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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Table of Contents

NOTE ON DATA

Except as otherwise indicated (*e.g.*, in endnotes), data cited in this report were derived from SNL Financial LC on April 25, 2013.

I. INTRODUCTION

The insurance industry plays a vital role in the economy of the United States. Insurance premiums in the life and health (L/H) and property and casualty (P/C) insurance sectors totaled more than $1.1 trillion in 2012, or approximately 7 percent of gross domestic product.[1] In the United States, insurers directly employ approximately 2.3 million people[2], or 1.7 percent of nonfarm payrolls.[3] Separately, more than 2.3 million licensed insurance agents and brokers hold more than 6 million licenses.[4]

U.S.-based insurers are also significant participants in the global financial markets. As of year-end 2012, the L/H and P/C sectors reported $7.3 trillion in total assets – roughly half the size of total assets held by insured depository institutions.[5] Of the $7.3 trillion in total assets, $6.8 trillion were invested assets.[6]

Insurers in the United States rank among the largest purchasers of corporate, sovereign, state, and local bonds. Insurer investment portfolios also include short-term commercial paper, asset-backed securities, and other financial instruments. Some U.S. insurers are significant participants in other institutional markets, such as the derivatives and securities lending markets.

Insurers have also been diversifying by expanding into new geographic markets and developing a greater array of insurance product offerings and services. Some insurers and non-insurance affiliates have become more involved with the broader U.S. financial markets, not only as customers or counterparties, but also by engaging in activities such as banking and asset management services. Evidence of this interconnectedness of insurers with the broader financial system was apparent in the financial crisis. Although firms such as American International Group (AIG) represent the most prominent examples, other insurers were also affected by the recent financial crisis.

In Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), Congress established the Federal Insurance Office (FIO) within the U.S. Department of the Treasury.[7] 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 Financial Stability Oversight Council (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);
- 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 and assisting the Secretary in negotiating covered agreements; and

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

In addition, before the Secretary can 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.

The Dodd-Frank Act also requires that the FIO Director report to the President and to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate each year "on the insurance industry and any other information as deemed relevant by the Director or requested by such Committees."[8] FIO has prepared this 2013 Annual Report on the Insurance Industry (Report) with a view to its role as monitor of the insurance industry.[9]

This Report is organized into four sections. Following the introduction and executive summary, Section III reports on the financial performance and condition of the principal insurance sectors (*i.e.*, the Life and Health sector and the Property and Casualty sector). Section III also includes a review of recent insurer insolvencies, risk management, and portfolio investment activities, together with a brief review of other insurance industry sectors such as reinsurance and distribution channels. Section IV of the Report reviews significant legal and regulatory developments affecting the insurance industry. In conclusion, Section V discusses of current and emerging trends that may have a significant impact on the industry.

II. EXECUTIVE SUMMARY

A. INSURANCE INDUSTRY FINANCIAL OVERVIEW

The financial performance and condition of U.S. insurers continued to show recovery and improvement from the decline during the financial crisis. In 2012, the U.S. insurance industry reported record aggregate premium levels. Net written premiums in the United States were approximately $645 billion in the life and health (L/H) sector and approximately $460 billion in the property and casualty (P/C) sector.

At year-end 2012, moreover, reported surplus levels were at record highs for both the L/H and P/C sectors. Both sectors had reported decreases to surplus in 2008 from the then-record surplus levels reported at year-end 2007, which were $267 billion and $529 billion, respectively. Since 2008, both sectors have reported surplus increases each year. For year-end 2012, L/H sector reported surplus was approximately $329 billion and P/C sector reported surplus was approximately $597 billion.

Both the L/H and P/C sectors reported improved profitability in 2012. The L/H sector had reported annual net incomes as high as $37 billion during pre-financial crisis years, but reported substantial losses during the crisis and only $14.4 billion of net income in 2011. Although still challenged by downward pressure on investment returns due to the current low interest rate environment, the L/H sector reported an aggregate net income of $40.9 billion in 2012. In the P/C sector, net income increased from $20.1 billion in 2011 to $37.3 billion in 2012. P/C sector net income was affected for a second consecutive year by large insured losses from natural catastrophes. P/C sector net income had dropped to as low as $3.7 billion in 2008.

Market values of insurers have also been recovering since the financial crisis, when large investment losses led to sharp declines in the book values for many insurers. Although both the market values and book values of insurers have recovered generally, L/H insurers still trade at discounts to book value as of year-end 2012.

Insurers are also end-users of derivatives and use these instruments both for hedging and for investment purposes. In 2012, the five largest U.S. insurers by assets reported more than $1 trillion of combined notional amounts outstanding. Insurers also continue to be significant participants in securities lending and repurchase agreement markets, although the level of activity has declined significantly since the crisis.

B. LEGAL AND REGULATORY DEVELOPMENTS

In 2012, regulators in the United States and internationally have expended significant efforts on financial stability and prudential matters with respect to financial firms, generally, and insurers, specifically.

Title I of the Dodd-Frank Act provides the Council with authority to designate nonbank financial companies for supervision by the Federal Reserve and the application of enhanced prudential standards. In general, nonbank financial companies that the Council could review for purposes

of designation include insurers. In April 2012, the Council issued a final rule and interpretive guidance to govern the designation of nonbank financial companies. The Council is reviewing such companies.

At the request of the G-20 Leaders and the Financial Stability Board (FSB),[10] the International Association of Insurance Supervisors (IAIS) is developing a methodology and indicators to identify global systemically important insurers (G-SIIs) for designation. The IAIS Financial Stability Committee (FSC) released a proposed methodology to identify G-SIIs on May 31, 2012. Public comments were submitted over the summer of 2012, and a final methodology has not yet been published. Once the IAIS completes the assessment methodology, any identified firms will be recommended to the FSB for designation by the FSB as a G-SII.

With respect to insurance regulation itself, state insurance regulators have continued work on the Solvency Modernization Initiative (SMI), begun in 2008, which is an effort to review insurer solvency laws and regulations.[11] As part of this initiative, in 2010 state regulators amended the National Association of Insurance Commissioners (NAIC) model insurance holding company law and regulation. In 2012, the state regulators, working through the NAIC, created a risk assessment and reporting protocol for insurers (referred to as an Own Risk and Solvency Assessment, or ORSA), evaluated potential enhancements to state risk-based capital (RBC) regulations, and proposed potential enhancements to corporate governance requirements.

In the European Union, the European Parliament, the Council of the European Union, and the European Commission (EC) (with technical support from the European Insurance and Occupational Pensions Authority (EIOPA)) have continued work on reforming the insurance regulatory and supervisory regime under an authority known as the Solvency II Directive, which was adopted in 2009. Due to the potentially important effects of Solvency II on U.S. insurers operating in the EU, in January 2012, FIO hosted the EC, EIOPA, and U.S. state regulators to launch a project intended to increase mutual understanding and enhance cooperation between the EU and the United States in furtherance of effective supervision, consumer protection, and promotion of business opportunity. The project seeks to identify the areas of insurance regulation appropriate for improved convergence, harmonization and compatibility between the EU and United States.

The IAIS continues development of the "Common Framework for the Supervision of Internationally Active Insurance Groups" (ComFrame), a framework for the group-wide supervision of internationally active insurance groups (IAIGs). In June 2011, the Technical Committee of the IAIS published a ComFrame concept paper for comment. The next draft of ComFrame will be released for public consultation in October 2013. The draft establishes a range of qualitative and quantitative requirements for IAIGs, and it sets out the processes and prerequisites for supervisors to implement ComFrame.[12]

C. CURRENT ISSUES AND EMERGING TRENDS

Low Interest Rate Environment – Despite near-record net investment income in 2012, insurers' investment yields remained low as a percentage of invested assets. The prospect of continued low interest rates for a prolonged period poses a challenge to insurers seeking to balance

investment risks and returns, especially while trying to build capital and to expand product offerings. Life insurers offering annuities with guaranteed benefits, in particular, may encounter stress in the event of a protracted low interest rate environment. The effects of low interest rates may be exacerbated by increased longevity risk for products offering lifetime income.

In addition to adversely affecting investment returns, the current low interest rate environment affects the present value of insurer contract obligations – particularly for life insurance products. As interest rates have decreased, the present values of such future obligations have increased. Nevertheless, as interest rates have remained low in 2012, insurers' financial results were less affected by reserve increases than in 2011.

While insurers would benefit from an increase in interest rates through improved investment returns, a sudden, significant rate increase could present threats. A sudden increase in general interest rate levels would increase unrealized losses in insurer fixed income portfolios and, at the same time, could prompt policyholders to surrender contracts for higher yield elsewhere. In such a circumstance, insurers could be forced to liquidate fixed income investments at a loss in order to fund contract surrender payments.

Natural Catastrophes – Natural catastrophes can have a significant, even devastating, impact on individuals, families, businesses, and communities. In many high risk areas, the high cost of insuring against catastrophic loss limits access to affordable coverage. 2011 was the second costliest year on record for natural catastrophes in the United States, with insured losses estimated to be $44.2 billion.[13] The only year with greater insured catastrophe losses in the United States was 2005, which included hurricanes Katrina, Rita, and Wilma.[14] While losses from natural catastrophes were relatively low during the first half of 2012,[15] 'Superstorm' Sandy struck densely populated communities across the U.S. eastern seaboard in late October. The most recent estimates of 2012 insured catastrophe losses from A.M. Best are $43 billion.[16]

Changing Demographics in the United States – The aging of the U.S. population, combined with increased life expectancy, has increased demand for products that offer lifetime income protection. The financial crisis and the ensuing low interest rate environment have made it more difficult for retirement and pension plans to provide needed lifetime income. Recent efforts by L/H insurers to develop products to meet increased demand and to fund longer payout periods for annuities might entail additional financial stability risks, as the low interest environment constrains the ability of insurers to generate sufficient rates of return on investment portfolios. Additional risks resulting from the low interest rate environment include increased market exposure associated with the minimum guaranty provisions included in variable life and variable annuity products.

Growth Opportunities in Emerging Markets – Asia and Latin America currently present growth opportunities for U.S. insurers. Between 2000 and 2007, three-fourths of global insurance premium growth was generated in North America and Western Europe. Since 2007, the majority of global premium growth has shifted to Asia and Latin America.[17]

III. INDUSTRY FINANCIAL OVERVIEW

A. PRINCIPAL INSURANCE SECTORS: LIFE AND HEALTH (L/H) AND PROPERTY AND CASUALTY (P/C)

The two principal sectors in the U.S. insurance industry are life and health (L/H) and property and casualty (P/C). The products offered by the L/H sector generally protect against the risk of financial loss associated with an individual's death, provide income streams through retirement, cover expenses for long-term care, or provide income in the event of disability. While the L/H sector includes certain accident and health (A&H) coverages, data from firms licensed solely as health insurers or health maintenance organizations are separate and not included in this Report. P/C sector products generally protect against the risk of financial loss associated with damage to property or exposure to liability.

The U.S. insurance industry currently has more than 1,000 L/H insurers[18] and more than 2,700 P/C insurers.[19] Although there are fewer L/H insurers than P/C insurers, the size of the L/H sector is greater in terms of premium volume and other metrics.[20] The L/H sector accounts for 58 percent of industry net written premiums (*i.e.*, direct written premiums less reinsurance premiums), with approximately $645 billion, while the P/C sector accounts for 42 percent with approximately $460 billion of net written premiums. The L/H sector holds approximately $5.6 trillion of total assets, while the P/C sector holds approximately $1.6 trillion.

Tables 1 and 2 provide a snapshot of the L/H sector marketplace, listing the largest ten L/H insurance groups by 2012 direct premiums written and the concentration in terms of premium volume for life insurance (*i.e.*, non-A&H) and for A&H lines of business, respectively.[21]

Table 1: L/H Insurance Groups by 2012 U.S. Life Insurance Lines Direct Premiums Written

	Insurance Group	Direct Premiums Written ($000)	Share of Total (%)
1	MetLife Inc.	102,321,495	16.62
2	Prudential Financial Inc.	85,852,775	13.94
3	Jackson National Life Group	24,206,886	3.93
4	New York Life Insurance Group	24,010,473	3.90
5	ING Groep N.V.	23,513,207	3.82
6	Lincoln National Corp.	21,004,314	3.41
7	Manulife Financial Corp.	20,965,672	3.41
8	Massachusetts Mutl Life Ins Co	20,751,732	3.37
9	AEGON NV	19,695,559	3.20
10	Principal Financial Group Inc.	18,336,972	2.98
	Combined Top 10	**360,659,085**	**58.57**
	Combined Top 25	**506,054,756**	**82.19**
	Combined Top 100	**608,285,157**	**98.79**
	Total U.S. Life Insurance Lines	**615,731,289**	

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

Table 2: L/H Insurance Groups by 2012 U.S. A&H Lines Direct Premiums Written

	Insurance Group	Direct Premiums Written ($000)	Share of Total (%)
1	UnitedHealth Group Inc.	40,368,154	22.72
2	Humana Inc.	19,349,478	10.89
3	Aflac Inc.	17,484,089	9.84
4	Aetna Inc.	16,258,192	9.15
5	Cigna Corp.	11,395,283	6.41
6	MetLife Inc.	8,623,170	4.85
7	Unum Group	5,207,865	2.93
8	Mutual of Omaha Insurance Co.	3,005,592	1.69
9	Guardian Life Ins Co. of Am	2,860,623	1.61
10	Assurant Inc.	2,606,401	1.47
	Combined Top 10	**127,158,847**	**71.57**
	Combined Top 25	**152,474,631**	**85.82**
	Combined Top 100	**175,789,459**	**98.95**
	Total U.S. A&H Lines	**177,662,145**	

Source: SNL Financial

While there are more than 1,000 L/H insurers in the United States, the ten largest L/H insurance groups by life insurance premiums accounted for more than half of total non-A&H L/H sector premiums in 2012. Moreover, the twenty-five largest L/H insurance groups by life insurance premiums accounted for more than 82 percent, and the top one hundred accounted for almost 99 percent of all non-A&H L/H sector premiums in the United States.

Similarly for A&H lines of business, the ten largest L/H insurance groups accounted for more than 71 percent of total premiums. The top twenty-five groups accounted for more than 85 percent, and the top one hundred accounted for almost 99 percent of total premiums.

The premiums reflected in Tables 1 and 2 aggregate all L/H sector products and all geographies of the United States.

Table 3 provides a snapshot of the U.S. P/C sector marketplace, listing the largest ten P/C insurance groups by 2012 direct premium written and the concentration of premium among the largest P/C insurance groups.

Table 3: P/C Insurance Groups by 2012 U.S. Combined Lines Direct Premiums Written

	Insurance Group	Direct Premiums Written ($000)	Share of Total (%)
1	State Farm Mutl Automobile Ins	53,654,237	10.40
2	Liberty Mutual	28,297,511	5.49
3	Allstate Corp.	26,652,040	5.17
4	American International Group	23,596,418	4.57
5	Travelers Companies Inc.	22,695,958	4.40
6	Berkshire Hathaway Inc.	20,236,495	3.92
7	Farmers Insurance Group of Cos	18,311,402	3.55
8	Nationwide Mutual Group	17,042,933	3.30
9	Progressive Corp.	16,559,746	3.21
10	USAA Insurance Group	13,286,274	2.58
	Combined Top 10	**240,333,014**	**46.59**
	Combined Top 25	**335,455,138**	**65.03**
	Combined Top 100	**444,199,947**	**86.11**
	Total U.S. P/C Sector	**515,838,150**	

Source: SNL Financial (includes personal, commercial, and A&H lines of business)

The premiums reflected in Table 3 also aggregate all P/C sector products and all geographies of the United States. While less concentrated than the L/H sector, nearly half of P/C sector premium volume was written by the ten largest insurance groups in 2012. This was true even with more than 2,700 insurers in the P/C sector. P/C sector premium was also less concentrated among the twenty-five and one hundred largest insurance groups relative to the L/H sector. However, these largest twenty-five and one hundred insurance groups still accounted for a significant majority of total P/C sector premium (65 and 86 percent, respectively).

Tables 4 and 5 provide snapshots of the two major markets in the P/C insurance sector – commercial lines and personal lines.

Table 4: P/C Insurance Groups by 2012 Commercial Lines Direct Premiums Written

	Insurance Group	Direct Premiums Written ($000)	Share of Total (%)
1	American International Group	18,217,418	7.22
2	Travelers Companies Inc.	15,683,525	6.21
3	Liberty Mutual	15,313,721	6.07
4	Zurich Insurance Group Ltd.	10,206,436	4.04
5	ACE Ltd.	8,294,989	3.29
6	CNA Financial Corp.	8,011,222	3.17
7	Chubb Corp.	7,265,146	2.88
8	Hartford Financial Services	7,260,797	2.88
9	Nationwide Mutual Group	6,637,002	2.63
10	QBE Insurance Group Ltd.	4,704,492	1.86
	Combined Top 10	**101,594,748**	**40.24**
	Combined Top 25	**150,917,092**	**59.77**
	Combined Top 100	**214,092,690**	**84.79**
	Total U.S. P/C Commercial Lines	**252,493,118**	

Source: SNL Financial

Table 5: P/C Insurance Groups by 2012 U.S. Personal Lines Direct Premiums Written

	Insurance Group	Direct Premiums Written ($000)	Share of Total (%)
1	State Farm Mutl Automobile Ins	48,615,654	19.06
2	Allstate Corp.	24,644,986	9.66
3	Berkshire Hathaway Inc.	16,748,872	6.57
4	Farmers Insurance Group of Cos	15,102,764	5.92
5	Progressive Corp.	14,469,788	5.67
6	Liberty Mutual	12,982,666	5.09
7	USAA Insurance Group	12,303,855	4.82
8	Nationwide Mutual Group	10,400,481	4.08
9	Travelers Companies Inc.	7,011,234	2.75
10	American Family Mutual	4,983,748	1.95
	Combined Top 10	**167,264,048**	**65.57**
	Combined Top 25	**202,158,523**	**79.25**
	Combined Top 100	**240,371,602**	**94.23**
	Total U.S. P/C Personal Lines	**255,083,029**	

Source: SNL Financial

B. FINANCIAL PERFORMANCE AND CONDITION

1. Life and Health (L/H) Sector Financial Performance

a. L/H Sector Net Written Premium

Approximately 75 percent of L/H sector revenue is derived from premiums charged for insurance and financial products and services; the remaining 25 percent is largely comprised of earnings on investments and administrative fees charged for asset management services. Net written premium is a principal measure of size and growth of the insurance industry. In 2012, L/H sector aggregate premiums totaled $645 billion, of which life insurance (individual and group life policies) generated 20 percent, annuity products generated 53 percent, and the balance originated from accident and health insurance (*e.g.*, disability or long-term care needs). As Figure 6 and Table 6 show, premium growth was disrupted by the financial crisis, but L/H sector aggregate premiums reached record levels in 2012.

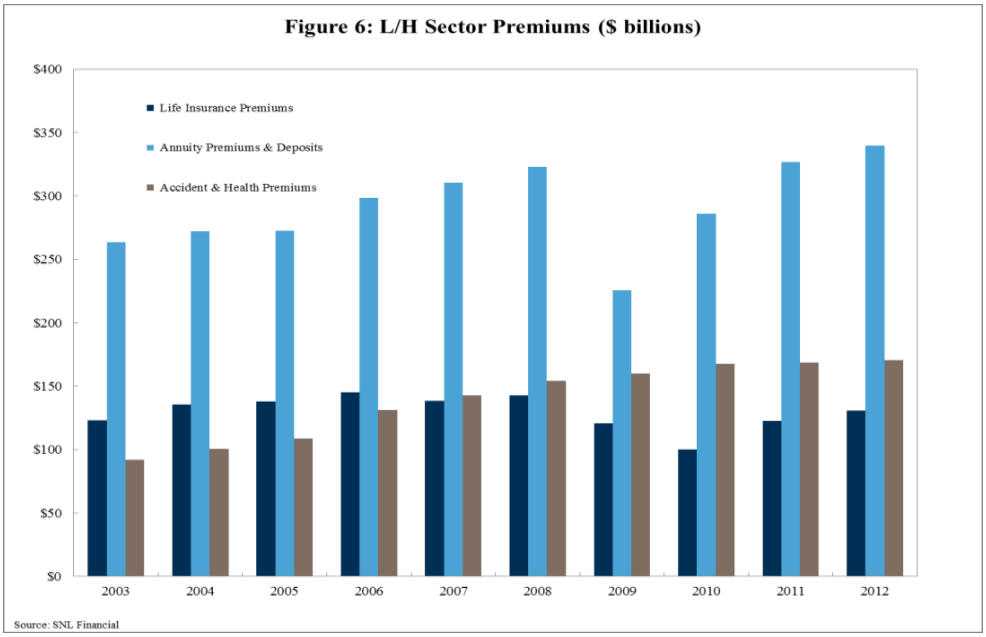


Table 6: L/H Sector Premiums, Considerations, and Deposits ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Life Insurance Premiums	142,738,171	120,603,672	100,301,700	122,854,878	130,604,448
Annuity Premiums & Deposits	322,991,601	225,476,691	286,318,850	326,985,001	339,916,415
Accident & Health Premiums	154,471,490	159,970,508	167,775,601	168,607,264	170,764,029
Credit Life & Credit A&H Premiums	2,073,722	1,597,906	1,566,013	1,582,995	1,554,052
Other Premiums & Considerations	781,762	541,155	23,116,619	2,071,361	2,245,756
Total	**623,056,746**	**508,189,932**	**579,077,796**	**622,080,928**	**645,084,701**

Source: SNL Financial

Growth of variable annuity premiums is generally correlated with changes in the performance of equity markets. For example, as markets declined in 2008 and early 2009, sales of variable annuities decreased and surrenders increased. However, since 2010, the recovery in the equity markets combined with the low interest rate environment has led consumers seeking greater returns away from traditional life insurance products (*e.g.*, fixed annuities and whole life insurance) and back to variable annuities. Variable annuities offer equity-based variable returns (*i.e.*, based on the underlying values of a portfolio of equities). In addition, variable annuities often include a product feature that guarantees at least a certain minimum return or withdrawal benefit. Known as "minimum guaranty provisions," these product features exposed insurers to market risk during the financial crisis.

In addition to the trend toward variable annuities in the low interest rate environment, life insurance ownership may also be declining for more general reasons. In the wake of the economic downturn, for example, a greater proportion of households may be foregoing purchasing life insurance because of other financial priorities, such as paying off debt.[22]

b. L/H Sector Policyholder Contract Benefits and Surrenders

Policyholder contract benefits are claims or obligations of L/H insurers under life insurance, annuity, and other contracts and polices. Such benefits, in addition to contract surrenders, make up a majority of total expenditures for life insurers. Expenses other than contracted benefit payments 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 the policy, including loss verification and adjustment expenses. Figure 7 and Table 7 show aggregate L/H sector contract benefit payments, surrenders, reserve increases, and all other expenses for recent years.

Figure 7: L/H Sector Expenses ($ billions)

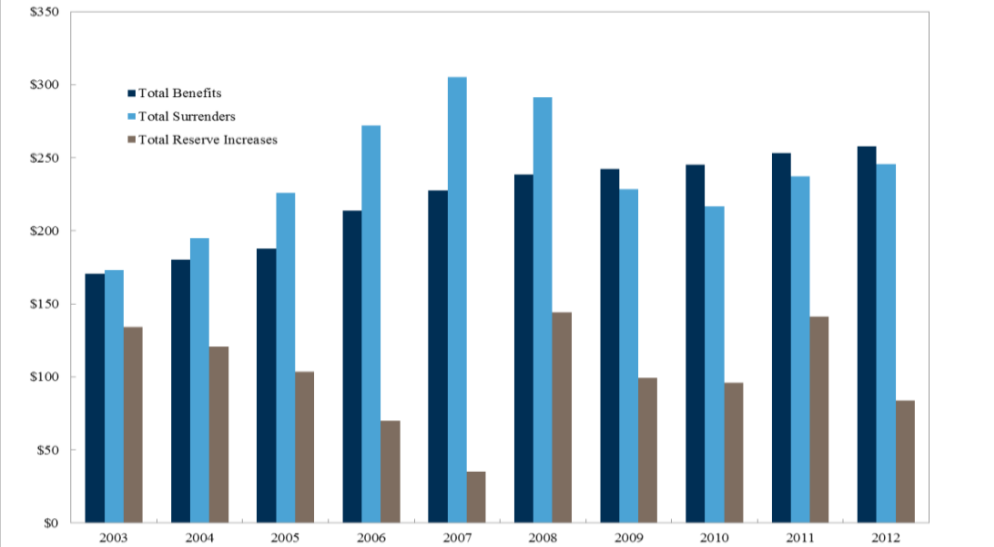


Table 7: L/H Sector Expenses ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Total Benefits	238,380,902	242,184,583	245,202,462	253,114,180	257,860,726
Total Surrenders	291,543,802	228,688,291	216,846,768	237,281,879	245,728,469
Total Inc. in Reserves	144,217,934	99,225,167	96,166,722	141,204,554	83,778,887
Total Trsfrs. to Sep. Accts	22,654,948	11,116,048	29,273,192	32,427,626	61,550,512
Commissions	51,593,844	48,863,381	49,269,277	51,816,417	53,073,946
General & Administrative Expenses	53,307,935	53,950,895	56,622,977	58,346,550	59,310,961
Insurance Taxes, Licenses and Fees	7,264,529	7,246,922	7,703,444	7,980,332	8,217,464
Other Expenses	17,185,292	7,166,900	2,202,678	8,134,923	6,680,970
Total	**826,149,186**	**698,442,187**	**703,287,521**	**790,306,461**	**776,201,935**

Source: SNL Financial

Benefit payments for a given portfolio of traditional life insurance contracts are generally stable and relatively 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 depending on prevailing economic conditions (*e.g.*, perceived market trends,

demand for liquidity). As Table 7 shows, these surrender payments were relatively high in 2008, as compared to more recent years.

Surrenders and withdrawals account for a substantial portion of L/H sector contract benefits. As the demand for liquidity increases, life insurance and annuity contract surrenders increase – adding to L/H sector annual expenses. Leading up to the financial crisis, annual surrenders and withdrawals increased from $226 billion in 2005 to $272 billion in 2006, $305 billion in 2007, and $292 billion in 2008. Since the crisis, L/H sector surrenders and withdrawals decreased to $229 billion in 2009, $217 billion in 2010, and $237 billion in 2011. Total surrenders were $246 billion in 2012.

c. L/H Sector Investment Income

Investment income represents a substantial portion of revenues for the L/H sector. Aggregate investment income grew steadily in the years leading up to the financial crisis. However, investment yields since the crisis have been relatively low, creating an environment that could challenge L/H insurers going forward. Figure 8 and Table 8 provide L/H sector net investment income on invested assets (excluding net realized gains and losses on the sale or disposition of investments) and net yield for recent years.

Figure 8: L/H Sector Annual Net Investment Income ($ billions) and Net Yield on Invested Assets

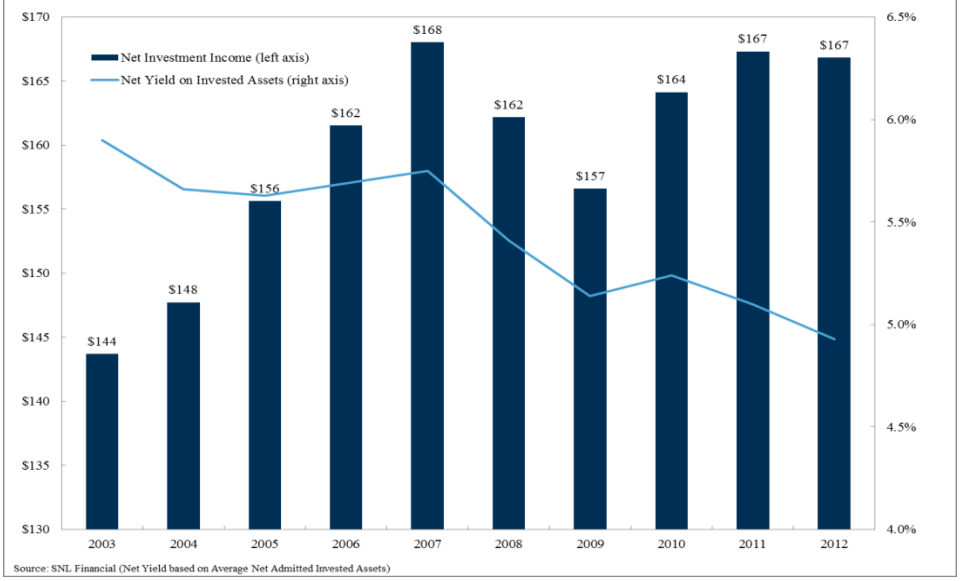


Table 8: L/H Sector Investment Income ($000s) and Net Yield

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Net Investment Income	162,189,779	156,618,379	164,137,870	167,322,081	166,834,788
Total Cash & Investments	3,018,319,002	3,071,852,481	3,196,195,125	3,360,535,194	3,406,632,407
Net Yield on Invested Assets	**5.41%**	**5.14%**	**5.24%**	**5.10%**	**4.93%**

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

Table 8 shows that L/H sector general investment account assets (see Box 1 for a discussion of general versus separate account assets) grew from $3.0 trillion to $3.4 trillion from 2008 to 2012.

Growth slowed significantly from 2005 through 2009, but has increased again since 2010, in part due to underlying premium growth.

Box 1: Separate Accounts – Trends and Financial Impact

Separate accounts, as the name implies, are held apart from the general investment account of an insurer and are created by sales of products for which the contract holder retains the investment risks. Although the investment risks on separate account assets are borne by the respective policyholders, the related insurance and annuity products often include 'riders' such as minimum guaranty benefits or other financial guarantees, which expose the general accounts of insurers to varying degrees of market risk.

Separate account assets grew at rates that ranged from 9 to 23 percent from 2003-2007 (see chart below). The robust growth was driven by both the strong performance of equity markets during that period (approximately 80 percent of separate account assets are in stocks) and the popularity of guaranteed minimum benefit provisions that were offered by many insurers. L/H insurers offer variable annuity contracts as a way to compete with the investment product offerings of other financial institutions, such as securities firms and investment managers. The appeal to prospective variable annuity policyholders is the ability to build value by investing premiums, while minimizing potential losses through insurer-provided minimum return guarantees.

An insurer can use derivatives to hedge against market risks related to the guaranteed minimum benefit provisions of variable annuities, but the reserves and expenses associated with these hedges are included in the general account of the insurer. Therefore, increases and decreases in such reserves and expenses have a direct impact on the surplus of the insurer.

Figure 9: Life Insurer General and Separate Account Assets Annual Growth

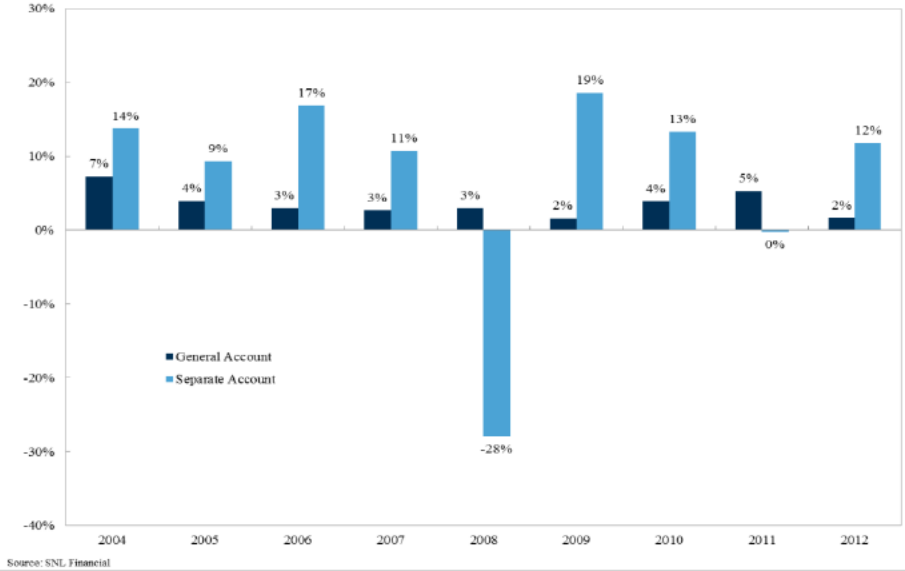


Table 9: L/H Sector General and Separate Account Assets ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
General Account Assets	3,178,979,434	3,230,475,723	3,356,501,480	3,534,370,609	3,592,523,599
General Account Assets Annual Growth	2 99%	1.62%	3.90%	5 30%	1.65%
Separate Account Assets	1,369,012,979	1,623,768,736	1,840,187,240	1,835,604,761	2,053,201,169
Separate Account Assets Annual Growth	-27 93%	18.61%	13.33%	-0 25%	11.85%
Total Assets	**4,547,965,512**	**4,854,244,459**	**5,196,688,720**	**5,369,975,370**	**5,645,724,768**
Total Assets Annual Growth	**-8.79%**	**6.73%**	**7.05%**	**3.33%**	**5 14%**

Source: SNL Financial

During the financial crisis, sharp declines in equity markets and other asset classes led to losses in separate account balances and decreased the popularity of variable annuity products. Minimum guarantees helped minimize losses for many policyholders, but exposed life insurers to "un-hedged" market risks.

Table 10 shows the composition of the L/H sector general account invested assets for recent years.

Table 10: L/H Sector Invested Asset Compositions ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Bonds	2,149,276,710	2,291,134,801	2,426,488,366	2,536,285,669	2,547,282,250
Preferred Stocks	64,004,406	11,685,702	9,116,406	8,082,049	7,783,814
Common Stocks	49,199,457	62,220,108	68,737,147	70,349,507	69,677,752
Mortgage Loans	328,010,174	315,953,480	307,376,528	323,083,104	335,600,334
Real Estate	20,042,478	19,468,931	19,690,208	20,592,003	21,384,013
Contract Loans	119,249,454	120,008,543	123,488,426	125,976,946	127,480,245
Derivatives	NA	NA	21,575,963	44,356,616	41,576,588
Cash & Short Term Investments	146,206,650	121,990,395	95,063,036	96,535,159	106,605,395
Other Investments	142,329,672	129,390,522	124,659,046	135,274,141	149,242,016
Total Cash & Investments	**3,018,319,002**	**3,071,852,481**	**3,196,195,125**	**3,360,535,194**	**3,406,632,407**

Source: SNL Financial

L/H sector invested asset allocations have been relatively stable, with approximately 75 percent in bonds, 10 percent in mortgage loans, and the balance in stocks, short-term assets, and other assets. L/H insurer portfolio compositions must comply with state laws regarding insurer investments, which include diversification requirements and disclosure requirements.

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

L/H sector net income was growing during the years leading up to the financial crisis. As the crisis deepened in 2008, L/H insurers realized aggregate net losses of $52.3 billion, primarily due to substantial realized losses on investments, the bulk of which were impairment write-downs. Although the broader L/H sector shared in 2008 losses to some extent, the greatest concentration of losses was borne by firms with relatively high exposures to mortgage-related investments.[23] Net income increased to $21.5 billion in 2009 and $28.0 billion in 2010 as equity markets began to recover, but decreased to $14.4 billion in 2011 as declining interest rates led to substantial reserve contributions. As interest rates stabilized in 2012, the L/H sector was less affected by reserve contributions than in 2011, and net income increased to a record $40.9 billion.

Figure 11 and Table 11 present L/H sector net incomes for recent years.

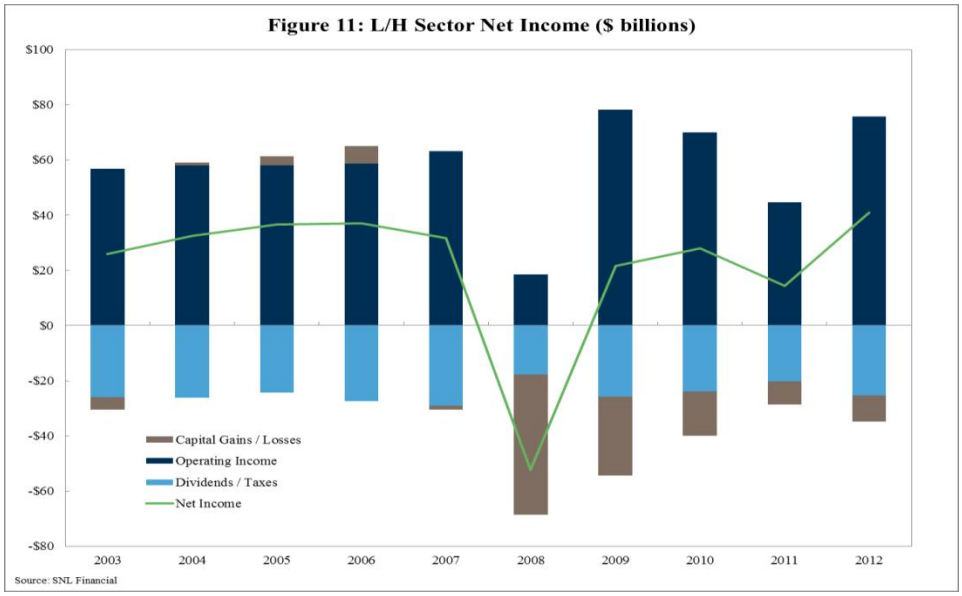


Table 11: L/H Sector Net Incomes ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Premiums, Consideration & Deposits	623,056,746	508,189,932	579,077,796	622,080,928	645,084,701
Net Investment Income	162,189,779	156,618,379	164,137,870	167,322,081	166,834,788
Reinsurance Allowance	17,832,119	61,517,250	(29,286,964)	(16,268,042)	(30,779,711)
Separate Accounts Revenue	21,177,404	20,375,256	23,360,670	26,085,983	29,516,598
Other Income	20,398,671	30,039,835	36,033,132	35,750,268	41,253,591
Total Revenue	**844,654,719**	**776,740,653**	**773,322,505**	**834,971,218**	**851,909,967**
Total Expenses	826,149,186	698,442,187	703,287,521	790,306,461	776,201,935
Policyholder Dividends	17,739,431	15,004,998	14,985,542	15,099,874	15,211,990
Net Gain from Operations before FIT	(1,423,877)	60,972,276	53,084,270	28,002,719	60,496,043
Federal Income Tax	(65,161)	10,656,532	8,955,196	5,059,952	10,166,764
Net Income before Cap Gains	(1,362,184)	50,257,907	44,075,051	22,895,712	50,329,279
Net Realized Capital Gains (Losses)	(50,935,494)	(28,704,680)	(16,022,641)	(8,534,289)	(9,448,453)
Net Income	**(52,312,286)**	**21,528,259**	**28,049,199**	**14,364,501**	**40,880,828**

Source: SNL Financial

The L/H sector return on average equity (ROE) for 2012 was 12.8 percent. Although a substantial increase relative to 2011, the 2012 ROE is modest relative to pre-financial crisis returns, which averaged 13.8 percent from 2003 to 2007. Table 12 provides the returns for the last five years.

Table 12: L/H Sector Operating Ratios (%)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Pre-Tax Operating Margin	-0.17	7.85	6.86	3.35	7.10
Return on Average Equity	-20.35	7.94	9.39	4.66	12.80
Pre-Tax Operating ROAE	-0.55	22.48	17.78	9.08	18.94
Return on Average Assets	-1.08	0.46	0.56	0.27	0.74

Source: SNL Financial

2. Life and Health (L/H) Sector Financial Condition

a. L/H Sector Policyholder Surplus

Policyholder surplus is the regulatory measure of capital available to an insurer (*i.e.*, the amount by which reported assets of an insurer exceed reported liabilities). It 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). Figure 13 and Table 13 display L/H sector policyholder surplus data for recent years.

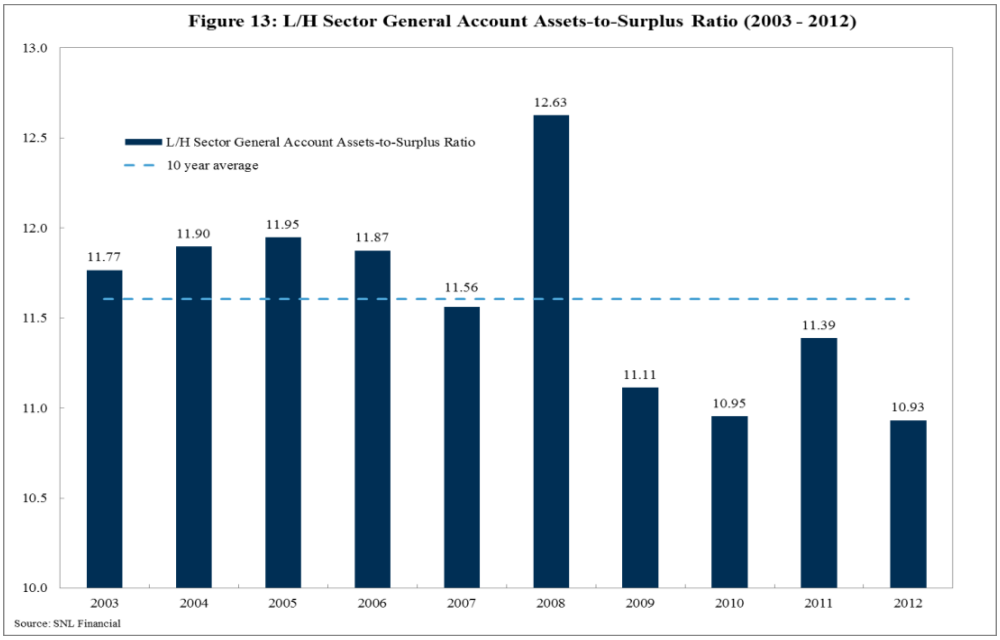


Table 13: L/H Sector Capital & Surplus ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Capital & Surplus	251,770,542	290,689,539	306,430,238	310,372,997	328,611,760
General Account Assets	3,178,979,434	3,230,475,723	3,356,501,480	3,534,370,609	3,592,523,599
General Account Assets-to-Surplus Ratio	**12.63**	**11.11**	**10.95**	**11.39**	**10.93**

Source: SNL Financial

Surplus levels declined in 2008 but have increased each year thereafter. The L/H sector reported a record high $328 billion in policyholder surplus as of December 31, 2012. In addition to record surplus levels, the L/H sector also reports relatively low leverage (as measured by general account assets to surplus).

b. L/H Sector Reserves

Life insurance reserves generally represent the net present value of expected future obligations of a life insurer. Estimates of these 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, the reserve increases can be attributed in part to cash flow testing – a form of stress testing that considers the changes in assets and liabilities given a number of scenarios. Cash flow testing may result in reserve increases under scenarios that assume interest rates will rise. In such scenarios, insurers may not be able to increase credited rates rapidly enough to stem surrender rates as contract holders pursue higher yields elsewhere, thus requiring the insurer to fund surrenders with asset sales at reduced prices. In addition, scenarios in which interest rates fall result in spread compression – the narrowing of the difference between the yield that an insurer is able to earn on investments and the yield that it must pay contract holders through benefit obligations.[24]

In the L/H sector, variable life insurance products and variable annuities offer consumers a combination of insurance protection and access to broader market gains. To reduce market risk to the contract holder, these products typically guarantee a minimum annual return. As the financial crisis drove invested asset values down in 2008, these minimum guaranty provisions were triggered, life insurer liabilities on these contracts increased, and reserves were therefore bolstered. As markets recovered in 2009, the impact of these minimum guaranty provisions subsided, and reserve growth rates returned to more traditional levels.

Aggregate L/H sector reserves reached a record $2.8 trillion as of December 31, 2011. The fact that the L/H sector reported record levels of both surplus and reserves at year-end 2011 indicates that insurers have undergone a significant recapitalization since the financial crisis. While still near $2.8 trillion at year-end 2012, L/H sector reserve levels decreased for the first time in more than a decade. Figure 14 and Table 14 show L/H sector reserve levels and growth for recent years.

Figure 14: L/H Sector Growth in Total Reserves & Deposits

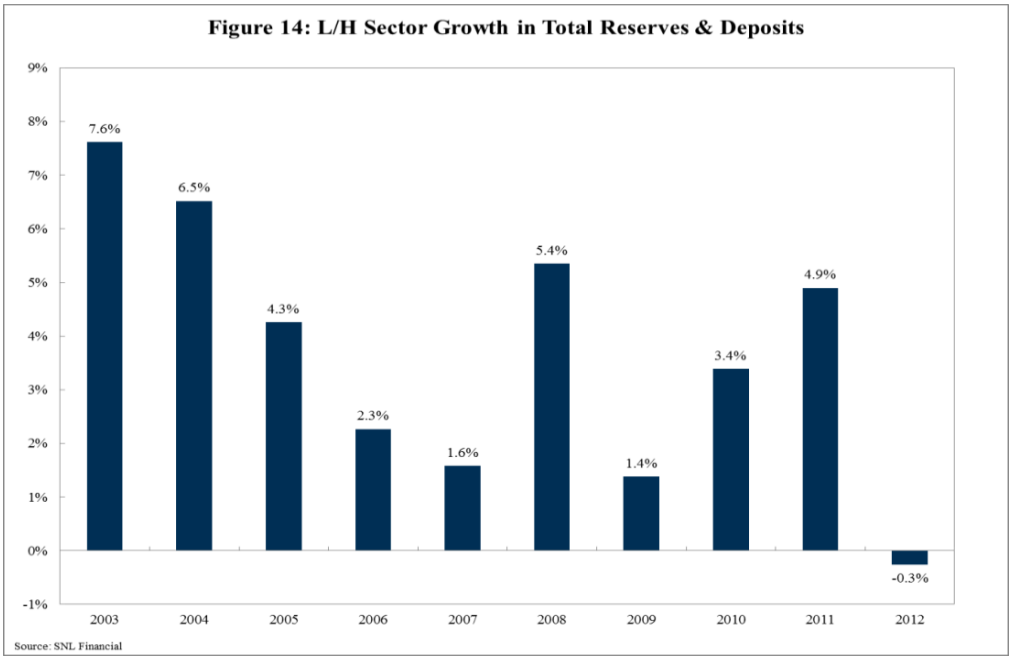


Table 14: L/H Sector Reserves ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Net Policy Reserves - Life	2,032,024,763	2,113,568,057	2,191,738,219	2,313,664,599	2,305,690,926
Net Policy Reserves - A&H	180,099,627	189,910,913	206,923,525	222,328,299	219,235,525
Liability for Deposit-Type Contracts	337,156,907	280,867,768	273,174,427	266,876,143	270,575,809
Total Policy Reserves plus Deposits	**2,549,281,298**	**2,584,346,739**	**2,671,836,171**	**2,802,869,041**	**2,795,502,260**
Growth - Total Reserves & Deposits	**5.35%**	**1.38%**	**3.39%**	**4.90%**	**-0.26%**

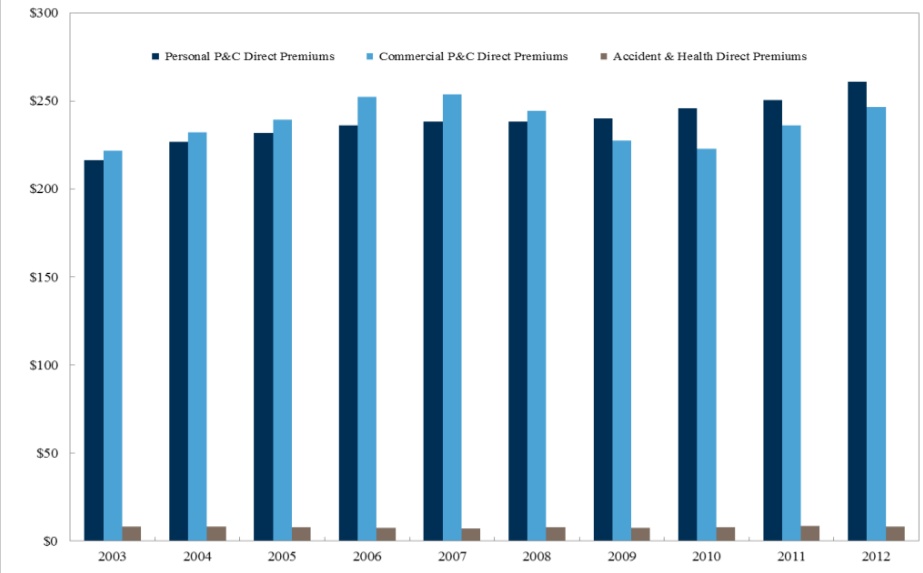
Source: SNL Financial

3. Property and Casualty (P/C) Sector Financial Performance

a. P/C Sector Net Written Premiums

P/C insurers underwrite a variety of products, which are generally categorized as personal lines (*e.g.*, homeowners or auto insurance sold to consumers) or commercial lines (*e.g.*, workers compensation or commercial multi-peril insurance sold to businesses and other institutions). In 2012, direct premiums written by P/C insurers were roughly split between personal and commercial lines. Figure 15 and Table 15 show P/C sector premiums by line of business for recent years.

Figure 15: P/C Sector Direct Premiums Written ($ billions)



Source: SNL Financial

Table 15: P/C Sector Premiums ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Personal P&C Direct Premiums	238,185,361	240,224,180	245,730,464	250,663,210	260,934,457
Commercial P&C Direct Premiums	244,532,138	227,407,576	222,868,720	235,984,214	246,676,965
Accident & Health Direct Premiums	7,723,322	7,550,149	8,027,426	8,548,067	8,373,873
Direct Premiums Written	**498,679,551**	**483,081,379**	**484,404,467**	**502,005,179**	**521,113,285**
Net Reinsurance Premiums	(58,411,930)	(60,062,645)	(58,176,156)	(60,034,264)	(60,708,731)
Net Premiums Written	**440,267,621**	**423,018,734**	**426,228,311**	**441,970,915**	**460,404,553**
Change in Unearned Premiums Reserve	(3,280,270)	(4,004,919)	1,545,490	3,615,254	7,848,138
Net Premiums Earned	**443,547,891**	**427,023,654**	**424,682,821**	**438,355,661**	**452,556,415**

Source: SNL Financial

After three years of declines, P/C sector annual net written premiums nearly returned to pre-financial crisis levels by 2011 and continued to grow in 2012. While personal lines premium levels remained stable during the crisis, commercial lines premiums decreased by $30 billion from 2007 to 2010, before growing again by $13 billion in 2011 and $9 billion in 2012.

b. P/C Sector Underwriting Results

P/C sector underwriting results are most often measured by the combined ratio. The combined ratio measures losses, loss adjustment expenses (LAE), and underwriting expenses as a percentage of premiums. A combined ratio above 100 percent indicates that premiums were inadequate to cover losses and expenses for a given reporting period. Investment income, realized gains/losses, and income taxes are not considered in the combined ratio. Table 16 provides the P/C sector combined ratios for recent years.

Table 16: P/C Sector Operating Ratios (%)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Loss Ratio	65.58	59.79	61.06	66.87	62.17
Loss Adjustment Expense Ratio	11.83	12.48	12.54	12.58	12.38
Loss and LAE Ratio	**77.41**	**72.26**	**73.59**	**79.45**	**74.55**
Net Commission Ratio	10.63	10.49	10.39	10.22	10.21
Salaries & Benefits Ratio	7.65	8.25	8.33	8.30	8.41
Tax, License & Fees Ratio	2.56	2.60	2.60	2.60	2.63
Admin & Other Expense Ratio	6.39	6.32	6.94	7.25	6.99
Expense Ratio	**27.23**	**27.66**	**28.26**	**28.37**	**28.23**
Policyholder Dividend Ratio	0.49	0.50	0.64	0.53	0.55
Combined Ratio	**105.12**	**100.42**	**102.49**	**108.35**	**103.34**

Source: SNL Financial

The aggregate combined ratio for all P/C lines in 2012 was 103 percent – down from 108 percent in 2011. The combined ratios of the last two years were primarily driven by catastrophe-related losses, as 2011 was the second-worst year on record for insured losses from natural catastrophes, and Superstorm Sandy in 2012 was the second-costliest natural catastrophe in U.S. history.

To gauge overall profitability, P/C sector combined ratios must be assessed in conjunction with the prevailing interest rate environment. For example, while Table 16 shows that the P/C sector did not report aggregate underwriting profits in recent years, in the 1980s, when P/C sector combined ratios were even higher than they are today, insurers were profitable because interest

rates were much higher and they were able to earn higher nominal returns on investment portfolios.

Box 2: P/C Insurers and the Underwriting Cycle

The P/C insurance business is cyclical in nature, transitioning between "hard" and "soft" markets. Generally speaking, a "hard" market is one in which insurance underwriting capacity is relatively low (competition has declined or capital is more scarce), prices for insurance are increasing, and policy terms and conditions are generally more restrictive. A "soft" market is one with more abundant capacity to write new insurance policies, increasing competition and, as a result, rates that are growing only marginally or even decreasing. Academic debate persists over whether these market phenomena are related to rational expectations of insurers based on market events; whether they are fundamentally caused by capital constraints, cycles of capital, and inefficiencies in capital markets; or whether some combination of these explanations is correct.

Insurer profitability generally improves in hard markets due to increased prices. As a result, industry participants closely monitor key factors that might indicate or help lead to a turn toward a hard market. While the list of indicators may vary, industry observers regularly cite the following: large underwriting losses (both catastrophic and non-catastrophic losses), a decline in policyholder surplus levels for the industry, an environment of rising reinsurance rates, and momentum in premium prices. Due to the diversity of insurance business lines, however, a turn in one market (*e.g.*, personal lines) may be independent of a turn in another market (*e.g.*, commercial lines), making an accurate assessment of the cycle for the entire industry more challenging.

c. P/C Sector Investment Income

As the combined ratio results indicate, P/C insurers are not often profitable from underwriting results alone. In addition to underwriting results, P/C insurers rely on income derived from investing policyholder premiums. The P/C sector held a total of $1.4 trillion in invested assets as of December 31, 2012, and earned $50 billion of net investment income during the year, which excludes $8.6 billion of realized gains. P/C sector investment returns had been declining since 2005, until the yield increased modestly in 2011 to 3.83 percent. Figure 17 and Table 17 show that P/C sector annual yield decreased again to 3.68 percent in 2012.

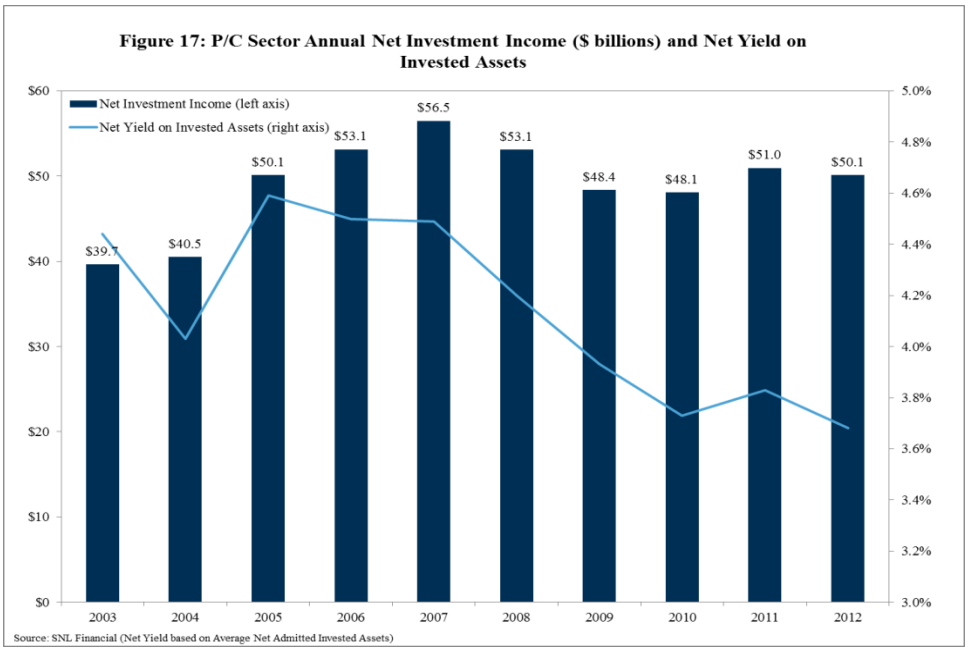


Table 17: P/C Sector Investment Income ($000s) and Net Yield

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Net Investment Income	53,132,865	48,401,892	48,099,454	50,972,121	50,109,178
Total Cash & Investments	1,205,368,271	1,260,404,124	1,316,192,292	1,343,505,691	1,382,861,199
Net Yield on Invested Assets	**4.20%**	**3.93%**	**3.73%**	**3.83%**	**3.68%**

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

As in the L/H sector, P/C sector investments are subject to state insurance laws and regulations. P/C insurers generally maintain portfolios that consist mostly of high-quality investment-grade bonds with relatively shorter maturities compared to those of the L/H sector because P/C liabilities are typically of a shorter-term nature than the payout of L/H sector obligations.

Table 18 summarizes the composition of P/C sector invested assets in recent years.

Table 18: P/C Sector Invested Assets ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Bonds	827,847,518	866,311,527	873,836,387	902,508,317	902,944,759
Preferred Stocks	21,771,760	18,819,098	17,574,224	11,619,064	11,929,781
Common Stocks	179,396,088	209,781,455	208,460,881	229,170,621	253,879,811
Mortgage Loans	4,995,688	4,481,789	4,171,188	4,969,359	5,682,044
Real Estate	10,410,081	10,218,014	9,772,963	10,370,543	10,372,442
Contract Loans	0	0	0	0	0
Derivatives	NA	NA	643,393	648,785	591,755
Cash & Short Term Investments	96,777,123	87,593,220	85,961,983	72,605,068	81,619,774
Other Investments	64,162,429	63,199,022	115,771,272	111,613,934	115,840,834
Total Cash & Investments	**1,205,368,271**	**1,260,404,124**	**1,316,192,292**	**1,343,505,691**	**1,382,861,199**

Source: SNL Financial

As of December 31, 2012, 65 percent of P/C sector investment holdings were in bonds, 19 percent were in stocks, and the remainder was in cash or cash-like instruments, mortgages, real estate, and other investments.

d. P/C Sector Net Income

As in the L/H sector, net income in the P/C sector grew steadily in the years prior to the financial crisis. In 2008, net income decreased as investment and underwriting results deteriorated as a result of the crisis. Unlike the L/H sector, however, the P/C sector still managed to achieve positive, albeit lower, net income in 2008. Net income grew in 2009 and 2010, but decreased again in 2011 as insured natural catastrophic losses were higher than any year on record other than 2005. Even with significant catastrophe losses in 2012, P/C sector net income increased to $36.3 billion compared to $20.1 billion in the prior year. Figure 19 and Table 19 show P/C sector net incomes for recent years.

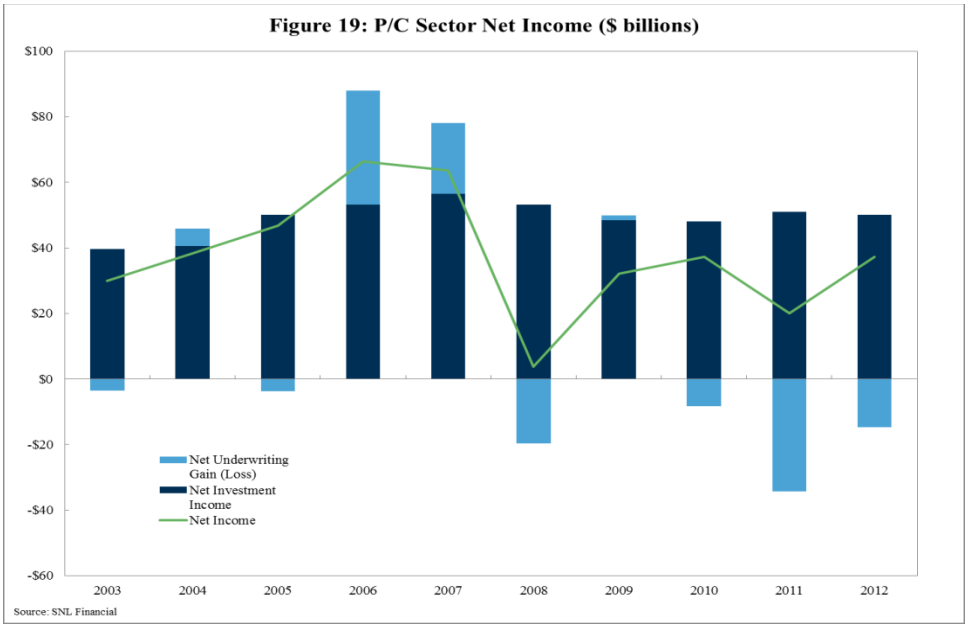


Table 19: P/C Sector Net Income ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Net Premiums Earned	443,547,891	427,023,654	424,682,821	438,355,661	452,556,415
Losses and LAE Incurred	343,331,234	308,587,576	312,543,284	348,266,777	337,390,725
Other Underwriting Expense Incurred	121,262,361	119,340,927	121,271,338	123,919,403	129,645,364
Other Underwriting Deductions	(1,398,022)	(2,347,251)	(808,897)	1,475,530	322,651
Net Underwriting Gain (Loss)	**(19,644,775)**	**1,442,402**	**(8,322,905)**	**(34,333,407)**	**(14,802,325)**
Policyholder Dividends (PHD)	2,189,330	2,133,182	2,701,811	2,315,009	2,505,944
Net Investment Income	53,132,865	48,401,892	48,099,454	50,972,121	50,109,178
Net Realized Capital Gains (Losses)	(20,105,640)	(7,798,261)	7,829,186	7,576,363	8,614,215
Finance Service Charges	2,967,161	3,078,731	3,182,086	3,179,564	3,288,146
All Other Income	(2,574,847)	(2,228,743)	(2,039,896)	(868,718)	(1,100,383)
Net Income after capital gains (loss) BT	**11,596,337**	**40,799,392**	**46,052,998**	**23,215,831**	**43,602,887**
Federal Income Tax	7,879,121	8,666,406	8,833,430	2,939,324	6,255,250
Net Income	**3,708,886**	**32,203,170**	**37,217,759**	**20,123,505**	**37,347,637**

Source: SNL Financial

As Table 20 shows, the aggregate ROE of the P/C sector of 3.58 percent in 2011 was low relative to 2009 and 2010. ROE increased to 6.45 percent in 2012. Since the Insurance Services Office (ISO) began annual recordkeeping of financial data in 1959, the P/C sector average ROE has averaged approximately 9 percent.[25]

Table 20: P/C Sector Operating Ratios (%)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Pre-Tax Operating Margin	6.38	10.20	8.07	3.22	6.93
Return on Average Equity (C&S)	0.74	6.57	6.89	3.58	6.45
Pre-Tax Operating ROAE	6.29	9.92	7.08	2.78	6.04
Return on Average Assets	0.25	2.19	2.45	1.28	2.31

Source: SNL Financial

4. Property and Casualty (P/C) Insurance Industry Financial Condition

a. P/C Sector Policyholder Surplus

As with the L/H sector, the P/C sector reported a record level of aggregate policyholder surplus at year-end 2012. Surplus levels declined in 2008 due to the financial crisis and the impact on the valuations of insurer invested assets, but have increased each year since 2009 as financial markets and premium levels improved. Figure 21 and Table 21 show P/C sector surplus for recent years.

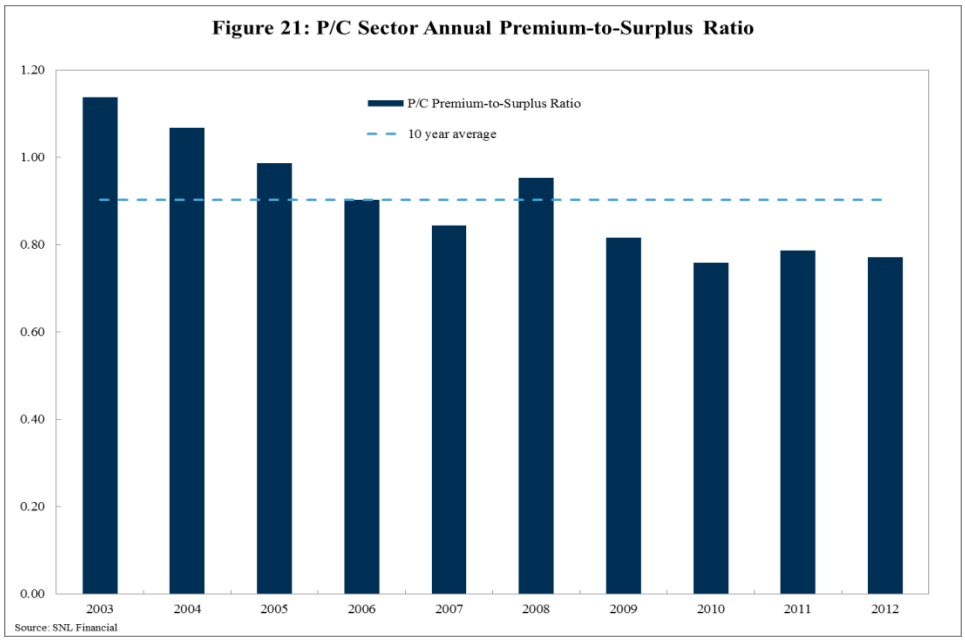


Table 21: P/C Sector Capital and Surplus ($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Capital & Surplus	461,756,316	517,970,768	561,776,605	562,093,722	596,653,220
Net Premiums Written	440,267,621	423,018,734	426,228,311	441,970,915	460,404,553
Net premiums written / Average C&S	**0.87**	**0.86**	**0.79**	**0.79**	**0.79**

Source: SNL Financial

While the asset-to-surplus ratio is the conventional measure of leverage for the L/H sector, the premium-to-surplus ratio is used for measuring P/C sector leverage. The difference in traditional leverage metrics can be attributed to the longer-term nature and lower volatility of L/H sector liabilities, relative to the shorter-term nature and higher volatility of P/C sector liabilities. State insurance regulatory guidelines require that P/C insurers maintain premium-to-surplus ratios of less than 3-to-1.[26] The P/C sector aggregate premium-to-surplus ratio has generally been declining over the last decade. It increased in 2008 as the financial crisis adversely affected insurer surplus levels, but continued its decline in 2009 and 2010. Premium-to-surplus appears to have plateaued in the last few years, but remains low relative to a decade ago.

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, the estimation of P/C sector reserves includes a significant degree of professional actuarial judgment.

The P/C sector reported record levels of both surplus and reserves at the end of 2011. While P/C sector surplus continued to increase through 2012, aggregate reserves decreased slightly. Figure 22 and Table 22 show P/C sector reserves for recent years.

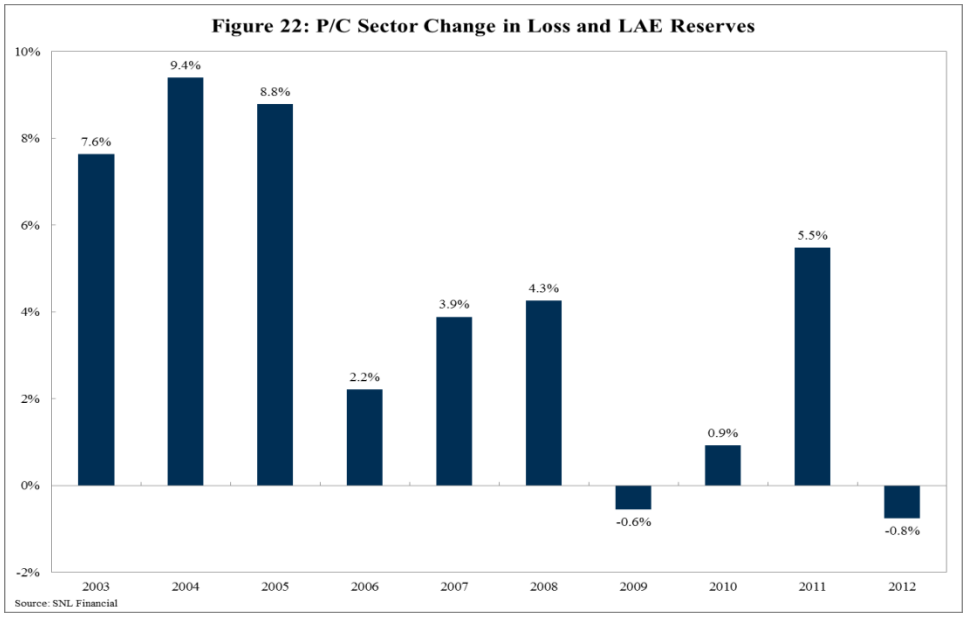


Table 22: P/C Sector Reserves ($000s)

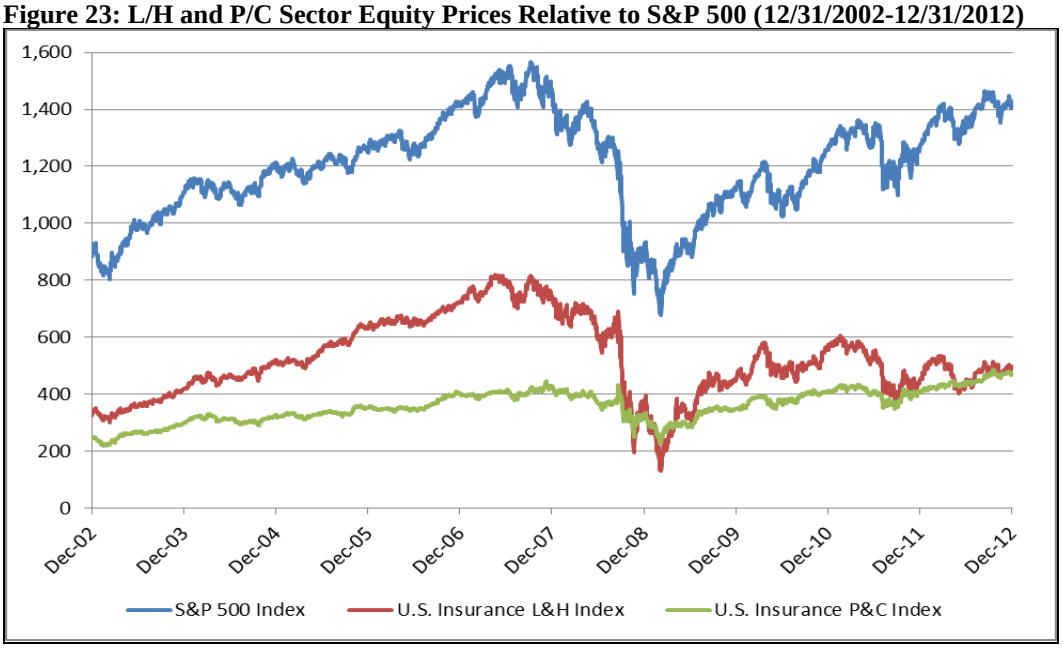
	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Major Segment - Personal	115,090,880	116,246,107	120,673,876	123,951,475	124,845,979
Major Segment - Commercial	448,194,274	443,442,614	444,089,132	471,814,917	466,413,501
Major Segment - Accident & Health	4,311,370	4,608,123	4,754,119	5,011,683	5,207,677
Total Loss and LAE Reserves	**567,404,770**	**564,280,620**	**569,505,155**	**600,707,767**	**596,201,715**
Change in Loss and LAE Reserves	**4.26%**	**-0.55%**	**0.93%**	**5.48%**	**-0.75%**

Source: SNL Financial

C. MARKET PERFORMANCE

Publicly-traded insurers represent a significant share of the total L/H and P/C sectors. Market perception of insurers and insurer future earnings capacities, as measured through equity prices and other market valuation metrics, have generally moved in parallel with broader market indices. L/H sector equity market prices have mirrored those of the broader market more closely than has the P/C sector. Figure 23 compares L/H and P/C sector equity prices with the S&P 500 index from year-end 2002 through year-end 2012.

Figure 23: L/H and P/C Sector Equity Prices Relative to S&P 500 (12/31/2002-12/31/2012)

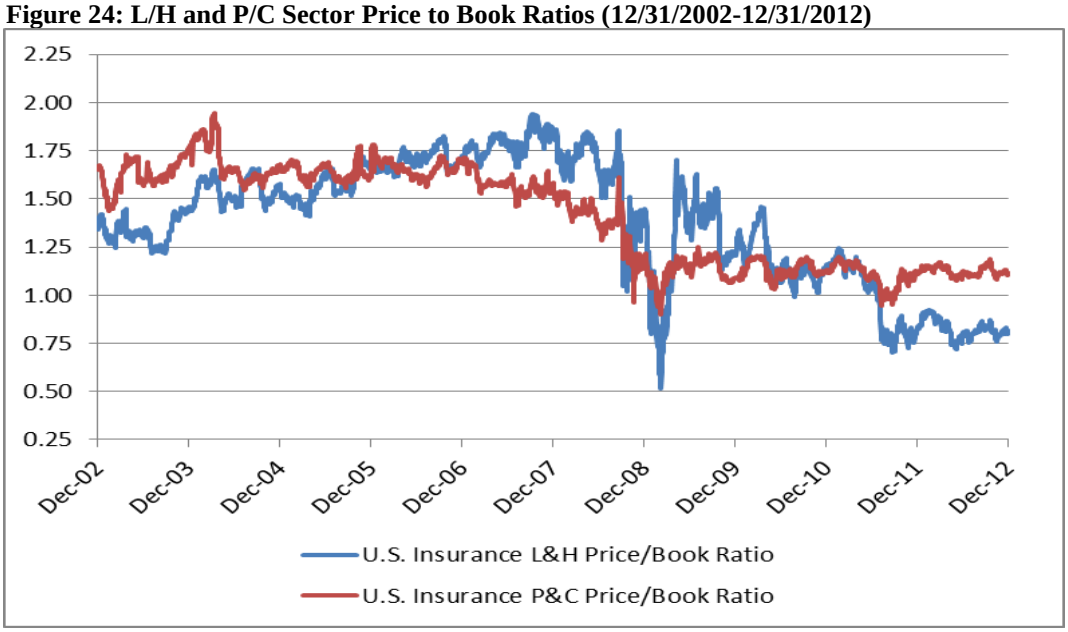


Source: SNL Financial

Due to the difference in business models between L/H and P/C insurers (*i.e.*, long-term versus short-term liabilities and investment portfolios, and L/H sector activity in capital and derivative markets, as described in Part III.E.), the equity prices of L/H insurers have been more pro-cyclical (*i.e.*, correlated with the S&P 500 index and the broader macroeconomic environment) than those of P/C insurers.

Another frequently cited metric for insurers (and other financial institutions) is price to book value, which compares the market value to the book value (*i.e.*, on the balance sheet) of the equity of an institution. Hence, if a company is trading at a discount to 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 company is trading at a premium. Figure 24 compares L/H and P/C sector price to book ratios from year-end 2002 through year-end 2012.

Figure 24: L/H and P/C Sector Price to Book Ratios (12/31/2002-12/31/2012)



Source: SNL Financial

During the financial crisis, insurers (in particular life insurers) suffered large realized and unrealized losses on investments. This led to sharp declines in insurer book value of equity. However, the equity market selloff in late 2008 led to even more precipitous declines in insurer equity market values, causing both L/H and P/C insurers to trade at discounts to book value. L/H insurers traded at steeper discounts to book values than did P/C insurers at the peak of the crisis.

Both the equity market values and book values of insurers have recovered since the crisis. However, L/H insurers still traded at discounts to book value as of year-end 2012, in part due to investor concerns about the future profitability of the sector in a low interest rate environment.

D. INSOLVENT OR FINANCIALLY IMPAIRED INSURERS

L/H insurer insolvency levels are at the lowest point in forty years. P/C insurer insolvency levels are at relative lows compared to the last few decades. However, certain segments of the insurance industry, most particularly financial guarantors, had high failure levels during the most recent four to five years, in part due to the effects of the financial crisis.

1. Recent Insurer Insolvencies in Historical Perspective

Insurer insolvencies occurred with some regularity during the late 1980s and early 1990s, and peaked in 1991 at 142. These insolvencies prompted Congressional inquiries and efforts by state regulators to develop a program whereby states were required, through an accreditation process, to adopt solvency laws and regulations that meet certain minimum standards. The laws and regulations of an accredited state must contain provisions substantially similar to, or no less effective than, the significant elements of the NAIC model solvency oversight laws and regulations that state regulators have identified as key. The accreditation standards include compliance with standardized practices, including those pertaining to off-site financial analyses,

on-site financial examinations, cross-jurisdictional regulatory information sharing, and assessment and intervention authority with respect to troubled insurers. The accreditation process is a peer review exercise, and all 50 states and the District of Columbia are currently accredited by the NAIC. As a result, the responsibility for taking regulatory actions rests with the insurance regulator of the state in which the legal entity is domiciled.

An insurer that has capital levels below certain regulatory thresholds is considered "impaired," and thus, subject to state regulatory actions. Qualitative or quantitative conditions may indicate that an insurer is in, or in danger of approaching, "hazardous financial condition" as defined by state laws. Specific quantitative triggers for regulatory action also exist within the risk-based capital framework that is utilized by state insurance regulators. Regulatory actions can range from more frequent or detailed reporting and monitoring requirements to court-imposed rehabilitation or liquidation proceedings. In rehabilitation, the insurer is placed under control of the appropriate state regulator or a court-appointed deputy charged with developing and implementing a plan to rectify the financial difficulties of the insurer. If the insurer fails to re-establish an adequate capital level, it may be found by state insurance regulators to be insolvent and be placed in liquidation.

The frequency of L/H insurer insolvencies has decreased since the early 1990s and has remained at relatively low levels for the period during and since the financial crisis. The number of reported financially impaired L/H insurers in recent years is at the lowest since the 1970s. Of the two L/H liquidations in 2011, one was a small stipulated premium life insurer and the other was a small burial insurer.

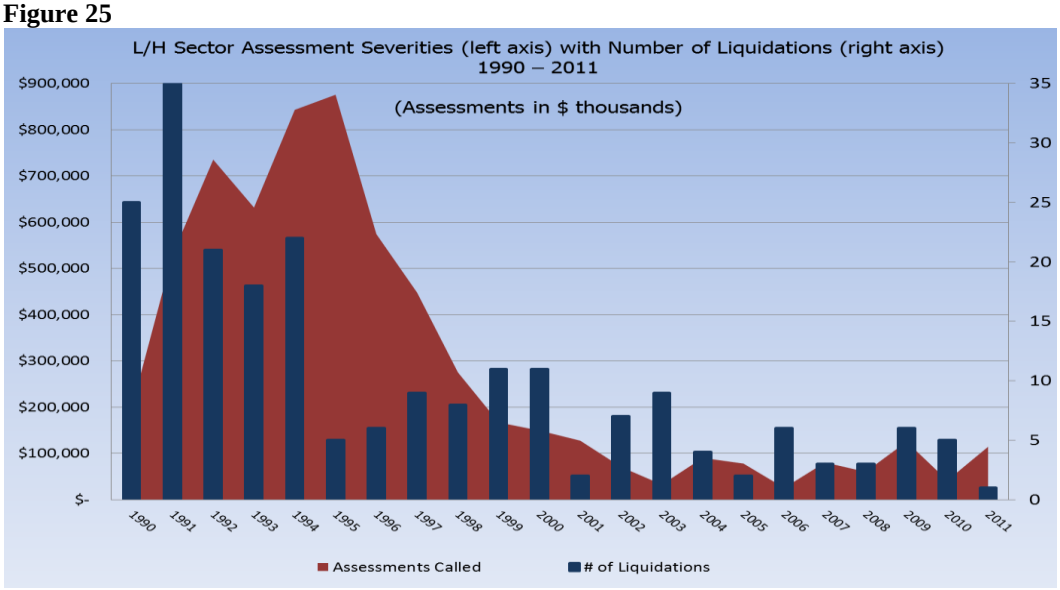
When an insurer receives a license to operate in a state, the insurer also agrees to pay assessments to the state guaranty fund. A guaranty fund serves to ensure that claimants and policyholders are compensated following an insurer's insolvency. In other words, the difference between the assets and liabilities of the insolvent insurer is made up by insurers that remain active in that market. Payments to claimants or policyholders are limited by statute.

The size of insolvencies is also an important consideration. The amount of assessments made by various state guaranty funds to pay for claims of insurers in liquidation provides a basis for measuring the severity of insolvencies. Such assessments do not reflect the entire financial impact of the insolvency because not all claims of insolvent insurers are covered by guaranty funds. Nevertheless, the trend in guaranty fund assessments may be a good proxy for the trend in severity of insolvencies.

Assessments in the L/H sector have generally remained under $200 million per year since the early 2000s. Conversely, the dollar value of assessments has increased in the P/C sector, indicating that insolvencies have involved much larger P/C insurers than did those of the 1990s. Indeed, the five largest P/C insolvencies (Reliance Insurance Company, Legion Insurance Company, Fremont Indemnity Company, California Compensation Insurance Company, PHICO Insurance Company) all occurred between 2000 and 2005, a period in which the P/C guaranty fund system paid out over 40 percent of the total of all claims and claim expenses since it was started in 1969.

Figure 25 shows the number of L/H sector insolvencies and the corresponding guaranty fund assessments from 1990 through 2011.[27]

Figure 25



Source: National Organization of Life and Health Insurance Guaranty Associations (NOLHGA)

Although the frequency of P/C insolvencies has increased in the last three years, it remains relatively low compared to the rates from the early 1990s. Figures 26 and 27 show the number of insolvencies and corresponding guaranty fund assessment severities in the P/C sector for recent.[28]

Figure 26

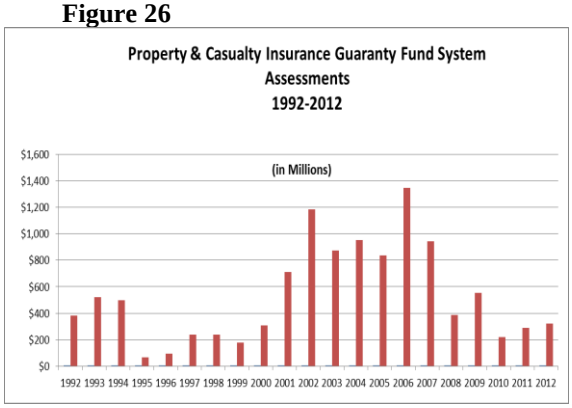
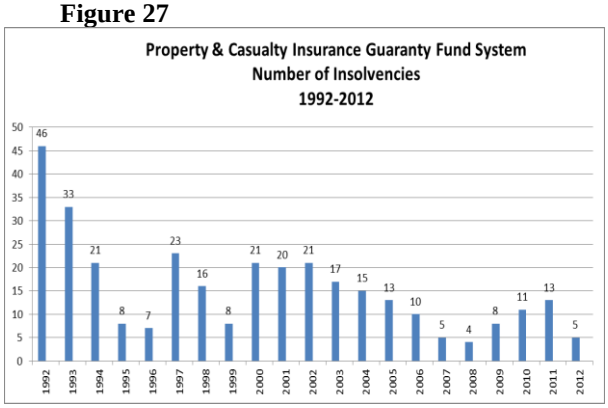


Figure 27



Source: National Conference of Insurance Guaranty Funds (NCIGF)

2. Mortgage Guaranty and Financial Guaranty Insurers

Mortgage guaranty and financial guaranty insurance are segments of the P/C sector that have played integral roles in the housing industry and in the financing of various forms of debt. Mortgage guaranty and financial guaranty insurers are subject to requirements that do not apply to other insurers. Although these mortgage guaranty and financial guaranty insurers represent only a small portion of the broader P/C sector in terms of premium volume (approximately $4.3 billion of direct premiums written for mortgage guaranty insurance and $765 million for

financial guaranty insurance, compared to $521 billion for the total P/C sector in 2012), the financial health of these insurers was damaged by the financial crisis, resulting in a relatively large number of insolvencies.

a. Mortgage Guaranty Insurers

Modern-day private mortgage insurance (PMI) developed as a private market insurance alternative for high loan to value (LTV) mortgages that are insured by the Federal Housing Administration (FHA). Fannie Mae and Freddie Mac (GSEs) may purchase loans with an LTV over 80 percent with qualified third party credit enhancement. PMI is one form of qualified credit enhancement.

PMI is regulated by state insurance regulators. In addition, because of the contractual relationship and subsequent eligibility requirements that the GSEs place on mortgage guaranty insurers, the GSEs and – through conservatorship – the Federal Housing Finance Administration (FHFA) also oversee mortgage guaranty insurers.

The financial crisis and its effect on the housing market in the United States imposed significant losses on mortgage guaranty insurers. In the wake of the crisis, regulators waived capital requirements to allow certain mortgage guaranty insurers to write high quality new business with an expectation that those insurers would regain the financial capacity necessary to pay existing obligations and anticipated claims.

In 2000, eight companies comprised the mortgage guaranty insurance industry. Of these, five companies continue to write PMI and three are in run-off or receivership. There are two new entrants to the industry since the financial crisis, bringing the total number of companies offering PMI to seven.

The mortgage guaranty insurance industry has not fully recovered from the financial crisis. Aggregate premiums have dramatically declined, and losses continued to exceed premiums through 2012. The industry continues to pay losses from claims reserves, where available, and capital infusions, if raised. There are signs of increased capacity, however, as the industry has attracted new capital since 2010.

b. Financial Guaranty Insurers

Until the financial crisis, financial guaranty insurers provided protection from credit-related losses on various debt products, particularly municipal bonds, mortgage and other asset-backed securities, and collateralized debt obligations (CDOs). This insurance guarantees that the principal and interest on the investment will be paid to the investor. The guaranty benefits issuers by providing better access to the market and reducing borrowing costs.

Before the financial crisis, financial guaranty insurers underwrote bonds issued by municipalities with relatively low default rates. In the years leading up to the financial crisis, most insurers expanded coverage to include structured financial products, including collateralized debt obligations consisting of mortgage-backed securities. As impairments and defaults on the

underlying assets increased, the private label mortgage-backed securities were downgraded and dropped in value. As a result, financial guaranty insurers realized substantial losses, and some became insolvent. During the crisis, all but one financial guaranty insurer stopped writing new business.

Prior to the financial crisis, at least eight insurers or insurance groups actively wrote financial guaranty insurance. Currently, insurer participation in this business line is very limited. Aggregate industry premiums of over $3 billion in 2008 decreased by more than 43 percent in 2009 alone, and have since continued to decrease. One new financial guaranty insurer began writing new municipal bond business in late 2012.

E. RISK MANAGEMENT AND OTHER MARKET ACTIVITIES

1. Use of Derivatives

Insurers are end-users of derivatives, as derivatives play a significant role in insurer risk management practices. L/H insurers that offer complex life insurance and annuity products (*e.g.*, those with interest rate and equity market risk) and globally active insurers that are exposed to currency exchange rate risk are active participants in the derivatives markets.

A 2009 industry survey of 45 insurers revealed that 96 percent used derivatives; in particular, 87 percent used interest rate derivatives, 89 percent used currency derivatives, and 76 percent used equity derivatives.[29] Table 28 displays the notional amounts of derivatives of the five largest publicly traded U.S. insurers (by assets), as reported in 2012 annual financial statements filed with the Securities and Exchange Commission (SEC).

Table 28: Notional Amounts of Outstanding Derivatives (2012)

Insurance Group	($ billions)
MetLife, Inc.	$334.4
Prudential Financial, Inc.	295.4
American International Group, Inc.	215.6
Hartford Financial Services Group, Inc.	169.8
Berkshire Hathaway Inc.	45.0

Source: Individual company 10-K Financial Statements (2012)

The instruments in which insurers transact are diverse. For example, L/H insurers typically use long-dated interest rate swaps to increase the interest rate duration of assets to better match the effective duration of insurer asset portfolios with liabilities. However, L/H insurers also use exchange traded futures and options in addition to relying on over-the-counter (OTC) markets for forwards, swaps, options, and credit derivatives. Insurers use credit default swaps to synthetically replicate investments that are otherwise more expensive or unavailable, and to hedge existing credit exposures where it is uneconomical to sell the existing related asset. Further, equity options are used to reduce market risks associated with certain L/H policies, especially variable annuity riders (*i.e.* minimum financial guarantees), and financial guaranty contracts.

Insurers also rely on derivatives to earn additional investment income. Many states permit insurers to sell covered call options, which can earn risk premiums in exchange for limiting the

upside potential on the underlying securities. Insurers may also replicate illiquid or unavailable securities by selling credit protection on a corporate name through a credit default swap while buying a liquid government or agency security, resulting with similar risks and returns on the corporate security at a lower cost and more favorable liquidity.

2. Participation in Securities Lending Markets

Insurers participate in securities lending markets. However, since the financial crisis, many insurers have reconsidered the exposure to securities lending risks, and many have reduced the size of securities lending programs. Prior to the crisis, the securities lending program of AIG alone was as large as $76 billion. According to a July 2011 NAIC report, the volume of securities lending programs of over 200 insurers in 2011 aggregated to $56 billion. Of the insurers considered in the NAIC report, 83 percent were L/H insurers, 13 percent were P/C insurers, and the remaining were health or other insurers.[30]

The experience of the crisis resulted in additional statutory reporting and disclosure requirements for securities lending activities. Accounting changes adopted in 2010 by state insurance regulators require collateral to be accounted for on the balance sheet, and specify when collateral should be treated as a non-admitted asset – an asset that is accorded limited or no value in statutory reporting for prudential regulatory purposes. Additional disclosures are also now required of insurers in financial filings with state insurance regulators to illustrate the timeframes within which collateral is due to be returned and the duration of the reinvestment of the collateral. An insurer is required to explain in the footnotes to financial statements how such duration mismatches are managed.

F. DISTRIBUTION CHANNELS

Insurers sell products to potential customers in many ways. Distribution channels have evolved over the years in response to changes in customer behavior, technological developments and competitive factors. Whereas distribution was largely an agent-based function years ago, it has developed today into one that includes brokers, financial planners (for life and annuity products), direct sales by telephone or mail, workplace selling (*e.g.,* for health and other voluntary benefits such as disability and life insurance for which payments are made by payroll deductions), bank channels, and the Internet, directly from the insurer or through aggregators. Moreover, relative to industry practices years ago, L/H insurers and P/C insurers selling personal lines such as auto insurance and homeowners insurance are less likely today to rely on any single means to reach the marketplace. Many insurers use the Internet extensively, at least for marketing and to disseminate information, if not also to solicit leads and close sales.

Evidence of the impact that the Internet is having on insurance distribution includes the following:

- A recent J.D. Power and Associates 2012 Insurance Study found that 74 percent of auto insurance shoppers visit at least one insurer Web site, and that 34 of auto insurance purchasers now buy their policies online.[31]

- LIMRA, formerly known as the Life Insurance Marketing and Research Association, reports that 48 of life insurance purchasers research online and buy from an agent, 23 percent research and buy online, 15 percent research online and buy via phone or mail, and 14 percent would not use the Internet at all.[32]

For the P/C sector, the main distribution channels are agents and direct writers. Agents include independent agents, brokers, general agents, and managing general agents. Direct writers include insurers that distribute through the Internet, captive agents, direct response, and affinity groups such as members of an association. AM Best reports that in 2011, 71 percent of personal lines P/C sector premiums were directly written and 28 percent were written through agents or brokers. Conversely, 67 percent of commercial lines P/C sector premiums were written through agents or brokers and 30 percent were written directly.

In the L/H sector, LIMRA reports that independent agents held 49 percent of the market for new life insurance sales in 2011, while captive agents held 40 percent, direct marketers held 4 percent, and other channels held a combined 7 percent.

While insurance agents typically represent insurers, insurance brokers typically represent businesses or institutions that are buying insurance. Business Insurance reports that as of July 2012, the top ten brokers of U.S. business were as follows.[33]

Table 29: Top Ten Insurance Brokers by 2011 U.S. Revenue

Rank	Company	2011 U.S. Revenue
1	Marsh & McLennan Cos. Inc.	$5,068,360
2	Aon P.L.C.	5,052,600
3	Arthur J. Gallagher & Co.	1,694,277
4	Wells Fargo Insurance Services USA Inc.	1,626,869
5	Willis Group Holdings P.L.C.	1,604,580
6	Brown & Brown Inc.	1,107,656
7	BB&T Insurance Services Inc.	1,104,127
8	National Financial Partners Corp.	692,987
9	USI Holdings Corp.	659,276
10	Lockton Cos. LLC.	633,082

Source: Business Insurance (ranked by 2011 brokerage revenues generated by U.S.-based clients – as of July, 2012)

G. THE REINSURANCE INDUSTRY

Reinsurance contracts typically provide for the reinsurer to indemnify the primary insurer, frequently referred to as the "cedent," for some portion of the claims incurred by the primary insurer with respect to an underlying insurance contract or portfolio of insurance contracts. Reinsurance is a risk management tool for insurers, and is used to reduce volatility and to improve financial performance and security. Reinsurance recoverables (amounts receivable on

paid losses and loss adjustment expenses, plus amounts by which reserves have been reduced for estimated future reinsurance recoveries) totaled $46.2 billion for P/C insurers in the United States at year-end 2012. By limiting the liability of the primary insurer on underlying risks and by stabilizing losses absorbed by primary insurers, the transfer of risk effectuated by reinsurance contracts increases the capacity of insurers in the primary market.

Reinsurance is a global market. Insurers in one jurisdiction often cede business to reinsurers in multiple jurisdictions. Reinsurers often similarly "retrocede" business to other reinsurers (*e.g.*, by transferring some of a risk or a portfolio of risks) in multiple jurisdictions. U.S.-based insurers rely extensively on the international reinsurance market and on off-shore reinsurers, and this reliance has increased over the last fifteen years. In 1997, U.S. reinsurers wrote over 60 percent of the premium ceded by U.S. primary insurers (*i.e.*, U.S. assumed premiums).[34] As of 2011, this figure had decreased to 42 percent. All told, in 2011, more than 2,900 foreign reinsurers domiciled in more than 100 foreign jurisdictions assumed business from U.S. ceding insurers.[35] Part of the explanation for this trend is that, over the past two decades, reinsurance capital has migrated offshore from the United States.

The global reinsurance industry is reported to have significant capacity. One such report indicates that at the end of 2012, reinsurance capital reached approximately $505 billion – a record high and an increase of approximately 11 percent compared to 2011.[36]

IV. LEGAL AND REGULATORY DEVELOPMENTS

The activities of the U.S. insurance sector bring it into contact with regulatory regimes at three different levels. First, pursuant to the McCarran-Ferguson Act,[37] individuals and entities engaged in the business of insurance are regulated principally at the state level. Each state has an insurance regulatory department, including an appointed or elected commissioner or director, which oversees both the solvency and market-related aspects of the business of insurance. The state insurance regulator operates subject to laws enacted and regulations adopted in that state.

Second, certain insurers have businesses or organizations that result in federal regulation. For example, many insurers are owned by companies that, under federal law, are bank holding companies (BHCs) or savings & loan holding companies (SLHCs). These insurers that are BHCs or SLHCs include large and small insurers. As of December 31, 2012, two of the top ten L/H insurance groups by premium volume were BHCs or SLHCs and four of the top ten P/C insurance groups were SLHCs.[38]

BHCs and SLHCs are subject to supervision by the Federal Reserve. BHC and SLHC subsidiaries that are insurance entities are primarily regulated by state insurance regulators, and remain individually subject to state insurance capital requirements.

Finally, a significant number of U.S. insurers have activities overseas and, therefore, are subject to regulation by foreign jurisdictions. One of the most significant regions in which U.S. insurers conduct substantial business is Europe. Thus, regulatory developments in the European Union are of particular interest to the U.S. insurance sector.

A number of legislative and regulatory developments at the state, federal and international levels are under review or development.

A. FEDERAL LAW AND REGULATION

In response to the financial crisis, Congress enacted and the President signed into law the Dodd-Frank Act, which has a number of provisions regarding nonbank financial companies which may have an impact on insurers. In addition, pursuant to the Basel III accord, federal banking regulators have been working with international counterparts to strengthen prudential regulation of banking institutions, which may also affect insurers that are structured as BHCs or SLHCs. These reform efforts include:

- The creation of the Council and its authorities to designate nonbank financial companies subject to supervision by the Federal Reserve and enhanced prudential standards;
- The creation of Orderly Liquidation Authority (OLA) to resolve failing complex financial institutions;
- The creation of a comprehensive regulatory regime for OTC derivatives; and
- Heightened capital requirements, including those proposed as part of the Basel II and Basel III agreements.

Each of these is addressed in greater detail below.

1. The Council and the Designation of Nonbank Financial Companies

Title I of the Dodd-Frank Act establishes the Council to identify risks to the financial stability of the United States and to respond to emerging threats to financial stability. The Dodd-Frank Act also gives the Council the authority to designate nonbank financial companies (including insurers) for supervision by the Federal Reserve and subjects these companies to enhanced prudential standards. Any determination that a nonbank financial company should be designated must be made by a vote of not less than two-thirds of the voting members of the Council, including an affirmative vote by the Chairperson, the Secretary of the Treasury. In April 2012, the Council issued a final rule and interpretative guidance to govern the procedures by which a nonbank is considered for designation.

2. Orderly Liquidation Authority (OLA)

Title II of the Dodd-Frank Act authorizes the Secretary of the Treasury, acting on the joint recommendation of the Federal Reserve and either the FDIC, SEC, or FIO, to place into receivership, under the auspices of the FDIC, a "covered financial company" that is in default or in danger of default and the failure of which could have significant systemic consequences. OLA may apply to covered financial companies that are insurers, or to holding companies in which the largest U.S. subsidiary is an insurer. In such cases, FIO has an important "key turning" role, together with the Federal Reserve. Such a determination by the Secretary with regard to an insurer requires the recommendation of both the Director of the FIO and the Federal Reserve (by an affirmative vote of two-thirds of the governors of the Federal Reserve, and in consultation the FDIC).

Under the Dodd-Frank Act, the liquidation or rehabilitation of a covered financial company or subsidiary of a covered financial company that is an insurer would be undertaken by the relevant state insurance regulator under applicable state law. However, the FDIC would have this authority if the state regulator fails to file the appropriate judicial action within 60 days. The FDIC issued its final rule for orderly liquidation in mid-2011.

3. Regulation of OTC Derivatives

Title VII of the Dodd-Frank Act creates a number of reforms that apply to the market for OTC derivatives, including central clearing, the regulation of swaps dealers, exchange-trading, and trade reporting. Over the last two years, the Commodity Futures Trading Commission (CFTC) and the SEC have proposed and finalized rules defining which instruments and entities are subject to regulation, setting forth prudential standards for clearinghouses and dealers, laying out reporting requirements, and proposing trading standards. At this stage, a number of these rules have taken effect and more are expected to become effective during 2013. Though insurance products are generally exempt from the definition of swaps, insurers – as regular users of OTC derivatives to hedge risk and gain exposure to certain financial market segments – may be subject to a changed compliance landscape as a result of these reforms.

4. Capital and Liquidity Standards

In June 2012, the banking agencies (Federal Reserve, FDIC, and Office of the Comptroller of the Currency (OCC)) issued three notices of proposed rulemaking (NPRs), as well as a final market risk rule amendment, to implement Basel regulatory capital standards as agreed upon internationally. The end date for the comment period for the NPRs was October 22, 2012.

In general, the Basel III NPRs would apply to BHCs and SLHCs and would increase the amount and quality of capital that such organizations must hold. In addition to the implementation of the Basel standards, Section 171 of the Dodd-Frank Act (referred to as the Collins Amendment) applies to BHCs and SLHCs with respect to consolidated leverage and risk-based capital requirements. The Federal Reserve sought public comment on its proposed application of Basel III to insurers. This comment period also closed October 22, 2012. Many insurers commented on the Federal Reserve proposal, and a final rule has not been promulgated.

B. STATE LAW AND REGULATION

Recent developments in solvency regulation and in group supervision have led insurance supervisors around the world to participate in the formulation of new supervisory standards. As described more fully below, these efforts are currently a focus of the IAIS, which has developed and adopted "insurance core principles" (ICPs) by which insurance supervisors are guided in regulating insurers. The International Monetary Fund (IMF) and World Bank performed the Financial Sector Assessment Program (FSAP) of the U.S. state insurance regulators in 2009 to determine compliance by the state-based insurance regulatory regime in the United States with IAIS ICPs. Since 2009, the ICPs have been modified to include enhanced supervisory standards with respect to group supervision, corporate governance, risk management, and reinsurance. In 2014, the IMF and World Bank will again perform an FSAP for insurance regulation in the United States and test the regulatory system against the modified ICPs.

In recent years, state regulators undertook an effort called the Solvency Modernization Initiative (SMI) to evaluate current solvency standards and to address the compatibility of regulatory standards in the United States with the ICPs developed by the IAIS. SMI has involved a review of key regulatory topics similar to those of the ICPs including group supervision, corporate governance, risk management, and reinsurance. SMI has been in progress for the past several years, and state regulators released a draft white paper, which summarizes this work, on April 1, 2013.

1. Group Supervision

An insurance "group" refers to two or more insurance legal entities that coexist as part of a corporate family by virtue of ownership or affiliation. A group may also include holding companies, subsidiaries or other non-insurance affiliates. "Group supervision" is the application of regulatory oversight to a group. Group supervision has become an important aspect of the overall supervisory regime because belonging to a group can pose unique risks (*e.g.*, liquidity or reputational risk) as well as potential benefits (*e.g.*, capital options or risk diversification) to one or more insurers that are members of the group. Group supervision has become an essential

component of the IAIS ICPs and ComFrame, as well as a focus of supervisory efforts to bolster U.S. regulatory standards and practices.

In recognition of the need to bolster group supervision, state regulators adopted amendments to the NAIC Model Insurance Holding Company System Regulatory Act (Holding Company Act). State regulatory authority is generally limited to the insurance entity licensed by, or operating in, that given state. The amended model Holding Company Act provisions would, where enacted:

- allow the state insurance regulator to access information regarding any entity within the insurance holding company system;
- provide state insurance regulators with information about corporate governance at the individual regulated insurer and group levels;
- provide reporting by the insurer on material risks within the insurance holding company system that could pose enterprise risk to the insurer and examination authority on a top-down basis with respect to enterprise-wide risks; and
- provide for participation by state insurance regulators in "supervisory colleges" (*i.e.*, a forum for regulators of the various jurisdictions in which the legal entities of an insurance group operate).

With these amendments to the Holding Company Act, state regulators who discover enterprise risk to the insurer are given state statutory authority to examine any entity within the group that poses such enterprise risk. As of April 2013, fourteen states have enacted the 2010 amendments to the model.

2. Corporate Governance

For purposes of SMI, state regulators compiled the corporate governance requirements from state insurance laws and regulations, general corporate governance law derived from state case law, stock exchange listing requirements, and other applicable federal laws such as the Sarbanes-Oxley Act in an effort to understand the totality of corporate governance laws to which insurers are subject. As a result of these efforts, state regulators are drafting a "Proposed Responses to a Comparative Analysis of Existing U.S. Corporate Governance Requirements" document, which proposes regulatory enhancements. An August 12, 2012 draft of the document includes proposals to "[r]eceive more regular and timely information on corporate governance practices of insurers through filing a confidential supplement on insurer governance practices with the domestic state of each insurance legal entity," and to require "insurers above a certain size to maintain an internal audit function."

3. Own Risk and Solvency Assessment (ORSA)

An "Own Risk and Solvency Assessment" (ORSA) refers to the processes and procedures used to identify, assess, monitor, manage, and report the short- and long-term risks that an insurer or group of insurers faces, and to determine that overall solvency needs will continue to be met. State regulators have developed and adopted an ORSA Guidance Manual, which provides regulators with expectations as to the manner in which an insurance group should perform an internal risk and solvency assessment. The ORSA Guidance Manual requires an internal

assessment of the risk associated with the current business plan of an insurance group and of the sufficiency of capital resources to support those risks. State regulators also developed the "NAIC Risk Management and Own Risk and Solvency Assessment Model Act" in 2012. If the model is uniformly enacted in the states, those laws would require large insurers and groups to perform an ORSA and to provide the results to state insurance regulators.

4. Reinsurance Collateral Reform

By ceding (*i.e.*, transferring) risk exposure through reinsurance, primary insurers can maintain or expand financial and underwriting capacity to offer additional primary coverage to consumers. This arrangement carries with it some level of credit risk (*i.e.*, the possibility that a reinsurer will be unable or unwilling to honor obligations to the insurer). For many years, U.S. insurance industry practices and regulations have provided for the means to reduce such reinsurance credit risk through collateral that is held by the insurer. Most notably, state insurance regulations have uniformly required foreign reinsurers to post collateral with U.S. insurers supporting 100 percent of contracted obligations. Conversely, foreign insurance regulations have generally not required U.S. reinsurers to post any collateral. This is a particularly important issue in the current EU-U.S. Insurance Project (see below), as many of the largest reinsurers are based in the European Economic Area.

Pressure has increased to eliminate the imbalance in collateral requirements for domestic and foreign reinsurers. Since the 1980s, state insurance regulators, working through the NAIC, have made various efforts to address the issues raised by reinsurers to eliminate collateral requirements. In November 2011, state regulators amended an NAIC model act that addresses reinsurance collateral requirements. As of April 2013, twelve states have adopted reinsurance collateral reform, although the adopted revisions have not been uniform.

C. EU-U.S. INSURANCE DIALOGUE PROJECT

In the European Union, the European Parliament, the Council of the European Union and the European Commission (EC), technically supported by the European Insurance and Occupational Pensions Authority (EIOPA), are reforming the insurance regulatory and supervisory regime through the Solvency II Directive, which has been in place since 2009. This Framework Directive was the culmination of work begun in the 1990s to update existing solvency standards in the EU. Current work aims to further specify the Framework Directive with technical rules and guidelines pertaining to matters including capital requirements and reinsurance, which are necessary for a consistent application by insurers and supervisors of the framework.

In early 2012, FIO hosted the EC, EIOPA, and U.S. state regulators for the purpose of establishing a formal dialogue and a related project. The purpose of the project 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. The project is carried out in collaboration with EIOPA, the EC and a representative of the United Kingdom, and with state insurance regulators and the NAIC in the United States. The steering committee for the project focused 2012 efforts on seven topics that are

fundamentally important to a sound regulatory regime, the protection of policyholders, and financial stability. The seven topics are:

- Professional secrecy/confidentiality;
- Group supervision;
- Solvency and capital requirements;
- Reinsurance and collateral requirements;
- Supervisory reporting, data collection and analysis;
- Supervisory peer reviews; and
- Independent third party review and supervisory on-site inspections.

Separate technical committees were assembled to address each topic. Each technical committee was comprised of experienced professionals from both the EU as well as the United States, including from the EC, EIOPA, EU member states, U.S. state insurance regulatory agencies, FIO, and the NAIC. The technical committees worked jointly and drafted a consensus report that included a fact-based summary of the key commonalities and differences between the EU's Solvency II regime and oversight of the U.S. insurance sector. The reports of the technical committees represented the culmination of work from the project and informed the work of the steering committee by agreeing to certain common objectives and initiatives.

In December 2012, both jurisdictions entered into an agreed-upon "Way Forward," a summary statement describing the areas appropriate for improved harmonization, convergence and compatibility. In the "Way Forward," the EU and the United States agreed to work closely together and, in early 2013, began development of detailed work plans that fulfill the stated objectives.

D. INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS)

Pursuant to the Dodd-Frank Act, FIO coordinates federal efforts and develops federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, at the IAIS. The IAIS is an association that represents insurance regulators and supervisors of nearly 140 jurisdictions, including U.S. state insurance regulators. The jurisdictions of the supervisors comprising the IAIS constitute 97 percent of the insurance premiums in the world. In addition to its members, the IAIS also has more than 130 interested parties and other observers. The IAIS objectives are to:

- promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and
- contribute to global financial stability.

In furtherance of these objectives, the 2012 IAIS by-laws[39] state that the IAIS will, among other things:

- develop principles, standards, and guidance for the supervision of insurance markets, which Members should strive to apply taking into account the specific circumstances of their markets;
- encourage the implementation and practical application of its principles and standards;
- develop methodologies for the assessment of the observance of its principles and standards, and facilitate assessment processes;
- encourage broader contacts and co-operation among insurance supervisors, facilitating mutual assistance, education and training on insurance supervision and the exchange of supervisory information; and
- engender awareness of common interests and concerns among insurance supervisors and identify potential risks that may affect insurance supervision.

FIO joined the IAIS as a full member on October 1, 2011, and now serves on the IAIS Executive Committee. FIO currently participates in the Financial Stability Committee (FSC), the Specialists' Committee supporting the work of the FSC, and the Macroprudential Surveillance Working Group. In addition, the Director of FIO serves as Chair of the Technical Committee, and FIO staff serve on various subcommittees of the Technical Committee. The Technical Committee, among other responsibilities, directs the development of the Common Framework for the Supervision of IAIGs (ComFrame).

1. Financial Stability Committee (FSC)

At the request of the G-20 Leaders, the Financial Stability Board (FSB)[40] has developed a comprehensive policy framework for systemically important financial institutions, new key international attributes for resolution regimes, essential elements for cross-border cooperation and recovery, and resolution planning. In addition, the FSB, in consultation with the Basel Committee on Banking Supervision (BCBS), requires additional loss absorbency for those institutions that will be identified in November 2014 as global systemically important banks (G-SIBs). The G-20 Leaders and FSB have asked the IAIS to develop the methodology and indicators to identify global systemically important insurers (G-SIIs), to recommend firms to the FSB that should be designated, and to develop policy measures to be applied to designated insurers. To address and answer the request of the FSB, the IAIS formed the FSC, which is comprised of experts from national authorities from around the world.

The IAIS published a proposed assessment methodology for G-SIIs for public consultation on May 31, 2012. Key elements of the proposed assessment methodology include the scope of analysis; criteria for systemic importance; quantitative and qualitative indicators (*e.g.*, nontraditional insurance activities, interconnectedness, substitutability, size, and global activity); data collection; analysis of data; and supervisory judgment. Once the IAIS collects and analyzes the data and conducts supervisory judgment according to the assessment methodology, any identified firms will be recommended to the FSB for designation. In addition to developing a methodology to identify G-SIIs, the FSC is developing heightened prudential policy measures designed to reduce the likelihood and impact of the failure of a G-SII. The proposed policy measures include enhanced supervision, effective resolution, and higher loss absorbency. The proposed policy measures were released for public comment in late 2012, and are currently being

evaluated. In February 2013, the FSB reported to the G-20 that the IAIS expected to complete the work on the global systemically important insurers by the end of the second quarter of 2013.

2. Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)

Recognizing that global insurance groups increasingly conduct business and generate earnings from outside a group's home jurisdiction, the IAIS is developing ComFrame, which will be an integrated, multilateral, and multidisciplinary framework for the group-wide supervision of Internationally Active Insurance Groups (IAIGs). In October 2013, the IAIS will release for public comment a revised draft of ComFrame that builds on and complements the ICPs.

ComFrame is intended to address group-wide activities and risks of insurers; develop principles for better global supervisory cooperation; and foster global convergence of regulatory and supervisory measures and approaches. ComFrame does not intend to set or require an insurance group to meet a global capital standard. Instead, in its July 2012 proposal, the IAIS states that the objectives in this area are to develop a system leading to comparability and consistency of application across IAIGs for solvency analysis of those IAIGs. The IAIS plans to complete the development phase of ComFrame in late 2013, and then proceed to a field testing or "calibration phase" in 2014. Field testing will allow for an evaluation of the impact of the ComFrame proposal on supervisors and insurers. The current planned implementation date for ComFrame is 2018.

V. CURRENT ISSUES AND EMERGING TRENDS

A. IMPACT OF LOW INTEREST RATES

A sustained low interest rate environment may have adverse consequences on the profitability of L/H insurers and, perhaps to a lesser extent, on P/C insurers. The extent of those consequences depends on a number of factors, such as the length and depth of the low interest rate environment, the composition and terms of the product offerings of an insurer, the extent to which an insurer has matched durations of assets and liabilities, and the degree to which it may have hedged risk through derivatives.

For example, L/H insurers often guarantee minimum policyholder returns for certain products, particularly annuity products. Many of these products were guaranteed years ago under different market conditions. As the low interest rate environment continues to suppress investment incomes, the obligation to fund guaranteed policyholder returns continues to challenge L/H insurers. Sufficient pressure might require insurers to liquidate some assets unexpectedly, which could place price pressure on certain classes of financial assets.

Additionally, in a protracted low interest rate environment, life insurers may be tempted to "reach for yield" by investing in higher-yielding, but riskier, assets. The risks of investment practices leading to higher yield and risk can be mitigated in part by state investment limitations and insurer risk management programs, but a certain level of discretion is allowed by both. Thus, a sustained low interest rate environment may lead insurers to offer products for which risk management becomes more tenuous.

L/H insurers have options for adapting to an extended low interest rate environment. Subject to regulatory and competitive limitations, insurers may be able to increase premiums and fees or change the terms of minimum guaranty provisions in life insurance and annuity products (*i.e.*, decrease the guaranteed rate of return). L/H insurers can also use derivatives to hedge interest rate risk and to earn income through writing covered call options. The costs of hedging, however, may off-set much of the expected returns in a low interest rate environment, and may subject L/H insurers to counterparty credit risks.

In addition to adversely affecting investment returns, the current low interest rate environment affects the present value of insurer contract obligations – particularly for life insurance products. As interest rates have decreased, the present values of such future obligations have increased. As a result, insurers increased reserve levels significantly in 2011, adding further downward pressure to 2011 reported financial results. As interest rates stabilized in 2012, insurers' financial results were less impacted by reserve increases than in 2011.

B. NATURAL CATASTROPHES

For P/C insurance purposes, a catastrophe is currently defined as an event that causes more than $25 million of insured losses. For P/C sector aggregate reporting purposes, catastrophe loss data are estimated by industry observers and reinsurers.

2011 was among the costliest years for insured losses resulting from natural catastrophes, with an estimated $44.2 billion of catastrophe losses in the United States,[41] far surpassing the 2010 amount of $14 billion. On a global scale, an A.M. Best report ranks 2011 as the second-costliest year ever with $110 billion of insured catastrophe losses, compared to $125 billion of catastrophe losses in 2005.[42]

The range of worldwide natural disasters in 2011 included flooding in Australia, earthquakes and the tsunami in Japan, and an earthquake in New Zealand. The United States experienced wildfires, earthquakes, tornados, flooding, and Hurricane Irene. U.S. communities were affected by 171 natural catastrophe events in 2011.[43]

During the first half of 2012, losses from natural catastrophes were relatively low.[44] However, in late October, 'Superstorm' Sandy made landfall near Atlantic City, NJ as a post-tropical storm system. Sandy produced wind gusts of 60 to 90 miles per hour in coastal New Jersey, New York, and southern New England. Sandy also caused significant storm surge and flooding in New Jersey, New York, Connecticut, Rhode Island, and the Delmarva Peninsula (Delaware, Maryland, and Virginia). Storm surge in lower Manhattan reached a record high 13.88 feet.[45] Superstorm Sandy struck the most densely-populated areas of the U.S. eastern seaboard, and current estimates suggest it caused $25 billion in insured losses, and up to $50 billion in total economic damages.[46] As a result, 2012 catastrophe losses are estimated to be $43.0 billion.[47]

Insured losses from large-scale natural catastrophes can strain the resources of the P/C insurance industry. Massive financial losses from these events often lead insurers and reinsurers to reevaluate underwriting exposure to catastrophes. Insurers often raise premium rates for consumers, especially in those areas exposed to the catastrophic risks typically insured in the private marketplace (*e.g.*, earthquake, wildfire, tornado, wind, and hurricane), increasing the cost of insurance for certain consumers. Insurers may also modify underwriting guidelines to limit exposure in catastrophe prone areas, making it more difficult for certain consumers to purchase insurance. Both increased premiums and modifications to underwriting guidelines allow insurers to rebuild capital levels and underwriting capacity.

The growth of population and infrastructure in coastal metropolitan areas, along with the frequency and severity of natural catastrophes has increased the insured and total economic loss resulting from these events.

Insurers and reinsurers may attempt to modify business models to reduce exposure to certain catastrophic risks, but such modifications take time. In some cases, recognizing the possibility that insurance supply may be limited in catastrophe-prone areas, states have responded by creating public insurance programs or reinsurance entities to restore or support private markets. States with residual market mechanisms may have to strike a careful balance between insurer capital requirements, public support for the cost of market backstops, risk-justified rates, and affordable insurance.

FIO will submit a report to Congress, pursuant to § 100247 of the Biggert-Waters Flood Insurance Reform Act of 2012,[48] assessing these and other factors related to natural catastrophes and insurance.

C. CHANGING DEMOGRAPHICS IN THE UNITED STATES

Changing demographics within the United States could have a significant impact on the U.S. insurance industry. One of the most notable ongoing demographic changes is the aging of the baby boom generation along with declining fertility rates.

From an insurance perspective, these demographic shifts present both risks and opportunities to individuals as well as to insurers. An increasing proportion of the U.S. population faces the increased risk that they may outlive their retirement assets. Likewise, insurers face the risk that liabilities on lifetime annuity contracts will exceed the underlying assumptions in effect when the annuity products were priced and sold.

These demographic changes also present opportunities for insurers to offer alternative lifetime-income solutions to protect the retirement security of individuals (*e.g.*, certain deferred fixed annuities). However, the ability of insurers to continue to develop and launch new products is affected by the current low-interest rate environment, tax rules, and the nature and extent of regulatory approval processes that apply in multiple states over product design and pricing.

D. GROWTH OPPORTUNITIES IN EMERGING MARKETS

The global insurance market is expanding rapidly – particularly in emerging markets in Asia and Latin America. By way of comparison, while total global premium volume grew by 90 percent from $2.4 trillion in 2001 to $4.6 trillion in 2011, U.S. premium volume only grew by 33 percent, from $904 billion to $1.2 trillion.[49]

Between 2000 and 2007, 75 percent of the growth in the global L/H insurance market came from North America and Western Europe. Between 2007 and 2011, more than 80 percent of the growth in the global L/H insurance market came from Latin America and Asia.[50] For the P/C sector, 75 percent of the growth in the global P/C insurance market came from North America and Western Europe between 2000 and 2007. Between 2007 and 2011, 70 percent of the growth in the global P/C insurance market came from emerging Asia and Latin America.

Going forward, the size of the middle class in the emerging markets of Asia and Latin America is expected to grow and likely to exceed that of the United States. The Organisation for Economic Co-operation and Development (OECD) reports that in 2009, the U.S. middle class comprised the largest share of purchasing price parity globally with a twenty-one percent market share – two-and-a-half times that of the next largest market, Japan. The study projects that by 2030 the U.S. market share will fall to seven percent globally, taking a distant third place behind India (twenty-three percent) and China (eighteen percent).[51]

The middle class in these emerging economies will drive future demand for insurance products in the global marketplace. The Swiss Re 2011 *sigma* update on world insurance markets found

that insurance premiums in emerging markets grew by 11.0 percent in 2010, compared to 1.4 percent growth in industrialized countries (calculated on an inflation-adjusted basis).[52] Specifically, premiums in China, which represent a third of the total emerging market premium volume, rose by 26 percent.

Emerging markets (countries in South and East Asia, Latin America and the Caribbean, Central and Eastern Europe, Africa, the Middle East, and Central Asia) accounted for only 15 percent of global premium volume in 2010. However, this number will increase substantially as the middle class in emerging economies grows. As Table 30 indicates,[53] the relative share of the global middle class is projected to increase dramatically in the Asia-Pacific region during the next twenty years.

Table 30: Size and Share of the Global Middle Class by Region

	2009		2020 (projected)		2030 (projected)	
	Millions of People	**Percent of Total**	**Millions of People**	**Percent of Total**	**Millions of People**	**Percent of Total**
North America	338	18%	333	10%	322	7%
Europe	664	36%	703	22%	680	14%
Central and South America	181	10%	251	8%	313	6%
Asia Pacific	525	28%	1,740	54%	3,228	66%
Sub-Saharan Africa	32	2%	57	2%	107	2%
Middle East and North Africa	105	6%	165	5%	234	5%
World	**1,845**	**100%**	**3,249**	**100%**	**4,884**	**100%**

Source: OECD

Such significant changes in demographics and buying power in emerging markets will have a significant impact on the markets that insurers choose to serve, the products insurers offer in those jurisdictions, the quality and nature of regulation, and how that regulation is administered.

The share of the global L/H insurance market in Latin America and Asia is expected to grow from 22 percent in 2010 to 37 percent in 2020.[54] The relatively mature markets of Korea and Japan are also expected to significantly increase demand for life insurance products in the future. With regard to the P/C sector, the share of global premiums in Latin America and Asia are expected to grow from 17 percent in 2010 to 32 percent in 2020.[55]

ENDNOTES

[1] *See* Department of Commerce, Bureau of Economic Analysis, http://www.bea.gov/national/index htm#gdp (reporting – via the "Current-dollar and 'real' GDP" hyperlink – 2012 nominal GDP of $15,684.8 billion).
[2] Department of Labor, Bureau of Labor Statistics, http://data.bls.gov/timeseries/CES5552400001?data_tool=XGtable (data extracted on April 5, 2013).
[3] *See* Department of labor, Bureau of Labor Statistics, http://data.bls.gov/cgi-bin/surveymost (data extracted on April 5, 2013) (reporting approximately 134.7 million nonfarm employees as of year-end 2012).
[4] National Insurance Producer Registry (NIPR), *2012 Annual Report*, 9, *available at* http://www.nipr.com/documents/2012_NIPR_Annual_Report.pdf.
[5] Federal Deposit Insurance Corporation (FDIC), *Quarterly Banking Profile*, 7 (Fourth Quarter 2012), *available at* http://www2.fdic.gov/qbp/2012dec/qbp.pdf (reporting $14.5 trillion of total assets held by FDIC-insured institutions.
[6] $6.8 trillion of invested assets includes separate account assets held by L/H insurers.
[7] Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 501-502, 31 U.S.C. § 313 (2010).
[8] Dodd-Frank Wall Street Reform and Consumer Protection Act § 502(a), 31 U.S.C. § 313(n)(2) (2010).
[9] This Report does not cover all aspects of the insurance industry. The Dodd-Frank Act provides that the authority of the FIO shall extend to all lines of insurance except: (1) health insurance, as determined by the Secretary of the Treasury in coordination with the Secretary of Health and Human Services based on section 2791 of the Public Health Service Act (42 U.S.C. 300gg–91); (2) long-term care insurance, except long-term care insurance that is included with life or annuity insurance components, as determined by the Secretary of the Treasury in coordination with the Secretary of Health and Human Services, and in the case of long-term care insurance that is included with such components, the Secretary of the Treasury shall coordinate with the Secretary of Health and Human Services in performing the functions of the Office; and (3) crop insurance, as established by the Federal Crop Insurance Act (7 U.S.C. § 1501 et seq.).
[10] *See infra* Part IV.D. The Financial Stability Forum (FSF) was established by G-7 Leaders in 1999 and re-established as the Financial Stability Board (FSB) in 2009 by G-20 Leaders. The FSB brings together G-20 finance ministries, central banks, financial sector regulators, and international bodies to monitor and make recommendations to strengthen global financial system stability.
[11] *See infra* Part IV.B. State regulators may coordinate efforts through the NAIC, but the NAIC does not have legal authority to make law or to bind any state official, including insurance regulators, governors, or legislators. References in this Report to the work of the NAIC or the development of NAIC model laws should be read with the understanding that the states enact their own laws and that their respective state insurance regulators ultimately interpret and enforce those laws.
[12] IAIS, ComFrame Frequently Asked Questions (April 4, 2013).
[13] Best's Special Report, Review & Preview (February 4, 2013).
[14] *Id.* at 12.
[15] ISO reports that U.S. natural catastrophe losses in the first half of 2012 were approximately $12.6 billion – down from $25.7 billion in the first half of 2011. *See* ISO, *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.isopropertyresources.com/Press/2012-Press-Releases/P-C-Insurers-Profits-and-Profitability-Surged-in-First-Half-2012 html.
[16] Best's Special Report, Review & Preview (February 4, 2013).
[17] McKinsey & Company, Study: The Increasing Internationalization of Insurance Markets (August 6, 2012) (presented at a public meeting of the Federal Advisory Committee on Insurance) [hereinafter *McKinsey Study*].
[18] AM Best's Aggregates and Averages, *2012 Life/Health Edition*.
[19] AM Best's Aggregates and Averages, *2012 Property/Casualty Edition*.
[20] Although insurers are licensed as life insurers, health insurers, or property and casualty insurers, state insurance regulators may authorize an insurer to sell other products. For example, a life insurer or property and casualty insurer may be authorized to sell health insurance. Monoline insurers, such as mortgage guaranty insurers and financial guaranty insurers, may not sell other insurance products.
[21] Premiums exclude amounts received on deposit-type contracts. Premiums have also been updated for completed mergers as of December 31, 2012.

[22] LIMRA, *Facts About Life 2010*, *available at* http://www.limra.com/newscenter/pressmaterials/10FOL.pdf. The study also reports that households blame a lack of information for the inability to obtain needed life insurance products.
[23] *See* Sebastian Schich, *Insurance Companies and the Financial Crisis*, OECD JOURNAL: FINANCIAL MARKET TRENDS, Vol. 2009/2, 8 (October 2009), *available at* http://www.oecd.org/insurance/insurance/44260382.pdf.
[24] *See* AM Best Special Report, Interest Rates & Operating Performance Issue Review, November 15, 2011.
[25] *See* ISO, *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.isopropertyresources.com/Press/2012-Press-Releases/P-C-Insurers-Profits-and-Profitability-Surged-in-First-Half-2012 html.
[26] *See* AM Best, *Glossary of Insurance Terms: Premium to Surplus Ratio*, http://www.ambest.com/resource/glossary html#P.
[27] National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), Presentation: Total Assessments Called against Total Liquidations per Year (1990-2011) (sent by NOLHGA directly to the U.S Department of the Treasury).
[28] National Conference of Insurance Guaranty Funds (NCIGF) Presentation: Property & Casualty Insurance Insolvencies and Guaranty Fund System Assessments (1992-2012) (sent by NCGIF directly to the U.S Department of the Treasury).
[29] International Swaps and Derivatives Association (ISDA), *Derivatives Usage Survey* (November 2, 2009). The global survey includes U.S. and foreign insurers.
[30] *See* NAIC Capital Markets Special Report (July 2011).
[31] J.D. Power & Associates, *2012 Insurance Website Evaluation Study Results* (May 24, 2012), *available at* http://www.jdpower.com/content/article-base/nlyQOQa/j-d-power-2012-insurance-website-evaluation-study.htm.
[32] LIMRA, *2013 Insurance Barometer Study*, 22, *available at* http://www.lifehappens.org/wp-content/themes/showtime/barometer/2013_LIFE_LIMRA_Insurance_Barometer_Study.pdf.
[33] Business Insurance, *100 Largest Brokers of U.S. Business* (July 16, 2012), *available at* http://alliantinsurance.com/Alliant-News/Industry%20News/BI_2012_Top_100.pdf.
[34] The Reinsurance Association of America (RAA), *Offshore Reinsurance in the U.S. Market* (2011 Data).
[35] Public comment submission: Public Input on the Report to Congress on the U.S. and Global Reinsurance Market, Reinsurance Association of America (RAA), 4 (August 27, 2012).
[36] Aon Benfield, Reinsurance Market Outlook (April 1, 2013).
[37] 15 U.S.C. §§ 1011-1015.
[38] MetLife "de-banked" in February 2013 and is no longer a BHC. *See* https://www.metlife.com/about/press-room/us-press-releases/index.html?compID=93061.
[39] International Association of Insurance Supervisors, *By-laws (2012 Edition)*, Article 2, *available at* http://www.iaisweb.org/By-laws-45.
[40] The Financial Stability Forum (FSF) was established by G-7 Leaders in 1999 and re-established as the Financial Stability Board (FSB) in 2009 by G-20 Leaders. The FSB brings together G-20 finance ministries, central banks, financial sector regulators, and international bodies to monitor and make recommendations to strengthen global financial system stability.
[41] Best's Special Report, Review & Preview (February 4, 2013).
[42] Best's Special Report, *Reinsurers Resilient Against Waves of Catastrophes, Economic Uncertainty* (April 23, 2012), *available at* http://www.ambest.com/press/042303globalreinsurancereport.pdf.
[43] NAIC, *Natural Catastrophe Response*, http://www.naic.org/cipr_topics/topic_catastrophe htm.
[44] ISO reports that U.S. natural catastrophe losses in the first half of 2012 were approximately $12.6 billion – down from $25.7 billion in the first half of 2011. *See* ISO, *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.isopropertyresources.com/Press/2012-Press-Releases/P-C-Insurers-Profits-and-Profitability-Surged-in-First-Half-2012 html.
[45] The previous record of 10.5 feet was set by Hurricane Donna in 1960. *See* EQECAT, *Superstorm Sandy Slams the North East with Winds, Storm Surge, and Flooding*, http://www.eqecat.com/catwatch/super-storm-sandy-slams-north-east-winds-storm-surge-flooding-2012-10-30/.
[46] *See* EQECAT, *Superstorm Sandy Post-Landfall Estimates*, http://www.eqecat.com/catwatch/post-landfall-loss-estimates-superstorm-sandy-released-2012-11-01/.

[47] Best's Special Report, Review & Preview (February 4, 2013).
[48] Pub. L. No. 112-141; 126 Stat. 916, 967-68 (2012).
[49] *See* Swiss Re, *sigma*, No. 3/2012, 33, *available at* http://media.swissre.com/documents/sigma_3_12_en.pdf; *and see* Swiss Re, *sigma*, No. 8/2003, 31, *available at* http://media.swissre.com/documents/sigma8_2003_en.pdf (showing 2001 premiums for comparison to 2002).
[50] *See McKinsey Study*, *supra* note 17, slide 9.
[51] OECD Development Centre, Working Paper No. 285, *The Emerging Middle Class in Developing Countries*, 26-29 (January 2010).
[52] Swiss Re, *sigma*, No. 2/2011, 30, available at http://media.swissre.com/documents/sigma2_2011_en.pdf.
[53] *Id.*
[54] *McKinsey Study*, *supra* note 17. The North American share is expected to decrease from 22 percent to 19 percent during the same ten years.
[55] *Id.* The North American share is expected to decrease from 41 percent to 34 percent during the same ten years.