurance groups, and address confidentiality for information received through group-wide supervision.[201] Two states have adopted these amendments as of April 15, 2015.
State regulators should build toward effective group supervision by continued attention to supervisory colleges.	State insurance regulators and the Federal Reserve have established supervisory colleges for all U.S. insurance groups meeting the criteria for IAIGs, with 22 U.S. group colleges now meeting.[202] In addition, "[t]here are 12 supervisory colleges for insurance companies operating in the United States which have foreign parent companies."[203] However, this process is still in its infancy. In the 2015 Financial Sector Assessment Program, the International Monitory Fund (IMF) concluded that "[s]upervisory colleges have not yet developed a structured, shared view of group-wide risks, group-wide governance and risk management or (absent a U.S. or global group wide capital standard) a view on the financial condition of the group."[204]

[201] Insurance Holding Company System Regulatory Act § 7.1 (2015), *available at* http://www.naic.org/store/free/MDL-440.pdf; *see also* "NAIC Takes Action on Insurance Priorities" (Dec. 16, 2014), *available at* http://www.naic.org/Releases/2014_docs/naic_takes_action_on_insurance_priorities.htm.
[202] IMF, United States Financial Sector Assessment Program, "Detailed Assessment of Observance on Insurance Core Principles," 117 (April 2015), *available at* http://www.imf.org/external/pubs/ft/scr/2015/cr1590.pdf
[203] IMF, 2015 Financial Sector Assessment Program, Detailed Assessment of Observance on Insurance Core Principles, at 118 (April 2015).
[204] *Id*.

Recommendation	**Status**
FIO should engage in supervisory colleges to monitor financial stability and identify issues or gaps in the regulation of large national and internationally active insurers.	FIO's statutory mission to monitor all aspects of the insurance industry, including issues or gaps in regulation, and FIO's significant role with respect to financial stability, including as described in Title I, II and V of the Wall Street Reform Act, support the view that FIO should engage in the supervisory colleges for insurers subject to Federal Reserve supervision. While in its first years FIO has not sought such involvement, future participation will not only strengthen the U.S. system of insurance regulation but also support the global credibility of the U.S. insurance industry.
Federal standards and oversight for mortgage insurers should be developed and implemented.	On April 17, 2015, FHFA, Fannie Mae, and Freddie Mac issued "Private Mortgage Insurer Eligibility Requirements" (PMIERs). Fannie Mae and Freddie Mac may only purchase a mortgage with less than 20 percent down if the loan has mortgage insurance. PMIERs establish new business and capital/liquidity requirements for MIs and continue requirement for MIs to be licensed by the states and in good standing. State insurance regulators are in the process of developing new business and capital standards. Given the importance of the housing finance system to the U.S. economy, federal standards and oversight for mortgage insurers should be developed and implemented. Additional information on the regulation and oversight of mortgage insurers can be found in section V.I.1 of this Report.

Recommendation	**Status**
To afford nationally uniform treatment of reinsurers, FIO recommends that Treasury and the United States Trade Representative pursue a covered agreement for reinsurance collateral requirements based on the National Association of Insurance Commissioners Credit for Reinsurance Model Law and Regulation.	In both the United States and the EU, progress has continued on procedural prerequisites for negotiation of a covered agreement, defined by each jurisdiction's respective relevant law. Only when those processes are complete may any negotiations commence. The objective shared by FIO and USTR is to jointly consult with Congress in the coming weeks and, thereafter, to initiate negotiations on a covered agreement. Additional information on covered agreements can be found in section VI.B of this Report.
States should: (1) adopt a uniform approach to address the closing out and netting of qualified contracts with counterparties; and (2) develop requirements for transparent financial reporting regarding the administration of a receivership estate.	The NAIC's Insurance Receivership Model Act (IRMA) was adopted in 2006, and addresses the closing out and netting of Qualified Financial Contracts (QFCs) and financial reporting requirements. Through the end of 2014, only two states had adopted IRMA in its entirety, leaving this important regulatory gap unaddressed. While all states have receivership laws and/or regulations, their content varies greatly. States have made some progress in the adoption of provisions related to QFCs, with 21 states having adopted these provisions in a substantially similar form as of June 2015. Financial reporting requirements through a receivership proceeding remain minimal and inconsistent among states. In the area of receivership, inconsistencies between the states negatively impact consumers and impose inefficiencies without any benefit to the administration of the receivership.

Recommendation	Status
States should adopt and implement uniform policyholder recovery rules so that policyholders, irrespective of where they reside, receive the same maximum benefits from guaranty funds.	No significant changes have been made in state laws establishing or unifying coverage limits under state guaranty funds for P/C insurers across state lines. In the case of life insurers, two states and the District of Columbia have adopted the key 2009 revisions to the NAIC's Life and Health Insurance Guaranty Association Model Act (Model Life Guaranty Act) since publication of the Modernization Report, bring the total number of states that have adopted the revised Model Life Guaranty Act to 42. Additional information on state guaranty funds can be found in section V.F of this Report.

Recommendation	Status
States should assess whether or in what manner marital status is an appropriate underwriting or rating consideration.	In June 2015, the Supreme Court ruled that same-sex couples across the nation have a constitutional right to marry.[205] Over the last two years, the right to marry has been extended rapidly and widely for gays and lesbians, expanding to thirty-six states and the District of Columbia, through new laws, court rulings, or voter approval. The June decision opens marriage legally to the remaining fourteen states and confirms the rights of those who married before the Supreme Court had decided the constitutional question. Recent studies inspired by FIO's Modernization Report, show that marital status may contribute significantly to a consumer's premium. One study found that a widower may pay as much as 20 percent more after the death of a spouse.[206] Many consumers opt not to marry, or are divorced or widowed, and such consumers should not, as a consequence of that status, be expected to pay higher premiums for personal insurance products. For these reasons, it remains important that states continue to assess whether marital status is an appropriate underwriting or rating consideration. Additional information on the use of marital status in underwriting can be found in section IV.A.2 of this Report.

[205] *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015).
[206] Consumer Federation of America, "New Research Shows That Most Major Auto Insurers Vary Prices Considerably Depending on Marital Status" (July 27, 2015), *available at* http://www.consumerfed.org/news/1106.

Recommendation	Status
State-based insurance product approval processes should be improved by securing the participation of every state in the Interstate Insurance Product Regulation Commission (IIPRC) and by expanding the products subject to approval by the IIPRC. State regulators should pursue the development of nationally standardized forms and terms, or an interstate compact, to further streamline and improve the regulation of commercial lines.	Since the publication of the Modernization Report, one additional state joined the IIPRC bringing the IIPRC's members to 44 states.[207] In addition, the Modernization Report recommends state insurance regulators streamline the regulation of commercial insurance products. Toward this end, the Commercial Lines Working Group at the NAIC issued draft recommendations in May 2015 to streamline the regulation of commercial lines of insurance by: (1) revising the definition of an exempt commercial policyholder; (2) allowing the use of manuscript policies without prior approval; (3) establishing conditions under which polities for multistate risks would be exempt from form and rate filing requirements; and (4) encouraging states to review existing authority to improve the efficiency and effectiveness of rate and form review for commercial lines.[208] While these are important steps forward, the Commercial Lines Working Group recommends against the development of an interstate compact for commercial lines, thereby potentially preserving an unnecessary inefficiency that neither bolsters consumer protection nor promotes efficiency of insurance regulatory oversight. [209]

[207] IIPRC News Release, "Commission Elects New Officers and Releases Annual Report" (March 29, 2015), *available at* http://www.insurancecompact.org/releases/new_officers_and_annual_report.htm.
[208] Commercial Lines (EX) Working Group Draft Recommendations (June 29, 2015), *available at* http://www.naic.org/documents/committees_ex_spped_to_market_clwg_related_final_recommendations.pdf.
[209] *Id*.

Recommendation	**Status**
In order to fairly protect consumers in all parts of the United States, every state should adopt and enforce the National Association of Insurance Commissioners Suitability in Annuities Transactions Model Regulation.	Following several state-based market conduct examinations and investigations that revealed unsupervised sales of annuities that were not appropriate for the consumer's profile, the NAIC adopted a strengthened Suitability in Annuity Transactions Model Regulation (Model Suitability Regulation) in 2010. In both the Modernization Report and the 2014 Annual Report on the Insurance Industry, FIO recommends that the states adopt the Model Suitability Report so that prospective annuity owners nationwide would receive its consumer protections. Despite industry support for appropriate suitability standards, however, states have not uniformly adopted or implemented the Model Suitability Regulation. In 2014, two additional states adopted some version of the Model Suitability Regulation; one additional state acted in 2015, bringing the total number of state adoptions to 35, plus the District of Columbia. In order to fairly protect consumers in all parts of the United States, every state should adopt and enforce NAIC Suitability in Annuities Transaction Model Regulations. Additional information on the suitability in annuities and life insurance transactions can be found in section IV.C.2 of this Report.

Recommendation	**Status**
States should reform market conduct examination and oversight practices and: (1) require state regulators to perform market conduct examinations consistent with the National Association of Insurance Commissioners Market Regulation Handbook; (2) seek information from other regulators before issuing a request to an insurer; (3) develop standards and protocols for contract market conduct examiners; and (4) develop a list of approved contract examiners based on objective qualification standards.	In 2014, the NAIC's Market Regulation and Consumer Affairs (D) Committee identified a number of action items to address the Modernization Report's recommendations regarding market conduct examination and oversight practices. The Committee formed a working group to develop a formal market regulation accreditation program proposal for the states' consideration. In March 2015, the working group issued an initial draft of the accreditation program proposal.[210] As stated in the draft accreditation program proposal, the working group's objectives are: (1) to provide a process whereby state regulation of the conduct of regulated entities in the insurance marketplace can be enhanced and objectively monitored for the benefit of regulators, consumers, and the insurance industry; (2) create substantially similar standards and regulatory activities for market regulation among NAIC member jurisdictions; and (3) develop a formal market regulation accreditation proposal for consideration by NAIC. Although difficult, uniformity, coordination, and avoidance of redundancy are objectives state insurance regulators should pursue. Leadership of the Committee has done well to drive forward with this important initiative.
States should monitor the impact of different rate regulation regimes on various markets in order to identify rate-related regulatory practices that best foster competitive markets for personal lines insurance consumers.	The Modernization Report urges states to monitor the impact of different rate regulation regimes to identity rate-related regulatory practices that best foster competitive markets for consumers of personal insurance lines. In its consideration of a number of issues pertaining to personal lines insurance, the NAIC's Property and Casualty Insurance (C) Committee has not identified rate-related regulatory practices that best foster competitive markets, and the NAIC has failed to reply to FIO inquiries. Given the importance of efficient, competitive markets to both consumers and industry, FIO will now move forward to identify those states and markets where a reduction in rate oversight could be tested.

[210] The Market Regulation Accreditation (D) Working Group materials are *available at* http://www.naic.org/committees_d_mra_wg.htm.

Recommendation	Status
FIO will work with state regulators to establish pilot programs for rate regulation that seek to maximize the number of insurers offering personal lines products.	Rate regulation in the states continues to vary with some requiring prior approval, file and use, or use and file. Illinois remains the only state with an open market that does not regulate base rates for affordability. FIO will continue to work with state insurance regulators to examine rate reform models that resulted in increased competition in the states and to encourage promotion of successful models. Given the importance of efficient, competitive markets to both consumers and industry, FIO will now move forward to identify these states and markets where a reduction in rate oversight could be tested.
States should develop standards for the appropriate use of data for the pricing of personal lines insurance.	The ever-expanding universe of available personal information raises important questions regarding the boundaries or limitations on the use of that personal information to ensure insurers do not rely on impermissible or discriminatory factors. As the industry continues to evolve, innovate, and develop new uses for big data, and with some exceptions, state insurance regulators have failed to keep pace. The increasing use of price optimization techniques and the inclusion of consumer demand for a particular product in the development of risk classification (and thus pricing) offer state insurance regulators the opportunity to move forward with the Modernization Report's recommendation regarding the appropriate use of data in insurance pricing.
States should extend regulatory oversight to vendors that provide insurance score products to insurers.	Many states require insurers to provide additional information about vendor models during the rate review process. Insurance score vendors indicate that they have met with each state insurance regulator to describe the data and algorithms used in generating insurance scores, but state insurance regulators have not, with some exceptions, implemented oversight standards for these vendors. As a result, consumers may not be protected consistent with state insurance laws and regulations.

Recommendation	**Status**
FIO will study and report on the manner in which personal information is used for insurance pricing and coverage purposes.	The use of price optimization techniques by insurers in rate making has drawn the attention of state insurance regulators. Generally speaking, price optimization is the practice of using non-insurance related personal consumer information to select rates. As of July 31, 2015, six states have issued bulletins prohibiting insurers from using price optimization. The Affordability and Accessibility Subcommittee of the FACI is also examining insurer use of price optimization and issues relating to big data in rating. FIO will continue to monitor the regulatory oversight regarding the use of big data in insurance.
States should identify, adopt, and implement best practices to mitigate losses from natural catastrophes.	In September 2015, FIO released its report on the state of the U.S. market for natural catastrophe insurance, which addresses mitigation.[211] As discussed in that report, states can support mitigation measures through grant programs and tax incentives, sustainable land use policies, and the passage and enforcement of up-to-date building codes. Several states provide financial incentives for mitigation measures, including Alabama, Colorado, Florida, Louisiana, and South Carolina. Within the federal government and together with a broad group of stakeholders, FIO continues to support efforts to promote the effective coordination of private and public sector work relating to mitigation. This work also supports the resilience priorities of President Obama, exemplified by Executive Order 13653, which, among other things, established a State, Local, and Tribal Leaders Task Force on Climate Preparedness and Resilience, and Executive Order 13690, which established a Federal Flood Risk Management Standard that requires all future federal investments in and affecting floodplains to meet an increased level of resilience.

[211] NatCat Report section VIII.

Recommendation	Status
The National Association of Registered Agents and Brokers Reform Act of 2013 should be adopted and its implementation monitored by FIO.	On January 12, 2015, President Obama signed into law the National Association of Register Agents and Brokers Reform Act of 2015 (NARAB II) that provides a structure to streamline non-resident producer licensing and establish reciprocity.[212] Any licensed insurance producer meeting certain criteria may become a member of a newly created nonprofit organization, the National Association of Register Agents and Brokers (Association), which authorizes the insurance producer "to sell, solicit, or negotiate insurance in any State for which the member pays the licensing fee set by the State for any line or lines of insurance specified in the home State license of the insurance producer."[213] NARAB II, when established, will address the multi-state inefficiency caused by an insurance producer serving consumers in more than one state. Despite the constructive efforts of state insurance regulators, true uniformity and reciprocity were unlikely in the absence of federal involvement through NARAB II. FIO, in its role as advisor to the Secretary on major domestic insurance policy issues, is supporting the effort to implement NARAB II, and conduct oversight of the Association. Additional information on the implementation of NARAB II can be found in section V.H of this Report.

[212] NARAB II, Title II of the Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. 114-1; 129 Stat. 12 (2015).
[213] *Id*. at § 323(e)(1)(A).

Recommendation	**Status**
FIO will convene and work with federal agencies, state regulators, and other interested parties to develop personal auto insurance policies for U.S. military personnel enforceable across state lines.	Through consultations with insurers, state insurance regulators, and the Department of Defense, FIO has identified some actions that may be taken to accommodate the special auto insurance needs of U.S. military personnel. These actions include: forgiveness from an insurer for a lapse in policy when deployed overseas; states requiring insurers to allow a service member to maintain minimal coverage on certain garaged vehicles when deployed overseas; and insurers allowing grace periods for a policy change when a service member is transferred to another base within the United States. These issues remain of prominent importance given the valor and service of U.S. military personnel. With the increasing awareness and understanding of the personal insurance issues confronted by members of the armed forces, FIO will convene relevant stakeholders to find appropriate federal and/or state solutions.
FIO will consult with Tribal leaders to identify alternatives to improve the accessibility and affordability of insurance on sovereign Native American and Tribal lands.	FIO has consulted with interested stakeholders, including Tribal leaders, relevant federal agencies, state insurance regulators, and Native American advocacy groups about improving the accessibility and affordability of insurance for exposures on sovereign Tribal land. Through this consultation, many Tribal leaders demonstrated a sophisticated knowledge and understanding of insurance markets. Together with a number of insurers, some Tribal leaders have designed policies protecting the Tribal financial assets. In addition, these consultations affirmed the importance of understanding and including the unique perspective that Native Americans bring to all issues of insurance, not only those specific to Indian Country. For this reason, continued engagement with Tribal leaders, members, and advocates on insurance issues remains a priority.

Recommendation	Status
FIO will continue to monitor state progress on implementation of Subtitle B of Title V of the Dodd-Frank Act, which requires states to simplify the collection of surplus lines taxes, and determine whether federal action may be warranted in the near term.	Where the states failed to act in a uniform manner, industry participants began to pay surplus lines taxes to the insured's state of domicile. In effect, the industry developed a solution that provides much-needed efficiency.