

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

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I. INTRODUCTION

The 2014 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 (Dodd-Frank Act). Pursuant to this section, the FIO Director is required 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, i.e., the life and health (L/H) sector and the property and casualty (P/C) sector. The industry financial overview also includes analysis of insurance industry capital markets activity, the increasing prominence of non-U.S. reinsurers, and the expanding role of alternative risk transfer mechanisms such as insurance-linked securities.

The Report next includes a section focusing on matters of consumer protection and access to insurance. This section highlights developments concerning affordability of personal auto insurance; portability of auto insurance for servicemembers; force-placed insurance (FPI) for homeowners; and topics concerning life insurance and annuities.

The Report then addresses a range of developments – at the state, federal, and international levels – which have occurred or progressed over the past year, and which have implications for the U.S. insurance sector. Discussions of domestic activities include updates addressing: the insurance-related activities of the Financial Stability Oversight Council (Council); federal supervision of designated nonbank financial companies; licensing of insurance producers (brokers and agents); private equity acquisitions of annuity writers; terrorism risk insurance; flood insurance; and captive life reinsurance. The international section addresses the EU-U.S. Insurance Project, including reinsurance collateral reform; supervision of internationally active insurance groups and global systemically important insurers; and concludes with an update on progress in developing standards for the resolution of troubled or failing insurers.

B. Federal Insurance Office Activities

In Title V of the Dodd-Frank Act, Congress 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 on the Council, FIO is authorized, pursuant to the Dodd-Frank Act, to:

- 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;
- recommend to the Council that it designate an insurer as an entity subject to regulation as a nonbank financial company supervised by the Board of Governors of the Federal Reserve System (Federal Reserve);
- assist the Secretary in administering the Terrorism Risk Insurance Program established in Treasury under the Terrorism Risk Insurance Act of 2002 (TRIA);
- coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (IAIS) and assisting the Secretary in negotiating covered agreements; and

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).

- consult with the states regarding insurance matters of national importance and prudential insurance matters of international importance.

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 an insurance company under Title II of the Dodd-Frank Act, the Secretary must first receive a written recommendation from the FIO Director and the Federal Reserve.³

In December 2013, Treasury released FIO's report entitled "How to Modernize and Improve the System of Insurance Regulation in the United States" (the *Modernization Report*).⁴ The *Modernization Report* has received considerable attention from industry and other stakeholders. FIO will provide additional updates on progress in the areas addressed by the *Modernization Report* as events warrant. In that regard, several recommendations from the *Modernization Report* are discussed in this Report.

Box 1: Modernization Report

In the *Modernization Report*, FIO recognizes certain "limitations inherent in a state-based system of insurance regulation," and concludes that "the proper formulation of the debate at present is not whether insurance regulation should be state or federal but whether there are certain areas in which federal involvement in regulation under the state-based system is warranted."⁵ In this respect, the *Modernization Report* observes:

In all events, federal involvement should be targeted to areas in which that involvement would solve problems resulting from the legal and practical limitations of regulation by the states, such as the need for uniformity or the need for a federal voice in U.S. interactions with international authorities.⁶

Within this framework, the *Modernization Report* offers a range of recommendations grounded in the view that the U.S. system of insurance regulation can be modernized and improved through a combination of steps by the states and by the federal government. The recommendations include 18 areas which FIO recommends for near-term reform by the states, relating to capital adequacy and safety/soundness, insurer resolution practices, and marketplace regulation.⁷ Also included are nine areas recommended for direct federal involvement in insurance regulation.⁸

In April 2014, the Secretary and the other members of the President's Working Group on Financial Markets (PWG) released a report entitled "The Long-Term Availability and Affordability of Insurance for Terrorism Risk" (*PWG Report*).⁹ The Terrorism Risk Insurance Program, including legislative activity, is highlighted in section V.E of this Report.

3 12 USC § 5383(a)(1)(C).

4 The *Modernization Report* is available at <http://www.treasury.gov/initiatives/fio/reports-and-notice>.

5 *Modernization Report*, 5.

6 *Id.* at 6.

7 *Modernization Report*, 6-7 (in summary).

8 *Id.* at 7-8 (in summary).

9 President's Working Group on Financial Markets, *The Long-Term Availability and Affordability of Insurance for Terrorism Risk* (April 16, 2014), available at <http://www.treasury.gov/initiatives/fio/reports-and-notice>. See discussion in section V.E below.

The Federal Advisory Committee on Insurance (FACI), which provides advice and recommendations to FIO's Director,¹⁰ was active throughout 2013, and met in Washington, D.C. in March, June, and September 2013.¹¹ In July 2013, a new charter for FACI was approved which, among other things, increased the authorized membership of the committee to 21.¹² In January 2014, Treasury published a notice in the Federal Register,¹³ seeking candidates to fill the reconstituted FACI, and a group representing a cross-section of stakeholders was announced on August 14, 2014.¹⁴

Throughout 2013 and the first half of 2014, FIO has continued its work representing the United States in the IAIS in accordance with FIO authorities.¹⁵ FIO has also continued its work with the EU-U.S. Insurance Project.¹⁶ In April 2014, FIO published a notice in the Federal Register seeking comment regarding how to define and measure affordability of auto insurance. These and related undertakings are addressed in this Report.

10 Federal Advisory Committee Act, as amended, 5 U.S.C. App. 2.

11 FACI membership information, meeting agendas, and minutes, *available at* <http://www.treasury.gov/initiatives/fio/Pages/faci.aspx>.

12 FACI, *Renewed Charter* (July 29, 2013), *available at* <http://www.treasury.gov/initiatives/fio/Pages/faci.aspx>.

13 Fed. Reg. DOC No. 2014-00137 (January 9, 2014), *available at* <http://www.treasury.gov/initiatives/fio/reports-and-notice>.

14 Press Release, *Treasury Announces Appointments to The Federal Advisory Committee on Insurance* (August 4, 2014), *available at* <http://www.treasury.gov/press-center/media-advisories/Pages/08012014.aspx>.

15 See section VI.B of this Report.

16 The Project was first convened as a Steering Committee by FIO in 2012, and is addressed in section VI.A of this Report.

II. EXECUTIVE SUMMARY

A. U.S. Insurance Industry Financial Overview

Analysis of 2013 data demonstrates that U.S. insurers have continued to show resilience in the aftermath of the financial crisis. Gains in net income drove reported surplus of both the P/C and L/H sectors to record levels. At year-end 2013, the L/H sector reported approximately \$335 billion in capital and surplus, and the P/C sector reported approximately \$665 billion in capital and surplus.

Aggregate net written premiums for the L/H sector, however, declined slightly from the record level set in 2012, largely as a result of lower annuity sales, whereas P/C sector net written premiums grew modestly in 2013. The L/H and P/C sectors reported approximately \$583 billion and \$481 billion, respectively, of aggregate net written premiums in 2013.

Bottom-line numbers were encouraging. Record net income levels were achieved in 2013 for both the L/H and P/C industry sectors. The protracted low interest rate environment, however, has been a drag on net income, particularly for life insurers. To partially mitigate declining investment yields, insurers, as a sector, have marginally increased asset allocations towards lower rated and less liquid assets with longer durations, which indicates increased portfolio risks. The L/H sector benefitted from the performance of separate accounts, and recorded net income of \$44 billion for 2013, as compared to the previous record high of \$37 billion set in 2006. Lower catastrophe losses and favorable loss development contributed to higher net income for the P/C sector, which reached a record \$72 billion; the previous high net income was \$66 billion, also set in 2006.

Capital markets continued to demonstrate interest in the insurance industry. Improved market valuations allowed the insurance industry to raise \$5 billion in new equity capital over 2013. The industry also raised \$42 billion in new capital through debt markets, as interest rates remained historically low, albeit significantly higher than 2013.

Finally, the Report also highlights the continued importance of global reinsurance markets to the U.S. insurance industry. The Reinsurance Association of America (RAA) released data showing that at least 62 percent of U.S. reinsurance premiums are ceded to non-U.S. reinsurers. Capital markets are also increasingly involved with risk transfer, with investors attracted to catastrophe bonds and similar instruments offering investment returns that are uncorrelated with those of traditional financial products. Industry sources report that capital in the alternative risk transfer market segment grew to \$50 billion in 2013, a nearly 30 percent increase from year-end 2012.

B. Consumer Protection and Access To Insurance

The Dodd-Frank Act directs FIO to monitor access to affordable insurance for traditionally underserved communities, minorities, and low- and moderate-income consumers. Studies suggest that owning an automobile is associated with higher probability of employment and economic well-being. Laws in 49 states and the District of Columbia require automobile owners to maintain auto liability coverage (the single exception is New Hampshire). Accordingly, in 2013, FIO determined to focus initially on affordability of personal auto insurance, and in April 2014, FIO solicited public comments on this subject, which are currently under consideration.

On a related topic, the *Modernization Report* raises the issue of product approval requirements disproportionately impacting members of the armed forces. Recently, Congressman Ed Royce and Congresswoman Tammy Duckworth introduced the Servicemembers Insurance Relief Act, designed to allow servicemembers (and spouses) to maintain their existing personal auto insurance policies after receiving military orders requiring relocation across state lines.

In the area of life insurance and annuities, the Report describes developments involving the Death Master File (DMF), which is a Social Security Administration (SSA) database. A number of state revenue departments and insurance departments have asserted that in the past some life insurers failed to make sufficient efforts to determine whether policyholders had passed away and thus whether benefits were due to beneficiaries. Certain legal settlements and state laws now require life insurers to perform regular and frequent comparisons of records of

in-force life and annuity policies against the DMF or a comparable database in order to identify benefits which may be due. Changes have been recently made to the data included in the DMF and the laws governing who may access the DMF. Continued access to a comprehensive file of confirmed deaths for the purpose of identifying potential beneficiaries may not be available to non-government actors. FIO will monitor efforts of industry and regulators to identify suitable alternative data sources, while working with stakeholders to support appropriate access to the DMF.

In the *Modernization Report*, FIO urges adoption in all states of the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation (Model Suitability Regulation), in order to enhance and standardize consumer protection with respect to purchases of annuities. In this regard, the Report notes that 30 states have adopted the Model Suitability Regulation.

Finally, the Report examines regulatory responses to FPI abuses. Section 1463 of the Dodd-Frank Act amended the Real Estate Settlement Procedures Act (RESPA) to prohibit mortgage servicers from triggering FPI coverage unless certain conditions are met. State laws vest insurance regulators with a range of authorities relating to FPI, resulting in uneven borrower protections state-by-state.

C. U.S. Regulatory Developments

The Report addresses a number of U.S. regulatory developments related to the business of insurance. First, in 2013 the Council designated two insurers – American International Group, Inc. (AIG) and Prudential Financial, Inc. (Prudential) – to be subject to Federal Reserve supervision and to enhanced prudential standards. Nonbank financial companies that are designated by the Council must register with the Federal Reserve, which is responsible for establishing the applicable enhanced prudential standards. In 2014, AIG and Prudential submitted draft resolution plans to the Federal Reserve and the FDIC.

Next, the Report considers licensing of insurance producers and related issues of access to insurance and retirement products. Non-uniform state licensing requirements for insurance producers can present redundant or inconsistent obligations and exacerbate barriers to entry, factors that may have contributed to the 3 percent decline in life insurance sales, despite indications of unmet demand. In the *Modernization Report*, FIO recommends adoption and implementation of legislation known as the National Association of Registered Agents and Brokers Reform Act of 2013 (NARAB II). The U.S. House of Representatives passed a NARAB II bill in 2013; the Senate passed companion legislation in July 2014. FIO intends to monitor life insurance sales and the number of life insurance agents and brokers to ascertain whether policymakers should consider efforts beyond NARAB II to facilitate agent licensing and access to retirement security through life insurance and annuity products.

The Report also considers regulatory matters regarding acquisition of annuity companies by private equity firms. Several states have increased regulatory scrutiny of such transactions, reflecting concerns that management of private equity firms may have a relatively short investment horizon, which is not fully consistent with the inherent long-term nature of annuity business and obligations to contract holders. Similar interests are reflected in the state regulators' formation in 2013 of a Private Equity Working Group, which is currently developing relevant provisions for inclusion in financial analysis standards used by state insurance regulators to evaluate and consider for approval the proposed acquisitions of annuity companies by private equity firms.

The Report next considers terrorism risk insurance. The April 2014 *PWG Report* found that insurance for terrorism risk likely would be less available or less affordable in the absence of TRIA. Originally enacted in 2002, and scheduled to expire at the end of 2014, TRIA mandates availability of insurance for terrorism risk from the private market, and provides a federal backstop for losses from such exposures. The President's budget for fiscal year 2015 "proposes to extend [TRIA] and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality." Congress is considering proposals for TRIA's reauthorization.

The Report also discusses regulatory developments related to the National Flood Insurance Program (NFIP). NFIP is administered by the Federal Emergency Management Administration (FEMA) and provides property owners with flood insurance coverage. Approximately 5.6 million NFIP flood insurance policies are in force. Legislation enacted

in 2012 included measures intended to improve the financial position of NFIP by, among other things, eliminating certain premium subsidies and increasing minimum required deductible amounts. Implementation of many rate increases, however, were subsequently prohibited in March 2014 by enactment of the Homeowner Flood Insurance Affordability Act of 2014.

Finally, the Report considers developments relating to the use of captive reinsurers by life insurance companies. In the *Modernization Report*, FIO recommends that states “develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives.” The recommendation is addressed particularly to the practice by some U.S. commercial life insurers of transferring insurance risk to captive life reinsurance companies as a means of addressing certain regulatory reserve requirements for some life insurance and annuity products. Although changes have not yet been adopted, this issue has received attention at the Federal level and from some state insurance regulators since 2011-2012 through the first half of 2014.

D. International Developments

The Report addresses a number of international regulatory developments related to the business of insurance in the United States. The U.S. remains the world’s largest insurance market by premium volume, even though the nation’s share of worldwide premiums has declined over the last several years. The interests of U.S. consumers and industry stakeholders are enhanced by engagement at the federal level through various international forums intended to improve the efficacy and consistency of insurance supervisory standards among jurisdictions, to enhance financial stability, and to promote a level playing field for firms operating globally. In that regard, the final section of the Report provides updates regarding the EU-U.S. Insurance Project (the Project) and the international prudential standard-setting activities of the IAIS, and concludes with an update of resolution activities at the Financial Stability Board (FSB) and the IAIS. Progress has occurred in all of these areas.

In order to increase mutual understanding and enhance cooperation between the European Union (EU) and the United States on prudential insurance matters, FIO and state insurance regulators have continued engagement with European authorities through the Project. The Project is intended to promote business opportunity, consumer protection, and effective insurance supervision. Among other initiatives, in 2013 Project participants studied and compared the professional secrecy/confidentiality legal frameworks for a number of U.S. states and EU member states. In December 2013, the Project’s Steering Committee sponsored a Supervisory Colleges Best Practices Forum in Washington, D.C. In light of recent developments in the EU and the United States, and of progress to date on the Project, the Steering Committee revisited, and in July 2014 updated, its December 2012 Way Forward document (which addresses the Project’s objectives), and reaffirmed its commitment to the Project.

The *Modernization Report* includes a recommendation concerning the implementation of nationally uniform treatment of reinsurers with respect to reinsurance collateral through a “covered agreement.” The Dodd-Frank Act authorizes the Secretary, jointly with the United States Trade Representative (USTR), to negotiate and enter into a covered agreement with one or more foreign insurance regulatory authorities regarding prudential measures with respect to the business of insurance or reinsurance. Treasury and USTR are engaged jointly with respect to such a covered agreement.

After discussion of a potential covered agreement, the Report turns to the subjects of Global Systemically Important Insurers (G-SIIs) and Internationally Active Insurance Groups (IAIGs). In July 2013, the FSB identified nine G-SIIs, three of which are U.S.-based firms. At present, this list will be evaluated annually and, by November 2014, decisions will be made as to whether any major reinsurers should be added to the list. The FSB identifies G-SIIs in consultation with national authorities and the IAIS, which utilizes an FSB-approved methodology. Subject to implementation by national authorities, G-SIIs may be subject to enhanced supervisory requirements and policies, which could include enhanced group-wide supervision, recovery and resolution planning, and higher loss absorbency (HLA) capital requirements.

In July 2013, the FSB called upon the IAIS to develop international capital standards to apply to IAIGs: straightforward “backstop capital requirements” (now referred to as “basic capital requirements,” or BCR) to be developed by November 2014 to serve as a common baseline for the G-SII HLA requirements; HLA requirements, to be developed by the end of 2015, with implementation in January 2019; and a quantitative “insurance capital standard” (ICS) applicable to IAIGs, including G-SIIs, to be developed by 2018 in advance of implementation in 2019. Development of the ICS will begin with an initial consultation in late 2014. International standards developed under IAIS auspices are not self-executing—an international organization cannot unilaterally impose a standard or requirement on an insurer in the United States. Rather, in the United States, any decision to implement such standards will be a function either of the relevant state authority or, for an insurer subject to its consolidated supervision, the Federal Reserve.

The ICS will become a component of the Common Framework for the Supervision of IAIGs (ComFrame), a multidisciplinary framework for the group-wide supervision of IAIGs begun in 2009 that will address the FSB’s July 2013 request for the IAIS to develop a comprehensive, group-wide supervisory and regulatory framework. The initial data gathering and field testing exercise began in March 2014, focusing on data necessary to shape the development of the BCR and on valuation methodologies.

Finally, the Report addresses international developments concerning resolution of insurers. In 2013, both the FSB and the IAIS began development of international standards pertaining to the resolution of insurers. In late 2013, the FSB formed the Cross-Border Crisis Management Group for Insurers (iCBCM) to assist and support authorities in implementing resolution-related policy measures for G-SIIs. Concurrently, the IAIS formed a committee known as the Resolution Working Group, to develop and maintain supervisory guidance on the resolution of insurers. FIO serves as a member of the iCBCM and of the Resolution Working Group.

III. U.S. INSURANCE INDUSTRY FINANCIAL OVERVIEW

U.S. insurers continued to show resilience in the aftermath of the financial crisis.¹⁷ Life and health insurance sector premiums grew consistently from 2010 to 2012, with high growth rates in the annuity business and moderate growth rates in the life and accident and health businesses. In 2013, L/H sector premiums decreased modestly. Investment yields continued to decline as higher-yielding bonds matured and proceeds were reinvested during a low-interest rate environment. However, total investment income continued to increase due to the sector's current increased base of invested assets. The L/H sector's 2013 pretax operating margin of 8 percent – reflective of underwriting deductions more than offsetting the decline in total revenue – was a new high, which contributed to the sector's 13 percent return on average equity. Both the L/H sector's reserves and surplus grew to record levels.

Property and casualty insurance sector premiums have grown consistently since 2010, and reached a record high of \$471 billion on a net earned basis in 2013. The P/C sector's combined ratio (addressed below in section III.A.3.b) for 2013 dropped below 100 percent for the first time since 2007, which was largely attributable to a reduction in catastrophe losses. As with the L/H sector, P/C sector investment yields continued to decline, and – unlike the L/H sector – the P/C sector's investment income declined as well. Nonetheless, net income of \$72 billion in 2013 was the highest level for the P/C sector since 2007, which drove surplus to a record level of \$665 billion.

A. Financial Performance and Condition

This section focuses on the aggregate financial performance and condition of the 924 L/H insurers and the 2,758 P/C insurers licensed in the United States.¹⁸ The products offered by the L/H sector fall into one of 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 cover expenses for health and long-term care or provide income in the event of disability. P/C sector products 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).

Net written premiums for the L/H sector were approximately \$583 billion in 2013, 55 percent of net written premiums for the combined L/H and P/C sectors.¹⁹ For the P/C sector, net written premiums were approximately \$481 billion, 45 percent of net written premiums for the combined L/H and P/C sectors. As of December 31, 2013, the L/H sector held approximately \$5.8 trillion of total assets (including \$2.3 trillion held in separate accounts), while the P/C sector held approximately \$1.5 trillion.

Figures 1 and 2 provide snapshots of the L/H sector marketplace, listing the largest ten L/H insurance groups by 2013 direct premiums written and the relative market distribution in terms of premium volume for life insurance (including annuities and other deposit-type contracts) and for A&H lines of business, respectively. The premiums reflected in Figures 1 and 2 aggregate all L/H sector products and all geographies of the United States.²⁰

17 Except as otherwise indicated, data cited in this section of the Report are as of December 31, 2013, as derived from SNL Financial, LC (SNL Financial) on April 14, 2014. These data are on a statutory accounting basis. SNL Financial continuously updates its data for corrections in filings; 2012 and prior data in this report are based on the updated data available as of April 14, 2014, and thus may differ in some respects from corresponding figures reported in FIO's 2013 annual report. 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.

18 Source: *A.M. Best Aggregates and Averages* (2013). The L/H and P/C sectors are the primary insurance industry sectors in the United States. There are other sectors, notably reinsurers and companies licensed solely as health insurers or as health maintenance organizations, but which are not the focus of this Report.

19 Net written premium means direct written premium less net ceded reinsurance premium.

20 Premiums have been updated for completed mergers as of December 31, 2013.

Figure 1: L/H Insurance Groups by 2013 U.S. Life Insurance Lines Direct Premiums Written

2012 Rank	2013 Rank	Insurance Group	2012 Direct Premiums Written (\$000)	Share of Total (%)	2013 Direct Premiums Written (\$000)	Share of Total (%)
1	1	MetLife Inc.	\$ 102,321,495	16.62	\$ 85,001,696	14.91
2	2	Prudential Financial Inc.	85,852,775	13.94	41,407,447	7.26
3	3	Jackson National Life Group	24,206,866	3.93	25,728,116	4.51
9	4	AEGON	19,695,559	3.20	24,499,916	4.30
6	5	Lincoln National Corp.	21,004,314	3.41	24,274,104	4.26
4	6	New York Life Insurance Group	24,010,473	3.90	24,223,396	4.25
NR	7	American International Group	16,321,551	2.65	21,698,620	3.81
5	8	Voya Financial Inc.	23,513,207	3.82	20,228,599	3.55
7	9	Manulife Financial Corp.	20,965,672	3.41	19,263,216	3.38
10	10	Principal Financial Group Inc.	18,336,972	2.98	18,909,411	3.32
		Combined Top 10	\$ 360,659,085	58.57	\$ 305,234,521	53.54
		Combined Top 25	\$ 506,633,053	82.28	\$ 456,565,190	80.09
		Combined Top 100	\$ 608,517,542	98.83	\$ 562,770,115	98.72
		Total U.S. Life Insurance Lines	\$ 615,728,408		\$ 570,052,825	

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

The data in Figure 1 for life and annuity business, and in the comparable charts that follow for other lines of business, are aggregated at a group level from filings made with state insurance regulators by individual legal entity insurers. For example, figures for MetLife, Inc. include the premiums written by all of its insurance subsidiaries in the United States, but exclude business written by affiliates in other jurisdictions.

Figure 1 shows a \$44 billion decrease in premium reported by Prudential Financial, Inc. from 2012 to 2013, which alone accounts for most of the \$46 billion decrease in premium reported by the entire L/H sector. In 2012, Prudential reported \$32 billion of premiums reflecting two significant pension risk transfer transactions, one involving General Motors Corp. and the other involving Verizon Communications, Inc. Prudential did not report similar large pension risk transfers in 2013. For the L/H sector, weakness in international operations, including an unfavorable currency impact, was responsible for much of the remaining decline in revenues.

Prior to its spinoff in an initial public offering by parent company ING Groep N.V. in 2012, Voya Financial, Inc. (which is ranked 8th in 2013, as shown in Figure 1) was known as ING U.S. (as reported in FIO's 2013 annual report).

Figure 2: L/H Insurance Groups by 2013 U.S. A&H Lines Direct Premiums Written

2012 Rank	2013 Rank	Insurance Group	2012 Direct Premiums Written (\$000)	Share of Total (%)	2013 Direct Premiums Written (\$000)	Share of Total (%)
1	1	UnitedHealth Group Inc.	\$ 40,049,291	22.57	\$ 41,801,793	23.13
3	2	Aetna Inc.	17,795,729	10.03	20,451,510	11.32
2	3	Humana Inc.	19,349,478	10.90	20,392,275	11.28
4	4	Aflac Inc.	17,484,089	9.85	15,371,911	8.51
5	5	Cigna Corp.	11,395,283	6.42	12,574,953	6.96
6	6	MetLife Inc.	8,623,170	4.86	6,285,051	3.48
7	7	Unum Group	5,207,865	2.93	5,236,873	2.90
8	8	Mutual of Omaha Insurance Co.	3,005,592	1.69	3,092,753	1.71
9	9	Guardian Life Ins Co. of America	2,860,623	1.61	3,029,428	1.68
10	10	Assurant Inc.	2,606,401	1.47	2,638,169	1.46
		Combined Top 10	\$ 128,377,521	72.34	\$ 130,874,717	72.42
		Combined Top 25	\$ 153,275,755	86.37	\$ 156,048,648	86.35
		Combined Top 100	\$ 175,632,230	98.97	\$ 178,888,871	98.99
		Total U.S. A&H Lines	\$ 177,458,495		\$ 180,720,128	

Source: SNL Financial

Figure 2 reflects A&H premium written by companies authorized to offer both life and health insurance; it excludes A&H premium written by companies authorized only to offer health insurance. Therefore, the data for a specific group listed in Figure 2 do not necessarily reflect that group's entire health insurance premium on a consolidated basis. For example, Figure 2 indicates that UnitedHealth Group Inc. (UHG) reported almost \$42 billion of U.S. health premium in 2013; however, that amount includes A&H premiums reported by UHG's subsidiaries that are authorized to offer life and health insurance, but excludes \$51 billion of such premium written by other UHG subsidiaries authorized only to offer health insurance.

As noted above, P/C insurers underwrite a variety of products, generally categorized as either personal lines or commercial lines. Figure 3 reports market share information on a combined P/C sector basis, which is then detailed for commercial lines (Figure 4) and personal lines (Figure 5).

Figure 3: P/C Insurance Groups by 2013 U.S. Combined Lines Direct Premiums Written

2012 Rank	2013 Rank	Insurance Group	2012 Direct Premiums Written (\$000)	Share of Total (%)	2013 Direct Premiums Written (\$000)	Share of Total (%)
1	1	State Farm Mutual Automobile Insurance Company	\$ 53,654,237	10.24	\$ 55,994,246	10.29
2	2	Liberty Mutual Insurance	28,297,511	5.40	28,906,283	5.31
3	3	Allstate Corp.	26,652,040	5.09	27,583,581	5.07
6	4	Berkshire Hathaway Inc.	20,237,537	3.86	23,169,106	4.26
5	5	Travelers Companies Inc.	22,695,958	4.50	22,842,941	4.20
7	6	Farmers Insurance Group of Companies	18,311,402	3.50	18,284,148	3.36
8	7	Nationwide Mutual Group	17,042,933	3.25	18,079,537	3.32
4	8	American International Group	23,596,418	4.50	17,802,678	3.27
9	9	Progressive Corp.	16,559,746	3.16	17,562,610	3.23
10	10	USAA Insurance Group	13,286,274	2.54	14,562,012	2.67
		Combined Top 10	\$ 240,334,056	45.88	\$ 244,787,141	44.97
		Combined Top 25	\$ 335,975,458	64.13	\$ 344,342,667	63.25
		Combined Top 100	\$ 447,198,010	85.36	\$ 462,354,340	84.93
		Total U.S. P/C Sector	\$ 523,879,204		\$ 544,386,565	

Source: SNL Financial (includes all lines of business)

Figure 4: P/C Insurance Groups by 2013 Commercial Lines Direct Premiums Written

2012 Rank	2013 Rank	Insurance Group	2012 Direct Premiums Written (\$000)	Share of Total (%)	2013 Direct Premiums Written (\$000)	Share of Total (%)
1	1	American International Group	\$ 18,217,418	7.05	\$ 16,503,438	6.09
2	2	Travelers Companies Inc.	15,683,525	6.07	16,126,917	5.95
3	3	Liberty Mutual Insurance	14,775,848	5.72	14,535,081	5.37
4	4	Zurich Insurance Group	10,206,436	3.95	10,816,040	3.99
5	5	ACE Ltd.	8,294,989	3.21	8,691,889	3.21
6	6	CNA Financial Corp.	8,011,222	3.10	8,440,261	3.12
8	7	Hartford Financial Services	7,260,797	2.81	7,370,550	2.72
7	8	Chubb Corp.	7,265,129	2.81	7,343,526	2.71
9	9	Nationwide Mutual Group	6,637,002	2.57	7,338,123	2.71
10	10	American Financial Group Inc.	4,426,418	1.71	4,819,736	1.78
		Combined Top 10	\$ 100,778,784	19.24	\$ 101,985,561	18.73
		Combined Top 25	\$ 150,308,795	28.69	\$ 155,383,266	28.54
		Combined Top 100	\$ 217,293,018	41.48	\$ 228,501,508	41.97
		Total U.S. P/C Commercial Lines	\$ 258,489,095		\$ 270,826,865	

Source: SNL Financial

Figure 5: P/C Insurance Groups by 2013 U.S. Personal Lines Direct Premiums Written

2012 Rank	2013 Rank	Insurance Group	2012 Direct Premiums Written (\$000)	Share of Total (%)	2013 Direct Premiums Written (\$000)	Share of Total (%)
1	1	State Farm Mutual Automobile Insurance Company	\$ 48,615,654	18.92	\$ 50,916,278	19.07
2	2	Allstate Corp.	24,644,986	9.59	25,496,146	9.55
3	3	Berkshire Hathaway Inc.	16,749,914	6.52	18,623,188	6.98
5	4	Progressive Corp.	14,469,788	5.63	15,407,391	5.77
4	5	Farmers Insurance Group of Companies	15,102,763	5.88	14,910,460	5.58
6	6	Liberty Mutual Insurance	12,982,666	5.05	14,369,723	5.38
7	7	USAA Insurance Group	12,304,404	4.79	13,495,247	5.05
8	8	Nationwide Mutual Group	10,400,481	4.05	10,731,733	4.02
9	9	Travelers Companies Inc.	7,011,234	2.73	6,714,829	2.52
10	10	American Family Mutual	5,501,428	2.14	5,820,136	2.18
Combined Top 10			\$ 167,783,319	65.29	\$ 176,485,132	66.10
Combined Top 25			\$ 202,931,409	78.97	\$ 211,837,110	79.34
Combined Top 100			\$ 242,012,179	94.18	\$ 251,246,671	94.10
Total U.S. P/C Personal Lines			\$ 256,977,212		\$ 266,987,275	

Source: SNL Financial

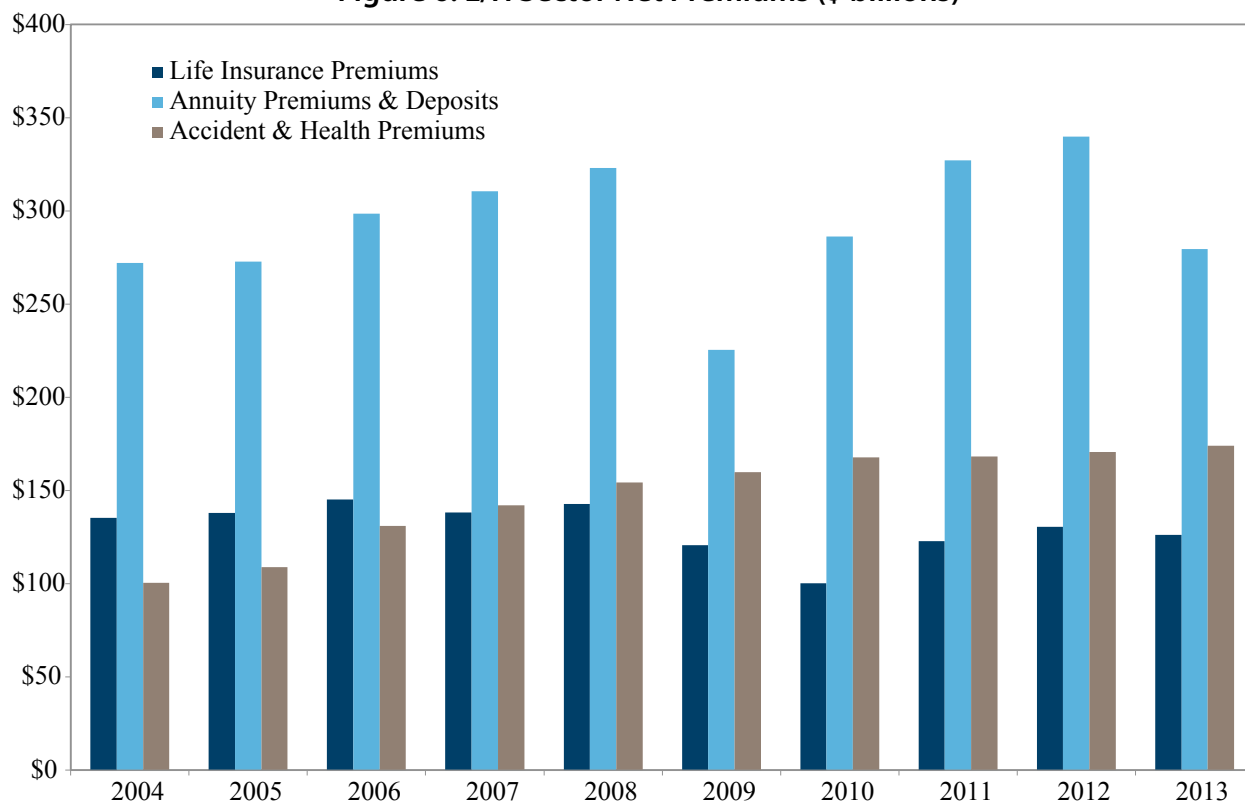
1. Life and Health Sector Performance

This section presents additional analysis of the financial performance of the L/H sector. It is followed by a section that analyzes the financial condition of the sector.

a. L/H Sector Net Written Premiums

Approximately 74 percent of L/H sector revenues in 2013 were derived from premiums charged for insurance and financial products and services; the remaining 26 percent were largely comprised of earnings on investments, and administrative fees charged for asset management services. Net written premiums (i.e., direct written premiums less net reinsurance premiums ceded) is a principal measure of the size and growth of the insurance industry. L/H sector net written premiums decreased 9.6 percent from \$645 billion in 2012 to \$583 billion in 2013. As shown in Figures 6 and 7, life insurance sold to individuals and through groups generated 22 percent of 2013 sector net written premiums; annuity products generated 48 percent; and the balance originated from A&H business. Year-over-year net written premiums for annuity products declined by 18 percent from 2012 to 2013. However, 2012 net written premiums were elevated due to several one-time transactions.²¹ Additionally, a significant increase in net reinsurance premiums ceded in 2013 contributed to the decline in net written premiums from the 2012 levels.

21 For example, as mentioned above, Prudential reported large pension risk transfer transactions in 2012 with General Motors and Verizon. In addition, MetLife, Inc. transferred much of a large subsidiary's business to a Japanese entity.

Figure 6: L/H Sector Net Premiums (\$ billions)

Source: SNL Financial

Figure 7: L/H Sector Net Premiums, Considerations, and Deposits (\$ thousands)

	2009	2010	2011	2012	2013
Life Insurance Premiums	\$ 120,602,044	\$ 100,301,700	\$ 122,849,095	\$ 130,585,518	\$ 126,121,966
Annuity Premiums & Deposits	225,476,691	286,318,850	326,985,000	339,914,846	279,434,352
Accident & Health Premiums	159,692,598	167,775,601	168,280,298	170,696,986	173,881,847
Credit Life & Credit A&H Premiums	1,597,676	1,566,013	1,582,995	1,556,674	1,445,214
Other Premiums & Considerations	541,155	23,116,619	2,071,361	2,247,325	2,345,598
Total	\$ 507,910,165	\$ 579,077,796	\$ 621,753,041	\$ 645,004,669	\$ 583,228,977

	2009	2010	2011	2012	2013
Life Insurance Premiums	24%	18%	20%	20%	22%
Annuity Premiums & Deposits	45%	52%	53%	53%	48%
Accident & Health Premiums	32%	30%	27%	27%	30%
	100%	100%	100%	100%	100%

Source: SNL Financial

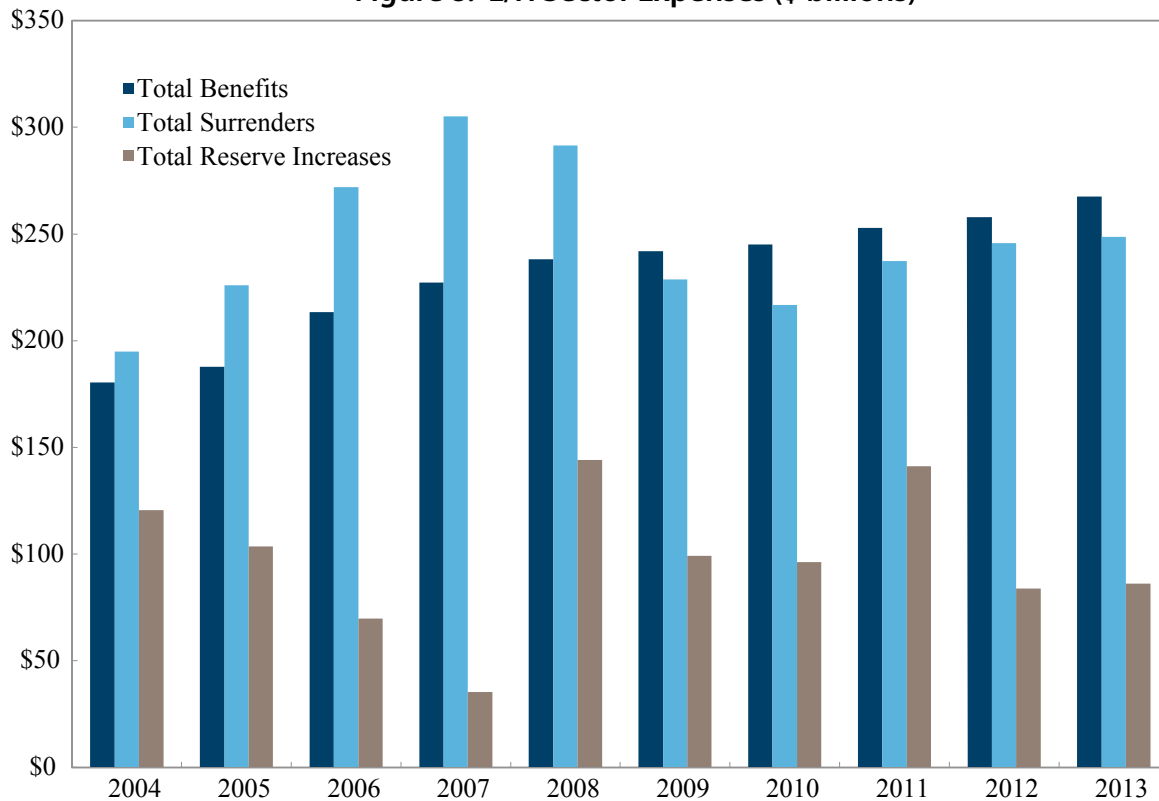
The trends displayed in Figures 6 and 7 are moderated by certain sizable transactions that took place within the L/H sector. For example, after considering the effects of Prudential's \$32 billion pension risk transfer transactions with General Motors and Verizon in 2012, the trend in annuity premiums and deposits would otherwise reflect a peak in 2011 and a fairly constant decline in 2012 and 2013. Accordingly, the surge in annuity premiums and deposits that occurred in the immediate post-crisis years appears to have tempered, with growth rates returning to more historic levels.

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

Policyholder contract benefits are claims or obligations of L/H insurers under life insurance, annuities, and other contracts and policies. Payments made for such benefits, in addition to contract surrenders, make up a majority of total expenditures for life insurers. Non-benefit-related expenses include general administrative and overhead expenses, expenses associated with acquiring business (particularly producer commissions), and expenses related to payments made under the contract provisions of policies, including loss verification and adjustment expenses. Figures 8 and 9 show aggregate L/H sector contract benefit payments, surrenders, reserve increases, and all other such expenses for recent years.

Benefit payments for a given portfolio of traditional life insurance contracts generally are relatively stable and predictable in the aggregate by reference to industry mortality tables or insurer experience. In contrast, benefits related to early withdrawals or surrenders on annuity contracts are more variable and dependent upon prevailing economic conditions (e.g., perceived market trends and demand for liquidity and policyholder behavior).

Figure 8: L/H Sector Expenses (\$ billions)



Source: SNL Financial

Figure 9: L/H Sector Expenses (\$ thousands)

	2009	2010	2011	2012	2013
Total Benefits	\$ 241,951,183	\$ 245,202,462	\$ 252,824,756	\$ 257,802,350	\$ 267,561,545
Total Surrenders	228,688,291	216,846,768	237,281,879	245,728,482	248,768,643
Total Increase in Reserves	99,218,977	96,166,722	141,209,745	83,794,837	86,244,543
Total Transfers to Separate Accounts	11,116,048	29,273,192	32,427,626	61,550,512	(771,567)
Commissions	48,852,836	49,269,277	51,806,167	53,074,542	53,473,791
General & Administrative Expenses	53,926,832	56,622,977	58,329,619	59,322,808	60,860,108
Insurance Taxes, Licenses and Fees	7,242,629	7,703,444	7,973,939	8,209,470	8,389,052
Other Expenses	7,411,928	2,202,678	8,135,096	6,684,742	(371,069)
Total	\$ 698,408,725	\$ 703,287,521	\$ 789,988,825	\$ 776,167,743	\$ 724,155,044

Source: SNL Financial

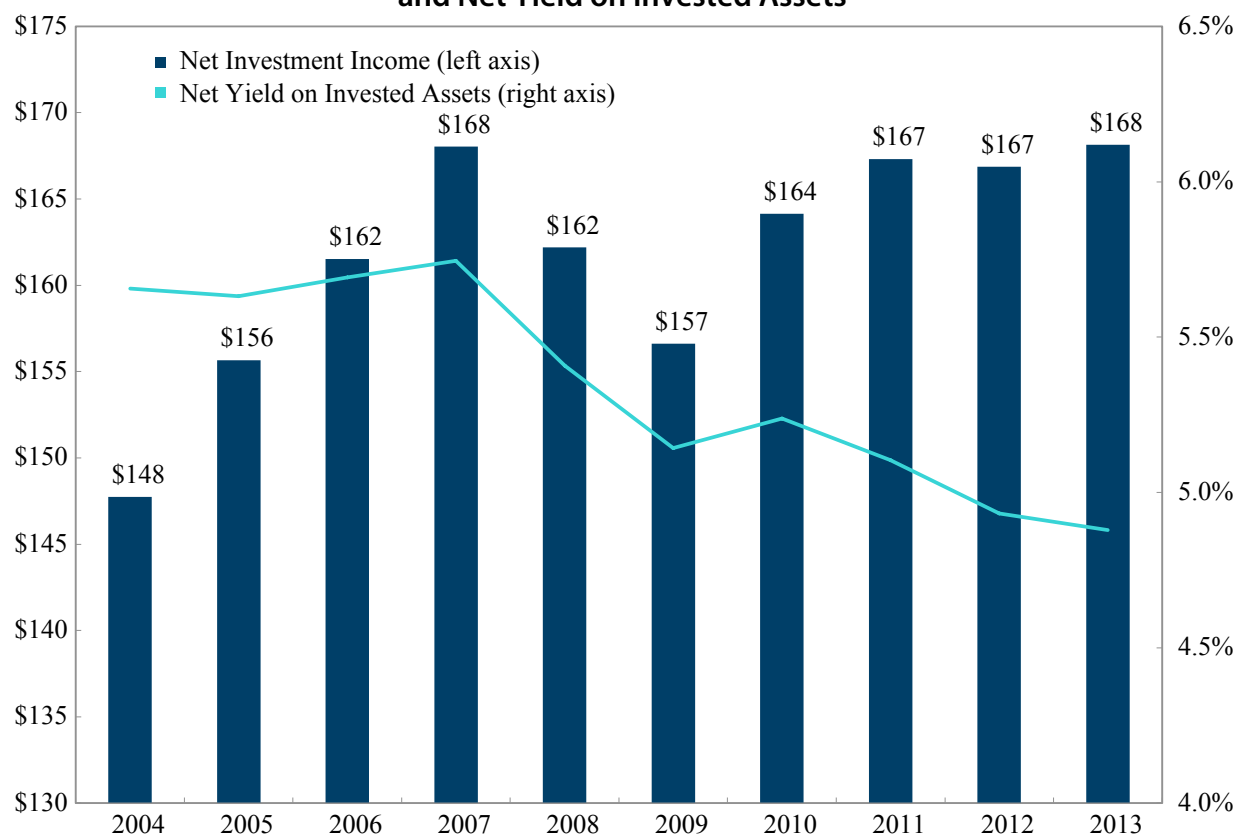
Total expenses for the L/H sector declined by 7 percent between 2012 and 2013. Notably, that decrease was attributable to a significant shift in transfers made by contract-holders to products in insurers' separate accounts.²² The industry had a net transfer of more than \$61 billion from general accounts to separate accounts in 2012; by contrast, there was a net transfer from separate accounts to general accounts of approximately \$800 million in 2013. 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.²³ Excluding such transfers, total expenses would have shown an increase of approximately 1 percent overall, led by a 4 percent increase in policyholder benefits expenditures. Total policy surrenders also increased slightly, rising 1 percent, but as a percentage of premiums (43 percent in 2013) remained well below levels experienced in the financial crisis (a peak of 50 percent in 2007).

c. L/H Sector Investment Income

As noted above, investment income represents a substantial portion of revenues for the L/H sector. Figures 10 and 11 display L/H sector net investment income from invested assets (excluding net realized gains and losses on the sale or disposition of investments) and net yields for recent years.

22 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 the contract-holder retains the investment risks. For U.S. insurance accounting purposes, a transfer from a firm's general account to a separate account is not viewed as an intra-company transaction.

23 Examples of macroeconomic factors that may affect a contract-holder's decision to surrender an annuity contract may include market investment rates relative to the crediting rate in the contract, the extent to which any guaranteed benefits are "in the money" due to the performance of underlying linked funds, and overall economic growth rates.

Figure 10: 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)

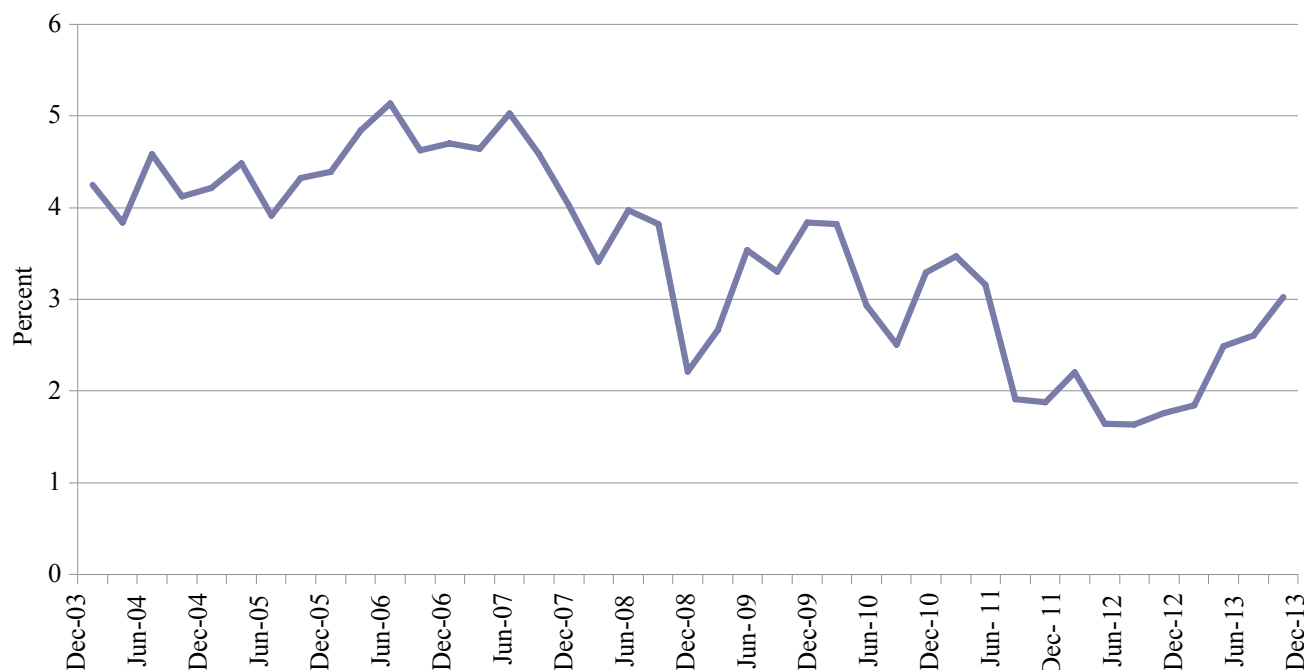
Figure 11: L/H Sector Investment Income (\$ thousands) and Net Yield

	2009		2010		2011		2012		2013
Net Investment Income	\$	156,618,379	\$	164,137,870	\$	167,322,081	\$	166,875,784	\$ 168,153,480
Total Cash & Investments		3,071,852,481		3,196,195,125		3,360,535,194		3,407,076,064	3,486,258,631
Net Yield on Invested Assets		5.14%		5.24%		5.10%		4.93%	4.88%

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

Despite a significant rise in longer term interest rates in 2013 (shown in Figure 12), the L/H sector continued to report investment margins that were lower than historic averages. Net investment income increased by slightly less than 1 percent in 2013. If interest rates remain low relative to historical levels, L/H insurers might face more challenges in generating investment returns that are sufficient to meet the cash flow demands of liabilities. To counter that trend, some L/H insurers have modestly extended portfolio durations or invested in lower credit quality fixed income assets, or both. Movement into longer-duration and lower quality assets may increase the vulnerability of L/H insurers to potential adverse effects of spikes in interest rates. For example, under such a scenario insurers may not be able to increase benefits rapidly enough to stem surrenders as contract-holders pursue higher yields elsewhere, and thus insurers may have to fund surrenders with asset sales at reduced prices.

Figure 12: Yield on 10-Year U.S. Treasury Bond



Source: Bloomberg LP

As shown in Figure 13, some insurers also have increased investments in commercial mortgage loans, real estate, and “alternative” assets such as private equity funds and hedge funds, all of which generally are less liquid than investment-grade fixed income investments. Of note are the 10 percent growth in “other investments” and the 5 percent growth in both mortgage loans and real estate in 2013.²⁴ Price volatility associated with less liquid assets could result in realized capital losses if such assets had to be sold at distressed prices in periods of economic or financial stress.²⁵

Figure 13: L/H Sector Invested Asset Compositions (\$ thousands)

	2009	2010	2011	2012	2013
Bonds	\$ 2,291,057,257	\$ 2,426,488,366	\$ 2,536,155,853	\$ 2,547,199,096	\$ 2,605,041,316
Preferred Stocks	11,685,702	9,116,406	8,082,049	7,781,708	8,259,459
Common Stocks	62,220,108	68,737,147	70,349,507	70,211,569	72,359,480
Mortgage Loans	315,953,480	307,376,528	323,083,104	335,600,765	353,154,594
Real Estate	19,463,203	19,690,208	20,586,580	21,379,092	22,362,069
Contract Loans	120,008,543	123,488,426	125,976,873	127,480,723	128,437,620
Derivatives	NA	21,575,963	44,356,616	41,576,588	37,806,864
Cash & Short Term Investments	121,896,715	95,063,036	96,485,538	106,605,897	94,710,208
Other Investments	129,567,474	124,659,046	135,459,074	149,240,626	164,127,020
Total Cash & Investments	\$ 3,071,852,481	\$ 3,196,195,125	\$ 3,360,535,194	\$ 3,407,076,064	\$ 3,486,258,631

Source: SNL Financial

²⁴ 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 13 excludes \$2.3 trillion held in separate accounts.

²⁵ Sustained low interest rates are associated with some additional risk-taking in non-U.S. insurance markets as well. See, e.g., *2013 Annual Report*, European Insurance & Occupational Pensions Authority (EIOPA), available at <https://eiopa.europa.eu/publications/annual-reports/index.html>; EIOPA Risk Dashboard (June 2014), available at https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/fn-stability/Risk_Dashboard/EIOPA-FS-14-057_EIOPA_Draft_Risk_Dashboard_-_June_2014.pdf (“Low interest rate environment continues.” “In the search for yield, equity exposure in some countries increased.”).

For 2013, the L/H sector recorded net capital losses of \$12 billion, an increase of 27 percent compared to the 2012 loss. Losses on derivative securities were only partially offset by realized gains on sales of bonds. L/H insurer portfolio compositions must comply with state laws regarding insurer investments, including diversification and credit quality requirements.

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

Figure 14 presents a summary income statement for the L/H sector. Pressure on net premiums and considerations and low gains in investment income led to a 6 percent decline in total revenues in 2013. However, expenses (Figure 9) decreased at a faster rate, resulting in a 7 percent increase in both pretax operating income and net income. Both profit measures reached record highs for the L/H sector. Figure 15 depicts key operating ratios for the L/H sector. The L/H sector's 2013 pretax operating margin of 8 percent stands as a new high. The gains in operating and net income resulted in an increase to the sector's return on average equity (ROAE), which exceeded 13 percent in 2013. Notwithstanding the increase relative to 2012, the sector's ROAE was below pre-financial crisis levels.

Figure 14: L/H Sector Net Income (\$ thousands)

	2009	2010	2011	2012	2013
Premiums, Consideration & Deposits	\$ 507,910,165	\$ 579,077,796	\$ 621,753,041	\$ 645,004,669	\$ 583,228,977
Net Investment Income	156,618,379	164,137,870	167,322,081	166,875,784	168,153,480
Reinsurance Allowance	61,517,250	(29,286,964)	(16,268,042)	(30,779,711)	(21,256,735)
Separate Accounts Revenue	20,375,256	23,360,670	26,085,983	29,516,598	31,425,611
Other Income	30,319,602	36,033,132	36,078,156	41,256,262	43,094,243
Total Revenue	776,740,653	773,322,505	834,971,218	851,873,602	804,645,576
Total Expenses	698,408,725	703,287,521	789,988,825	776,167,743	724,155,044
Policyholder Dividends	15,004,998	14,985,542	15,099,874	15,211,990	15,704,870
Net Gain from Operations before Tax	60,972,276	53,084,270	28,002,719	60,493,710	64,785,663
Federal Income Tax	10,649,771	8,955,196	5,056,898	10,149,451	8,886,790
Net Income before Capital Gains	50,257,907	44,075,051	22,895,712	50,344,257	55,898,873
Net Realized Capital Gains (Losses)	(28,704,553)	(16,022,641)	(8,534,613)	(9,448,168)	(12,026,682)
Net Income	\$ 21,528,259	\$ 28,049,199	\$ 14,364,501	\$ 40,896,084	\$ 43,872,190

Source: SNL Financial

Figure 15: L/H Sector Operating Ratios (%)

	2009	2010	2011	2012	2013
Pre-Tax Operating Margin	7.85	6.86	3.35	7.10	8.05
Return on Average Equity	7.94	9.39	4.66	12.79	13.22
Pre-Tax Operating Return On Average Equity	22.48	17.78	9.08	18.92	19.52
Return on Average Assets	0.46	0.56	0.27	0.74	0.75

Source: SNL Financial

2. Life and Health Sector Condition

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

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

Figure 16 shows the financial condition of the L/H sector as represented by its assets, capital and surplus, and leverage ratios.

Figure 16: L/H Sector Capital & Surplus (\$ thousands)

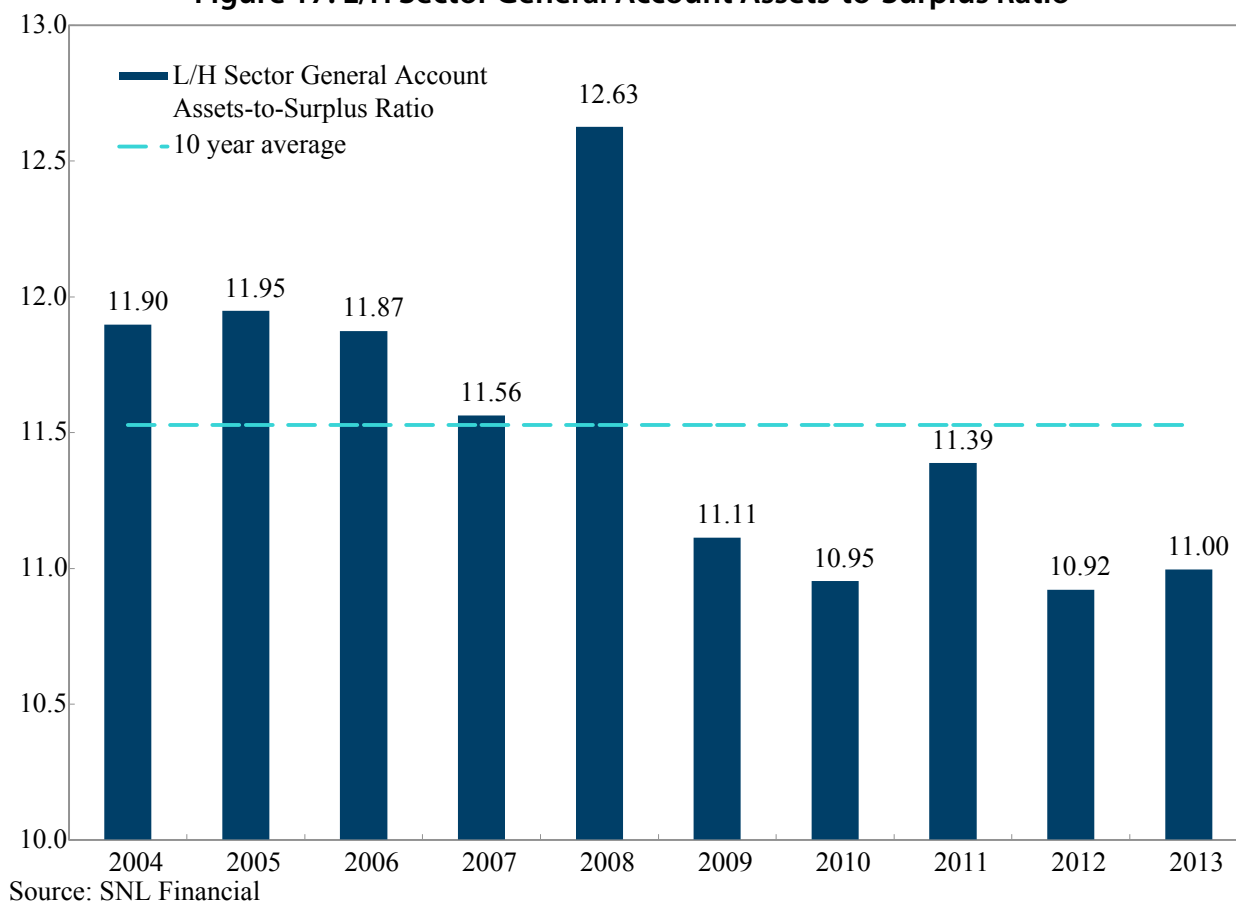
	2009	2010	2011	2012	2013
Capital & Surplus	\$ 290,689,539	\$ 306,430,238	\$ 310,372,997	\$ 328,974,951	\$ 334,968,095
General Account Assets	3,230,475,723	3,356,501,480	3,534,370,609	3,592,916,712	3,683,202,543
General Account Assets-to-Surplus Ratio	11.11	10.95	11.39	10.92	11.00

Source: SNL Financial

Capital and surplus is the regulatory measure of capital available to an insurer (i.e., the amount by which reported assets of an insurer exceed its reported liabilities), and 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 2013, L/H sector general account assets increased by nearly 3 percent, while capital and surplus grew by less than 2 percent. The slower growth in capital and surplus was attributable to increases in stockholder dividends and net unrealized capital losses and a reduction in aggregate paid-in surplus relative to 2012. When combined, these changes largely offset the stronger gain in net income. The sector's leverage ratio (i.e., assets-to-surplus) thus increased slightly in 2013.

Figure 17 provides a longer-term illustration of the 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 17: L/H Sector General Account Assets-to-Surplus Ratio

b. L/H Sector Reserves

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 number of scenarios.

In 2012, the L/H sector's aggregate reserves decreased for the first time in over a decade, albeit very modestly. That decrease reversed in 2013, with sector aggregate reserves and deposits increasing by slightly more than 2 percent, as shown in Figure 18. The \$2.9 trillion in reserves and deposits at year-end 2013 exceeded the previous record level from 2011.

Figure 18: L/H Sector Reserves (\$ thousands)

	2010	2011	2012	2013
Net Policy Reserves - Life	\$ 2,191,738,219	\$ 2,313,663,878	\$ 2,305,715,830	\$ 2,377,163,353
Net Policy Reserves - A&H	206,923,525	222,320,321	219,238,549	218,977,714
Liability for Deposit-Type Contracts	273,174,427	266,876,143	270,575,924	264,390,856
Total Policy Reserves plus Deposits	\$ 2,671,836,171	\$ 2,802,860,342	\$ 2,795,530,303	\$ 2,860,531,923
Growth - Total Reserves & Deposits	3.39%	4.90%	-0.26%	2.33%

Source: SNL Financial

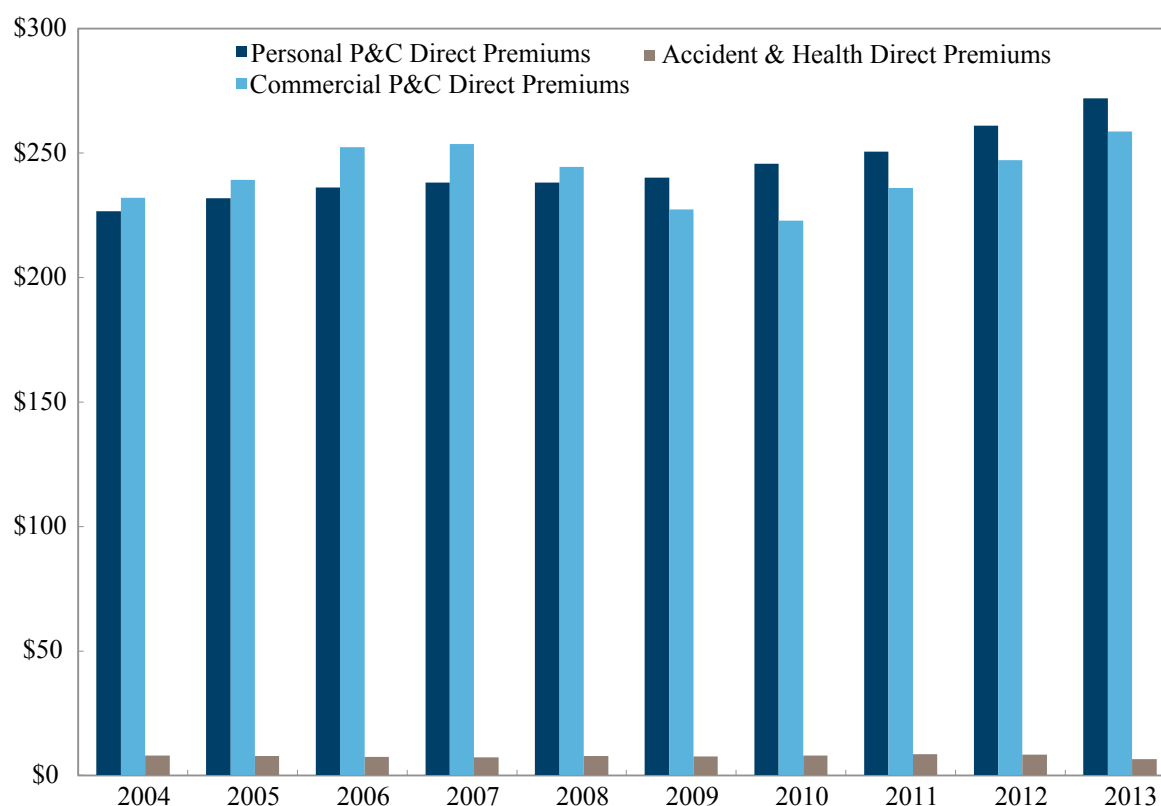
3. Property and Casualty Sector Performance

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

a. P/C Sector Net Written Premiums

Figure 19 depicts the level and composition of P/C sector direct written premiums by major lines of business, and Figure 20 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). In 2013, total P/C sector net written premiums reached a new record level of approximately \$481 billion. Growth in excess of 4 percent in direct written premiums for both personal and commercial lines, offset somewhat by a more modest 1 percent increase in net reinsurance premiums, led to the gain in net written premiums. Rate increases across most lines of business, both personal and commercial, bolstered growth in aggregate premiums in 2013.²⁶

Figure 19: P/C Sector Direct Premiums Written (\$ billions)



Source: SNL Financial

²⁶ Saurabh Nair, *P/C Insurers See Low Catastrophes and High Pricing, 2013 Data Show*, SNL Financial (March 13, 2014).

Figure 20: P/C Sector Premiums (\$ thousands)

	2009	2010	2011	2012	2013
Personal P&C Direct Premiums	\$ 240,224,180	\$ 245,730,464	\$ 250,663,210	\$ 260,935,804	\$ 271,903,369
Commercial P&C Direct Premiums	227,407,576	222,868,720	235,984,214	247,126,969	258,747,833
Accident & Health Direct Premiums	7,566,755	8,037,142	8,557,416	8,412,897	6,572,426
Direct Premiums Written	483,081,379	484,404,467	502,005,179	523,879,204	544,386,565
Net Reinsurance Premiums	(60,062,645)	(58,176,156)	(60,034,264)	(62,958,726)	(63,509,368)
Net Premiums Written	423,018,734	426,228,311	441,970,915	460,920,478	480,877,197
Change in Unearned Premiums Reserve	(4,004,919)	1,545,490	3,615,254	7,865,418	9,978,133
Net Premiums Earned	\$ 427,023,654	\$ 424,682,821	\$ 438,355,661	\$ 453,055,061	\$ 470,899,065

Source: SNL Financial

b. P/C Sector Underwriting Results

Combined ratio – the sum of the loss ratio (incurred loss divided by earned premium) and the expense ratio (incurred expense divided by written premium) – is a commonly accepted means of comparing underwriting performance for the P/C sector. Figure 21 shows the P/C sector combined ratio for each of the past several years.²⁷ For 2013, the sector's combined ratio dropped below 100 percent for the first time since 2007, when the combined ratio was 96 percent. A combined ratio less than 100 percent indicates that premiums covered losses and expenses in a given period (i.e., the sector's underwriting operations made a positive contribution to its bottom line). Investment income, realized gains/losses, and income taxes are not considered in the combined ratio. The sector's combined ratio benefitted from relatively low catastrophe losses in 2013, which was the main driver of a nearly 7 percentage point decrease in the loss ratio as compared to 2012.²⁸

Figure 21: P/C Sector Operating Ratios (%)

	2009	2010	2011	2012	2013
Loss Ratio	59.79	61.06	66.87	61.95	55.53
Loss Adjustment Expense Ratio	12.48	12.54	12.58	12.39	11.92
Loss and Loss Adjustment Expense Ratio	72.26	73.59	79.45	74.34	67.46
Net Commission Ratio	10.49	10.39	10.22	10.21	10.25
Salaries & Benefits Ratio	8.25	8.33	8.30	8.41	8.53
Tax, License & Fees Ratio	2.60	2.60	2.60	2.62	2.60
Administrative & Other Expense Ratio	6.32	6.94	7.25	6.99	6.77
Expense Ratio	27.66	28.26	28.37	28.23	28.15
Policyholder Dividend Ratio	0.50	0.64	0.53	0.59	0.64
Combined Ratio	100.42	102.49	108.35	103.15	96.24

Source: SNL Financial

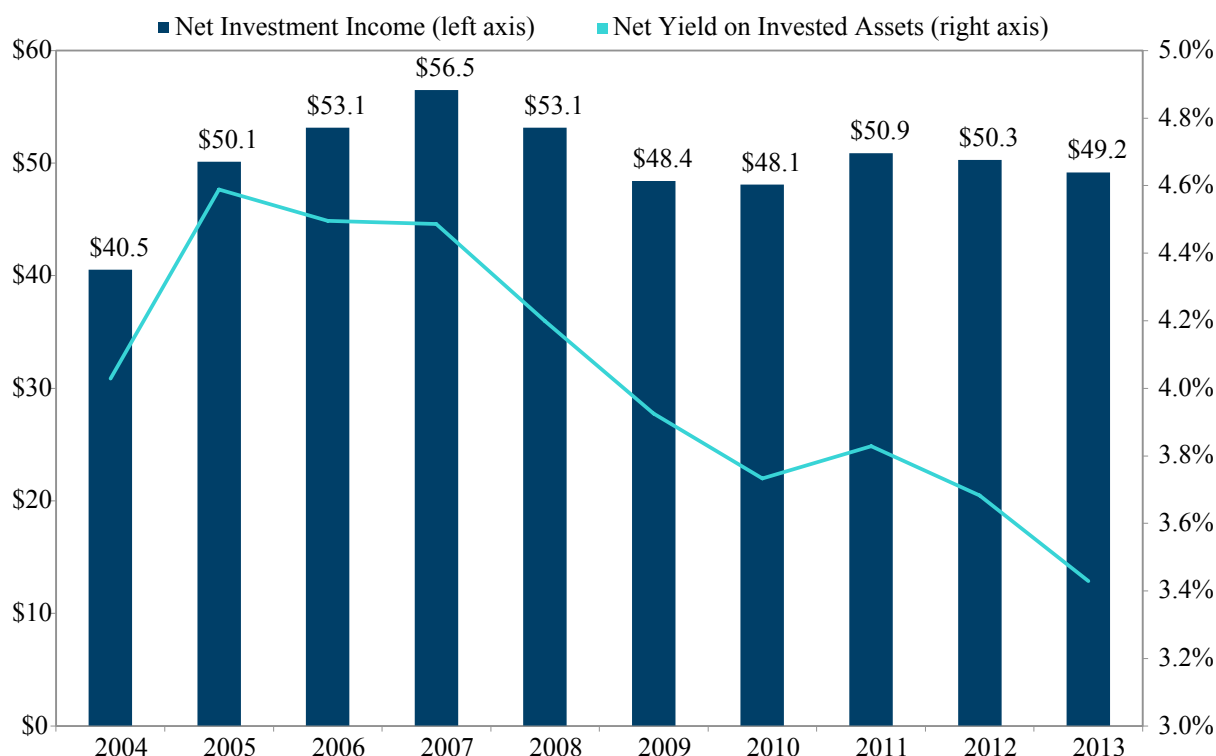
c. P/C Sector Investment Income

For 2013, both net investment income and the net yield on invested assets continued to decrease for the P/C sector. Net investment income decreased by approximately 2 percent, while the yield on invested assets decreased by 25 basis points. The 2013 net yield of 3.43 percent was the P/C sector's lowest net yield in over a decade. Figure 22 shows that the net yield on invested assets has been declining for a number of years, consistent with the trend in the interest rate yield curve. Figure 23 provides the P/C sector's net yield and investment income for the past five years. Excluded from net investment income are realized capital gains and losses.

27 SNL Financial ratios include the policyholder dividend ratio for transparency, because these dividends represent a cash outlay.

28 Katherine Dela Cruz, *Net Gains on Underwriting Improve Private U.S. P&C Insurers' Results in '13*, SNL Financial (April 21, 2014).

Figure 22: 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 23: P/C Sector Investment Income (\$ thousands) and Net Yield

	2009	2010	2011	2012	2013
Net Investment Income	\$ 48,401,892	\$ 48,099,454	\$ 50,890,625	\$ 50,278,403	\$ 49,180,450
Total Cash & Investments	1,260,404,124	1,316,192,292	1,341,904,107	1,388,998,246	1,479,349,321
Net Yield on Invested Assets	3.93%	3.73%	3.83%	3.68%	3.43%

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

While premiums for some P/C lines result in cash flows that can be invested by insurers for ten years or more, P/C insurance losses are generally more likely to develop in the short term as compared to the payout of L/H benefits, which may not become due for decades. Thus, the P/C sector generally relies more on cash flows from operations to fund losses and expenses, rather than on investment income; conversely, the L/H sector relies more heavily on investment income to fund benefits.

Net investment income accounted for approximately 8 percent of total sector revenues in 2013. Nonetheless, as is the case for the L/H sector, historically lower interest rates have caused P/C firms to seek higher yields from increased investments in mortgage loans and “alternative” investments. Figure 24 shows the composition of P/C sector invested assets over the past five years. As compared with 2012, in 2013 the sector’s exposure to common stocks increased 24 percent (primarily due to strong market performance), while its exposure to mortgage loans increased 41 percent and “other investments” (which includes alternative asset classes) grew by 7 percent.

Figure 24: P/C Sector Invested Assets (\$ thousands)

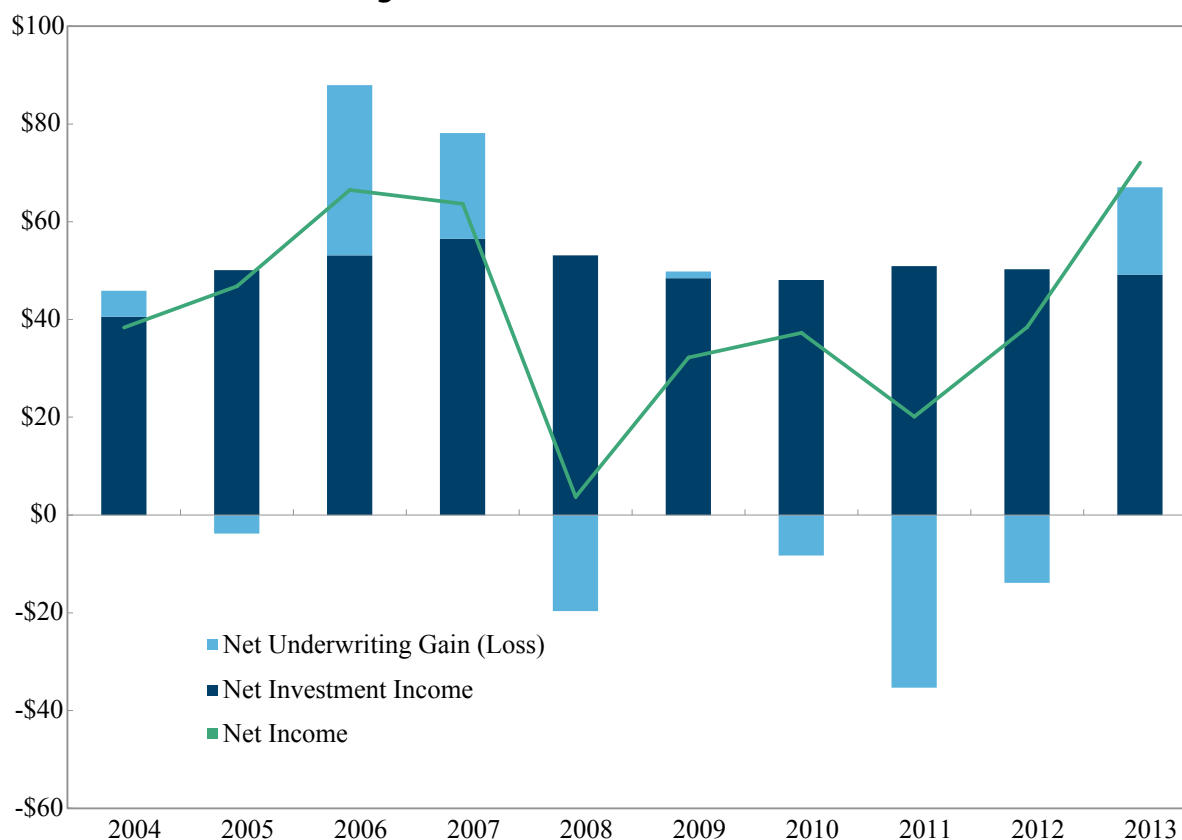
	2009	2010	2011	2012	2013
Bonds	\$ 866,307,648	\$ 873,836,387	\$ 902,506,061	\$ 907,483,023	\$ 925,303,980
Preferred Stocks	18,819,098	17,574,224	11,619,100	11,929,781	11,505,347
Common Stocks	209,781,455	208,460,881	227,253,516	254,133,017	316,177,213
Mortgage Loans	4,481,789	4,171,188	4,969,359	5,682,044	7,985,242
Real Estate	10,218,014	9,772,963	10,373,603	10,386,643	9,951,891
Contract Loans	0	0	0	0	0
Derivatives	NA	643,393	648,785	591,755	577,504
Cash & Short Term Investments	87,591,432	85,961,983	72,604,907	82,602,614	83,356,048
Other Investments	63,204,689	115,771,272	111,928,776	116,189,369	124,492,095
Total Cash & Investments	\$ 1,260,404,124	\$ 1,316,192,292	\$ 1,341,904,107	\$ 1,388,998,246	\$ 1,479,349,321

Source: SNL Financial

Realized capital gains on investments also contributed to the P/C sector's profitability in 2013. For the year, the P/C sector recorded net realized capital gains of \$18 billion, marking a 113 percent increase over the 2012 level. Profits on the sale of equities, which benefitted from strong equity market performance during 2013, were the most significant contributors to realized capital gains. Gains on the sale of bonds also had a positive effect on realized gains, but to a lesser degree than that of gains on the sale of equities.

d. P/C Sector Net Income

The P/C sector's net income increased by 88 percent in 2013 to \$72 billion, as shown in Figure 25. While not unprecedented, this was the sector's largest net income since 2007. The operating improvements noted above (e.g., the significant drop in the loss ratio) were the primary contributors to the significant increase in net income. Also making a notable positive contribution were realized capital gains. Figure 26 provides a summary income statement for the sector.

Figure 25: P/C Sector Net Income (\$ billions)

Source: SNL Financial

Figure 26: P/C Sector Net Income (\$ thousands)

	2009	2010	2011	2012	2013
Net Premiums Earned	\$ 427,023,654	\$ 424,682,821	\$ 438,355,661	\$ 453,055,061	\$ 470,899,065
Losses and Loss Adjustment Expense Incurred	308,587,171	312,543,284	348,267,037	336,797,760	317,646,867
Other Underwriting Expense Incurred	119,340,718	121,271,338	123,919,420	129,777,721	135,821,072
Other Underwriting Deductions	(2,347,251)	(808,897)	1,475,530	322,517	(471,454)
Net Underwriting Gain (Loss)	1,443,015	(8,322,905)	(35,306,326)	(13,842,937)	17,902,579
Policyholder Dividends	2,133,182	2,701,811	2,315,009	2,656,168	3,018,673
Net Investment Income	48,401,892	48,099,454	50,890,625	50,278,403	49,180,450
Net Realized Capital Gains (Losses)	(7,798,301)	7,829,186	7,576,363	8,658,766	18,412,731
Finance Service Charges	3,078,731	3,182,086	3,179,564	3,287,910	3,392,739
All Other Income	(2,228,743)	(2,039,896)	(868,718)	(1,062,516)	(1,745,529)
Net Income After Capital Gain (Loss) Before Tax	40,799,392	46,052,998	23,155,391	44,663,458	84,124,297
Federal Income Tax	8,666,592	8,833,430	3,027,893	6,254,180	12,035,100
Net Income	\$ 32,203,170	\$ 37,217,759	\$ 20,124,876	\$ 38,409,278	\$ 72,089,197

Source: SNL Financial

Figure 27 shows key measures of returns for the P/C sector. In 2013, these metrics were at the highest levels since the financial crisis (2007), but still below the peaks set in 2006. The 2013 return on average equity of 11.45 percent was above the long-term average of 9 percent.²⁹

Figure 27: P/C Sector Operating Ratios (%)

	2009	2010	2011	2012	2013
Pre-Tax Operating Margin	10.20	8.07	3.17	7.12	12.60
Return on Average Equity (Capital & Surplus)	6.57	6.89	3.59	6.65	11.45
Pre-Tax Operating Return on Average Equity	9.92	7.08	2.78	6.23	10.43
Return on Average Assets	2.19	2.45	1.28	2.37	4.26

Source: SNL Financial

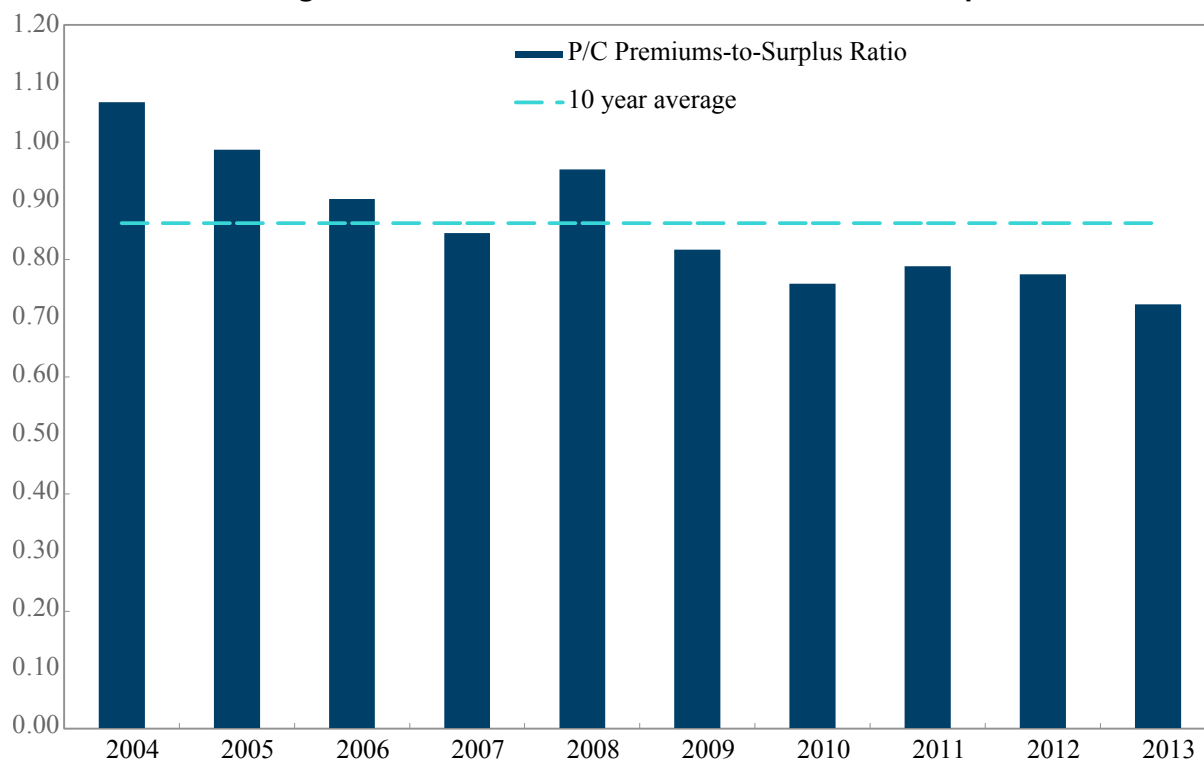
4. Property and Casualty Sector Condition

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

a. P/C Sector Policyholders' Surplus

As a result of the strong operating performance in 2013, the P/C sector's year-end policyholders' surplus of \$665 billion marked an 11 percent increase over the 2012 level and a new record high. This continues the trend of increasing surplus, further enhancing the sector's claim-paying resources and loss-absorption capacity. Figure 28 provides a 10-year perspective on the sector's leverage, with corresponding dollar values for periods since 2008 shown in Figure 29. 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 (and as in the case of the L/H sector), the P/C sector has been deleveraging. The 2013 premiums-to-surplus ratio of 72 percent is well below the ten-year average.

29 See Verisk Analytics, Inc., *P/C Insurers' Profits and Profitability Surged in First-Half 2012 as Underwriting Results Benefited from Drop in Catastrophe Losses* (October 4, 2012), available at <http://www.verisk.com/Press-Releases/2012/P-C-Insurers-Profits-and-Profitability-Surged-in-First-Half-2012.html>.

Figure 28: P/C Sector Annual Net Premiums-to-Surplus Ratio

Source: SNL Financial

Figure 29: P/C Sector Policyholders' Surplus (\$ thousands)

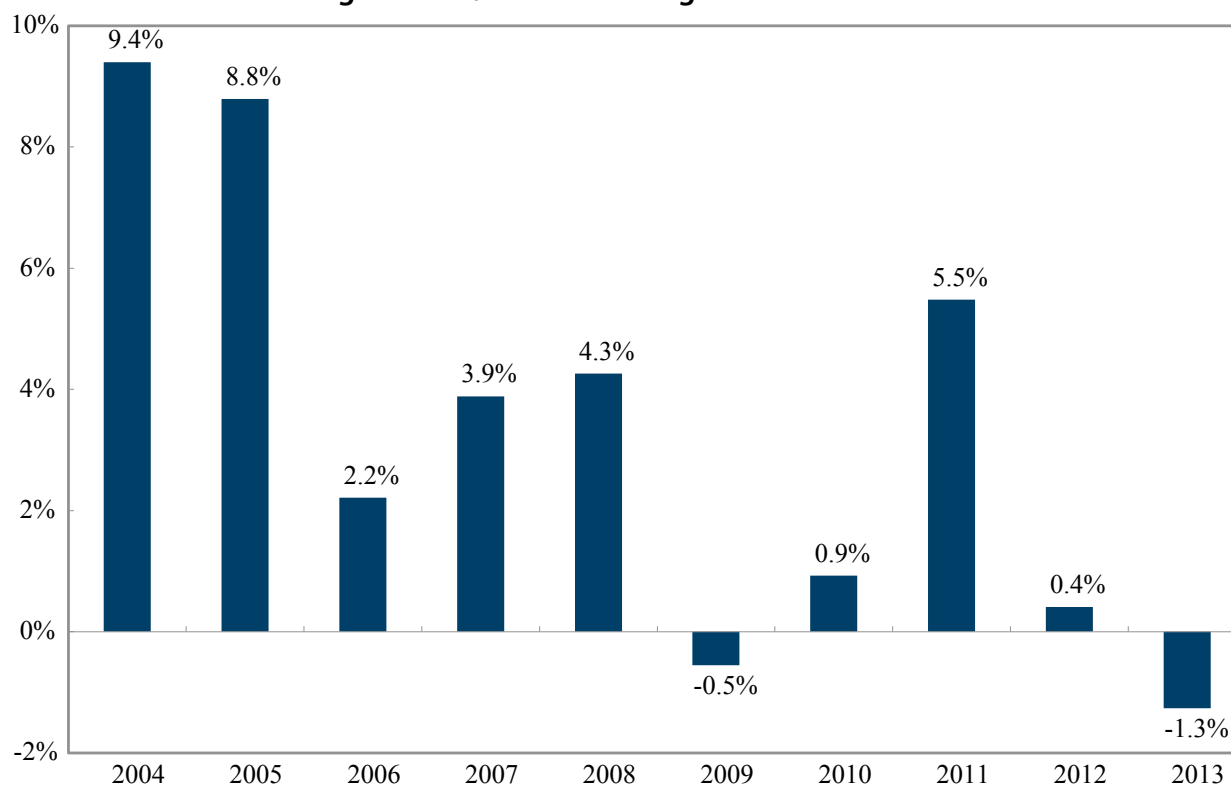
	2009	2010	2011	2012	2013
Policyholders' Surplus	\$ 517,970,768	\$ 561,776,605	\$ 560,322,549	\$ 594,818,948	\$ 665,175,012
Net Premiums Written	423,128,170	426,252,627	441,997,964	460,968,626	481,706,991
Net Premiums Written/Policyholders' Surplus	81.69	75.88	78.88	77.50	72.42

b. P/C Sector Reserves

P/C sector reserves represent estimates 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. As is the case for L/H sector reserves, estimation of P/C sector reserves includes a significant degree of professional actuarial judgment.

Total P/C sector reserves decreased in 2013 for only the second time in the past ten-year period, as shown in Figure 30. Total reserves declined by more than 1 percent in 2013, primarily due to a 2 percent decline in reserves for commercial lines of business, as shown in Figure 31. Much of the decrease in commercial lines reserves was due to a one-time reserve release by a financial guaranty insurer as part of its rehabilitation plan.³⁰ Excluding this one-time reserve release, total sector reserves decreased by less than 1 percent. Other lines that reported favorable loss development (i.e., actual losses ultimately developed to be less than previously estimated levels for an accident year), and notable corresponding reserve releases, included homeowners insurance, medical malpractice insurance, and auto physical damage insurance. Only a few lines of business reported increased reserves, and those increases were generally low.

30 Tim Zawacki, *Insurer's Massive Reserve Release Skews Q3 P/C Industry Statutory Results*, SNL Financial (December 6, 2013).

Figure 30: P/C Sector Change in Loss and LAE Reserves

Source: SNL Financial

Figure 31: P/C Sector Reserves (\$ thousands)

	2009		2010		2011		2012		2013
Major Segment - Personal	\$	116,246,107	\$	120,673,876	\$	123,951,475	\$	124,846,984	\$ 125,345,252
Major Segment - Commercial		443,439,768		444,089,132		471,815,067		473,386,896	465,112,144
Major Segment - Accident & Health		4,608,123		4,754,119		5,011,683		5,210,754	5,378,025
Total Loss and Loss Adjustment Expense Reserves	\$	564,277,773	\$	569,505,155	\$	600,707,917	\$	603,179,216	\$ 595,571,611
Change in Loss & Loss Adjustment Expense Reserves		-0.55%		0.93%		5.48%		0.41%	-1.26%

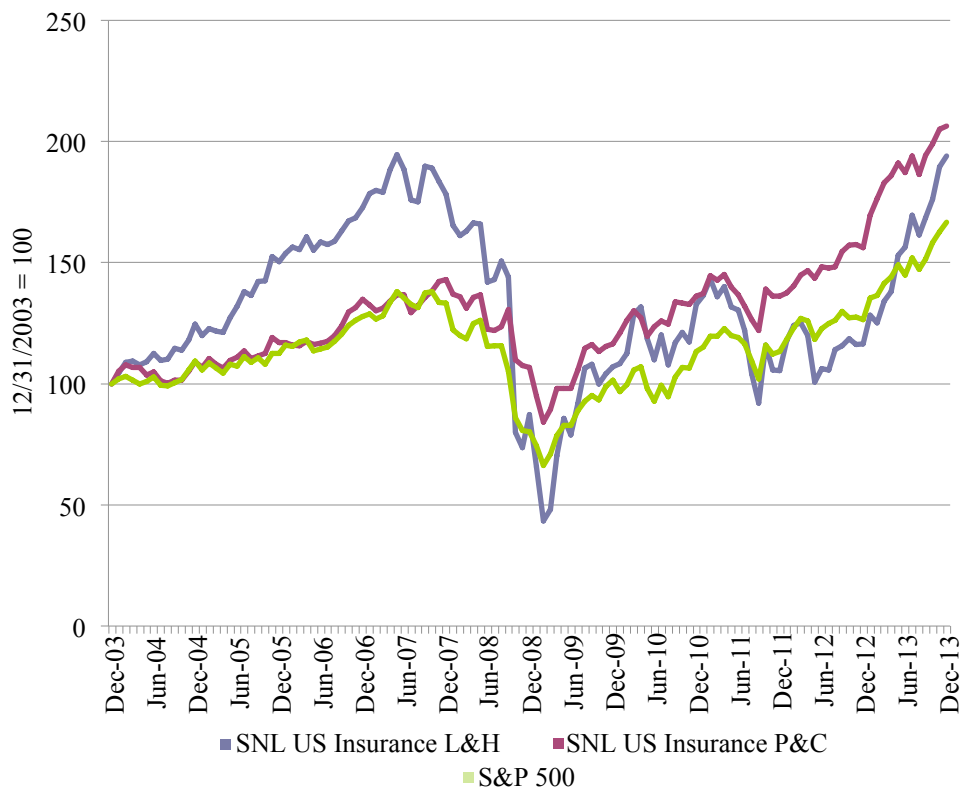
Source: SNL Financial

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 general economy. The discussion below considers the price performance of stock indices in 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 L/H and P/C sectors have outperformed the S&P 500, as shown in Figure 32. The L/H sector outperformed the S&P 500 before and after the financial crisis, but underperformed relative to the S&P 500 during the crisis itself; the P/C sector closely tracked the S&P 500 leading up to the crisis, but outperformed the S&P 500 during and after the crisis. Since the end of 2003, P/C sector stocks gained 106 percent and L/H sector stocks increased 94 percent.³¹ The S&P 500 gained 67 percent over the same time period.

³¹ Source: SNL Financial.

Figure 32: Insurance Sector Stock Prices vs. S&P 500

The effect of interest rate movements on equity values is greater in the L/H sector than in the P/C sector because L/H insurers are, in general, more dependent on investment earnings and have products that are spread-based (i.e., the L/H business model relies on investment yields that are expected to provide returns in excess of amounts due under policyholder contracts). Thus, as interest rates drop, spreads earned by L/H insurers become compressed. On the positive side, falling interest rates mean higher realized and unrealized gains on investments.

While P/C sector stocks generally are less affected by interest rate movements, this sector also benefited from realized and unrealized gains as interest rates fell. Improving fundamentals (i.e., earnings, balance sheet strength) also have contributed to the performance of insurance industry stocks since the crisis.

Over 2013, the effective yield on AA-rated bonds issued by U.S. corporations rose 60 basis points, or 30 percent, while the effective yield on the 10-year U.S. Treasury bond rose 130 basis points, or 76 percent.³² This increase apparently led equity markets to perceive that the spread compression that had plagued life insurers for several years was beginning to abate. Reductions in rates of return offered by L/H insurers on annuity products that had occurred in response to the protracted period of low interest rates further suggested widening spreads and increased profit margins to investors in the L/H sector, driving up sector stock prices.

32 Source: Bank of America Merrill Lynch and Bloomberg Financial, LLP.

Figure 33: Insurance Sector Indexed Stock Prices versus S&P 500

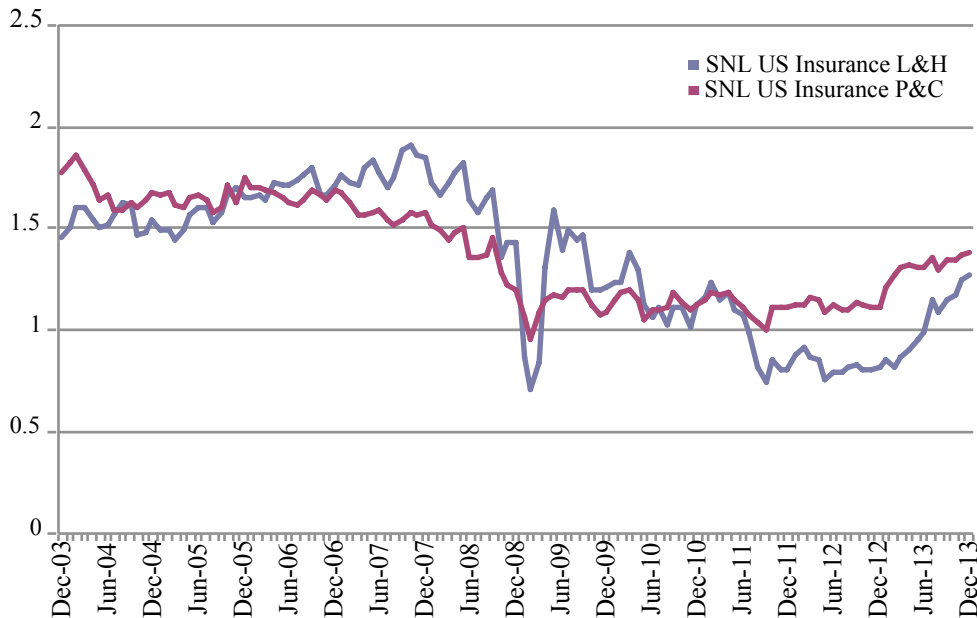
	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Qtr/Qtr	Yr/Yr
SNL Life	116	134	156	168	194	15.2%	66.8%
SNL P&C	156	183	187	194	206	6.3%	32.2%
S&P 500	126	141	145	152	167	9.9%	31.8%

December 31, 2003 = 100

Source: SNL Financial

The P/C sector also outperformed the S&P 500, although to a lesser degree than did the L/H sector. As noted, the impact of low interest rates on the P/C sector was not as significant as it was on the L/H sector. Similarly, the positive impact of increasing interest rates in 2013 on the P/C sector was not as significant as it was on the L/H sector. Reserve releases, relatively low natural catastrophe losses, and higher premium rates, as well as improving general economic conditions and continued low inflation, were the drivers behind the performance of P/C sector stocks in 2013.

Another frequently cited metric is the price-to-book value multiple, 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). Hence, if a share of an insurer's stock is trading at a discount to its book value, the market is valuing the company at less than the current value of its assets minus its liabilities; the opposite is true if the insurer is trading at a premium to its book value per share. Figure 34 compares L/H and P/C sector price-to-book ratios from year-end 2003 through year-end 2013. Since the financial crisis, both market and book values of insurers have recovered. For the first time since July 2011, the L/H sector regained a premium over book value in July 2013, reaching a multiple of 1.3 times book value by the end of the year.³³

Figure 34: Insurer Price/Book Value Ratios

33 Source: SNL Financial.

C. Capital Markets Activity

Merger and acquisition (M&A) activity in the insurance industry was considerably lower in 2013 as compared to 2012, in both the number of transactions and aggregate value.³⁴ In 2013, 85 transactions with an aggregate value of \$7.8 billion were announced.³⁵ In comparison, 121 transactions with an aggregate value of \$27.4 billion were completed in 2012.³⁶ The number of transactions decreased 30 percent in 2013, while the aggregate value of those transactions decreased by 71 percent.

Only one transaction in 2013 – Protective Life Corporation’s acquisition of MONY Life Insurance Company (discussed below) – was valued at over \$1 billion, while in 2012 six transactions exceeded that level, with one valued at over \$5 billion.³⁷ Observers cited a sluggish economy, a lack of attractive acquisition targets, and low market valuations as at least partly responsible for the relatively low volume and value of transactions in 2013.³⁸

Protective Life Corporation’s acquisition of MONY Life Insurance Company was valued at \$1.1 billion. Other large transactions in 2013 included SCOR SE’s acquisition of the U.S. life reinsurance business of Assicurazioni Generali SpA, valued at \$920 million, and the acquisition of Torus Insurance Holdings Limited (Bermuda), valued at \$652 million, by Enstar Group Limited (Bermuda) and private equity firm Stone Point Capital LLC (U.S.). A number of other transactions in 2013 involved private equity firms acquiring various insurance operations, including life insurers and reinsurers. For example, Apollo Global Management, LLC acquired Aviva; Global Atlantic Financial Group acquired Presidential Life Insurance Company; and Guggenheim Partners, LLC acquired Sun Life Assurance Company of Canada.³⁹

In contrast to M&A activity, the number of insurer initial public offerings (IPOs) increased, from one in 2012 to five in 2013. The aggregate value of those IPOs, nevertheless, decreased compared to 2012 (\$1.0 billion in 2013 versus \$1.5 billion in 2012).⁴⁰ Of the five industry IPOs in 2013, two involved reinsurers, two involved mortgage insurers, and one involved a life insurer.⁴¹

Most of the IPOs in 2013 involved private equity firms cashing out of certain investments in the insurance industry. One of the reinsurers involved in an IPO in 2013, Third Point Reinsurance Ltd., was initially funded by private equity sources.⁴² Similarly, the two mortgage insurers, NMI Holdings, Inc. and Essent Group Ltd. – both new entrants to the mortgage insurance business – received initial funding through private equity sources.⁴³ Additionally, a life insurer, Fidelity & Guaranty Life Insurance Company, had been purchased by a hedge fund company (Harbinger Group, Inc.) in 2011.⁴⁴

NMI Holdings, Inc.’s November 2013 IPO was a small offering (\$26 million) with very little participation by selling stockholders (i.e., initial investors). It was followed by a much larger (\$700 million) secondary offering in December

34 M&A activity includes acquisitions of whole companies as well as lines of business classified by SNL Financial as insurance underwriters and underwriting; no M&A transactions involving insurance brokers are included. All transaction valuations are as of the announcement date.

35 Source: SNL Financial.

36 Source: SNL Financial.

37 Source: SNL Financial.

38 Clyde & Co. Report, *Global Insurance M&A Activity at Four-Year Low* (September 9, 2013), available at <http://www.bloomberg.com/news/2013-09-08/insurance-m-a-drops-to-four-year-low-clyde-co-report-shows.html>.

39 See section V.D below.

40 Source: SNL Financial.

41 Source: SNL Financial.

42 Third Point Reinsurance, Ltd., Prospectus (August 14, 2013).

43 NMI Holdings, Inc., Prospectus (November 7, 2013); Essent Group Ltd., Prospectus (October 30, 2013).

44 Fidelity & Guaranty Life Insurance Company, Prospectus (December 12, 2013).

2013, which was a nearly complete cash-out by the initial investors; selling stockholders retained an estimated 8 percent ownership following the offering.⁴⁵ In the other three insurer IPOs, the initial investors retained significant ownership stakes.⁴⁶ Harbinger Group received some of the funds from the Fidelity & Guaranty Life offering, in the form of dividends after completion of the stock sale.

Beyond IPOs, insurers were actively raising additional capital. In 2013, U.S. insurers raised a total of \$41.8 billion in new debt funding in 88 separate offerings, benefiting from the low interest rate environment.⁴⁷ Among the largest offerings in 2013 were three sales by MetLife, Inc. totaling approximately \$3.25 billion. In addition, American International Group, Inc. and Voya Financial, Inc. (Voya Financial) both sold two \$1 billion issues, while Berkshire Hathaway, Inc. completed a single \$1 billion offering. Together, these eight debt offerings constituted approximately 20 percent of the total debt sold by U.S. insurers in 2013.⁴⁸ Insurers also had success in raising equity capital in 2013. In total (including the IPOs discussed above), U.S. insurance underwriters raised nearly \$5 billion in new equity capital in 22 equity offerings.⁴⁹ The largest individual offering was the \$1.2 billion spin-off of Voya Financial from its parent, ING Groep NV.

The success of U.S. insurers in raising new capital in 2013 was noteworthy in the mortgage insurance sector. These insurers have bolstered capital since 2008 by steadily accessing the capital markets, finding strong demand for equity and debt issues. As noted above, Essent Group Ltd. and NMI Holdings, Inc. both completed IPOs in 2013; in addition, MGIC Investment Corp. and Radian Group, Inc. successfully raised a combined \$1 billion in new equity capital, bringing the total equity capital raised in the sector to approximately \$2 billion. Mortgage insurers were also successful in raising debt during 2013; combined, MGIC Investment Corp. and Radian Group, Inc. placed just over \$1 billion.⁵⁰

D. Reinsurance

This section highlights the continuing trend of reliance by U.S. insurers on international reinsurance markets and provides an overview of the increasing convergence of reinsurance and capital markets through various insurance-linked securities and special purpose vehicles.

1. The Importance of Non-U.S. Reinsurers

Reinsurance may be described as “insurance of insurance companies.”⁵¹ Reinsurance is an international business through which worldwide capital can be made available to meet local insurance market demands, while spreading risk and losses beyond local borders. Among other reasons, insurers rely on reinsurance for capital to support the ability to expand existing business and write new policies, and to assist in paying losses from low-frequency, high-severity events such as catastrophes and natural disasters.

As one of the largest insurance markets in the world, the United States attracts considerable attention from global reinsurers. While a number of large and highly rated reinsurers are domiciled in the United States, the share of premiums ceded by U.S. insurers to non-U.S. reinsurers has been steadily increasing for more than a decade (Figure 35). Whereas approximately 60 percent of reinsurance premiums paid by U.S. insurers went to U.S. reinsurers in 1997, by 2013 that figure had decreased to 38 percent. If measured based on the jurisdiction of the reinsurers’ ultimate parent companies, the importance of the global reinsurance market to U.S. insurers is even more evident.

⁴⁵ Based on information available in the NMI Holdings, Inc. Prospectus (December 6, 2013).

⁴⁶ Based on information available in the respective prospectuses, initial investors appear to have retained 81 percent ownership of Fidelity & Guaranty Life, 75 percent ownership of Third Point Re, and 71 percent of Essent.

⁴⁷ Sources: SNL Financial (as compiled by FIO); Bloomberg LP. Currency translations for debt issues denominated in currencies other than USD were calculated using spot rates on dates on which transactions were publicly announced.

⁴⁸ Data based on issuances announced during 2013.

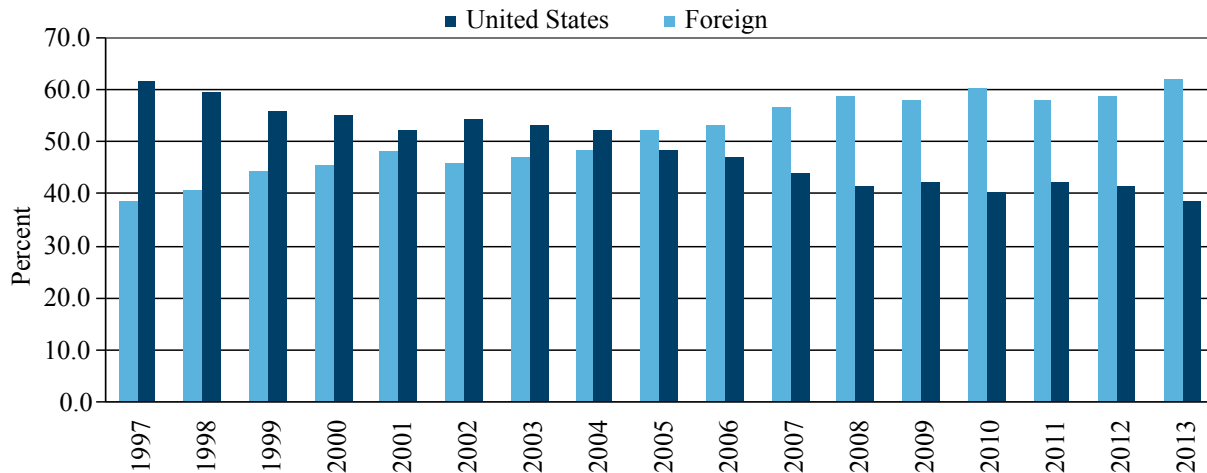
⁴⁹ Source: SNL Financial (as compiled by FIO).

⁵⁰ Source: SNL Financial.

⁵¹ RAA, *Fundamentals of Property & Casualty Reinsurance*, available at <http://www.reinsurance.org/Fundamentals>.

Reinsurers owned by groups headquartered or domiciled outside the United States accounted for approximately 92 percent of reinsurance premiums ceded by U.S.-based insurers in 2013.⁵²

**Figure 35: Market Share of U.S. and Non-U.S. Reinsurers
Unaffiliated Reinsurance Premium (Excluding Pools)**



Source: Reinsurance Association of America (2014)

As highlighted in the *Modernization Report* and discussed elsewhere in this Report, FIO is engaged in furthering the national interest in establishing uniform prudential standards applicable to the supervisory treatment in the U.S. of the global reinsurance industry.⁵³

2. Reinsurance and Capital Markets Convergence

Aon Benfield (Aon) estimates that global reinsurance sector capital at year-end 2013 stood at \$540 billion, an increase of 7 percent (\$35 billion) over the prior year. Aon also reports that reinsurance sector net income was up 16 percent across the board, to \$34 billion, and that industry return on equity improved to 10.6 percent for 2013. The latter improvements are generally attributed to relatively low catastrophe and natural disaster losses in 2013, together with favorable reserve development on losses from prior years.⁵⁴ Aon has offered the following summary of market conditions at first quarter 2014:

Benign catastrophe losses in 2013 contributed to a sub-90 reinsurer combined ratio, and coupled with a 28 percent growth in alternative capital led to a 7 percent increase in total reinsurer capital during 2013, representing a nearly 60 percent increase since the reinsurer capital level of 2008.⁵⁵

Although low catastrophe losses benefited net income, reinsurance premiums have continued to decline. Market capacity expansion and accompanying competition for deployment of reinsurance capital is partially responsible for this

⁵² RAA, *Offshore Reinsurance in the U.S. Market: 2013 Data*, 13 (2014).

⁵³ Section VI.A.2 addresses reinsurance collateral.

⁵⁴ Aon Benfield, *The Aon Benfield Aggregate: Results for the Year Ended December 31, 2013*, available at http://thoughtleadership.aonbenfield.com/Documents/201404_marketanalysis_fy_2013.pdf.

⁵⁵ Aon Benfield, *Reinsurance Market Update* (April 1, 2014), available at http://thoughtleadership.aonbenfield.com/Documents/20140401_analytics_reinsurance_market_outlook_april2014.pdf.

trend of decreasing reinsurance premiums.⁵⁶ Reinsurance broker Guy Carpenter reported that catastrophe reinsurance renewal premiums fell 11 percent year-over-year at January 2014.⁵⁷ For U.S. catastrophe risks, the year-over-year premium decline was 15 percent. The trend continued with respect to reinsurance that renewed in April 2014.⁵⁸

One factor driving expansion of the capacity for supplying reinsurance is the growing interest of capital markets in a range of reinsurance-like risk transfer vehicles (known as alternative risk transfer capital, or “ART”) and insurance-linked securities, including vehicles such as sidecars⁵⁹ and catastrophe (“cat”) bonds.⁶⁰ Referring to insurance-linked securities, one journalist stated: “The yields have been falling as demand rises, encouraging insurers to issue more and larger deals as costs have fallen relative to buying traditional reinsurance policies.”⁶¹ Industry sources report that capital in this market segment grew to \$50 billion during 2013, up nearly 30 percent from year-end 2012, and constituting 9 percent of total reinsurance capital.⁶²

In recent years, such investments – which have gained favor with institutional investors, including pension funds and private equity funds – increasingly have been in the form of cat bonds. The growth of alternative reinsurance capital has been overwhelmingly in the catastrophe risk market. Storm losses, for example, can now be more effectively modeled, and the seasonal nature of storms provides a relatively predictable and brief investment horizon. Commenters have described these instruments as increasingly mainstream products,⁶³ although the long-term commitment of these non-traditional capital sources has not yet been tested.

56 Insurance Journal, *P/C Reinsurance Market Softer Due to Alternative Capital* (March 14, 2014), available at <http://www.insurancejournal.com/news/national/2014/03/14/323319.htm> (according to Towers Perrin survey, “CFOs attribute this [reinsurance premium] softness primarily to the significant growth of insurance-linked securities and other alternative forms of reinsurance capital”).

57 Guy Carpenter Report (Dec. 29, 2013), available at <http://www.gccapitalideas.com/2013/12/29/january-1-2014-renewals-bring-downward-pressure-on-pricing/>.

58 Guy Carpenter Report (April 9, 2014), available at <http://www.gccapitalideas.com/2014/04/09/april-renewals-bring-price-reductions-focus-on-tailored-coverage/>. See, e.g., Chubb Benefits from Reinsurers’ Pricing Pain During April 1 Renewals (April 25, 2014), available at <http://www.snl.com/InteractiveX/article.aspx?ID=27888892&KPLT=4> (“excess supply has driven down prices for certain risks”).

59 A sidecar is one among several fully-collateralized structures allowing investors to provide capital and take on the risk and benefit from the return of specific books of insurance or reinsurance business. See *What is a Reinsurance Sidecar*, available at http://www.artemis.bm/library/what_is_a_reinsurance_sidecar.html.

60 A catastrophe bond is one among several fully collateralized risk-linked securities transferring a specific set of risks (generally catastrophe and natural disaster risks) from an issuer or sponsor to investors. See *What is a Catastrophe Bond*, available at http://www.artemis.bm/library/what_is_a_catastrophe_bond.html.

61 Record ‘Cat Bond’ Grows Again, Cuts Insurer’s Costs (April 24, 2014), available at <http://blogs.wsj.com/moneybeat/2014/04/24/record-cat-bond-grows-again-cuts-insurers-costs/>.

62 Aon Benfield, *Reinsurance Market Update* (April 1, 2014), available at http://thoughtleadership.aonbenfield.com/Documents/20140401_analytics_reinsurance_market_outlook_april2014.pdf.

63 “Once the domain of specialty funds narrowly focused on insurance-linked debt, cat bonds have become an alternative for traditional corporate bond managers as they seek higher returns.” Wall Street Journal Money Beat, *Record ‘Cat Bond’ Grows Again, Cuts Insurer’s Costs* (April 24, 2014), available at <http://blogs.wsj.com/moneybeat/2014/04/24/record-cat-bond-grows-again-cuts-insurers-costs/>.

IV. CONSUMER PROTECTION AND ACCESS TO INSURANCE

A. Affordability of Personal Auto Insurance

The Dodd-Frank Act authorizes FIO to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products. In 2013, FIO staff consulted with various stakeholders, including insurers, industry trade associations, and consumer representatives, to ascertain views as to how FIO should effectuate this authority. FIO also received advice from the FOCI's Availability and Affordability Subcommittee. In addition, FIO consulted with three state insurance departments with significant experience collecting and analyzing premium statistics at the sub-state or zip code level – California, Massachusetts, and Missouri – regarding data collection requirements for personal auto insurance and/or homeowners insurance.

Following those consultations, FIO determined to focus initially on personal auto insurance because 49 states (all except for New Hampshire) and the District of Columbia require consumers to maintain auto liability insurance as a condition of automobile ownership, and studies suggest that owning an automobile is associated with a higher probability of employment and other factors associated with economic well-being.⁶⁴

Accordingly, FIO reviewed existing research on the availability and affordability of personal auto insurance and found a lack of consensus regarding how to define affordable personal auto insurance. In April 2014, FIO published a notice in the Federal Register seeking comment on: (i) what is a reasonable and meaningful definition of “affordability;” (ii) the appropriate metrics to use to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable personal auto insurance; and (iii) the data source(s) FIO should use to monitor this issue.⁶⁵

Box 2: Marriage and Insurance

As discussed in FIO's *Modernization Report*, insurers may use marital status as an underwriting and rating factor. Auto insurers and homeowners insurers, for example, often offer a lower premium for the same coverage to married individuals than would be offered to single persons. Similarly, underinsured motorist coverage may not extend to a same-sex couple who married in one jurisdiction that recognizes marriage equality, but reside in a jurisdiction that does not recognize that marriage, unless both spouses are named policyholders. Marital status may also impact other insurance policy provisions. For example, title insurance policies are issued to owners in the same manner in which the owners take title to the deed, and only married persons may take title as tenants in the entirety, protecting the property from liens against only one of the parties.

As of July 2014, marriage equality exists in 19 states and the District of Columbia.⁶⁶ The use of marital status as an underwriting and rating factor may disadvantage an individual who is lawfully married under the laws of another state to a person of the same sex. The *Modernization Report* calls upon the states to assess whether or in what manner marital status is an appropriate insurance underwriting or rating consideration.⁶⁷ FIO renews this call and will continue to monitor relevant state activity.

⁶⁴ See Yingling Fan & Arthur Huang, *How Affordable is Transportation? A Context-Sensitive Framework*, Center for Transportation Studies, University of Minnesota (May 2011); Melvin Stith, Jr. & Robert Hoyt, *The Demand for Automobile Insurance: Evidence from Underserved Areas in California*, University of Georgia (July 19, 2012); Stephen Brobeck & J. Robert Hunter, *Lower-Income Households and the Auto Insurance Marketplace: Challenges and Opportunities*, Consumer Federation of America (January 30, 2012).

⁶⁵ *Monitoring Availability and Affordability of Auto Insurance*, 79 Fed. Reg. 19969 (April 10, 2014), available at <http://www.treasury.gov/initiatives/fio/reports-and-notice>. The comment period expired June 9, 2014. FIO received 20 comments. See <http://www.treasury.gov/initiatives/fio/reports-and-notice/Pages/default.aspx>.

⁶⁶ Not included in this figure is Oklahoma. The unconstitutionality of its same sex marriage ban was affirmed by the 10th Circuit Court of Appeals in July 2014, but the ruling is stayed and the state is seeking review by the U.S. Supreme Court.

⁶⁷ *Modernization Report*, 48.

B. Servicemember Personal Auto Policies

As raised in the *Modernization Report*, for members of the military, the portability of insurance products across state lines has long been a challenge.⁶⁸ Active duty members of the military who are required to relocate in compliance with official orders may transfer credit cards, checking accounts, and other financial services simply by submitting a change of address form or accessing similar online resources. By contrast, an active duty member moving from one state to another may be required to obtain a new auto insurance policy upon each transfer. Even if an insurer has developed processes to smoothly manage this transition, the additional inefficiency imposes a cost borne by policyholders.

The *Modernization Report* states FIO's intention to work with interested parties in identifying more accommodating approaches for servicemembers who have personal auto insurance policies and are required to move across state lines. In May 2014, Congressman Ed Royce and Congresswoman Tammy Duckworth introduced H.R. 4669, the Servicemembers Insurance Relief Act of 2014, which is intended to allow a servicemember or his or her spouse or dependents to maintain an existing personal auto insurance policy when the servicemember relocates to another state to comply with any temporary duty or permanent change of station order. Providing servicemembers and their families relief from the burdens of a move with respect to auto insurance policies appropriately recognizes and supports the extraordinary commitment to public service made by members of the United States' armed forces.

C. Life Insurance and Annuities

1. Death Master File

Several major insurance company demutualizations in the late 1990s gained the attention of state unclaimed property departments as the mutual insurers sought to cash out existing policyholders—the owners of the mutual insurers. Using door-to-door agents, these insurers had sold small face amount “industrial” or “burial” policies from about 1900 until the early 1960s.⁶⁹ In time, some insurers declared such policies on the books paid in full, in order to address ongoing expenses as well as criticism of the cost to consumers.⁷⁰ In addition, some insurers experienced difficulty maintaining full and accurate books and records relating to some of these policyholders. In order to complete the demutualizations, the insurers attempted to comply with state-imposed requirements to locate all policyholders, including the owners of such industrial or burial policies. Nevertheless, sizeable amounts of money belonging to unaccounted-for policyholders or beneficiaries who could not be located were escheated to state unclaimed property departments following the demutualizations.

Several state revenue departments subsequently engaged auditors who employed the Social Security Administration's (SSA) Death Master File (DMF) to help determine whether life insurers had complied with state unclaimed property laws. Auditors discovered that some of the audited insurers used the DMF to determine whether annuity owners had died (a basis for terminating benefits), but were not using the DMF to determine whether life insurance policyholders had died (a basis for paying benefits), and therefore began notifying state insurance regulatory departments of these contradictory practices in 2009.

In response, at least 35 states joined in efforts to examine insurers' business practices relating to life and annuity claim settlements and the identification and reporting of unclaimed property. As a result of these examinations, regulators concluded that a number of life insurers had engaged in unfair claim settlement practices in using the DMF to support cessation of payments to annuitants who had died, but not using the DMF to determine if payments should be made to beneficiaries of life insurance policyholders who had died but for whom death benefit claims had not been made. Insurers representing over 50 percent of the total national life insurance market entered into settlements with state insurance regulators requiring the insurers to reform their business practices by, among

⁶⁸ *Modernization Report*, 49.

⁶⁹ See Leslie Scism, *Life Insurers Pressed on Lost Policies*, Wall Street Journal (updated August 13, 2012).

⁷⁰ *Id.*

other things, conducting regular and timely searches of the DMF for deceased policyholders.⁷¹ In addition, several states enacted laws requiring life insurers to perform regular and frequent comparisons of records of in-force life policies against the DMF or a database or service at least as comprehensive as the DMF. Under these laws, an insurer that learns a policyholder has died is required to identify and pay any death benefits that may be due.⁷²

The SSA receives death data from a number of sources, including state vital records agencies. Since November 1, 2011, however, DMF data available to insurers have not included the reports of deaths received from states. The “full” death file, which includes such data, is now only available for use by certain federal benefit-paying agencies.⁷³ Further, the Bipartisan Budget Act of 2013 limits access to the DMF to persons certified under a program established by the Secretary of Commerce.⁷⁴ In March 2014, the National Technical Information Service (NTIS), the agency in the Department of Commerce which supervises public access to the DMF, published an interim final rule establishing a temporary certification program for subscribers of the DMF.⁷⁵ The NTIS has reported that a number of life insurers have complied with the certification program. Without access to the full file, the effectiveness of using the DMF as the method of identifying life policyholders who have died, in order to help ensure that beneficiaries receive death benefit payments, is unclear. FIO is working to support stakeholder efforts to identify suitable alternative data sources, while working with stakeholders (including the NTIS) to support appropriate access to the DMF.

2. Annuity Suitability

The *Modernization Report* addresses the importance of national consumer protection standards with respect to the sale of all annuity products and urges states to adopt the Model Suitability Regulation.⁷⁶

The Model Suitability Regulation expressly defines suitability information, and if adopted as state law would require insurance producers (i.e., agents or brokers who market, distribute, or sell insurance products) to make reasonable efforts to obtain this information and to take it into consideration before recommending any annuity purchase. Further, the Model Suitability Regulation would require insurers to provide product-specific training to producers and to review the suitability of an annuity for a particular consumer prior to issuing the annuity, thereby providing an important check on the producer’s recommendation. The Model Suitability Regulation also would require producers to complete a one-time training course approved by the respective state insurance regulator and would require an insurer to verify that producers have completed this training prior to receiving the insurer’s authorization to sell its annuity products.

In order for all prospective annuity owners to receive the consumer protections provided in the Model Suitability Regulation, it must be adopted by all states. In 2013, the Model Suitability Regulation was adopted in seven states, bringing to 30 the total number of states that have adopted it in full (three additional states have adopted only the training provisions). With unprecedented numbers of seniors reaching retirement age and living longer, annuity suitability standards should not vary based on geography and should meet or exceed a common standard. FIO will continue to monitor and report on the states’ progress toward full adoption of the Model Suitability Regulation.

71 Information regarding the insurers that have entered into such settlement agreements can be accessed from the website of the Florida Department of Financial Services, *available at* <http://www.myfloridacfo.com/division/consumers/faq/faq.htm>.

72 *See, e.g.*, N.Y. Ins. Law § 3240 (2013). The states of Alabama, Kentucky, Maryland, Montana, Nevada, New Mexico, New York, North Dakota, and Vermont have enacted similar laws.

73 The Social Security Act prohibits SSA from using death information it obtains from the states for purposes other than those described in section 205(r) thereof, and exempts that information from disclosure under the Freedom of Information Act and the requirements of the Privacy Act. 42 U.S.C. § 405(r)(6).

74 Section 203 Pub. L. 113-67 (Dec. 26, 2013).

75 *Temporary Certification Program for Access to the Death Master File*, 79 Fed. Reg. 16671 (March 26, 2014), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2014-03-26/pdf/2014-06701.pdf>.

76 *Modernization Report*, 51-52.

D. Force-Placed Insurance

Force-placed insurance protects the interests of a mortgage lender who accepts a borrower's real property as collateral, in the event the borrower fails to maintain adequate property insurance.⁷⁷ Under a common industry practice, the mortgage servicer, on the lender's behalf, obtains FPI for all collateralized real property in the lender's portfolio. During the financial crisis, personal financial issues resulted in higher usage of FPI. Investors and borrowers pointed to the deleterious impact of the high premium for FPI relative to traditional property insurance, which made it more difficult both for borrowers to keep their home and for investors to recoup the full principal after foreclosures. Some borrowers complained that FPI was erroneously placed on their homes.

Section 1463 of the Dodd-Frank Act amended the Real Estate Settlement Procedures Act (RESPA) to prohibit a mortgage servicer from triggering FPI coverage for a property unless the mortgage servicer has a reasonable basis to believe the borrower has failed to comply with the contractual requirement to maintain property insurance.⁷⁸ RESPA now specifies the requirements a mortgage servicer must meet to demonstrate such a reasonable basis, including notifying borrowers in writing prior to triggering FPI.⁷⁹ In addition, a servicer must terminate FPI within 15 days of receipt of confirmation of a borrower's insurance coverage, and refund all FPI premiums.⁸⁰ RESPA also requires all charges related to FPI, other than a the premium regulated under state law, to be "bona fide and reasonable."⁸¹

In November 2013, the Federal Housing Finance Agency (FHFA) directed Fannie Mae and Freddie Mac to prohibit mortgage servicers from (i) receiving FPI commissions, and (ii) using affiliated entities to insure or reinsure FPI.⁸²

Three states – California, Florida, and New York – have taken action to address concerns about the cost of FPI. The California Department of Insurance directed insurers writing FPI to submit new rate filings in 2012 and, as a result, insurers reduced the premiums for FPI by about 30 percent. The Florida Office of Insurance Regulation ordered insurers writing FPI to file new premium rates in 2009, 2012, and 2013, and used the rate review process to enter into a consent order with one of the largest FPI insurers that requires a premium rate review each year until further notice. In September 2013, the New York Department of Financial Services (NYDFS) proposed regulations for FPI that, among other things, would require an insurer to file rates for FPI premiums assuming an expected loss ratio of at least 62 percent (with the expectation that these premium rates would reduce costs to consumers), to annually report the FPI loss ratio, and to re-file FPI premium rates at least once every three years or more frequently if the loss ratio falls below 40 percent for the immediately preceding calendar year.⁸³

State-by-state variations create uneven protections from abusive FPI practices for borrowers across the country. FIO will continue to monitor and report on activities of state insurance regulators with regard to concerns about FPI premiums and practices.

77 FPI is sometimes referred to as "lender-placed insurance" or "creditor-placed home insurance."

78 12 U.S.C. § 2605(k).

79 12 U.S.C. § 2605(l).

80 12 U.S.C. § 2605(l)(3).

81 12 U.S.C. § 2605(m).

82 Press Release, *FHFA Directs Fannie Mae and Freddie Mac to Restrict Lender-Placed Insurance Practices* (Nov. 5, 2013), *available at* <http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Directs-Fannie-Mae-and-Freddie-Mac-to-Restrict.aspx>.

83 NYDFS Proposed Insurance Regulation 202 (to be codified at N.Y. Comp. Codes R. & Regs. Tit. 11 § 227.7).

V. U.S. REGULATORY DEVELOPMENTS

A. Designations by the Financial Stability Oversight Council

The Council was established by Title I of the Dodd-Frank Act and charged with several primary purposes, including identifying risks to the financial stability of the United States that could arise from the material distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, and to respond to emerging threats to financial stability. The Dodd-Frank Act also authorizes the Council to designate a nonbank financial company – which may include an insurer – to be subject to supervision by the Federal Reserve and enhanced prudential standards (e.g., addressing liquidity, resolution planning, and other factors). The Dodd-Frank Act sets forth standards for the Council’s determinations regarding nonbank financial companies, and the Council voluntarily issued a rule and interpretative guidance that provides transparency into the Council’s detailed framework and process for evaluating these companies for designation.⁸⁴

In 2013, the Council determined that three nonbank financial companies, two of which are insurers, must be subject to supervision by the Federal Reserve and enhanced prudential standards. Specifically, the Council voted in July 2013 to make a final determination regarding AIG, and in September the Council voted to make a final determination regarding Prudential.⁸⁵

B. Supervision of Nonbank Financial Companies by the Federal Reserve

Under the Dodd-Frank Act, a nonbank financial company must register with the Federal Reserve within 180 days from the date on which the Council makes its final determination. Under Section 165 of the Dodd-Frank Act, the Federal Reserve is responsible for establishing the enhanced prudential standards that will be applicable to a nonbank financial company. Pursuant to Section 165, the Federal Reserve issued a final rule establishing enhanced prudential standards for large U.S. bank holding companies and foreign banking organizations.⁸⁶ However, the Federal Reserve’s rule currently does not apply to the designated nonbank financial companies. Instead, the Federal Reserve plans to apply enhanced prudential standards to a nonbank financial company through a forthcoming order or rule following an evaluation of the business model, capital structure, and risk profile of each designated nonbank financial company.⁸⁷

In 2011, the Federal Reserve issued a final rule requiring large U.S. bank holding companies and nonbank financial companies designated by the Council to submit resolution plans to the Federal Reserve and the FDIC.⁸⁸ In July 2014, the two insurers designated by the Council submitted initial resolution plans.⁸⁹

C. Insurance Producers

Non-uniform state licensing requirements for insurance producers can present redundant or inconsistent obligations and barriers to entry.⁹⁰ Steps to promote greater uniformity in state producer licensing requirements have included the NAIC’s development in 1996 of the National Insurance Producer Registry (NIPR), a centralized producer database, and enactment in 1999 of the Gramm-Leach-Bliley Act (GLBA), which set a November 2002 deadline for

⁸⁴ See 12 C.F.R. pt. 1310.

⁸⁵ Bases for final determinations are *available at* <http://www.treasury.gov/initiatives/fsoc/designations/pages/default.aspx#nonbank>.

⁸⁶ 12 C.F.R. Part 252.

⁸⁷ Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240, 17, 243-45 (Mar. 27, 2014), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2014-03-27/pdf/2014-05699.pdf>.

⁸⁸ 12 C.F.R. pt. 381.

⁸⁹ AIG Resolution Plan (July 1, 2014), *available at* <https://www.fdic.gov/regulations/reform/resplans/plans/aig-165-7114.pdf>; Prudential Resolution Plan (June 30, 2014), *available at* <https://www.fdic.gov/regulations/reform/resplans/plans/pru-165-7114.pdf>.

⁹⁰ See *Modernization Report*, 46-48.

a majority of the states to either enact uniform producer licensure laws or adopt reciprocity laws (Uniform Licensing Standards).⁹¹

A majority of states have adopted frameworks for reciprocal recognition of producers seeking to be licensed in more than one state and have adopted laws implementing Uniform Licensing Standards. Notwithstanding such efforts, some states do not participate in these reciprocity and uniformity efforts, resulting in unnecessary regulatory burdens that are detrimental to the interests of consumers.⁹² To address this concern, FIO has recommended adoption and implementation of legislation known as the National Association of Registered Agents and Brokers Reform Act of 2013 (NARAB II).⁹³ Under NARAB II, a commission would be established and guided by a board comprised of state insurance regulators and producers. The National Association of Registered Agents and Brokers would be responsible for issuing multi-state licenses to producers, which would preempt the application of any state law or regulation for purposes of licensing and continuing education. If and when NARAB II becomes law, uniform standards will be established by state insurance regulators, and producers will benefit from implementation of a single, centralized licensing location and process.

In 2008, 2009, and again in 2011, “NARAB II” bills were introduced to establish a national producer registry.⁹⁴ Related legislative activity has occurred in the 113th Congress. The House passed a NARAB II bill (H.R. 1155) in September 2013. The Senate passed NARAB II legislation in January 2014 (S. 1926, Title II) and in July 2014 (S. 2244, Title II).

Recruitment of new producers is a related matter. Life insurance industry representatives report that the agent sales force has decreased by one-third since the 1970s and is expected to decline further as the baby boom generation enters retirement.⁹⁵ The observed decrease in the number of life insurance agents may partially explain the 3 percent decline in individual life insurance sales in 2013, ending two years of positive policy count growth in the U.S.⁹⁶ While the internet has transformed how insurers and insurance producers interact with consumers, many consumers still appear to prefer in-person contact with an insurance producer.⁹⁷ Despite the decline in the number of life insurance policies sold to individuals, consumer surveys suggest that demand remains high, with one in four U.S. consumers expressing a need more life insurance.⁹⁸ Additionally, an increasing number of consumers need sound advice to achieve retirement aspirations.⁹⁹ FIO continues to monitor life insurance sales and the number of life insurance producers to ascertain whether policymakers should consider efforts beyond NARAB II to encourage producer licensing and to promote access to essential insurance products.

91 See Subtitle C, Pub. L. 106-102, 113 Stat. 1422 (Nov. 12, 1999).

92 *Modernization Report*, 47.

93 *Id.* at 46.

94 H.R. 5611 (2008); H.R. 2554 (2009); H.R. 1112 (2011); S. 2342 (2012).

95 See ACLI presentation at the Producer Licensing Testing and Examinations Public Hearing of the NAIC, *Why Producer Licensing Matters* (August 17, 2010).

96 *LIMRA Reports Individual Life Insurance Sales Flat in 2013* (March 13, 2014). See generally PWC, *fs viewpoint* (Feb. 2013), available at http://www.pwccn.com/webmedia/doc/635133955178416045_insurance_fs_viewpoint_feb2013.pdf (addressing life insurance distribution channels).

97 Best’s Special Report, *Distribution Trends Continue to Shift in the Private Passenger Automobile Market* (Sept. 16, 2013). As noted in FIO’s 2013 annual report, distribution channels have evolved over the years in response to changes in customer behavior, technological developments, and competitive factors—and now include distribution through producers, financial planners (for life and annuity products), direct sales by telephone or mail, workplace selling (for voluntary benefits), bank channels, and the internet.

98 *LIMRA 2014 Insurance Barometer Study* (April 9, 2014).

99 See Society of Actuaries 2013 Life & Annuity Symposium, *Perspectives on Life Insurance and Annuities in the Middle Market* (May 6-7, 2013).

D. Private Equity Acquisition of Annuity Writers

The nature of the annuity business – long-term liabilities – demands that management of annuity writers have a long-term view of risk management. Some believe these attributes could be inconsistent with the business model of private equity firms, thereby creating risks which regulators should monitor and/or mitigate when private equity firms acquire annuity writers.¹⁰⁰ In 2013, the NAIC formed the Private Equity Working Group to consider these concerns, and in 2014 the working group directed NAIC staff to develop a new section to the NAIC Financial Analysis Handbook regarding review of change in control applications and analysis of investment portfolios of insurers owned by private equity firms as compared to other insurers.

In addition, two states already have imposed enhanced regulatory expectations while authorizing the acquisition of three annuity writers by private equity firms. In 2013, the NYDFS required Sun Life Insurance and Annuity Company of New York¹⁰¹ and Aviva Life and Annuity Company of New York¹⁰² to maintain risk-based capital levels at specified levels, to establish a separate backstop trust account, to obtain regulatory approval of any material changes to the operations of these subsidiaries, and to disclose certain information about the operations of the subsidiaries. Similarly, the Iowa Insurance Commissioner required Aviva to meet the reserving standards of Actuarial Guideline 33 for all non-variable deferred annuities containing guaranteed minimum death benefits or withdrawal benefits issued after December 31, 2013, to obtain regulatory approval before paying ordinary or extraordinary dividends or changing its plan of operations, and to submit all affiliated agreements and investments for review.¹⁰³ Recently, the NYDFS took additional steps to codify and amplify the requirements it imposed for the Sun Life and Aviva Life acquisitions by proposing to amend New York's insurance holding companies regulation.¹⁰⁴

E. Terrorism Risk Insurance Program

After the terrorist attacks of September 11, 2001, insurers and reinsurers largely withdrew from the terrorism risk insurance market. Finding that the widespread unavailability of insurance for terrorism risk “could seriously hamper ongoing and planned construction, property acquisition, and other business projects, generate a dramatic increase in rents, and otherwise suppress economic activity,” Congress enacted TRIA in 2002.¹⁰⁵

TRIA established the Terrorism Risk Insurance Program (TRIP) within Treasury. The Dodd-Frank Act authorizes FIO to assist the Secretary in administering TRIP. In general, TRIA requires each commercial P/C insurer to participate in TRIP and to make coverage available for losses resulting from “certified” acts of terrorism. Further, TRIA authorizes the Secretary to make federal payments to an insurer for a portion of insured losses resulting from a certified act of terrorism that exceed the insurer's deductible as determined under TRIA. Insurers also co-participate with federal funding with respect to payments for losses above the deductible, and may be required to surcharge policyholders in order to fund recoupment payments to Treasury. To date, an act of terrorism has not been certified.

¹⁰⁰ E.g., Center for Insurance Policy Research Newsletter, *Private Equity & Hedge Funds Seek to Move into the Insurance Arena* (NAIC July 2013).

¹⁰¹ NYDFS, *Guggenheim Partners Agrees to Heightened Policyholder Protections As Part of Planned Acquisition of Sun Life* (July 31, 2013), available at <http://www.dfs.ny.gov/about/press2013/pr1307311.htm>. Sun Life Insurance and Annuity Company of New York was acquired by Guggenheim Partners LLC.

¹⁰² NYDFS, *DFS Announces Second Major Firm Agrees to Enhanced Policyholder Protections As Part of Annuity Company Acquisition* (August 14, 2013), available at <http://www.dfs.ny.gov/about/press2013/pr1308141.htm>. Aviva Life and Annuity Company of New York was acquired by Apollo Global Management LLC.

¹⁰³ Iowa Insurance Division, *Insurance Commissioner Issues Conditional Approval of Athene Purchase of Aviva* (August 15, 2013), available at <http://www.iid.state.ia.us/node/6504139>. Aviva Life and Annuity Company was acquired by Apollo Global Management LLC.

¹⁰⁴ NYDFS, Proposed Fifth Amendment to 11 NYCRR 80-1 (Insurance Regulation 52), New York State Register (May 14, 2014), available at http://www.dfs.ny.gov/insurance/r_prop/rp52a5t.pdf.

¹⁰⁵ Pub. L. No. 107-297; 15 U.S.C. § 6701 note.

Section 108(e) of TRIA requires the PWG to conduct, on an ongoing basis, an analysis of the long-term availability and affordability of insurance for terrorism risk, and to report to Congress the PWG's findings.¹⁰⁶ The PWG most recently submitted its report to Congress in April 2014.¹⁰⁷ Among other findings, the April 2014 *PWG Report* concluded that insurance for terrorism risk is, in general, currently available and affordable, but that it likely would be less available or less affordable in the absence of TRIA.¹⁰⁸

As enacted, TRIA was originally scheduled to expire on December 31, 2005, and was reauthorized in 2005 and again in 2007. With both reauthorizations, Congress modified elements of TRIP, in part to reduce federal taxpayer exposure under TRIA to insured losses from certified acts of terrorism. The 2007 reauthorization of TRIA is scheduled to expire on December 31, 2014. Whether Congress should allow TRIA to expire, reauthorize the program in its current form, or reauthorize it with reforms is being discussed in Congress.¹⁰⁹ Alternative versions of legislation pending in Congress would reauthorize TRIP beyond December 31, 2014.¹¹⁰

The President's Budget for fiscal year 2015 "proposes to extend [TRIA] and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality."¹¹¹ The President's Budget also provides that "[t]he Administration will work with Congress to identify appropriate adjustments to program terms to achieve budget neutrality and, over the longer term, full transition of the program to the private sector." The Administration recently noted the continued importance of TRIP: "Since it was first established in 2003, the Program has effectively kept terrorism insurance available and affordable so that American businesses can secure necessary coverage, thereby promoting economic growth and employment opportunities for American workers."¹¹²

106 TRIA § 108(e). The PWG is comprised of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Securities and Exchange Commission, and the Chairman of the Commodity Futures Trading Commission (or their respective designees). The Secretary of the Treasury serves as chair of the PWG. Exec. Order No. 12,631; 53 Fed. Reg. 9,421 (Mar. 18, 1988).

107 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-notice>.

108 *Id.* at 2. Public comments submitted to the PWG in connection with the *PWG Report* are available at <http://www.treasury.gov/initiatives/fio/reports-and-notice>.

109 The House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs held hearings on the potential reauthorization of TRIA in 2012 and 2013, and on February 25, 2014. *Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II, Hearing before the S. Comm. on Banking, Housing, & Urban Affairs*, 113th Cong. (February 25, 2014), available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=08e1735c-d2be-4260-a1dc-12975ab9397f.

110 See H.R. 508, 113th Cong.; H.R. 1945, 113th Cong.; H.R. 2146, 113th Cong., H.R. 4871, 113th Cong.; and S. 2244, 113th Cong.

111 Fiscal Year 2015 Budget of the U.S. Government, Office of Management and Budget, Appendix 1041, available at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/appendix.pdf>.

112 Executive Office of the President, *Statement of Administration Policy*, S. 2244—Terrorism Risk Insurance Program Reauthorization Act of 2014 (July 17, 2014), available at http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saps2244s_20140717.pdf.

Box 3: Cyber Risk Insurance

Companies of all sizes are becoming more aware of exposures to cyber risk and are increasingly seeking or purchasing cyber risk insurance to reduce a range of cyber-related exposures. Theft of personally identifiable information (PII), especially on the scale witnessed in the 2013 cyber attacks against prominent retailers, can cause financial distress for consumers and significant litigation, data recovery, and business interruption costs for companies. One retailer, for example, disclosed costs of \$60 million in connection with the 2013 data security breach.¹¹³ In a July 2014 presentation, the Secretary highlighted the growing threat from cyber attacks on financial institutions.¹¹⁴

Until recently, companies may have assumed that cyber incidents would be covered under commercial property or general liability policies; however, this might not be the case, and standalone cyber risk insurance take-up rates are growing. Increased awareness of cyber risks, new product offerings, and competition from smaller insurers are seen as reasons for growth in the cyber insurance market.¹¹⁵ Such insurance can provide a range of protections including, for example, coverage for data loss and restoration costs, litigation and regulatory costs, and the costs of incident response and recovery efforts. Insurers continue to develop new and innovative products to address these and other cyber risk exposures.¹¹⁶

Additionally, many insurers are now encouraging policyholders to put in place policies, procedures, and systems to reduce the likelihood of cyber loss and to mitigate the severity of damage such cyber incidents might cause.

One report estimates that approximately ninety insurers offer cyber risk insurance and that the standalone cyber risk insurance market is approaching \$2 billion in annual direct written premium.¹¹⁷ Recent data show trends in both take-up rates and product offerings markedly increasing. Those industries that rely more heavily on technology and that manage the largest caches of PII (such as financial services and insurance, telecommunications, retail, and health care) are demonstrating stronger cyber risk insurance take-up rates.

F. Flood Insurance

The National Flood Insurance Program¹¹⁸ has been the subject of significant attention in Congress during the past several years. Established in 1968 to provide property owners with flood insurance coverage which was not available through the private market,¹¹⁹ the NFIP enables a property owner in participating communities to purchase federally-backed flood insurance through participating insurers. Participating communities are required to adopt adequate land use and control measures intended to reduce flood risk.¹²⁰

113 Target Corp., *Annual Report for Fiscal Year Ended Feb. 1, 2014*, pages 16-17, available at <http://www.sec.gov/Archives/edgar/data/27419/000002741914000014/tgt-20140201x10k.htm>. The \$60 million figure does not include future litigation and business restoration costs.

114 Press Release, *In Call To Action, Treasury Secretary Lew Urges U.S. Financial Sector To Redouble Efforts Against Cyber Threats* (July 17, 2014), available at <http://www.treasury.gov/press-center/press-releases/Pages/jl2571.aspx>; *Remarks of Secretary Jacob J. Lew at the 2014 Delivering Alpha Conference Hosted by CNBC and Institutional Investor* (July 17, 2014), available at <http://www.treasury.gov/press-center/press-releases/Pages/jl2570.aspx>.

115 Betterley Risk Consultants, Inc., *The Betterley Report: Cyber/Privacy Insurance Market Survey—2014* (June 2014), 6.

116 See, e.g., Press Release, *AIG Expands Cyber Coverage to Include Physical Risks Posed by Cyber Attacks, Security Failure* (April 23, 2014), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=76115&p=irol-newsArticle&ID=1921298&highlight=>.

117 Betterley Risk Consultants, Inc., *The Betterley Report: Cyber/Privacy Insurance Market Survey—2014* (June 2014), 5.

118 42 U.S.C. § 4001 *et seq.*

119 42 U.S.C. § 4001(b).

120 42 U.S.C. § 4022.

The NFIP, which is administered by FEMA, currently has approximately 5.6 million policies in force, totaling about \$1.3 trillion of insured coverage, for which it annually collects approximately \$3.8 billion in premiums.¹²¹ The NFIP paid approximately \$2.4 billion of insured losses in 2011, \$8.9 billion in 2012, and \$478 million in 2013.¹²² Annual paid losses, which were as low as \$252 million in 2000, peaked at \$17.8 billion in 2005 (largely related to Hurricane Katrina).¹²³

Premiums under the NFIP may be subsidized or unsubsidized, depending on when the insured property was constructed and when the applicable Flood Insurance Rate Map (FIRM) was issued. “Post-FIRM” buildings (i.e., buildings constructed after the issuance of a FIRM) are charged unsubsidized, full-risk premiums. Premiums for Post-FIRM buildings that do not comply with local floodplain management ordinances may be much higher than premiums for Post-FIRM buildings that do comply. “Pre-FIRM” buildings (i.e., buildings constructed before the issuance of a FIRM) are charged subsidized, less than full-risk premiums. While the subsidized premiums for Pre-FIRM buildings are significantly higher than the full-risk premiums for Post-FIRM buildings, these subsidized premiums nonetheless amount to only 40 to 45 percent of what the full-risk premiums for Pre-FIRM buildings would otherwise be. Approximately 78 percent of NFIP policies are charged full-risk premiums, and approximately 22 percent are subsidized.¹²⁴

Before 2005, aggregate NFIP premiums were generally sufficient to offset insured flood losses. On several occasions, the NFIP exercised its authority to borrow from Treasury when losses exceeded available capital, and in each instance NFIP repaid the debt to Treasury. More recently, NFIP’s borrowing authority and its debt to Treasury increased substantially due to repetitive losses and large-scale events such as long-term recovery in Katrina and Superstorm Sandy. Hurricane Katrina alone caused more than \$16 billion of NFIP-insured flood losses.¹²⁵

The Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) includes measures designed to improve the financial position of the NFIP, and would eliminate premium subsidies for several classifications of Pre-FIRM properties.¹²⁶ For example, Biggert-Waters would require the NFIP to charge full-risk premiums for any: (1) non-primary residences; (2) “severe repetitive loss” properties; (3) properties that have accumulated damage amounts exceeding their values; (4) business properties; (5) properties recently damaged or improved to certain extents; (6) properties with new or lapsed policies; or (7) properties for which FEMA mitigation assistance has been refused.¹²⁷ Biggert-Waters also would increase the minimum-required deductible amount for all NFIP policies¹²⁸ and increase the limit on rate increases that could be implemented on any single class of properties during a policy year.¹²⁹

121 FEMA, *Total Policies in Force by Calendar Year*, available at <http://www.fema.gov/policy-claim-statistics-flood-insurance/policy-claim-statistics-flood-insurance/policy-claim-13-14>; FEMA, *Total Coverage by Calendar Year*, available at <http://www.fema.gov/policy-claim-statistics-flood-insurance/policy-claim-statistics-flood-insurance/policy-claim-13-12>; FEMA, *Total Earned Premium by Calendar Year*, available at <http://www.fema.gov/statistics-calendar-year/total-earned-premium-calendar-year>. See also <http://www.fema.gov/flood-insurance-statistics-current-month/>.

122 FEMA, *Loss Dollars Paid by Calendar Year*, available at <http://www.fema.gov/statistics-calendar-year/loss-dollars-paid-calendar-year>.

123 *Id.*

124 Information and data in this paragraph from: National Flood Insurance Program, *Actuarial Rate Review*, 4 – 6 (October 1, 2011), available at http://www.fema.gov/media-library-data/20130726-1809-25045-6893/actuarial_rate_review2011.pdf.

125 FEMA, *Significant Flood Events*, available at <http://www.fema.gov/significant-flood-events>.

126 Pub. L. No. 122-141, (July 6, 2012).

127 Flood Insurance Reform Act § 100205(a).

128 Flood Insurance Reform Act § 100210.

129 Flood Insurance Reform Act § 100205(c).

In January 2013, Congress increased the NFIP's borrowing authority from \$20.725 billion to \$30.425 billion,¹³⁰ after "Superstorm" Sandy caused more than \$7.6 billion of NFIP-insured flood losses in October 2012.¹³¹ As of July 31, 2013, the NFIP's outstanding debt to Treasury was approximately \$24 billion.¹³² In March 2014, Congress passed and the President signed the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA),¹³³ which prohibits the implementation of many of the Biggert-Waters rate increases.¹³⁴ In addition, HFIAA requires FEMA to submit an "affordability framework" to Congress, which would address the issues identified in an affordability study required by Biggert-Waters.¹³⁵ FIO will continue to monitor U.S. flood insurance developments, a topic likely to remain of interest as severe weather events increase in frequency and severity.¹³⁶

G. Captive Life Reinsurance

In the *Modernization Report*, FIO recommends that states "develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives."¹³⁷ This recommendation is addressed particularly to the practice by some commercial U.S. life insurers of transferring insurance risk to captive life reinsurance companies ("reinsurance captives") – i.e., affiliated special-purpose insurers – as a means of addressing certain regulatory reserve requirements for some life insurance and annuity products. As explained in the *Modernization Report*, many overseas jurisdictions and states in the U.S. serve as domiciles for captives, with some states competing to be domestic regulators for reinsurance captives.¹³⁸ Concerns include: (i) that reinsurance captives allow insurers to receive credit against reserve and capital requirements by transferring risk to reinsurance captives even though the reinsurance captives are not bound by rigorous or consistent capital rules across the states; and (ii) a lack of transparency and consistent oversight of reinsurance captives from state-to-state.¹³⁹

Other key stakeholders also have recognized the need for reforms in order to promote transparency and uniformity. In June 2013, the NYDFS characterized cessions of insurance risk by life insurers to reinsurance captives as "shadow insurance."¹⁴⁰ In August 2013, Moody's released a report noting that the increased use of captives by life insurers "can lead to complex corporate structures and reduced financial transparency," both of which the report described as "credit negatives."¹⁴¹ In its recent annual report, the Council also raised concerns related to captive reinsurance.¹⁴²

130 Pub. L. No. 113-1.

131 FEMA, *Significant Flood Events*, available at <http://www.fema.gov/significant-flood-events>.

132 Government Accountability Office, *National Flood Insurance Program: Continued Attention Needed to Address Challenges*, GAO-13-858T (September 18, 2013), available at <http://www.gao.gov/assets/660/657939.pdf>.

133 Pub. L. No. 113-89 (March 21, 2014).

134 See FEMA, *Homeowner Flood Insurance Affordability Act: Overview*, 1 (March 28, 2014), available at <http://www.fema.gov/media-library/assets/documents/93074>. HFIAA provides that certain Biggert-Waters rate increases that have already been implemented shall be refunded. *Id.* at 2.

135 HFIAA § 9(a). See Biggert-Waters § 100236.

136 See, e.g., FEMA, *National Strategy Recommendations: Future Disaster Preparedness* (September 2013 at 2, available at [http://www.fema.gov/media-library-data/bd125e67fb2bd37f8d609cbd71b835ae/FEMA+National+Strategy+Recommendations+\(V4\).pdf](http://www.fema.gov/media-library-data/bd125e67fb2bd37f8d609cbd71b835ae/FEMA+National+Strategy+Recommendations+(V4).pdf)).

137 *Modernization Report*, 32.

138 *Id.* at 33.

139 *Id.*

140 NYDFS, *Shining a Light on Shadow Insurance* (June 2013), available at http://www.dfs.ny.gov/reportpub/shadow_insurance_report_2013.pdf.

141 Moody's Investors Service, *The Captive Triangle: Where Life Insurers' Reserve and Capital Requirements Disappear*, 3 (August 23, 2013).

142 Council, *2014 Annual Report* (May 2014), 73, available at <http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/default.aspx>.

Additionally, a March 2014 report by economists associated with the Federal Reserve Bank of Minneapolis highlighted the “increasing use of ‘captive reinsurance’” as a source of risk in the life insurance sector.¹⁴³

State regulators began to address this issue in 2011 - 2012. A proposal developed by an NAIC consultant concerning regulatory treatment of reinsurance captive transactions received a range of comments and replies from state insurance regulators in the first quarter of 2014. Some regulators pressed for accelerated implementation of its recommendations, while others advocated an immediate moratorium on reinsurance captive transactions until further reforms can be implemented. In June 2014, a revised proposal was released, and the NAIC has received additional comment from regulators and other stakeholders. The NYDFS characterized the June proposal as a step backward which, if adopted, would leave unresolved a “gaping regulatory problem that is ... central to the protection of policyholders.”¹⁴⁴ FIO will continue to monitor and report on regulatory treatment of this issue.

143 Ralph S. J. Koijen and Motohiro Yogo, *Growing Risk in the Insurance Sector*, Federal Reserve Bank of Minneapolis Economic Policy Paper 14-2 (March 2014), *available at* http://www.minneapolisfed.org/pubs/eppapers/14-2/epp_14-2.pdf.

144 *See* NYDFS Letter to Commissioners (Aug. 8, 2014), *available at* <http://www.dfs.ny.gov/about/press2014/pr140814-letter.pdf>. *See also* Comment Letter to NAIC Principles-Based Reserving Implementation Task Force (March 21, 2104), *available at* <http://www.dfs.ny.gov/about/press2014/pr1403211-letter-rector.pdf>.

VI. INTERNATIONAL REGULATORY DEVELOPMENTS

While the United States remains the world's largest insurance market by premium volume, its share has declined both as a percentage of domestic GDP and as a percentage of worldwide market share. Emerging economies have seen dramatic increases in premium volume, as highlighted in Figure 36. For example, from 2008 to 2013, China's premium volume nearly doubled, to \$278 billion, and its global market share increased from 3.30 percent to 5.99 percent. Opportunities for the private insurance industry continue to expand in established and emerging markets.

Figure 36: Gross Premium Written in Market Share by Country, 2008 vs. 2013

2008 Rank	2013 Rank	Country	2008 Premium Volume	2008 World Market Share (%)	2013 Premium Volume	2013 World Market Share (%)	Change in World Market Share (%)
1	1	United States	\$ 1,240,643,000,000	29.06	\$ 1,272,724,000,000	27.13	-6.64
2	2	Japan	473,197,000,000	11.08	531,506,000,000	11.45	3.34
3	3	United Kingdom	450,152,000,000	10.54	329,643,000,000	7.10	-32.64
6	4	China	140,818,000,000	3.30	277,965,000,000	5.99	81.52
4	5	France	273,007,000,000	6.39	237,605,000,000	5.49	-14.08
5	6	Germany	243,085,000,000	5.69	247,162,000,000	5.33	-6.33
7	7	Italy	140,689,000,000	3.30	168,554,000,000	3.63	10.00
10	8	South Korea	97,023,000,000	2.27	145,427,000,000	3.13	37.89
9	9	Canada	122,532,000,000	2.87	125,344,000,000	2.70	-5.92
8	10	Netherlands	112,611,000,000	2.64	101,120,000,000	2.18	-17.42
13	11	Taiwan	64,265,000,000	1.51	90,977,000,000	1.96	29.80
17	12	Brazil	47,493,000,000	1.11	88,931,000,000	1.92	72.97
12	13	Australia	70,951,000,000	1.66	78,309,000,000	1.69	1.81
11	14	Spain	87,038,000,000	2.04	72,510,000,000	1.56	-23.53
14	15	India	56,190,000,000	1.32	65,576,000,000	1.41	6.82
16	16	Switzerland	48,718,000,000	1.14	62,597,000,000	1.35	18.42
18	17	Ireland	44,918,000,000	1.05	55,780,000,000	1.20	14.29
19	18	South Africa	42,515,000,000	1.00	54,121,000,000	1.17	17.00
NR	19	Sweden	NR	NR	41,478,000,000	0.89	NA
15	20	Belgium	49,077,000,000	1.15	39,008,000,000	0.84	-26.96
World			4,218,115,000,000		4,640,941,000,000		

Source: Swiss Re Sigma, World Insurance in 2013, May 2014
Swiss Re Sigma, World Insurance in 2008, December 2009 (Statistical Appendix Update)

The United States participates in a number of initiatives in various international forums intended to improve the efficacy and consistency of insurance supervisory standards among jurisdictions, to enhance financial stability, and to promote a level playing field for firms operating globally. International prudential standard-setting activities spearheaded through the IAIS, and implementation of such standards by the appropriate national authorities, are driven by at least three important factors:

- (1) Promotion of financial stability;
- (2) Enhancement of understanding among supervisors in whose jurisdictions insurers are pursuing increased market share; and
- (3) Implementation of consistent insurance supervisory regimes reflective of international best practices.

Current developments in these areas are highlighted in this section of the Report.

A. The EU-U.S. Insurance Project

1. Update on the Project

FIO and state insurance regulators have continued active participation in the Project, the objective of which is 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.¹⁴⁵ The Project is carried out through collaboration with 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, FIO, state insurance regulators, and the NAIC.

¹⁴⁵ Additional information is available at <http://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project>.

In December 2012, both sides agreed upon “The Way Forward,” a summary statement describing the areas appropriate for improved harmonization, convergence, and compatibility (*Way Forward Statement*).¹⁴⁶ In the *Way Forward Statement*, the EU and the United States agreed to work closely together and, for 2013, to focus efforts on priority topics that are fundamentally important to a sound regulatory regime, the protection of policyholders, and financial stability. Specifically, those priority topics are: professional secrecy/confidentiality; group supervision; solvency and capital requirements; and reinsurance and collateral requirements.

Project developments in these areas for 2013 included the following:

- A Technical Committee comprised of experts from both the U.S. and EU researched professional secrecy/confidentiality legal frameworks in a number of U.S. states and EU member states that are home supervisors to groups operating on a cross-border basis in both jurisdictions.
- In December 2013, the Steering Committee held a Supervisory Colleges Best Practices Forum in Washington, D.C.¹⁴⁷ The forum consisted of panels which discussed the state of college cooperation.¹⁴⁸ 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 respect to reinsurance and collateral requirements, the *Way Forward Statement* provides, among other initiatives, that FIO would respond to suggestions regarding its authority under the Dodd-Frank 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 pursue a covered agreement for reinsurance collateral requirements based on the National Association of Insurance Commissioners Credit for Reinsurance Model Law and Regulation.”¹⁴⁹ Reinsurance collateral reform is discussed further below.

Since the *Way Forward Statement* was first published in 2012, various jurisdictional and international developments have continued to emerge. For example, in March 2014, the European Parliament adopted the Omnibus II Directive that will move forward “Solvency II”—the EU’s modernized insurance regulatory regime which goes into effect in January 2016.¹⁵⁰ Similarly, the FSB requested that the IAIS develop certain international capital standards (as described in section VI.B of this Report). In light of recent developments in the EU and the United States, and of progress to date on the Project, the Steering Committee revisited and, in July 2014, updated, the *Way Forward Statement* and reaffirmed the participants’ commitment to the Project.¹⁵¹

2. Reinsurance Collateral

Under the current U.S. state-based insurance regulatory regime, each state’s insurance regulator regulates the solvency of insurers domiciled in that state. A state-licensed insurer may purchase reinsurance from non-U.S. reinsurers or U.S. reinsurers not licensed in the state in which the ceding insurer is licensed. The state regulator for the ceding insurer does not directly regulate those unlicensed reinsurers, including non-U.S. reinsurers. Under the laws of most states, however, if a reinsurer is not licensed, accredited, or approved by the regulator of the state in which it seeks to provide reinsurance, the U.S. ceding insurer typically must obtain from the reinsurer collateral

¹⁴⁶ *Id.*

¹⁴⁷ The IAIS defines a supervisory college as “[a] forum for cooperation and communication between the involved supervisors established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to an insurance group; facilitating both the supervision of the group as a whole on a group-wide basis and improving the legal entity supervision of the entities within the insurance group.” IAIS Glossary, *available at* www.iaisweb.org/index.cfm?pageID=47&vSearchLetter=s##.

¹⁴⁸ Information *available at* http://www.naic.org/meetings1312/committees_g_eu_us_dialogue_2013_fall_nm_agenda.pdf.

¹⁴⁹ *Modernization Report*, 37. See section VI.A.2 of this Report, below.

¹⁵⁰ EIOPA, *Solvency II*, *available at* <https://eiopa.europa.eu/activities/insurance/solvency-ii/index.html>.

¹⁵¹ *Way Forward Statement* (July 2014 revision), *available at* <http://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project>.

equal to 100 percent of the ceded reinsurance liabilities in order for the ceding insurer to receive full “credit for reinsurance” on its financial statements. Absent credit for reinsurance, such transactions are much less beneficial to the ceding insurer in the short term.¹⁵² In this way, state laws regulating credit for reinsurance have the effect of compelling unlicensed reinsurers to post collateral, and thus may be described as a form of “indirect” regulation of such reinsurers.

Non-U.S. reinsurers assert that state laws that require the posting of substantial collateral restrict the ability of a non-U.S. reinsurer to manage risk globally, restrict reinsurance capacity in the U.S., and thereby increase costs for U.S. consumers. The issue is significant because, as described above, non-U.S. reinsurers play a critical role in the U.S. reinsurance market, accounting for 60 percent or more of reinsurance premium ceded by U.S.-based insurers. Moreover, Europe’s Solvency II insurance regulatory regime will call for evaluation of regulatory treatment of reinsurers in non-EU jurisdictions, including such collateral requirements.

State insurance regulators support reinsurance collateral reform, as recognized by their unanimous vote approving the 2011 amendments to the NAIC’s Credit for Reinsurance Model Act and Regulation (Model Reinsurance Collateral Law). The Model Reinsurance Collateral Law – which, if enacted by any of the 50 states, Washington, D.C., or U.S. territories – would provide discretion to the insurance regulator in that jurisdiction to designate “certified reinsurers” that are domiciled in countries determined by the NAIC to be “qualifying jurisdictions.” Certified reinsurers would be eligible for reduced collateral, based on the nature and strength of the regulatory regime in the reinsurer’s home jurisdiction and other factors, including consideration of the credit rating and the reputation of the respective reinsurer.

As of July 2014, 23 states have adopted some measures to reform the requirements relating to collateral for reinsurance. Among those states, however, authorization to accept less than 100 percent collateral has not been uniform in structure or implementation. Other concerns include that the Model Reinsurance Collateral Law relies heavily upon assessments of reinsurers’ creditworthiness by credit rating agencies, rather than on risk-based empirical factors. These observations support Treasury’s view that in the context of international prudential matters regarding the business of insurance, questions concerning reinsurance collateral should be uniformly addressed on the national level.¹⁵³

The Dodd-Frank Act authorizes the Secretary, jointly with USTR, to negotiate and enter into a “covered agreement” with one or more foreign governments, authorities, or regulatory entities regarding “prudential measures with respect to the business of insurance or reinsurance.”¹⁵⁴ Accordingly, Treasury and USTR are engaged internally regarding the *Modernization Report’s* recommendation to reform reinsurance collateral through a covered agreement based on the amended Model Reinsurance Collateral Law.¹⁵⁵

¹⁵² The ceding insurer would benefit to the extent that any reinsured losses that it actually pays are ultimately reimbursed by the reinsurer, but in the meantime (and reserves for incurred losses may be on an insurer’s books for years), there would be no relief from the regulatory burden on the ceding insurer’s capital. Credit for reinsurance permits the ceding insurer’s transfer of risk to the reinsurer to be recognized as a reduction in its liabilities (if the ceding insurer has not yet paid the underlying policy claim), or as an asset (if the ceding insurer has already paid the claim but has not yet been reimbursed by the reinsurer).

¹⁵³ See *Modernization Report*, 37-38.

¹⁵⁴ 31 U.S.C. § 314.

¹⁵⁵ See *Modernization Report*, 38. Prior to and during negotiation of a covered agreement, the Secretary and USTR are required to consult with the Committee on Financial Services and the Committee on Ways and Means of the House of Representatives as well as with the Committee on Banking, Housing, and Urban Affairs and the Committee on Finance of the Senate.

B. Supervision of Global Systemically Important Insurers and Internationally Active Insurance Groups

In July 2013, the FSB, in consultation with the IAIS and national authorities, identified nine G-SIIs, three of which are based in the United States. Currently, the list of G-SIIs will be updated annually (based in part on recommendations from the IAIS' Financial Stability Committee) and published by the FSB every November, starting this year. In addition, the FSB will decide on the G-SII status of major reinsurers by November 2014.

Also in July 2013, the FSB called upon the IAIS to develop international capital standards to apply to IAIGs. First, the FSB called upon the IAIS to finalize in 2014 straightforward "backstop capital requirements" (now referred to as "basic capital requirements," or BCR) to serve as a common baseline for the G-SII HLA requirements. The IAIS has adopted principles to guide the development of the BCR. The BCR will employ an approach in which factors are applied to various categories of risk. The IAIS released its second public consultation document on the BCR in July 2014.¹⁵⁶ The FSB request to the IAIS is for the BCR to be finalized by the time of the G-20 Summit in November 2014. The IAIS subsequently will develop the HLA by the end of 2015, with implementation in January 2019.

In addition, recognizing that insurers increasingly conduct business and generate earnings from outside an insurer's domicile jurisdiction, since 2009, the IAIS has been developing a Common Framework for the supervision of internationally active insurance groups or ComFrame. When implemented, ComFrame will be an integrated, multilateral, and multidisciplinary framework for the group-wide supervision of IAIGs.

The FSB also called upon the IAIS to develop a work plan for a comprehensive, group-wide supervisory and regulatory framework and to include a quantitative ICS applicable to IAIGs. The IAIS has since determined that ComFrame will serve as this framework. ComFrame will establish standards for aspects of group-wide supervision and risk management, including recovery and resolution and the ICS. The IAIS plan to develop ComFrame was reviewed by the FSB in late 2013. The IAIS will develop and field test ComFrame, including the ICS, through 2018 in advance of implementation in 2019. Once finalized, the ICS will become a component of ComFrame and may replace the BCR as the foundation for the HLA requirements for G-SIIs.

The IAIS has commenced the first field testing exercise to inform the development of the BCR and the ICS. In this first exercise, the IAIS collected and evaluated data from a variety of participating international insurance groups, presently including eight U.S.-based groups. Participating groups provided data utilizing three different accounting and valuation bases, which the IAIS will evaluate for comparability and responsiveness to stress. The IAIS will also analyze qualitative requirements (e.g., those pertaining to supervisory and risk management practices) in ComFrame.

156 IAIS Press Release, *BCR Public Consultation* (Dec. 16, 2013), available at <http://www.iaisweb.org/News/Press-releases-51>.

C. Resolution Activities of the FSB and IAIS

In 2013, activity increased respecting development of international standards and regulations pertaining to the resolution of insurers. Progress occurred through the work of both the FSB and the IAIS.

Following the FSB's designation in July 2013 of nine insurers (including three U.S.-based firms) as G-SIIs, in late 2013 the Resolution Steering Group (ReSG) of the FSB formed the iCBCM to assist and support authorities in implementing the resolution-related policy measures for G-SIIs published by the IAIS in mid-2013.¹⁵⁷ The policy measures that are the purview of the iCBCM include recovery and resolution planning applicable to all G-SIIs under the Key Attributes of Effective Resolution Regimes for Financial Institutions (*Key Attributes*).¹⁵⁸ Specifically, the iCBCM assists the ReSG in finalizing implementation guidance for resolution regimes for G-SIIs through an Annex (currently in draft) on the Resolution of Insurers to the *Key Attributes*, monitoring of the progress in establishing Crisis Management Groups (CMGs) for G-SIIs, the negotiation of cross-border cooperation agreements among CMG members, and the development of resolution strategies and recovery and resolution plans for G-SIIs. The IAIS Resolution Working Group (ReWG, discussed below) is represented on the iCBCM. FIO is a member of the iCBCM.

Concurrently, the IAIS formed the ReWG to develop and maintain supervisory guidance on the resolution of insurers, including G-SIIs, and the resolution-related content of ComFrame and of the IAIS' Insurance Core Principles (ICPs).¹⁵⁹ The ReWG will also address standard-setting measures regarding resolution as initiated by the FSB, and represent the IAIS at relevant FSB bodies such as the ReSG and iCBCM. FIO is a member of the ReWG.

157 IAIS, *Global Systemically Important Insurers: Policy Measures* (July 18, 2013), available at <http://www.iaisweb.org/G-SIIs-988>.

158 Financial Stability Board (October 2011), available at http://www.financialstabilityboard.org/publications/r_111104cc.pdf.

159 IAIS, *Insurance Core Principles* (2013), available at <http://www.iaisweb.org/Insurance-Core-Principles-material-adopted-in-2011-795>.