Recent Insurance Industry Developments

FIO Reports on Insurance Industry Consumer Issues; FSB Updates G-SII List

SUMMARY
On November 21, 2016, the Federal Insurance Office ("FIO") issued its first annual Report on Protection of Insurance Consumers and Access to Insurance (the "Report"). The Report discusses and provides FIO’s policy recommendations on five themes in insurance and consumer protection, including: (i) insurance and technology, (ii) environmental hazards and insurance, (iii) fairness in insurance practices, (iv) fairness in state insurance standards, and (v) retirement and related issues.

Also on November 21, 2016, the Financial Stability Board (the "FSB") published the 2016 list of global systemically important insurers ("G-SIIs") after consultations with the International Association of Insurance Supervisors (the "IAIS") and national authorities. The nine insurers on the 2016 G-SII list remain the same as those on the FSB’s 2015 list. In the release announcing the 2016 G-SII list, the FSB also announced that the IAIS is considering using an activities-based approach to complement its current entity-based G-SII assessment approach.

FIO’S REPORT ON INSURANCE INDUSTRY CONSUMER ISSUES
The Report is the first report from FIO to focus on consumer protection issues in insurance. In the Report, FIO notes that while FIO’s existing annual reports on the insurance industry have addressed consumer protection issues, consumer protection issues in insurance are significant enough to warrant a dedicated report. FIO states that the aims of the Report are (i) to educate consumers on key insurance-related issues, and (ii) to recommend areas of reform in state consumer protection regimes.
A. INSURANCE AND TECHNOLOGY

The Report discusses and makes policy recommendations on big data and cyber risks arising as technological developments are applied in the insurance sector.

- **Big Data:** The Report notes that while “the use of big data . . . facilitates innovation and modernization in insurance product design, distribution, and delivery”, the use of big data in the insurance industry also raises potential concerns with respect to (i) unfair price optimization using big data, (ii) intentional or unintentional discrimination against protected classes, (iii) use of factors that are not appropriate bases for consumer insurance pricing, and (iii) lack of transparency by big data vendors. The Report recommends that consumers educate themselves on how their personal data is being used. Additionally, the Report recommends that state insurance regulators (1) ensure that big data is used by the insurance industry in compliance with applicable state and federal laws, and (2) consider asserting regulatory authority over third-party vendors that provide insurance pricing and rating tools.

- **Cyber Risks:** The Report notes various state and federal efforts to improve cybersecurity in the insurance industry, such as the U.S. Department of the Treasury’s Financial Services Information Sharing and Analysis Center, FIO’s collaboration with the IAIS to develop international standards for regulatory examination and risk management practices relating to insurer cybersecurity, and the state insurance regulators’ efforts in developing the Insurance Data Security Model Law and updating the Financial Condition Examiners Handbook. The Report recommends that consumers update critical software and be proactive when there are data breaches. The Report also calls on insurers to adopt baseline protections based on leading cyber risk management standards and best practices, review their vendors’ cyber risk management practices, and develop a comprehensive cybersecurity strategy. Finally, the Report recommends that state governments (i) review existing and proposed laws and regulations, (ii) enact uniform laws governing insurer cyber security issues, and (iii) perform regular cybersecurity examinations of insurers.

B. ENVIRONMENTAL HAZARDS AND INSURANCE

The Report discusses and makes policy recommendations on insurance-related issues posed by human-induced earthquakes and climate change.

- **Human-Induced Earthquakes:** The Report notes that while there have been questions concerning whether human activity such as fracking is responsible for increased earthquake activity in some areas of the United States, most earthquake insurance policies only cover damages that result from natural earthquakes and exclude damage caused by human-induced earthquakes. The Report recommends that consumers living in earthquake-prone areas consider purchasing earthquake insurance after carefully reviewing the policies to understand scope of coverage, and recommends that state insurance regulators in states at risk for human-induced earthquakes seek greater clarity for consumers on whether earthquake insurance policies in their states cover human-induced earthquakes.

- **Climate Change:** The Report notes that climate change is expected to increase both the frequency and severity of natural hazards and natural catastrophes, and highlights the importance of hazard mitigation measures and incentives such as resilience-based building codes, mandated insurance premium discounts when homeowners undertake specific mitigation measures, and the availability of financing for mitigation projects. The Report also calls on insurers to provide financial incentives for homeowners that take mitigation measures against natural disasters. Additionally, the Report further calls on government officials to (i) raise awareness of the value of hazard mitigation, and (ii) support investment in resilience and mitigation efforts.
C. FAIRNESS IN INSURANCE PRACTICES

The Report reviews a series of practices in the insurance industry that FIO believes “raise fundamental questions of fairness” and makes recommendations for consumers and state regulators.

- **Risk Classifications – Marital Status:** The Report notes that insurers’ use of marital status as a factor in the rating and pricing of personal lines insurance can “raise issues of fairness.” FIO further notes that certain states prohibit the use of marital status in pricing certain personal lines insurance policies, and recommends that consumers with questions about the effect of marital status on the pricing of their insurance policies contact their insurance producer, insurer or state insurance regulator. Additionally, the Report recommends that state insurance regulators continue to assess whether marital status is an appropriate rating consideration for all personal lines insurance.

- **Risk Classifications – Sex & Gender:** The Report notes that insurers’ use of sex and gender as risk classification factors for non-health insurance products such as life insurance, annuities, and auto insurance “raise questions of fundamental fairness.” FIO further notes that state policies on this issue have varied, with some but not all states limiting the use of sex or gender in the pricing of certain non-health insurance products. The Report recommends that consumers with questions about the effect of sex or gender on insurance product pricing contact their insurance producer, insurer or state insurance regulator. The Report also recommends that state and federal policymakers assess whether sex and gender are appropriate underwriting factors, and calls upon Congress to examine how the states are addressing the issue.

- **Homeowners’ Insurance Coverage:** The Report notes that (i) there has been an increasing use of non-standardized homeowners insurance policies with less favorable terms than standardized policies, and (ii) policy forms and coverage terms often do not become available to a consumer until after the purchase of the policy. The Report recommends that insurers and state regulators both work to improve the transparency of consumer disclosures regarding policy forms and coverage limits, and recommends that state insurance regulators (i) prioritize the issue areas identified by the NAIC’s Transparency and Readability Working Group in 2016, and (ii) provide more assistance to consumers with homeowners insurance policies.

- **Mandatory Arbitration Clause:** The Report notes that state approaches to mandatory arbitration clauses in insurance policies vary greatly, with 24 states allowing unrestricted use, 16 states prohibiting any use, and the remaining states prohibiting use in certain situations, such as personal lines insurance products. The Report recommends that consumers with questions about mandatory arbitration clauses speak with their insurance producer or insurer, or their state insurance regulator, to receive an explanation or assistance, and recommends that policymakers and state insurance regulators (i) develop appropriate limits on the use of mandatory arbitration clauses in insurance contracts, and (ii) assess whether state consumer protections relating to mandatory arbitration clauses in insurance should be better aligned with protections given to consumers of other financial products and services.

- **Costs of Filing an Insurance Claim:** The Report notes that filing a claim can lead to premium increase or non-renewal, and that insurers share information regarding policyholders’ damages and claims and use that information when reviewing applications or setting premiums. The Report recommends that policymakers and insurance regulators “identify any reforms needed to address increased premiums after claims caused by accidents for which the policyholder was not at fault.”

D. FAIRNESS IN STATE INSURANCE STANDARDS

Noting that “disparity in state insurance standards can give rise to a variety of consumer protection issues,” the Report discusses and makes policy recommendations on (i) the state insurance guaranty system, and (ii) legislative developments in the workers’ compensation market.
State Insurance Guaranty Associations: The Report identifies as key issues in the state insurance guaranty associations system: (i) inconsistent consumer guaranty association coverage limits across states, and (ii) state prohibitions on the advertising of state guaranty association protections that reduce transparency in the marketplace and contribute to a lack of trust among prospective insureds. The Report recommends that consumers proactively seek information about guaranty association coverage of their insurance policies and annuities. Additionally, the Report recommends that state policymakers and insurance regulators evaluate whether their state’s guaranty association coverage is in line with those of other states. The Report further argues that if coverage limits are not standardized by the states, Congress should consider prescribing uniform national standards.

Workers’ Compensation Insurance: The Report identifies several issues relating to workers’ compensation insurance, including: (i) certain states reducing workers’ compensation benefits that shift burdens to the federal Social Security Disability Insurance program, (ii) certain states’ legislative efforts to allow employers to opt-out of workers’ compensation programs, (iii) inconsistent protections for workers across states, as states compete to reduce employers’ costs, and (iv) certain employers’ intentional misclassification of workers to deny access to workers’ compensation programs. The Report cautions federal, state, and local policymakers against shifting costs to taxpayer-supported programs and calls on policymakers to evaluate the fairness of state-by-state differences in workers’ compensation systems.

E. RETIREMENT AND RELATED ISSUES

The Report also reviews and makes policy recommendations on consumer protection issues related to retirement, such as retirement security products, the secondary market for life insurance and annuity products, long-term care insurance and unclaimed death benefits.

Retirement Security: The Report notes that financial security relating to retirement is a key concern among Americans, as longer life spans increase longevity risks and market uncertainty and shifts to defined contribution plans increase market risks. The Report surveys different kinds of annuities and life insurance products, and states that “the private market can serve as another key element of a sound retirement plan [in addition to Social Security Benefits].” The Report recommends that a consumer “first understand his or her own needs” and seek help from financial professional or state insurance regulators before accessing private market retirement solutions, but does not make policy recommendations relating to such products.

Secondary Market for Life Insurance & Annuity Products: Focusing especially on structured settlement buyouts, FIO notes while the 2001 Model State Structured Settlement Protection Act has been adopted in 49 states, the laws are not uniform across states and in-person court proceedings required in some states sometimes have lacked the rigor to adequately protect consumers. The Report recommends that consumers seek financial and legal advice before entering into a structured settlement buyout. Additionally, the Report recommends that state legislators and insurance regulators promote more rigorous consumer protections relating to structured settlement buyout transactions, especially by requiring a court hearing in the consumer’s county of residence before any structured settlement buyout. The Report further argues that if the states fail to sufficiently protect structured payees, “Congress should consider whether additional federally imposed standards or protections are warranted.”

Long-Term Care Insurance: The Report surveys the current problems in the long-term care insurance (“LTCI”) market, such as (i) the need for insurers to increase LTCI rates due to initial mispricing of LTCI policies, (ii) inconsistencies among states in rate increase approval processes, (iii) the significant decline in availability of LTCI products despite the increasing need for such products in an aging society, and (iv) the costs of failed LTCI insurers being borne by state guaranty funds, other insurers and ultimately consumers. The Report calls for state policymakers and insurance regulators to address “the lack of regulatory uniformity that has exacerbated the
inherent challenges of the LTCI market” and actively work with federal officials to address the issue of financing LTCI policies.

- **Unclaimed Death Benefits:** The Report notes that the key issues relating to unclaimed death benefits are (i) inconsistency of the laws and regulations governing unclaimed death benefits across states and (ii) the reliability of the Death Master File for insurers. The Report recommends that consumers conduct policy searches if they believe a family member was insured under a life insurance policy but cannot find the policy, but does not make any specific policy recommendations relating to unclaimed death benefits.

### 2016 G-SII LIST

#### A. BACKGROUND

The FSB and IAIS define G-SIIs as insurers whose distress or disorderly failure, because of their size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity. As part of FSB’s policy measures to “address the systemic and moral hazard risks associated with systemically important financial institutions,” G-SIIs are subject to certain international capital and supervisory standards which are currently being developed and are intended to be adopted by national insurance regulators.

The FSB, in consultation with the IAIS and national authorities, designates G-SIIs on an annual basis each November based on an assessment methodology developed by the IAIS which is subject to review and revision every three years. Under the assessment methodology, the IAIS uses quantitative and qualitative factors to propose a recommended list of G-SIIs to the FSB, and the FSB then determines whether to accept the recommendation. Most recently, the IAIS updated its G-SII assessment methodology in June 2016. In its 2015 list of G-SIIs, the FSB indicated it is postponing a decision on the G-SII status of reinsurers, pending further development of the G-SII methodology. The 2016 G-SII list does not provide any update with respect to the G-SII status of reinsurers.

G-SIIs are to be subject to certain capital and supervisory standards that are currently being developed and will be implemented by national regulators, including: (i) group-wide recovery and resolution planning and regular resolvability assessments; (ii) enhanced group-wide supervision; and (iii) higher loss absorbency (“HLA”).

#### B. 2016 G-SII LIST

The nine insurers on the 2016 G-SII list are:

- Aegon N.V.;
- Allianz SE;
- American International Group, Inc.;
- Aviva plc;
- Axa S.A.;
- MetLife, Inc.;
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- Ping An Insurance (Group) Company of China, Ltd.;
Prudential Financial, Inc.; and
Prudential plc.

This list was based on a recommendation by the IAIS using end-2015 data. These are the same insurers who were identified in 2015.

C. ACTIVITIES-BASED APPROACH TO COMPLEMENT THE G-SII ASSESSMENT APPROACH

The FSB also announced that the IAIS is “exploring an activities-based approach to addressing systemic risk as a possible complement to the G-SII entity-based assessment approach.” Currently there is no further detail available on what an activities-based approach as applied to the G-SII assessment process would entail, and the FSB states that it “looks forward to receiving further updates [from the IAIS] on this work.”

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ENDNOTES


5. The Working Group noted the need to “[s]ystematize and improve presale disclosures of coverage”; “increase consumer accessibility to different carriers’ policy forms on a presale basis” and “facilitate consumers’ capacity to understand the content of insurance policies and assess differences in insurers’ policy forms.” See the Report at 22-23; NAIC, Transparency and Readability of Consumer Information (C) Working Group: 2016 Charges, available at http://naic.org/cmte_c_trans_read_wg.htm.

6. The Report notes that Texas and Oklahoma have enacted legislation to allow employers to opt out of their workers’ compensation systems to varying degrees, while South Carolina and Tennessee are currently considering similar legislation. In Oklahoma, the state Supreme Court invalidated the opt-out legislation in September 2016. See the Report at 32.

7. Structured settlement products are insurance products for settling legal disputes or judgments involving severe physical injuries, sicknesses or permanent disablement. In a structured settlement buyout, the consumer-payee would receive lump sums of cash from a third party (typically a funding company) in exchange for the income streams from the structured settlement product. FIO notes that while structured settlement buyouts can “benefit certain consumers by providing cash not available from other sources,” there is significant concern over whether the consumer-payee has been treated fairly in such transactions. See the Report at 38-39.


9. The Death Master File is a computer database of death records maintained by the Social Security Administration. See the Report at 44.


11. FSB notes that the IAIS will provide FSB with a work plan for further work on the assessment methodology in the first quarter of 2017. For additional information on IAIS 2016 update to the G-SII assessment methodology, see our memorandum to clients entitled “IAIS Issues Updated G-SII Assessment Methodology” (June 2016), available at: https://sullcrom.com/iais-issues-updated-g-sii-assessment-methodology-iais-updates-assessment-methodology.

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