Legal Alert: Insurance Topics We Will Be Watching in 2014

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With the first month of the year behind us, this report outlines major insurance topics that we will be watching throughout 2014.

• Forces, trends and events that we believe will affect regulation, transactions and litigation in the insurance industry during the coming year include:

  • The effect of low interest rates and an uneven global economic recovery.
  
  • The impact of large amounts of capital being deployed in the property/casualty and reinsurance sectors.
  
  • Continuing advancement of a risk-based approach to regulation and its emphasis on enterprise risk management and capital models.
  
  • NAIC and Congressional responses to the Federal Insurance Office’s report on “How to Modernize and Improve the System of Insurance Regulation in the United States”.
  
  • Implementation of the Affordable Care Act.

For the reasons indicated in greater detail in the various sections of this report, we expect:

• Conditions will be more conducive to insurance M&A activity.

• The flow of alternative capital into the property catastrophe reinsurance market will continue and will be deployed in a variety of structures, including cat bonds and sidecars.

• There will continue to be life insurance reserve financing transactions, but they could be subject to closer scrutiny than transactions in the past.

• New product development by the U.S. life insurance industry likely will pick up, with further fixed indexed product innovation, continued growth and evolution of payout annuity products, and more companies offering “hybrid” or indexed linked products registered with the U.S. Securities and Exchange Commission.

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• While Federal and state tax reform may dominate headlines, taxation of life products should remain largely unchanged.

• We will likely see significant developments with regard to life insurers’ unclaimed property settlements, regulation, legislation and litigation.

• U.S. corporate pension sponsors will take steps to de-risk, or make definitive plans to do so, which should result in annuity purchases and lump sum payouts.

We have addressed each of these topics and others in this report, which you may navigate by using the below links to each of the report’s various sections.

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Regulatory

Federal

Federal Insurance Office

On December 12, 2013, the Federal Insurance Office (FIO) released its much anticipated study, *How to Modernize and Improve the System of Insurance Regulation in the United States* (FIO Report), required by Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The long overdue FIO Report represents the most recent comprehensive statement by a federal authority on the state of insurance regulation and is expected to be the most referenced, discussed and debated insurance public policy document in the United States in 2014. Although the FIO Report does not recommend direct federal regulation of insurance, it does recommend significantly greater federal involvement in a number of areas. The first Congressional hearing to discuss the FIO Report was held this week before the Housing and Insurance Subcommittee of the House Financial Services Committee, and Committee members and witnesses alike demonstrated general support for the “go slowly” approach to reform urged in the FIO Report. While the Dodd-Frank Act mandated only this report, the FIO has an ongoing charge 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 United States financial system.” Consequently, it is expected there will be continued monitoring and further recommendations for direct federal action. Indeed, during this week’s hearing, FIO Director Michael McRaith indicated that FIO intends future reports and recommendations to Congress urging greater federal activity should states make “insufficient” progress towards the FIO Report’s uniformity recommendations.

Enhanced Supervision of Domestic SIFIs

In 2014, the Federal Reserve Board (FRB) is expected to begin defining the enhanced supervision that the Dodd-Frank Act mandates the FRB apply to insurers designated as non-bank systemically important financial institutions (SIFIs) by the Financial Stability Oversight Council (FSOC). To date, the FSOC has designated three non-bank SIFIs, including American International Group
Inc., Prudential Financial Inc., and General Electric Co.’s finance unit. Furthermore, MetLife Inc. is in the final stage of FSOC review for systemic importance, and reports indicate that Berkshire Hathaway Inc. is also being considered for review. In addition to 2014 expectations with regard to the FRB’s development of the contours of enhanced supervision for non-bank SIFIs, the Federal Deposit Insurance Corporation (FDIC) is anticipated to give guidance on the resolution of insurers under Title II of the Dodd-Frank Act. Non-bank SIFIs, like all SIFIs, must prepare and file “living wills” that detail how they would be resolved. The Dodd-Frank Act preserves the state insurance insolvency system but allows the FDIC a role in the resolution of the consolidated holding company. To date the FDIC has not given any guidance on how it envisions this process to work, but such guidance is expected in 2014 so that insurance SIFIs can comply with the Dodd-Frank Act mandate.

**Terrorism Risk Insurance Act**

Last reauthorized in 2007, the Terrorism Risk Insurance Act (TRIA) is set to expire on December 31, 2014, unless extended by Congress. TRIA was enacted following the September 11, 2001 terrorist attacks to address the near complete withdrawal of private terrorism coverage and provides commercial property and casualty insurers access to a federal backstop for certain large terrorism events and requires that insurers of certain “covered lines” make coverage available for losses resulting from certified acts of terrorism. The current politically-split Congress and the Obama Administration are skeptically reevaluating TRIA and appear to be hoping to find ways to increase private participation in the terrorism coverage marketplace. Possible changes to the program, if reauthorized, could be some adjustments to insurers’ retentions and covered lines of insurance. There also may be a push to clarify how the program responds to cyber-terrorism.

The House Financial Services Committee and the Senate Banking Committee held a combined three hearings on TRIA in 2013, and legislative language reauthorizing and likely restructuring TRIA is anticipated to be released and acted on in the House in the first quarter of 2014. It remains to be seen what proposals will emerge from the Senate and how early both chambers act on reauthorization before the December 31st expiration date.

**IRA Rollovers**

In 2014, life insurance company participation in the rollover (individual retirement accounts (IRAs) marketplace is likely to face increased regulatory scrutiny. Life insurance companies participate in various ways in IRA rollovers, including as issuers of individual retirement annuities, and also as purveyors of platforms that provide recordkeeping and other services in connections with IRA rollovers. The Financial Industry Regulatory Authority (FINRA) issued two regulatory notices in 2013 addressing its member broker-dealer firms’ practices in the context of IRA rollovers. These notices focused in a detailed manner on the sales practices,
fees, marketing methods and compensation received in connection with rollover IRAs. In addition, each of FINRA and the Securities and Exchange Commission’s (SEC) Office of Compliance, Inspections and Examinations signaled enhanced scrutiny of the rollover marketplace in 2014 by identifying it as an area of scrutiny under their respective annual examination priority letters issued in early January. The focus on IRA rollovers appears to be driven to some degree on demographics as the swelling retirement population prepares to separate from their employers and move into retirement. In addition, FINRA in particular appears to be concerned about the complexity in determining whether to rollover to an IRA given the tax impact and other factors involved in an IRA rollover decision.

**NARAB II**

We will be monitoring the developments related to the so-called National Association of Registered Agents and Brokers Reform Act in 2014 (NARAB II). The FIO Report recommended congressional adoption of NARAB II, and indicated that it could remove some of the burdens associated with the state insurance producer licensing process. NARAB II is currently included as Title II of S. 1926, which also includes the Homeowner Flood Insurance Affordability Act of 2014. While NARAB recently cleared the Senate for the first time, there still appears to be some administration concerns with the current form of the legislation.

**Standard of Care of Insurance Intermediaries**

We will be watching carefully the development/adoptions of state annuity suitability regulations and the federal securities law debate on the appropriate standard of care for broker-dealers and investment advisers to determine how that will impact insurance producers. The SEC is continuing to debate the appropriate standard of care owed by broker-dealers and investment advisers to their clients in the wake of the Dodd-Frank Act dictates from 2010. The debate has centered on whether broker-dealer standards of care owed to customers should be increased from the “suitability” standard to a “fiduciary standard” that is owed to investment adviser clients. With a relatively new SEC Chair, the trajectory of that debate and ultimate regulatory action remains uncertain. In fact, one SEC Commissioner recently indicated that he considers the fiduciary duty issues to be “very, very, very hard.” In addition to the debate related to the standard of care, much of the focus has been on addressing broker-dealer conflicts of interest and possibly creating a new disclosure obligation with respect to conflicts. We will be continuing to watch the impact that these developments at the federal level on securities intermediaries could have on insurance intermediaries. Life insurance producers have only recently been subject to an express regulatory suitability obligation with respect to their annuity sales. It remains to be seen whether insurance regulators will attempt to expand the scope of products subject to a suitability review obligation, or even consider heightening the standard of care owed by insurance producers to their
customers.

**National**

**First Enterprise Risk Management Reports**

One of the most notable new regulatory requirements arising out of the 2010 amendments to the Model Insurance Holding Company System Regulatory Act and Regulation (Holding Company Act Amendments) will begin to become effective in 2014. Specifically, the ultimate controlling person of insurers domiciled in states that have adopted the Holding Company Act Amendments will now be required to file an “enterprise risk report” (Form F) annually, with the first reports in some states due April 30, 2014. These reports must identify, to the best of the ultimate controlling person’s knowledge and belief, the material risks within the insurance holding company system that could pose enterprise risk to the insurers. Furthermore, all holding companies that directly or indirectly control any insurer licensed in New York will be required to comply with New York’s version of the enterprise risk report requirements. Whether regulators proactively use these reports in their oversight of insurers, or whether the reports end up providing only generic disclosures about the insurance business, remains to be seen. We expect that in practice both companies and regulators will have a steep learning curve with regard to the content of the filings for the first few years while reports are filed, reviewed, and commented on.

**Reduced Reinsurance Collateral**

The pace at which states will approve non-U.S. reinsurers as “certified reinsurers” that can reinsure U.S. domestic cedents with reduced collateral requirements should increase considerably during 2014. Under the Credit for Reinsurance Model Law and Regulation, the insurance department in the state of domicile of a ceding insurer may certify an unauthorized reinsurer for collateral reduction if the reinsurer is licensed and domiciled in a “qualified jurisdiction.” According to National Association of Insurance Commissioners (NAIC) staff, as of December 2013, 18 states representing 53% of direct insurance premiums have adopted the revised Reinsurance Models, and 5 additional states are expected to adopt the models within the next year, bringing the total direct insurance premiums of adopting states to 75% of the U.S. total. In 2013, the NAIC approved Bermuda, Germany, Switzerland and the U.K. as “conditional qualified jurisdictions,” and the chair of the NAIC’s Qualified Jurisdiction Working Group, California Deputy Commissioner John Finston, stated that the Working Group has also received inquiries from France and Ireland and expects to begin working with their respective insurance regulatory authorities in connection with the Working Group’s review to approve them as qualified jurisdictions within the next year.
Also in 2013, the NAIC’s recently-formed Reinsurance Financial Analysis Working Group (R-FAWG), began its task of providing advisory support and assistance to states in their review of reinsurance collateral reduction applications, determinations of “qualified jurisdiction” and “certified reinsurer” status, and coordinating multistate recognition of “certified reinsurers.” Specifically, as reported in December 2013, R-FAWG completed its peer review of and gave “passport” status to 21 reinsurers, allowing other states to accept the “certified reinsurer” designations of the reinsurers’ respective lead states. We expect that non-U.S. reinsurers will continue filing applications for certified reinsurer status and that in 2014 U.S. cedents will begin to see the effects of the designation in their reinsurance placements.

**Principles-Based Reserving Developments**

In 2009, the NAIC adopted a revised Model Standard Valuation Law, which authorizes Principles-Based Reserving (PBR) and a Valuation Manual that sets forth the minimum reserve and related requirements for certain products under PBR. In 2012, after nearly a decade of work, the NAIC adopted the Valuation Manual thereby allowing PBR to move forward to state legislatures. Several key states, however, strongly oppose PBR implementation, and the NAIC itself has been considering whether states have adequate resources to implement and administer it. PBR will not be implemented until the amended Standard Valuation Law is adopted by 42 states and state adoption reflects 75% of total life insurance premium written in the United States. This means that New York and California, two major objectors to PBR, and which have large volumes of life insurance premium written in their states, could, with one other state, derail the process. As of December 2013, only 7 states—accounting for merely 7.98% of total life insurance premium written in the United States—had adopted the amended Standard Valuation Law. In September 2013, New York allowed the expiration of principles-based guidelines involving certain life products and repeated its call for state regulators to halt pursuit of principles-based reserving. The NAIC has repeatedly reiterated its commitment to PBR and has stated that it will continue working to develop critical components, including a peer review process intended to help regulators refine the new system. Although also supported by a majority of the life insurance industry, it is still very much an open question whether PBR will ever be put into practice.

**Reserve Financing Transactions/Captives**

The use of life insurer-owned captives and special purpose vehicles has been the subject of much debate and discussion among regulators and interested parties during the past year. Following a lengthy study of these captive transactions, the NAIC published the Captive and Special Purpose Vehicles White Paper (the White Paper) in June 2013. The White Paper outlined the NAIC Captive and Special Purpose Vehicle (SPV) Use (E) Subgroup’s findings and recommendations on the use of life insurance captives to transfer excess reserve strains. The recommendations centered on better approaches to
accounting considerations, credit for reinsurance, access to alternative markets and confidentiality. As recommended in the White Paper, the NAIC engaged Rector & Associates to assess the solvency implication of such captive transactions and alternative mechanisms. Shortly after the release of the White Paper in June 2013, the New York Department of Financial Services (the New York Department) released its own captive report, which sharply criticized all such captive transactions as being part of a “shadow industry” that could potentially contribute to future financial crises, and called for a “national moratorium” on further transactions with captive reinsurers until the FIO, the NAIC and state insurance departments complete investigations into the use of captives and “a fuller picture emerges.” The White Paper and New York Department study were noted in the FIO Report, which reiterated the New York Department’s call for enhanced disclosure for captive reinsurance transactions.

To summarize the current state of affairs, views among regulators are divergent with respect to the use of captives for actuarial reserves required to be held under the NAIC Valuation of Life Insurance Policies Model Regulation #830 and the NAIC Actuarial Guidance XXXVIII – the Application of the Valuation of Life Insurance Policies Model Regulation. There are states on both ends of the spectrum and in between, with the New York Department being the most critical. A few states have voiced similar concerns, while a handful of other states have been strong proponents of the use of captives to alleviate reserve strain. Many other states, however, fall somewhere in between these views and have approved transactions that are varied in accounting considerations and credit for reinsurance approaches including the type of collateral required. The only constant in the current regulatory environment of captive transactions is the lack of uniformity. Such lack of uniformity is seen in the determination of the level of economic reserves, compliance with the credit for reinsurance regulations and the types of assets that are used to support the reserves.

With the ongoing national debate on the propriety of the life insurer-owned captive transactions, and in the context of questions about the future of PBR, the outcome of the captive debate could not be more uncertain. States also have now selectively submitted filed captive transactions to the NAIC’s Financial Analysis (E) Working Group (FAWG) for parallel reviews. As a result, in the near future, there could be closer scrutiny by state insurance regulators of reserve financing transactions using captives, including in captive and non-captive jurisdictions. This could slow the approval process and could result in more conditions on approvals than in prior transactions. However, reform of the reinsurance collateral rules to allow reinsurance to be ceded to highly rated non-U.S. reinsurers with only partial collateral may provide an alternative to reliance on deal structures that require the use of a captive for reserve financing transactions.
Moving forward, 2014 may not bring complete clarity on these life insurance captive issues. The September 2013 Rector & Associates report commented that the NAIC could decide either to prohibit captive transactions altogether or allow them but with more uniformity in regulating such transactions. If the latter view is taken, the process of reaching regulatory uniformity could be lengthy as there are complicated issues to be resolved (e.g., how to determine accounting standards or methods of reserving, what asset quality is appropriate to back which portion of reserves, and the implication of credit for reinsurance regulations). On January 30, 2014, the Wall Street Journal reported that newly-elected NAIC President Adam Hamm has indicated that “everything is on the table” for potential reform of the regulation of captives.

Non-Variable Separate Account and Other Product Regulation

In 2013, the NAIC Separate Account Risk (E) Working Group (SAR Working Group) published proposed recommendations related to the use of insulated separate accounts to fund non-unitized, non-variable products. The initial recommendations would have prohibited the use of insulated accounts in connection with stable value contracts, group annuities and funding agreements sold in the retirement market, and would also have prohibited their use in connection with corporate-owned life insurance and bank-owned life insurance products as well as indexed and modified guaranteed annuities sold in the individual markets. The industry espoused a principles-based approach to this issue, urging that the SAR Working Group permit use of insulated separate accounts so long as several principles are adhered to that are designed to ensure that general accounts are adequately compensated for the risks assumed by the general account. The SAR Working Group adopted these principles as their recommendation for group and other products offered in the retirement market, but further SAR Working Group meetings and industry input will be taking place in 2014 to address corporate owned and bank owned life insurance products as well as products offered in the individual market. The SAR Working Group has so far been adamant that use of insulated separate accounts in the individual annuity market should be prohibited. It is likely that whatever recommendations the SAR Working Group ultimately makes will then be considered in 2014 by other NAIC committees and working groups. If the recommendations are ultimately adopted by the parent committees, then the next step would be consideration of changes to existing NAIC model regulations or financial statement requirements to implement the recommendations. Ultimately, any final NAIC actions are likely to involve protracted consideration extending well into 2015.

The NAIC is already at a more advanced stage with respect to the regulation of contingent deferred annuities (CDAs). In 2013, after determining that these products were properly offered by life insurance companies, the NAIC Life Insurance and Annuities (A) Committee delegated to the Contingent Deferred
Annuity (A) Working Group review and consideration of four model regulations (annuity disclosure, suitability, advertisements, and replacements) to consider or specifically reference their applicability to contingent deferred annuities. Various other NAIC committees and other groups (including the Life Actuarial (A) Task Force, the Financial Condition (E) Committee and the Life Risk-Based Capital (E) Working Group) are also charged with addressing issues related to CDAs within their specific subject-matter expertise. We expect that considerable progress will be made on these initiatives in 2014. While the market for CDAs so far has been limited, and the industry's appetite for the product has been affected by the market and regulatory developments over the past several years, it would seem likely that progress at the NAIC will facilitate more product development in this space.

Meanwhile, another NAIC working group, the Index-Linked Variable Annuities (A) Subgroup, has begun consideration of the proper regulatory treatment of index-linked products that have been registered as securities with the SEC because their minimum values do not meet the requirements of the standard non-forfeiture laws for individual annuities. These products appear to have considerable appeal to both consumers and insurance companies in that they do provide some significant, but not complete, protection from market downturns. Unlike traditional variable annuities, however, these products do not directly pass through the investment experience of one or more separate accounts. At this juncture it is unclear what, if any, recommendations this Subgroup will make regarding the proper regulation of the design of these products and use of separate accounts. It is also unclear what effects the activities of this Subgroup will have on companies’ ability to develop and offer these products on a nationwide basis.

Corporate Governance

The NAIC’s Corporate Governance (E) Working Group has been working to develop a model law that will require licensed insurers to file an annual report describing their corporate governance practices, and significant developments are expected. A draft Corporate Governance Annual Filing Model Act and draft Corporate Governance Annual Filing Guidance Manual were exposed for public comment in December of last year. These drafts were developed by NAIC legal staff with assistance from several member states, utilizing work previously submitted by interested parties. The drafts contained a number of differences from the interested party submission, most notably the inclusion of an NAIC Guidance Manual to house the detailed annual filing instructions. Industry representatives have been almost uniformly opposed to the use of a guidance manual.

Under the proposed drafts, each insurer, or the insurance group of which the insurer is a member, would be required to submit an annual filing that contains: (1) a description of the insurer’s corporate governance framework; (2) a description of the insurer’s board of directors and committee policies and
practices; (3) a description of management policies and practices; and (4) a description of management and oversight of critical risk areas. The insurer is specifically permitted to provide information regarding corporate governance at the ultimate controlling parent level, an intermediate holding company level, or the individual legal entity level, depending upon how the insurer or insurance group has structured its system of corporate governance. Finally, the draft guidelines state that in recognition of the fact that an insurer’s corporate governance framework and practices may not vary significantly from year to year, and to facilitate regulatory review of the annual filings, insurers are encouraged to file a redline version of the filing each year to track those items that have changed from the previous year. The comment period on the drafts ended January 31, 2014, and it is expected that the Working Group will continue moving forward with a final proposal. Whether the proposal includes references to a guidance manual remains to be seen.

Mortgage Guaranty Insurance

In 2013, the NAIC’s Mortgage Guaranty Insurance (E) Working Group began working on amendments to the Mortgage Guaranty Insurance Model Act to address regulator concerns regarding the regulation of private mortgage insurers and issues facing the private mortgage guaranty insurance market. The current conceptual draft amendments to the Mortgage Guaranty Insurance Model Act contain extensive expansions to the geographic concentration, investment limitations, reinsurance, underwriting standards, capital standards and reserves sections; introduce new sections relating to quality assurance and rescission; and propose the development and adoption of a Mortgage Guaranty Insurance Standards Manual by the NAIC. Interested parties have been actively following and participating in the drafting of the amendments, including providing comprehensive comments and presentations to the Working Group. Public comment on the current conceptual draft amendments ends on February 15, 2014, after which the Working Group is expected to begin incorporating the comments received into final draft amendments for further discussion and comment.

International

International Association of Insurance Supervisors

In 2014, the International Association of Insurance Supervisors (IAIS) is expected to continue its work on the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), a set of international supervisory requirements focusing on group-wide supervision of internationally active insurance groups (IAIGs). ComFrame is built and expands upon the high-level requirements and guidance currently set forth in the IAIS Insurance Core Principles (ICPs), which generally apply on both a legal entity and a group-wide level. ComFrame is primarily intended to be a framework for supervisors to efficiently and affectively cooperate and coordinate by providing a basis for
comparability of IAIG regulation and supervisory processes. The IAIS released a revised version of ComFrame in October 2013 and announced that it has already begun field testing the latest version with the expectation that jurisdictions will begin implementing ComFrame in 2018. Furthermore, the U.S. Federal Reserve has now applied for IAIS membership in its capacity as the consolidated supervisor of United States insurance groups designated systemically important by FSOC. Some observers anticipate that the Federal Reserve’s membership in the IAIS may be an early indication of importing IAIS-developed supervisory standards to the United States, and others believe that the Federal Reserve might use its influence to seek to advocate U.S. standards in the international arena.

**U.S. Financial Sector Assessment Program**

This year, the United States will undergo its second Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund. The 2010 FSAP urged the United States to further centralize and federalize insurance supervision and, although the creation of the FIO and the Federal Reserve’s increased role in U.S. insurance supervision demonstrate some movement on the federal level, the next assessment might view these examples as perhaps only modest progress toward more centralized insurance supervision.

**Solvency II**

Originally slated for implementation in 2012, Solvency II had been delayed in EU negotiations until a final deal was reached in November 2013. As such, EU insurers are expected to begin preparing for the phased implementation of Solvency II beginning in 2016. Solvency II would establish a single group supervisor and consolidated capital requirements for insurance groups, and would require adherence to risk-based capital requirements at both the individual regulated entity and group levels. Solvency II’s risk-based approach to insurer capital requirements relies on three pillars, modeled after the three-pillared Basel II framework for banks. These pillars include: (i) substantive and quantitative risk-based capital requirements; (ii) a system of governance; and (iii) market discipline through disclosures to supervisors and the public. Despite the fact that Solvency II as originally formulated would have provided for unilateral assessments of insurance regulation in other jurisdictions for so-called “equivalence,” and insurers in non-equivalent jurisdictions would have been required to “ring-fence” European assets from non-European assets, under the EU-U.S. Insurance Project, the EU and the United States committed to a collaborative work plan aimed at increasing the convergence and compatibility of the two insurance regulatory regimes. The results of any progress made under this work plan may have important consequences for U.S. insurers doing business in the EU.
Capital Requirements

The Financial Stability Board (the FSB), the IAIS, the FIO, and the NAIC continue to focus on improving the risked-based capital (RBC) framework for insurers.

IAIS’s Basic Capital Requirement Consultation Document

On July 18, 2013, the FSB and the IAIS announced that the IAIS would develop straightforward, backstop capital requirements to apply to the group activities, including non-insurance subsidiaries, of global systemically important insurers (G-SIIs), which currently include American International Group, Inc., MetLife, Inc., and Prudential Financial, Inc. According to the IAIS’s Consultation Document on Basic Capital Requirements for Global Systemically Important Insurers (2013 BCR Consultation Document), it will establish group-wide global capital standards in three steps. The 2013 BCR Consultation Document provides that the IAIS will:

- develop a Basic Capital Requirement (BCR) by the end of 2014;
- develop Higher Loss Absorbency requirements for G-SIIs by the end of 2015; and
- develop a risk-based group-wide global insurance capital standard by the end of 2016, which would apply to IAIGs, including G-SIIs, beginning in 2019.

The IAIS has proposed that the BCR for G-SIIs address:

- insurance liability risks;
- asset risks;
- non-traditional and non-insurance risks; and potentially
- asset liability matching.

The BCR will include both on- and off-balance-sheet risks and will not address operational or liquidity risks. In developing the BCR, the IAIS will strive for comparability of outcomes across jurisdictions and the IAIS expects that the BCR will have resilience to stress. Note that comparability of outcomes would ultimately require that global accounting standards be adopted for valuing insurance liabilities and assets. Internal models will not be used for the BCR. After considering the Basel III leverage ratio as a possible approach for developing a BCR, the IAIS determined that it was not appropriate to apply the
ratio to G-SIIs because the ratio is too narrowly focused on asset risk and is not risk-sensitive. The capital resources supporting the BCR would be made up of both core and additional capital, as described in ComFrame.

**FIO’s View on Risk Based Capital Developments**

On the topic of the RBC framework applicable to U.S. insurers, the FIO Report highlights the stated shortcomings, including that:

- RBC applies a single framework to all insurers regardless of size, complexity and risk profile;

- RBC does not capture certain risks (e.g., operational risk);

- RBC relies on static statutory accounting valuation of assets and liabilities instead of economic valuations;

- RBC uses predetermined factor-based calculations instead of dynamic risk models; and

- the risk weights for certain assets and liabilities should be modified (e.g., those for investment assets and reinsurance recoverables).

The FIO Report notes that the state regulators intend to address some of these shortcomings and have developed Own Risk and Solvency Assessment (ORSA) to complement RBC requirements (see discussion below).

The FIO recommends that state-based solvency oversight and capital adequacy regimes should converge toward best practices and uniform standards. The FIO believes that programs such as ORSA raise the question of “whether state regulators possess sufficient resources with the prerequisite technical skills and experience to review the complex insurer self-assessments of risk and capital adequacy,” and that solvency oversight and capital adequacy principles should be attuned to international developments, standards and principles.

**Own Risk and Solvency Assessment**

Six states have adopted versions of the Risk Management and Own Risk and Solvency Assessment Model Act (the ORSA Model Act) since it was adopted by the NAIC in September 2012. The NAIC released the ORSA Model Act for a one-year comment period (which began on January 1, 2014) for consideration as a state accreditation standard in 2017. The ORSA Model Act focuses on enterprise risk management at the group level, and ORSA reporting is scheduled to be required beginning January 1, 2015 in those states that have adopted the ORSA Model Act as of that date. If adopted by the states as
currently contemplated, the ORSA Model Act would require many insurers to conduct self-assessments of capital adequacy at least annually for both an insurance entity and a consolidated group engaged in the business of insurance, and to provide an ORSA summary report to their respective lead state regulators upon request. The NAIC is currently in the process of establishing guidance for state regulators’ review of ORSA reporting. The guidance is expected to focus on using the summary report to enable the analyst to assess the liquidity, leverage, profitability and financial condition, and capital of the insurance group.

With respect to international developments, the Chief Executive Officer of the NAIC, Ben Nelson, has stated that “[a]lthough U.S. state insurance regulators continue to have doubts about the timing, necessity and complexity of developing a global capital standard given regulatory differences around the globe, [the NAIC] intends to remain fully engaged in the process to ensure that any development augments the strong legal entity capital requirements in the U.S. that have provided proven and tested security for U.S. policyholders and stable insurance markets for consumers and industry.”

**The Federal Reserve Board**

The FRB has not yet adopted regulatory capital or other prudential standards for nonbank companies designated by the FSOC for supervision by the FRB (see discussion of SIFIs above), but has made clear that it will tailor these standards to each nonbank SIFI’s capital structure, riskiness, complexity, financial activities and size.

Under the Volcker Rule, nonbank SIFIs that engage in proprietary trading activities or make investments in covered private equity or hedge funds may be subject to additional capital requirements and quantitative limits by the appropriate Agency or Agencies (i.e., the FRB, the FDIC, the Office of the Comptroller of the Currency, the SEC, and the Commodity Futures Trading Commission). In adopting the final Volcker Rule on December 10, 2013, the Agencies noted that two of the three nonbank SIFIs are affiliated with insured depository institutions (American International Group, Inc. and General Electric Capital Corporation, Inc.) and are therefore currently banking entities for purposes of section 13 of the Bank Holding Company Act. Interestingly, the FRB staff indicated that it “is exploring whether the third entity [(i.e., Prudential Financial, Inc.)] engages in any activity that would be subject to section 13 of the Bank Holding Company Act, and will propose action consistent with that section if appropriate and applicable.” The fact that the Agencies refrained, at least preliminarily, from applying to Prudential Financial, Inc. capital requirements with respect to its proprietary trading and investments in covered funds suggests that, for purposes of the Volcker Rule capital requirements and quantitative limits, the Agencies are considering treating nonbank SIFIs differently from SIFIs that are banking entities.
On July 2, 2013, the U.S. banking agencies released final rules implementing Basel III (Basel III Rules) for most bank holding companies domiciled in the United States, but excluded savings and loan holding companies (SLHCs) that are substantially engaged in insurance underwriting or commercial activities. After considering the comments received from SLHCs substantially engaged in commercial activities or insurance underwriting activities, the FRB decided to consider further the development of appropriate capital requirements for these companies, taking into consideration information provided by commenters as well as information gained through the supervisory process. The FRB expects to implement a framework for these companies by the time covered SLHCs must comply with the final rule in 2015.

**Mergers & Acquisitions**

**M&A Outlook**

*Forecasting Insurance M&A Activity in 2014*

Financial, regulatory and political challenges, coupled with a general lack of confidence in an uncertain immediate future, continued to dampen U.S. insurance merger and acquisition (M&A) activity in 2013, despite some early predictions that 2013 would accelerate beyond 2012. While insurers continue to reassess their strategies, their product lines and their processes, the focus has been on internal improvement and, in many cases, utilizing any excess capital to initiate stock buybacks or to otherwise establish beachheads in markets outside of the United States (e.g., Asia-Pacific and Latin America). Nevertheless, certain attributes of the insurance business—namely, the desire for scale, efficient existing market harvesting and new market penetration—all continue to be forces that will drive future M&A activity. As the fog of uncertainty begins to clear throughout 2014, we expect that there indeed may be an uptick of activity for savvy buyers and sellers who realize the importance of thoughtful and well-timed acquisitions and dispositions in their overall business strategies.

**The Non-Life Arena**

Last year was one of the most profitable years ever for the non-life insurance sector, but premium growth remains slow, interest rates are at historic lows and an abundance of capital devoted to the sector is putting pressure on pricing in reinsurance and commercial lines. In addition (and not unique to the property and casualty sector), new laws and regulations and their focus on enterprise risk management are increasing the cost of compliance while some worry that future heightened capital standards could lower returns on equity for those insurance groups that adhere to a traditional insurance business model.
The resulting landscape simply serves to reinforce the need for increased scale to meet these challenges. As the larger players can devote technological and other analytical resources to better manage their risks and price their products, other players will need to consider ways to acquire or otherwise achieve (e.g., perhaps via a merger) greater scale to spread the future cost of the tools they will need to continue to challenge the other competition. Alternatively, smaller, nimble insurers that have developed niche markets or other competitive edges will be attractive targets. Efforts to expand in emerging markets in Asia and Latin America will continue for those companies that have the capital to do so.

Finally, some industry observers are asking whether a structural change to the entire reinsurance sector is occurring – namely, whether these factors, coupled with oversupply and inadequate demand, will lead to a reshaping of the industry in which for all but the largest reinsurance groups, underwriting expertise, access to distribution and capital will be disaggregated and provided by separate sources. This reshaping of the industry could be another contributor to greater M&A activity during 2014.

The Life Insurance Arena

Not surprisingly, many of the same drivers affecting the non-life sector are present, and perhaps more acute, in the U.S. life insurance market. A combination of foreign players leaving the U.S. market, certain carriers ceasing lines of non-core or non-strategic businesses (while others look to increase their position in those same businesses), the continuing need for increasing scale in core businesses (and thus decreasing unit cost in those businesses) and the growing role of private equity players may serve to stimulate activity in 2014. Low interest rates, slowing growth in mature markets and increased regulatory costs will continue to constrain some potential players but others will likely find value despite these conditions. In addition to achieving scale, acquirers will likely also be interested in acquiring talent and technology either as a defensive or offensive long term strategy.

If deal activity over the past several years is any indication, it seems likely that transactions will continue to be dominated by sales of blocks of business rather than entire insurance entities. For both sellers and buyer, success in these transactions will be based on a robust understanding of the complexities (financially, structurally and legally) of the various alternatives for such portfolio acquisitions and dispositions. Creative and efficient structuring and execution of such transactions will be a substantial advantage. In turn, to be successful, such strategies will require bold management at the top and a team of dedicated expert resources.
Distribution Channels

Irrespective of the activity at the insurance company level, we expect further consolidation of distribution channels. Broker-dealers, insurance agencies and other third-party distributors, faced with margin pressure, increasing costs of administration and compliance and a competitive landscape for new customer acquisition will continue to generate M&A activity. It is also likely that private equity participants will be an increasing player in this arena. In fact, this segment has been very active early in 2014, as evidenced by transactions announced in January (e.g., USI Insurance Service’s proposed acquisition of certain Wells Fargo insurance brokerage and consulting locations and Nicholas Schorsh’s proposed acquisition of J.P. Turner and Cetera Financial Group). Almost without question, the distribution segment will be robust in the coming year.

The coming year will likely be a bit more active than the past two as uncertainty abates, properties become available and acquisition strategies become more honed; and we suspect that the second part of the year will be more active than the first. In any event, the successful participants will be those with thoughtful strategies and dedicated resources available to execute on those strategies.

Role of Private Equity

During 2013, the New York Department raised concerns over the trend of private equity firms and other investment companies seeking to acquire insurance companies, particularly those that write fixed and indexed annuity contracts. Based on its public pronouncements, the crux of these concerns relates to the New York Department’s perception that private equity firms typically tend to focus on maximizing their immediate financial returns over a shorter time horizon, rather than ensuring that policyholders and contract owners receive their promised contractual benefits.

Following its public comments, the New York Department subpoenaed several companies, including Apollo Global Management LLC (Apollo), Guggenheim Partners LLC (Guggenheim), Harbinger Group, Inc. and Global Atlantic Financial Group, to obtain information on the investments held by these companies to back their fixed annuity businesses. Separately, the New York Department requested multiple New York authorized insurers to provide information concerning inquiries or proposals received from private investors to acquire, reinsure or invest in the insurers’ annuity or life businesses.

In 2013 the New York Department also approved the acquisitions of Sun Life Insurance and Annuity Company of New York and Aviva Life and Annuity Company of New York by Guggenheim and Athene Holding, Ltd. (Athene), respectively. Each transaction was approved subject to the condition that the acquiring party agree to implement an “enhanced set of policyholder safeguards.” These safeguards included an obligation on the part of Guggenheim and Apollo (an affiliate of Athene) to maintain heightened RBC
levels at the acquired company; establish and fund a backstop trust account that would kick in if the specified RBC level falls below the stipulated amount; obtain prior regulatory approval of material changes to the acquired company's plan of operations (including changes to investments, dividends and reinsurance transactions); and comply with more expansive reporting requirements (such as quarterly RBC level reports and reports on corporate structures, control persons and other operating information).

Additionally, the Iowa Insurance Division (the Iowa Division) imposed a series of enhanced policyholder safeguards with respect to its approval of Athene's acquisition of Aviva Life and Annuity Company (Aviva), including an agreement on the basis for calculating reserves for Aviva's non-variable deferred annuities and post-acquisition restrictions on the payment of dividends and distributions, changing Aviva's plan of operations, and certain affiliated transactions. In connection with its acquisition, Athene also agreed voluntarily to increase policy reserves and enter into a capital maintenance agreement with respect to RBC requirements.6

We will continue to monitor regulatory and other developments that may add clarity to this topic in 2014. In addition to tracking announced insurance transactions that conceivably could result in the imposition of enhanced policyholder safeguards, the actions taken by the New York Department to date are acknowledged to be merely a precursor to the promulgation of formal regulations concerning private equity company ownership of annuity companies. Although, as of this writing, the New York Department has not issued regulations, it has suggested that the new regulations are likely to require greater disclosure from private equity firms in a manner comparable to the disclosures required of companies that propose to invest in or acquire banks. Likewise, the Iowa Division has not issued special regulations on this topic to date.

The NAIC has also taken an interest in the topic, as evidenced by its formation of the Private Equity Issues (E) Working Group (the Private Equity Working Group). The Private Equity Working Group was established as the result of a referral by FAWG on May 6, 2013, in which FAWG opined, among other things, that the prudence required to manage life insurance and annuity assets for the benefit of policyholders is "inconsistent with the business model of private equity firms and therefore creates inherent risks[.]" The Private Equity Working Group's charge for 2014 activities is to "consider development of procedures that regulators can use when considering ways to mitigate or monitor risks associated with private equity/hedge fund ownership or control of insurance company assets, including the development of best practices and consideration of possible changes in NAIC policy positions as deemed appropriate." In response to this development, one insurance group with private equity investors indicated in a letter to the Private Equity Working Group that it supports some of the proposed best practices being considered so long as they apply to all life insurance companies, and not just those life insurance companies owned by
private equity firms. The practices it proposed be applied across the board include:

• Coordinating with international or other regulators where another non-U.S. insurer is involved, other financial institutions are involved, or where the ultimate controlling entity is not based in the United States.

• Reviewing the investment portfolio of the insurer and its affiliates.

• Requiring ongoing annual stress testing of the insurer and the group. This includes stress testing not only the investments, but also the policyholder liabilities, to ensure that the assets and liabilities continue to be properly matched.

• Requiring the acquiring entity to provide pro forma results for the insurer and the other insurers in the group under certain stress scenarios.

• Requiring a capital maintenance agreement.

**U.S. Life Insurance Industry Product Development**

As the U.S. life insurance industry reacted over the past several years to the new economic and market environment characterized by ultra-low interest rates and market volatility, the number of carriers offering SEC-registered variable products consolidated, and the number of carriers offering fixed indexed products increased significantly. With the steepening of the yield curve in 2013 and the industry's adjustment to the “new normal”, however, we believe it likely that we will begin to see some shifts in market leadership in the variable annuity marketplace and, more generally, more active new fixed and variable product development in 2014. The regulatory environment for product innovation is relatively benign, although as is typically the case with product innovation, the existing federal and state regulatory regimes do not always easily or obviously accommodate all innovation.

Payout annuities—both single premium immediate annuities and deferred income annuities—were notable positives in 2013, with a number of carriers developing and launching these products and sales reaching new record levels. While a relatively small part of the overall retirement planning marketplace, these products have gained widespread acceptance as an appropriate retirement planning tool with a rightful place in the product line-up. We expect more carriers to enter this market in 2014, and expect to see continuing product evolution. Existing state non-forfeiture laws, federal income tax treatment, and SEC guidance on when products may take on securities status will likely play a significant role in the extent of innovation. Depending on the level of market and industry interest, it is possible that regulatory and/or tax accommodations might
be sought to facilitate further innovation, although we would not anticipate that occurring before 2015.

Index-linked products that tie contract values to stated index returns and provide some downside protection through use of buffers or floors on the amount of downside risk assumed by the customer appear to have found some initial significant acceptance in the marketplace. They can be viewed as a "hybrid" of traditional variable annuities and fixed indexed annuities, and a mix of those characteristics may prove very attractive to consumers. The products, however, are complex. While the SEC registration process is fairly straightforward, the level of required company-related disclosure in SEC prospectuses can be daunting. In 2014, we expect that FINRA will clarify treatment of these products under its rules in several respects. From a state regulatory perspective, existing regulations certainly do not specifically recognize certain aspects of the hybrid nature of the products. As noted above, an NAIC working group is expected to consider these issues in 2014. While the regulatory landscape is not completely clear, we expect these products will garner further significant interest in the marketplace in 2014. For similar reasons, including the steepening of the yield curve, we will not be surprised if market value adjusted (or MVA) annuities enjoy a resurgence in popularity in 2014.

Happenings in the Capital Markets

**Resurgent IPO Market**

In 2013, we witnessed the return of the insurance company IPO market after a two-year drought. Aside from the much publicized $1.5 billion IPO by ING U.S. Inc. (which will soon change its name to Voya Financial, Inc.), six other insurance companies completed IPOs in 2013, including Fidelity & Guaranty Life, NMI Holdings, Inc., Blue Capital Reinsurance Holdings Ltd., Essent Group Ltd., Third Point Reinsurance Ltd. and Health Insurance Innovations, Inc. Of these seven insurance companies, four availed themselves of the confidential SEC registration statement submission process and relaxed SEC disclosure requirements afforded to “emerging growth companies” (i.e., companies with total annual gross revenues of less than $1 billion) under the Jumpstart Our Business Startups Act (commonly referred to as the JOBS Act).

The insurance company IPO market should continue its upward trend this year given the expected further strengthening of balance sheets of insurance companies due to the more favorable economic and financial market conditions forecasted for 2014. In addition, the JOBS Act’s IPO “on-ramp” provisions – including the confidential submission of SEC registration statements, the relaxed disclosure and financial statement requirements and the up-to-five-year delay in complying with the Sarbanes-Oxley Act Section 404(b) auditor attestation of internal control requirement – should further support this trend by making the IPO process easier for and more attractive to insurance companies. The 2014 insurance company IPO market has already kicked off on a positive note with
the January 2014 public IPO filing by 1347 Property Insurance Holdings, Inc. Consistent with the precedent in 2013, 1347 Property Insurance Holdings had confidentially submitted its IPO registration statement with the SEC pursuant to the provisions of the JOBS Act late last year.

**General Solicitation and Advertising in the Private Placement and Rule 144A Markets**

In July 2013, the SEC adopted final rules under the JOBS Act removing the ban on general solicitation and advertising in private offerings made in reliance on Rule 144A and Rule 506 of Regulation D under the Securities Act of 1933, as long as only certain types of investors participate in such offerings and, in the case of Rule 506 offerings, certain other conditions are satisfied. There was some speculation that the elimination of the 80-year ban on general solicitation and advertising would spur insurance companies to use general solicitation and advertising in private offerings to market their securities and insurance-linked securities to wider group of investors. However, to date, we are not aware of any insurance companies that have done so. Given that 2014 will be the first full year with the new rules in place, we will be keeping an eye on how market practice developments around this new found freedom to publicly advertise in private offerings.

**The SEC Taking its Cue from Insurance Regulators**

After state insurance regulators raised concerns regarding the use of captives by life insurance companies (see discussion above), the staff in the SEC’s Division of Corporation Finance began to issue comments to a large number of life insurers, including MetLife, Inc., Genworth Financial Inc., The Hartford Financial Services Group, Inc., Protective Life Corp. and Reinsurance Group of America Inc., asking them to address in their SEC filings the potential impact on their financial condition and results of operations of a moratorium or ban on the use of captives. As a result, we expect that the SEC will continue to formulate the comments it issues to insurance companies based on developments at the state insurance regulatory level.

Another issue we will be watching in 2014 is whether the SEC follows up on a recommendation made by the SEC staff to simplify and eliminate disclosure and financial reporting overload in SEC reports and registration statements for all public companies, not just emerging growth companies, by overhauling its rules. The SEC staff recommendation was the result of a study it was required to undertake under the JOBS Act.

**Pension De-Risking**

The markets were very good to corporate defined benefit (DB) plans in 2013. Specifically, a steepening yield curve that reduced liabilities and a 30% increase in the S&P 500 that increased assets both pushed up the funding ratio of DB
plans. The average funded ratio rose from approximately 77% at the end of 2012 to approximately 95% at the end of 2013. This sharp improvement over a year ago is a good illustration of why more corporate plan sponsors are focusing on plan liabilities, i.e., the volatility of plan contributions and funded status complicates a corporate CFO’s balance sheet and liquidity planning.

If in 2014 rates or equity markets rise over end-2013 levels (and during January both were headed in the opposite direction), pension funding ratios will continue to improve, and some experts believe that an increasing number of DB plan sponsors would then take steps to de-risk their plans via lump sum payments or annuity purchases. If this happens, the providers of annuities may benefit from an active market in 2014. Besides the effect of market volatility on liquidity and balance sheet planning, other incentives may trigger de-risking action by CFOs over the next couple of years:

The higher the funding ratio, the lower the cost to the sponsor of purchasing an annuity, which makes this de-risking option more attractive.

• In an August 2013 notice, the Internal Revenue Service (IRS) requested comments regarding future updates to mortality tables used for minimum funding purposes under the Code. Mercer LLC has suggested that an update to the table may cause a 2% to 8% increase in the plan liabilities that sponsors will be required to fund. While insurers currently offer annuities at a price estimated to be equal to 105% to 110% of the book value of a retiree’s benefit, updated mortality tables will move sponsors’ book valuations of plan liabilities closer to insurers’ valuations, potentially narrowing the bid/ask spread in annuity purchase negotiations.

• Under changes adopted in the recent bipartisan budget agreement, Pension Benefit Guaranty Corporation (PBGC) fixed premiums are expected to rise sharply in 2015 and 2016 for all DB plans. PBGC variable premiums for underfunded DB plans are also expected to rise sharply in 2015 and 2016.

• The financial crisis of 2008 was a recent reminder that DB funding requirements can be procyclical. A corporation may be required to raise liquidity to fund pension obligations at precisely the wrong moment – when the markets demand a premium for liquidity.

• Sponsors of large DB plans that are considering an annuity purchase may wonder about the desire of qualifying annuity providers to execute several large deals simultaneously.
De-risking is generally subject to rules requiring communications to participants and will give rise to a range of ERISA, tax and insurance regulatory issues that differ depending upon the de-risking path chosen by the sponsor, e.g., full buy-out, partial risk transfer, lump sum payments, or annuity purchase. Future actions by the NAIC on separate accounts could also affect deal structuring. We understand that the IRS and the Treasury Department may have concerns about certain de-risking strategies, particularly those involving lump sum payments. In addition, the ERISA Advisory Council recommended in November 2013 that the Department of Labor (DOL) provide guidance in five areas. Any de-risking action by DB plan sponsors will therefore need to take account of the DOL’s evolving approach on these recommendations. The ERISA Advisory Council recommendations are:

1. Confirm that Interpretive Bulletin (IB) 95-1 applies to any purchase of an annuity from an insurer as a distribution of benefits under a defined benefit plan, not just purchases upon plan termination, and consider developing safe harbors for such purchases.

2. A defined benefit pension plan providing participants with an option of a lump sum distribution within a specified window, with or without a separate option of the distribution of an annuity described in IB 95-1, should provide disclosures similar to required plan termination disclosures, with not less than 90 days’ notice, which should include disclosures comparing a lump sum to the receipt of an annuity from the plan, regarding any tax penalties, and as to whether the lump sum includes the value of an early retirement subsidy.

3. Consider providing guidance under ERISA section 502(a)(9) clarifying, among other things, the consequences of a breach of fiduciary duty in the selection of an annuity contract for distribution out of the plan and when posting of security may be required.

4. Provide education and outreach concerning de-risking to plan sponsors on:
   a. The range of options available
   b. The distinction between settlor and fiduciary functions
   c. The distinctions among disclosure, education, and advice to participants in connection with distributions, options, and elections.
5. Consider collecting relevant information regarding plan de-risking transactions.

**ERISA**

We continue to follow, and be involved in, the DOL’s exemption program for the assumption of employee welfare benefits by a captive of the plan sponsor. Notwithstanding its announced reconsideration of the conditions for exemptive relief, DOL continued to grant expedited exemptions, predicated on prior exemptions, in 2013.

A revised ERISA “fiduciary” definition, which, along with the Patient Protection and Affordable Care Act (Affordable Care Act), has absorbed DOL’s regulatory resources since the initial 2010 proposal, is once again scheduled to be re-proposed in the current year, in August 2014. The 2010 proposal, had it been adopted without revision or the issuance of additional exemptions, would have compelled significant changes particularly in the distribution of products and services in the ERISA plan and IRA markets. Given the history of this project, the appointment of a new Secretary of Labor and other considerations, this date could again slip, until the fourth quarter or later. At present, it appears that DOL’s re-proposal will not be coordinated in timing or content with any SEC guidance on fiduciary responsibilities for broker-dealers. The publication of a re-proposal, should it occur, will be consequential for any life company with an interest in the retirement or IRA market.

The industry continues its urgent request for needed ERISA and tax guidance on in-plan lifetime income products. DOL’s regulatory agenda includes a proposed safe harbor for annuity selection in defined contribution plans, scheduled for October 2014. It is unclear whether the Treasury Department’s other priorities will allow it to issue tax guidance in 2014 beyond, hopefully, the finalization of the February 2012 proposed regulations for qualified longevity contracts.

**Insurance-Linked Securities**

In 2013, there was an acceleration of three trends in the property catastrophe reinsurance market:

First, there was an increase in alternative capital as more capital markets investors assumed property catastrophe risk in the form of collateralized reinsurance and insurance-linked securities (ILS). Alternative capacity has grown from $25 billion to $45 billion during the last 3 years. Some of this increase is due to greater appetite for property catastrophe risk by U.S. pension fund investors, which see this asset class as less correlated with equities. In addition, high net worth and retail investors also deployed capital in this space during 2013, as the same interest in higher-yielding investments that drove mutual funds’ interests in collateralized loan obligations spread to the property catastrophe market. Stone Ridge Asset Management and Blue Capital Reinsurance Holdings Ltd. used different routes to source high net worth and
retail capital, respectively. Whether more of these investors provide capital in 2014 may depend on whether they can find comparably high-yielding investment alternatives in the corporate bond market.

Second, many traditional catastrophe reinsurers sought to tap the growing investor base for property catastrophe risk by raising capital for collateralized reinsurance transactions via unrated collective investment vehicles and capital markets distribution channels. Since capital markets investors may charge less for the use of their capital than reinsurers may charge for the use of their rated balance sheet, traditional reinsurers are moving in part from underwriting risk to fee models. Some traditional reinsurers view this ability to access capital from capital markets investors as complementing their ability to provide rated capacity to primary insurers or reinsurers. We expect in 2014 to see many traditional reinsurers use their unrated vehicles in collateralized reinsurance transactions where it is efficient to do so. We also expect traditional catastrophe reinsurers to be active in 2014 in establishing sidecars.

Third, the increased capacity for property catastrophe reinsurance continued to pressure rates, with ILS spreads tightening by 20% to 30%. According to a report released by S&P on January 20, 2014, the catastrophe reinsurance market reached a “tipping point” over the new year, when primary insurers renewing annual policies profited from the biggest drop in premiums in more than a decade. S&P believes that small reinsurers and those that provide a high amount of property catastrophe coverage will be under the greatest pressure. In addition to lower premiums, the increased reinsurance capacity also resulted in larger ILS deal sizes and a predominance of indemnity-based triggers in ILS deals.

AIG’s Tradewynd Re deals illustrated the healthy appetite for indemnity-based deals. Finally, less than a year after Superstorm Sandy, the market saw in 2013 its first storm surge risk deal, with a $200 million issuance by MetroCat Re, sponsored by First Mutual Transportation Assurance Co. We expect reinsurers and brokers to try to continue in 2014 to expand the types of short-tailed risk that capital market investors are interested in gaining exposure to.

Unclaimed Property - Will 2014 Be a Watershed Year?

As we enter 2014, numerous life insurance companies remain under audits or multi-state market conduct exams relating to their use of the Social Security Administration’s Death Master File (the DMF) and unpaid death benefits. State officials are targeting not only the top 40 life insurers, but also small to mid-sized insurers. To date, 13 companies have entered into multi-state Regulatory Settlement Agreements with insurance regulators that require companies to implement certain business practices related to using the DMF and locating beneficiaries on a largely prospective basis. In addition, 18 companies have
entered into multi-state Global Resolution Agreements with state treasurers resolving unclaimed property issues on a largely retrospective basis. Also, one insurer entered into a settlement with Minnesota addressing both insurance regulatory issues and unclaimed property issues. We expect that, while some insurers will choose to litigate these issues, there will also be more settlements with states during 2014.

One insurer’s multi-state market conduct exam was resolved during 2013 with a finding of no violation because the insurer had shown that it used the DMF on a symmetrical basis. We will be watching to see if any other insurers are able to resolve exams on a similar basis.

During 2014, at least six cases are expected to work their way up to the court of appeals level, or higher, and these decisions could have important implications for the industry. First, a West Virginia Circuit Court decision (Perdue v. 63 Insurers) that insurers have no duty under West Virginia law to search the DMF is expected to be reviewed by West Virginia’s highest court in 2014. The Florida Court of Appeals is set to hear two cases on appeal. The first Florida case addresses the issue of the dormancy trigger for life insurance proceeds in an appeal of an administrative ruling by the Florida Department of Financial Services, in In re: Petition for Declaratory Statement of Thrivent Financial for Lutherans, Case No. 137963-13-DS. That administrative ruling also stated that the Florida unclaimed property statute requires DMF searches, which is also an issue on appeal. Concurrently on appeal in Florida is a trial court decision holding that there is no duty to search the DMF in Florida. See Total Asset Recovery Servs. LLC, v. Metlife, Inc., Case No. 2010-CA-3719 (Fla. Cir. Ct. Aug. 20, 2013).

Elsewhere, the U.S. Court of Appeals for the First Circuit will consider whether insurers have a duty to search the DMF under Massachusetts and Illinois law in an appeal brought by private plaintiffs in Feingold v. John Hancock Life Insurance Co., No. 1:13-cv-10185-JLT, 2013 WL 4495126 (D. Mass. Aug. 19, 2013). Litigation in Kentucky regarding the constitutionality of recent legislation imposing a DMF search requirement is now on appeal to the Kentucky Court of Appeals. See United Ins. Co. of Am. v. Kentucky (Ky. Cir. Ct. April 1, 2013). And, in the first litigation arising directly out of the ongoing unclaimed property audits, an insurer is appealing a preliminary injunction issued by a California Superior Court ordering the company to turn over to state auditors all data and documents requested by the State in the course of an unclaimed property audit. See Chiang v. American National Insurance Company, Case No. 34-2013-00144517 (Sup. Ct. Sacramento Cal. Oct. 9, 2013). The California Court of Appeals will consider the question of what information must be turned over to the state in an audit. Rulings in these cases could have a substantial impact on the conduct of ongoing unclaimed property audits and market conduct examinations.
On the legislative front, nine states have amended their insurance statutes to require life insurers to run the DMF against some portions of their business, to make good faith efforts to locate beneficiaries, and to escheat the proceeds to the state, if the beneficiary cannot be found or does not file a claim. Alabama State Representative Greg Wren, President of the National Conference of Insurance Legislators (NCOIL), has indicated that similar legislation will be introduced in a number of states in 2014. It is also expected that NCOIL and the NAIC will be discussing ways to improve uniformity among the states on expectations for using the DMF, locating beneficiaries and escheating unclaimed death benefits.

After significant lobbying by the industry, we witnessed a change in attitude at the NAIC in late 2013 on unclaimed insurance benefits. In contrast to the NAIC’s prior inaction regarding the development of a model law to codify the expectations of state insurance regulators, the NAIC’s Life Insurance (A) Committee approved a charge on December 4, 2013 to undertake a study in 2014 “to determine if recommendations should be made to address unclaimed death benefits.”

While some state insurance regulators appear to be poised to provide guidance to the industry, tensions remain high between states that insist on pursuing settlements and those intent on providing regulatory guidance to the industry on these issues.

The passage of the Bipartisan Budget Act of 2013, signed into law by President Obama on December 26, 2013, will bring significant changes to how insurers and their service providers can access the DMF. The Act requires the Secretary of Commerce to establish a fee-based certification program for all persons wanting to access DMF data for any deceased individual within three years of death. Certification is limited to those with specified need for the information and who can attest that they not only have systems, facilities and processes in place to safeguard the DMF data but also the experience to do so. The Department of Commerce is required to conduct “periodic and unscheduled” audits of those persons certified to access the DMF and impose stiff penalties for improper use and sharing of DMF data. While the Department of Commerce has stated that user access to the DMF will continue without interruption until the certification program has been established, this issue could have important collateral consequences for how unclaimed property settlements, regulation, legislation and litigation unfold in 2014.
Litigation

Class Actions

The class action landscape continues to evolve, with key developments in 2013 foreshadowing others worth watching in 2014, all of which may have an impact on the insurance industry. In 2013’s most eagerly anticipated decision, Comcast v. Behrend, the U.S. Supreme Court vacated the certification of a massive antitrust damages class action because the plaintiffs could not show that damages were calculable on a class-wide basis. Comcast built on the Court’s admonition in Wal-Mart v. Dukes that the class certification inquiry must be rigorous. We are following several key cases in which Comcast calls into question the viability of classes that the Courts of Appeals have held to be properly certified. Certiorari petitions are pending in three cases in which Comcast calls into question the viability of classes that the Courts of Appeals have held to be properly certified. Certiorari petitions are pending in three cases in which the Court is asked (i) to further define “predominance” under Rule 23(b)(3), (ii) to rein in the practice of partial, or “issue” certification, as an end-run against a rigorous predominance test, and (iii) to decide whether expert evidence offered at the certification stage must pass the Daubert test. Rulings on these key issues could impose additional, stringent requirements on certification or, conversely, prompt waves of new class filings.

In January 2014, the Supreme Court decided its second Class Action Fairness Act (CAFA) case, and it was a setback for proponents of robust CAFA jurisdiction. In Mississippi ex rel. Hood v. AU Optronics Corporation, the Court held that a parens patriae action brought by the Mississippi attorney general, seeking millions of dollars in damages on behalf of individual purchasers of liquid crystal display (LCD) devices, could not be removed to federal court under CAFA’s mass action provisions. The Hood complaint was virtually identical to parallel class action complaints pending in a federal court multidistrict litigation, and the same class action plaintiffs lawyers were retained to pursue the copycat parens patriae action. Nevertheless, the Court ruled that the parens patriae case did not qualify as a “mass action” because the state was the only named plaintiff, and a CAFA “mass action” requires at least 100 plaintiffs. Parens patriae actions have targeted insurers in the past. We will be watching in 2014 to see if the Hood decision spurs an increase in such cases, in which state attorneys general team with prominent plaintiffs class action firms to bring high-exposure damages cases that bear many of the indicia of class actions, but without the protections of CAFA, Rule 23 or an often more neutral federal forum.

Cost of Insurance Litigation

Cost of Insurance (COI) rates have been challenged in a number of cases across the country. Plaintiffs generally allege that COI rates must be based solely on mortality factors (e.g., age, sex, underwriting class, policy year, according to the plaintiffs), without consideration of other factors such as expected policy lapse rates, agent commissions, and anticipated death benefit costs. The Seventh Circuit in two cases (one unpublished) rejected this theory
based on the policy language at issue, and these decisions are a significant victory for the industry. In another recent decision, a United States District Court in Florida dismissed a putative COI class action as barred by a prior class action settlement.

_Norem v. Lincoln Benefit Life Company, 737 F.3d 1145 (7th Cir. Dec. 13, 2013),_ is the leading published federal appellate case on COI issues. There, the court held that absent a promise to use a specific formula when calculating a COI rate, an insurer is not bound to consider only those factors listed in a COI provision. Interpreting the policy language at issue, the court affirmed summary judgment for the insurer. In so ruling, the Seventh Circuit rejected or distinguished the reasoning of several lower court decisions that reached opposite conclusions. In particular, the court rejected the reasoning of _Jeanes v. Allied Life Ins. Co., 168 F. Supp. 2d 958 (S.D. Iowa 2001)_ and _Yue v. Conseco Life Ins. Co., No. CV 08-1506, 2011 WL 210943 (C.D. Cal. Jan. 19, 2011) (Yue I),_ in which courts held that “based on” should be interpreted as “solely based on.” The Seventh Circuit also distinguished _Yue v. Conseco Life Ins. Co., 282 F.R.D. 469, 481 (C.D. Cal. 2012)_ (Yue II) as involving different circumstances and policy language. COI litigation is expected to continue in 2014 as the rulings to date appear to be driven in large part by differing policy language from case to case.

**Universal Life Litigation**

Continued historically low interest rates have increased pressure on life insurers to adjust rates on universal life policies. Although policies generally permit rate increases, plaintiffs are exploring legal theories to challenge the increases and to create liability on life insurers for the “damages” allegedly suffered by policyholders due to such rate increases. In the leading case to date, one federal Court of Appeals rejected plaintiffs’ theories of liability (e.g., alleged failure to disclose, breach of contract). We will continue to monitor these developments, as these products will continue to experience interest rate pressures in 2014.

**Data Breach, Privacy and Related Coverage Litigation**

2013 ended with highly publicized data breaches that compromised private records of more than 100 million Americans. Increasingly, data breaches are followed within days (hours, in some instances) by class action lawsuits against the companies whose systems were hacked. This growing wave of consumer-privacy litigation should be of interest to the insurance sector, which is the repository of billions of private records. Key issues percolating in data breach litigation include whether plaintiffs must prove actual injury from a company’s data collection methods or a data breach, or whether state and federal statutes relax traditional standing requirements of injury-in-fact.

A related issue of interest to the industry is whether companies targeted by data breaches may shift their remedial and litigation costs onto commercial general liability (CGL) insurers. A January 2014 Connecticut decision, _Recall Total_
Information Management v. Federal Insurance Company, considered whether liabilities stemming from the theft of laptops containing private employee records could be covered under the “personal injury” provision common to many CGL insurance agreements. The court found no coverage because the policy defined “personal injury” to include the publication of private data, and in that case there was no evidence that private data from the stolen laptops had been published to anyone. Other pending CGL coverage cases are worth watching in 2014, particularly if data breach class actions continue to proliferate.

Unclaimed Property

Unclaimed property litigation remains an area of keen interest to the industry. 2013 witnessed significant decisions from trial courts in West Virginia, Florida, Kentucky, California, and Massachusetts. We expect these cases to work their way up through the appellate courts, and these decisions could have important implications for the industry. This topic is more thoroughly addressed in another section of this Legal Alert: Unclaimed Property – Will 2014 Be a Watershed Year?

Tax Matters

Implementation of the Foreign Account Tax Compliance Act

As of July 1, 2014, the Foreign Account Tax Compliance Act (FATCA) rules under IRC §§ 1471-1474 generally will require any payor of a “withholdable payment” to withhold 30% of such payment, unless (i) the payee satisfies the FATCA reporting requirements or fits into an exception to the FATCA rules or (ii) the payment satisfies such an exception. For purposes of the FATCA rules, a “withholdable payment” includes any U.S. source payments of fixed or determinable annual or periodical (FDAP) income, and FDAP income includes passive income such as interest, dividends, royalties, insurance and reinsurance premiums, and compensation. Because the FATCA rules have broad application, both non-U.S. insurance companies and U.S. insurance companies, which may be withholding agents for FATCA purposes, should consider how these rules might apply to their particular circumstances.

Of primary importance to non-U.S. insurance companies, FATCA contains two different sets of reporting requirements – one for foreign financial institutions (FFIs) and one for non-financial foreign entities (NFFEs). In brief, the FFI reporting rules require an FFI to enter into an agreement with the IRS pursuant to which the FFI will agree (i) to perform due diligence to identify account holders that are U.S. persons or entities with substantial U.S. ownership, (ii) to report information about such account holders and their accounts to the IRS, and (iii) to withhold on certain payments, including payments made to recalcitrant account holders. Once an FFI is FATCA compliant and provides the proper documents to its withholding agents, the withholding agents need not withhold on payments made to that FFI. However, if an FFI is not FATCA compliant, any withholdable
payment made to it will be subject to the 30% withholding tax. Importantly, an insurance company generally will constitute an FFI only if it issues cash value insurance policies or annuity contracts.

A non-U.S. insurance company that is not an FFI generally will constitute a NFFE. NFFEs are not required to enter into an agreement with, or otherwise to provide information directly to, the IRS. Instead, NFFEs are required only to report to their withholding agents information with respect to the U.S. persons that own, directly or indirectly, more than 10% of the NFFE’s stock (by vote or value). These greater-than-10% owners are called “substantial U.S. owners,” and a NFFE must provide their names, addresses, and taxpayer identification numbers to the NFFE’s withholding agents. If a NFFE has no substantial U.S. owners, it must report that fact to the withholding agents. The withholding agents then must report such information to the IRS. In the event that a NFFE does not provide the required information to a withholding agent, the withholding agent must withhold 30% of any withholdable payment made to that NFFE.

On January 28, 2013, the Treasury Department and the IRS published extensive final regulations that provide detailed rules governing the application of FATCA (the Final FATCA Regulations) and set an implementation date of January 1, 2014, for most of FATCA’s withholding and account due diligence requirements. See T.D. 9610, 78 Fed. Reg. 2874 (Jan. 28, 2013). Thereafter, on July 12, 2013, the IRS extended many of the implementation dates included in the Final FATCA Regulations by six months to July 1, 2014. See Notice 2013-43, 2013-31 I.R.B. 113. Most recently, the IRS issued Notice 2013-69, 2013-46 I.R.B. 503, on October 29, 2013, describing its intention to update and amend the Final FATCA Regulations relating to NFFEs. One expected regulatory change will allow NFFEs to report their substantial U.S. owners directly to the IRS on IRS Form 8966 (FATCA Report), thus allowing a NFFE that is not part of a publicly traded group to avoid reporting such information to its U.S. insureds and other withholding agents.

The FATCA rules are complex and contain numerous exceptions and special rules. With the July 1, 2014, implementation date for most of FATCA’s withholding and account due diligence requirements looming, it is advisable for companies to be moving into the final stages of implementing system changes and new procedures in order to ensure compliance with the FATCA regime.

Federal Tax Reform

Impact of 2014 Mid-Term Elections

With the mid-term elections in full view, 2014 could be an important staging period that will lay the groundwork for comprehensive federal tax reform legislation to be considered in 2015. However, with the likely arrival of new chairmen at both the House Ways and Means Committee and the Senate Finance Committee, it would not be surprising to see a shift in legislative
priorities at the outset of the next Congress, if not sooner.

*Tax Extenders*

For 2014, the front-burner issue is whether Congress will act on the package of expired tax provisions known as “tax extenders,” including the exceptions from Subpart F insurance income and foreign personal holding company income for “exempt insurance income” under IRC § 953(e) and “active” insurance income under IRC § 954(i). Any “selective inaction” on these now-expired provisions could signal congressional interest in reforming them in the near term.

*Taxation of Life Insurance and Annuity Products*

The potential impact of federal tax reform efforts on life insurance and annuity products also is an issue that we continue to monitor closely. In the past, changes in the taxation of such products have been proposed to restrict or eliminate the current exclusion of inside build-up from income. However, more recent tax reform efforts have tended to shy away from proposals to change the taxation of these products. In this regard, the Obama Administration’s budget proposals for fiscal year 2015 may offer clues as to the future direction of discussions concerning the taxation of life insurance and annuity products.

*“Non-Taxed” Reinsurance Premiums Paid to Foreign Affiliates*

Another area of continuing congressional interest has been the “non-taxed” reinsurance premiums paid to foreign affiliates. In particular, recent proposals by Sen. Max Baucus (D-Mont.), Rep. Richard Neal (D-Mass.), and the Obama Administration (i) would deny an insurance company a deduction for premiums and other amounts paid to affiliated foreign companies with respect to reinsurance of property and casualty risks to the extent that the foreign reinsurer (or a U.S. shareholder of that company) is not subject to U.S. federal income tax with respect to the premiums received, and (ii) would exclude from the ceding company’s income (in the same proportion in which the premium deduction was denied to it) any return premiums, ceding commissions, reinsurance recovered, or other amounts received with respect to a reinsurance transaction for which a premium deduction is wholly or partially denied. Notably, under these proposals, the reinsurance premiums paid to the foreign reinsurer would remain subject to the U.S. federal excise tax under IRC § 4371, and it appears that the ceding company still would have to reduce its tax reserves by the amount ceded to the reinsurer. The latter result effectively would put the ceding company on a cash basis for deducting losses on the business reinsured, unless the affiliated foreign reinsurer could elect to treat such reinsurance premiums as effectively connected income.
**Ongoing Federal Tax Litigation**

**Insurance Characterization**

Although a number of federal tax cases involving insurance characterization are pending, an important case recently was decided in the taxpayer’s favor. Specifically, on January 14, 2014, the United States Tax Court issued a reviewed opinion in *Rent-A-Center Inc. v. Commissioner*, 142 T.C. 1 (2014), which held that subsidiaries of Rent-A-Center Inc. (RAC) were entitled to claim deductions for insurance premiums paid to a Bermuda captive insurance company – Legacy Insurance Co. – that (i) was wholly owned by RAC and (ii) had made an election under IRC § 953(d) to be treated as a U.S. corporation for federal tax purposes. Another case involving a captive insurance arrangement – *Securitas Holdings, Inc. v. Commissioner* – has been tried in the Tax Court and briefs have been filed.

Additionally, a case has been filed in the Tax Court involving the assertion by the IRS that residual value insurance is not insurance for federal tax purposes – *R.V.I. Guaranty Co. Ltd. v. Commissioner*. In that case, the IRS claims that residual value insurance provides coverage for a risk of loss that is more akin to an investment risk than an insurance risk, while the taxpayer contends that residual value insurance constitutes insurance for federal tax purposes.

**Federal Excise Tax**

On January 25, 2013, Bermuda-based reinsurer Validus Reinsurance, Ltd., filed a tax refund suit in the United States District Court for the District of Columbia challenging the imposition of a “cascading” 1% U.S. federal excise tax (FET) under IRC § 4371(3) on reinsurance premiums that it paid in connection with reinsurance contracts that it entered into outside of the United States with other non-U.S. reinsurers to reinsure underlying U.S. insurance risks. See generally Rev. Rul. 2008-15, 2008-12 I.R.B. 633 (describing the IRS’s position regarding the cascading application of the FET under IRC § 4371(3)). Cross motions for summary judgment have been filed in the case, which is the first to challenge the IRS’s position on the cascading FET.

**State Tax Issues**

There is a continuing trend among state tax authorities to attempt to impose corporate income or franchise taxes on insurance companies that are not licensed to write business in their state. For example, several state tax authorities have challenged the statutory preemption of insurance companies from their state’s corporate income or franchise tax by taking the position that the statutory preemption should be interpreted narrowly and limited to those insurance companies that pay premium tax in the state. Thus, in combined reporting states, the state tax authority may attempt to include the insurance company’s income in the combined group’s taxable income. Despite this trend,
insurance companies have several strong arguments – constitutional, statutory, and under the Nonadmitted and Reinsurance Reform Act – against state tax authorities attempting to impose corporate income or franchise taxes on them.

Healthcare

We are following developments regarding several different issues of interest to insurers under the Affordable Care Act, including the issuance of guidance regarding certain taxes and fees.

Section 9010/Annual Health Insurance Providers Fee

As a reminder, calendar year 2014 will be the first year that health insurance issuers will be subject to the new annual fee established by section 9010 of the Affordable Care Act (Section 9010 Fee). The IRS and the Treasury Department issued final regulations defining key terms and otherwise implementing the Section 9010 Fee in November 2013. Covered entities must report 2013 net premiums written for health insurance on IRS Form 8963 no later than April 15th of this year. The IRS will make a final calculation of net premiums written and provide each covered entity with a notice of the amount due by August 31, 2014, and covered entities must remit the amount assessed by the IRS by September 30, 2014.

The NAIC is considering changes to SSAP No. 35R regarding the accounting treatment of the Section 9010 Fee. The changes would require the liability for the fee to be recognized in the year that the fee is payable (called the “fee year” under the regulations), rather than the prior year (called the “data year” under the regulations).

Stop Loss

Medical stop loss coverage, and its treatment as health insurance coverage for purposes of the Affordable Care Act, has been a key topic for issuers since the enactment of health reform. In the preamble to final regulations regarding the Section 9010 Fee issued in November 2013, the IRS stated that it is “considering” whether medical stop loss insurance should be excluded from the definition of “health insurance” for purposes of the fee. The statement signals that the federal agencies charged with administering the Affordable Care Act are continuing to consider the status of stop loss coverage for this and other purposes under the law, as had previously been indicated in the Request for Information regarding the use of stop loss insurance issued jointly by the DOL, the Treasury Department and the Department of Health and Human Services (the Departments) in May 2012. At the same time, several states are considering legislation that would raise minimum stop loss attachment points and make other regulatory changes to medical stop loss. Changes to the treatment of medical stop loss coverage could have a significant impact on issuers of stop loss insurance, as well as employers that self-insure employee health benefits, with
the greatest impact likely for small employers with low attachment points. Sutherland will continue to monitor stop loss developments at state and federal levels in 2014.

**Excepted Benefits**

In December 2013, the Departments filed proposed rules that would amend the regulations regarding Health Insurance Portability and Accountability Act (HIPAA)-excepted benefits under ERISA, the Internal Revenue Code, and the Public Health Services Act. The health insurance market reforms added to these statutes by the Affordable Care Act generally do not apply to excepted benefit plans and policies. The proposed rules would amend the law only with regard to “limited benefit” plans such as limited-scope vision and dental, and benefits for long-term care, nursing home care, home health care, or community-based care.

In relevant part, the proposed regulations would (i) eliminate the requirement that participants pay an additional premium or contribution for limited-scope vision or dental benefits to qualify as benefits that are not an integral part of a self-insured plan, and (ii) treat “wraparound” health coverage meeting certain conditions and provided under an employer’s group health plan as excepted benefits when offered to employees who have individual health coverage and could receive benefits through the employer’s basic group health plan, but who do not enroll in the employer’s plan because the premium is unaffordable under the Affordable Care Act. The proposed amendments would only apply to group coverage and would not impact individual limited benefit policies. We expect these regulations will be issued in final form in 2014.

Based on other guidance, we also expect that the Departments will propose two additional amendments to the regulations defining excepted benefits in 2014, clarifying one category of excepted benefits and adding an additional category. A Frequently Asked Question posted by the DOL on January 9, 2014, indicated that the Departments will propose amendments to clarify that coverage for fixed indemnity benefits that are supplemental to group health plan coverage is an excepted benefit even if the indemnity benefits are paid on a per service or other fixed basis, rather than solely on a per-period basis. Similarly, it was announced that the Department of Health and Human Services will propose regulations to allow fixed indemnity coverage sold in the individual market to be treated as an excepted benefit if four conditions are met, including that the individuals buying the coverage must have minimum essential coverage and that there can be no coordination between the benefits under the fixed indemnity coverage and any other health coverage. Finally, in September 2013 releases, the Departments indicated that they would propose regulations to treat employee assistance plan (EAP) benefits as excepted benefits as long as the EAP does not provide significant benefits in the nature of medical care or treatment.
Section 6055 Reporting

In September 2013, the IRS issued proposed regulations under IRC § 6055(a), as added by the Affordable Care Act. Under Section 6055(a), each entity that provides minimum essential health coverage (including health insurance issuers and sponsors of self-insured health plans) will be required to file annual returns reporting specific information for each individual for whom minimum essential coverage is provided beginning in 2015. The reporting will be used to verify health coverage for purposes of the Affordable Care Act’s individual health insurance mandate and to facilitate administration of federal insurance premium assistance to low-income individuals and families. Final regulations are expected in early 2014.

1 Rollovers to Individual Retirement Accounts, Regulatory Notice 13-45 (December 2013); Brokerage and Individual Retirement Account Fees, Regulatory Notice 13-23 (July 2013).


4 SEC’s Piwowar Talks Fiduciary, Money Fund Reform, Investment News (Jan. 27, 2014) (quoting Commissioner Piwowar from a speech to the U.S. Chamber of Commerce).

5 We note that the FIO Report urged that annuity suitability obligations be adopted on a nationwide basis at the risk of some type of federal action if they are not.


If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed under ‘Related People/Contributors’ or the Sutherland attorney with whom you regularly work.