WILLKIE FARR & GALLAGHER LLP

NEW YORK WASHINGTON HOUSTON PARIS LONDON FRANKFURT BRUSSELS MILAN ROME

Developments and Trends in

Insurance Transactions and Regulation

2015 YEAR IN REVIEW

January 19, 2016

To Our Clients and Friends:

We are pleased to present our 2015 Year in Review. In it we review the year's most important developments in insurance transactions and regulation, including developments relating to mergers and acquisitions, corporate governance and shareholder activism, insurance-linked securities, alternative capital, traditional capital markets transactions, and the regulation and taxation of insurance companies, both in the United States and internationally.

We hope that you find this 2015 Year in Review informative. Please contact us if you would like further information about any of the topics covered in this report.

Sincerely,

Corporate Insurance and Regulatory Group
Willkie Farr & Gallagher LLP

Band 1 for Insurance – Transactional and Regulatory

Chambers USA
Nationwide and New York | 2015 and 2014

Insurance Practice Group of the Year

Law360
2015 and 2014

#1 Legal Adviser in Insurance M&A

SNL Financial
Based on number of deals over prior two years

#1 Issuer's Counsel for U.S. Insurance Capital Markets Offerings

Thomson Reuters
2015 and 2014

"One Firm I Would Not Want to Be Without"

Client quote in *Chambers USA* 2015

"Excellent and Responsive" Team in London

Client quote in *Legal 500 UK* 2015

Table of Contents

I. Review of M&A Activity in 2015

A. Market Trends – North America

1. By the Numbers

Fewer insurance M&A transactions in North America were announced in 2015 than in 2014, but the aggregate value of the transactions increased significantly. A total of 61 life and health and property casualty ("P&C") insurance M&A transactions in North America were announced in 2015, representing over $58 billion in aggregate transaction value.[1] A total of 73 transactions were announced in 2014, representing $17.3 billion in aggregate transaction value. When the activity in the M&A market for managed care insurance companies during the same periods is also considered, the disparity in aggregate transaction value becomes even more significant, with the transactions announced in 2015 having over $148 billion in aggregate transaction value as compared to approximately $17.6 billion for transactions announced in 2014.

Big dollar deals dominated industry headlines over the past year. Seven North American transactions in the life and health, P&C and managed care insurance sectors that were announced in 2015 had an equity value in excess of $5 billion. This number excludes the abandoned $11 billion merger between Axis and PartnerRe. For context, only four $5 billion-plus transactions in the industry were announced in North America over the prior nine years.

The trend toward big dollar deals was evident in all sectors of the industry. In the life and health sector, the number of transactions remained relatively flat year-over-year (21 transactions announced in 2015, compared to 19 in 2014), but the aggregate transaction value increased more than 60%, from $8.5 billion in 2014 to $13.7 billion in 2015. In the non-life/P&C sector, 40 transactions were announced in 2015 representing almost $44.5 billion in aggregate transaction value, as compared to 54 transactions representing almost $8.8 billion in aggregate transaction value in 2014. Finally, the managed care insurance sector saw aggregate transaction value jump from $310 million in 2014 to over $90 billion in 2015.

We discuss some of the drivers of this activity and provide our views regarding future activity below.

2. In-Bound Investment from Asia

In our 2014 Year in Review, we commented on the increased participation in the North American and European insurance M&A markets from insurance and investment companies based in the Asia-Pacific region, and we predicted that this trend would continue. We were correct: the trend not only continued, it intensified. The year 2015 saw a boom in Japanese and Chinese acquisitions of North American insurance companies.

Asian buyers accounted for a substantial majority of the most significant activity in the life and health insurance sector in North America during 2015. Meiji Yasuda Life Insurance Company announced a $5 billion acquisition of StanCorp Financial Group Inc., Sumitomo Life Insurance Company announced a $3.7 billion acquisition of Symetra Financial Corporation and Anbang Insurance Group announced a $1.58 billion acquisition of Fidelity & Guaranty Life. Another significant transaction in the life and health insurance sector involved the acquisition by Dai-ichi Life's subsidiary Protective Life of a block of term life insurance policies from Genworth Financial for $661 million.

Asian buyers' participation in insurance industry M&A during 2015 was not limited to the life and health insurance sector. In the non-life/P&C sector, Tokio Marine acquired HCC Insurance Holdings, Inc. for $7.5 billion, China Minsheng Investment Corp. announced a $2.24 billion acquisition of Sirius International Insurance Group from White Mountains Insurance Group, and Fosun International Limited announced a $2.1 billion acquisition

[1] Deal volume and transaction values in this report are from *SNL*'s database.

of Ironshore Inc. Tokio Marine's acquisition represents its third significant transaction in the United States in recent years. It acquired Delphi Financial Group in 2012 and Philadelphia Consolidated Holding Corp. in 2008. It also acquired Kiln Ltd., a Lloyd's of London insurer, in 2008.

Japanese firms initially focused on the North American insurance market as a result of pressure on rates and profitability and demographic challenges in the domestic Japanese market, as well as a desire to deploy their significant capital base and diversify geographically. These factors continue to exist, so we expect that Japanese buyers and their U.S. platforms will continue to be active participants in the United States insurance M&A market in the near term. The prospect of continued participation of Chinese firms in the North American insurance M&A market is a little more uncertain. It remains to be seen whether recent turmoil in the domestic Chinese economy and an aggressive anti-corruption campaign by the Chinese government, which has implicated executives of some Chinese financial services companies, will have an effect on the appetite of such firms to continue to seek acquisition opportunities in the United States and other foreign markets. On the other hand, given macroeconomic trends regarding the continuing growth and development of China, the potential certainly exists for Chinese firms to become even larger players in the North American insurance market. Furthermore, the companies that have already been acquired by these Asian firms, as U.S. platforms of the insurance operations of their Asian parent companies, likely will continue to be active players in the insurance M&A market in North America.

3. The Life and Health Insurance Sector

a. Life Insurance Carriers

Other than the four significant transactions noted above that involved Asian firms or their subsidiaries, the life and health insurance sector in North America saw very few significant M&A transactions involving life insurance carriers in 2015. Three noteworthy exceptions deserve mention.

The first is the merger of Pan-American Life Mutual Holding Company and Mutual Trust Holding Company. This transaction represents the most significant merger of mutual holding companies in years. The merger brought together two companies with complementary businesses. Mutual Trust's business is primarily focused on operations in the United States while Pan-American's business focuses largely on Latin American and Caribbean markets in addition to certain U.S. markets.

The second is Nassau Reinsurance Group's $217 million announced acquisition of Phoenix Companies, Inc. Nassau is backed by the private equity firm Golden Gate Capital. The transaction concludes a long period of uncertainty for Phoenix, which had struggled since the financial crisis and in recent years suffered through ratings downgrades and the need to restate financial statements.

The third is the acquisition by Magic Johnson Enterprises, Inc., the eponymous firm founded by the former basketball star, of a controlling interest in EquiTrust Life Insurance Company from Guggenheim Partners. EquiTrust characterized the investment as the largest purchase of a United States financial services company by an individual African-American entrepreneur or group of African-American entrepreneurs.

Aside from these exceptions and the acquisitions by Asian buyers, there appears to have been a relative lack of significant North American M&A activity by life insurance companies over the last few years, both among direct writers of life insurance and among life reinsurers. Established direct writers appear generally to be seeking growth through other means and in other markets, such as Latin America and Southeast Asia.[2] M&A activity has also been low among life reinsurers, at least on a direct basis,[3] although several life reinsurers have been active in seeking to acquire run-off blocks of life insurance business through reinsurance transactions.

[2] Notably, the Indian government in 2015 revised its law to loosen regulatory oversight over Indian insurance companies and increase the cap on foreign direct investment in such entities from 26% to 49%. These changes might lead to further investment by international insurance groups in India in the near term.

[3] Reinsurers often participate in M&A transactions on an indirect basis as facilitators that provide support to transaction participants through the reinsurance of existing blocks of business.

We see several reasons for this lack of activity in 2015. Life insurance companies continue to be affected by slow organic growth in the mature North American market. This, along with weak growth in the general economy, the persistent low-interest-rate environment which has affected investment yields, and other factors, have combined to create a situation in which fewer industry participants seek growth through acquisitions in North America. While these factors have existed for a number of years, M&A activity in the sector in the recent past was sometimes caused by regulatory factors or broader changes in the economy, and that was generally not the case in 2015.[4] It appears that this trend is beginning to change.

Regulatory factors appear poised to propel activity in life insurance M&A in 2016 and future periods. In 2013 and 2014, three insurers (AIG, Prudential and MetLife) were designated non-bank "systemically important financial institutions" ("SIFIs"). This designation has the potential to result in higher levels of capital being required to be held by such insurers. Because SIFI designation is largely affected by the overall size of a company, this designation could lead to structural changes being implemented by the three affected entities, or by other entities seeking to avoid such designation in the future. Such structural changes could include divestment of non-core assets that could be adversely affected by SIFI designation. Notably, in late 2015 activist investor Carl Icahn commenced an attempt to push AIG in the direction of structural changes (see Section II.A below for a discussion of the AIG situation), and on January 12, 2016, MetLife announced a plan to pursue the separation of a substantial portion of its U.S. Retail segment.

b. Group and Voluntary Benefits

The managed care insurance sector experienced a sea change in 2015, as changes to the industry resulting from the implementation of the Patient Protection and Affordable Care Act of 2014 and related legislation (collectively, the "Affordable Care Act") created a flurry of aggressive consolidation in the sector and caused some participants to exit the managed care insurance sector completely. The most notable transactions in the sector were Anthem's $48 billion acquisition of Cigna, Aetna's $35.5 billion acquisition of Humana and Centene's $6.3 billion acquisition of Health Net. At the time of this writing, it remains unclear whether these transactions will obtain antitrust clearance and other regulatory approvals and ultimately be completed.

Significantly for the life and health insurance sector, the market realities resulting from the implementation of the Affordable Care Act also caused some industry participants to increase their focus on employee group and voluntary benefits businesses, which provide voluntary benefit products to insurable groups and other policyholders. Several large insurance groups have announced plans to focus more attention on this market in the U.S. For example, early in 2015, AXA, S.A. announced that it was entering the United States employee group benefits market for the first time. In making the announcement, AXA said that it had identified certain market opportunities in the United States that were created in part by the "transformation [of the market] following the implementation of the Affordable Care Act."

This increased focus on group and voluntary benefits businesses led to some M&A activity in the life and health insurance sector in 2015. The largest of these transactions was the acquisition by Sun Life of Assurant's employee benefits business for $940 million. Other significant transactions in this space were the acquisition by Guardian Life Insurance Company of America of Avesis Incorporated and the acquisition by Centerbridge Partners of Superior Vision Corp. We expect that the regulatory and market dynamics relating to the managed care sector in the United States will continue to create opportunities in group benefits businesses, and that could drive additional M&A activity in the sector.

[4] While not a negotiated M&A transaction, a notable exception to this in 2015 was the final disposition to the public markets of ING's remaining shares in Voya Financial. This completed a spin-off of Voya Financial from ING that began in 2013 to generate funds for ING to repay the Dutch government for a loan it provided during the financial crisis.

4. The Non-Life/P&C Sector

a. Market Trends and Primary Drivers of Activity

M&A activity in the non-life/P&C sector was fairly robust in 2015, and included several significant transactions. The largest transaction was the $28 billion merger involving The Chubb Corporation and Ace Limited, which is the largest P&C transaction in the United States since the financial crisis. Three other significant transactions involved Asian buyers and were discussed above. The largest of these was the $7.5 billion acquisition by Tokio Marine of HCC Insurance Holdings. Unlike in the life and health insurance sector, however, while the M&A transactions involving Asian buyers were all sizeable, they do not represent a large percentage of the M&A activity in the sector.

Except with respect to the acquisitions by Asian firms, the primary driver of this M&A activity appears to be increased competition among industry participants, as well as the continued plethora of alternative capital available for the reinsurance of catastrophe risk. This increase in competition can be traced to a number of factors. P&C insurers have enjoyed several years of benign loss experience and, with a few exceptions, solid financial performance. While these are positive factors for industry participants, they have also attracted new players to the industry and burdened traditional players, particularly reinsurers, with excess capital. The historically soft reinsurance market has increased the availability of attractively priced reinsurance, and that has further increased the availability of deployable capital among direct writers. This generally has led to increased competition among market participants, put downward pressure on pricing and loosened underwriting restrictions. These factors, along with the persistent low-interest-rate environment, which depresses investment yields but makes the borrowing of money to finance acquisitions relatively inexpensive, expense growth and other factors, have created a situation in which market participants are exploring M&A transactions to fuel growth, diversify their operations and position themselves to compete for business from stronger platforms.

b. M&A Activity Involving Reinsurance Companies

In our 2014 Year in Review, we discussed in some detail the shifting dynamics in the market for reinsurance and retrocessional coverage and how such factors have resulted in consolidation in the industry. Total reinsurance capacity has increased substantially over the last decade due to benign loss experience, new entrants into the industry and the emergence of the ILS market, the state of which we describe in greater detail in Section III below. This has led to a string of transactions in the reinsurance industry, particularly among off-shore reinsurers with significant exposure to catastrophe risks.

Several transactions in the industry were announced in 2014 and, at the time we published our 2014 Year in Review in early 2015, the trend was showing no signs of slowing down. XL Group had just announced its agreement to acquire Catlin Group Limited and Axis and PartnerRe had just announced a "merger of equals" whereby they would create a company with a combined market value of approximately $11 billion. While XL and Catlin completed their announced merger during 2015, the Axis/PartnerRe merger was never completed. Instead, after an extended takeover battle that included a number of bids, counter-bids, and amended terms, Exor S.p.A. ultimately was successful in acquiring PartnerRe in an all-cash transaction worth over $6 billion. Axis received a $315 million termination fee from PartnerRe but was left without a merger partner. At the time of this writing, Axis remains an independent company.

Axis is not the only Bermuda reinsurer that was unable to complete a merger with its preferred merger partner in recent years. In our 2014 Year in Review we detailed Endurance's $3.2 billion hostile bid for Aspen Insurance Holdings Ltd. Aspen ultimately was successful in repelling Endurance's bid. In 2015, Endurance moved on and acquired Montpelier Re Holdings Ltd. for $1.4 billion.

The recent consolidation of reinsurers to achieve scale, and to diversify into other geographic regions and into direct insurance and new business lines, seems likely to continue in the near term, although probably at a slower pace since there are few off-shore reinsurers with significant exposure to catastrophe risks that remain independent after the recent string of consolidations.

c. Other Notable Transactions

After abandoning a potential bid for RSA in the U.K., in December Zurich Insurance Group announced an agreement to acquire U.S. crop insurer RCIS for approximately $1.05 billion. This represents the third significant transaction in the highly regulated U.S. crop insurance industry over the last two years. In 2014, HCC Insurance Holdings acquired Producers Ag Insurance Group from CUNA Mutual Group for $110 million, and Farmers Mutual Hail Insurance Company of Iowa acquired John Deere Insurance Company from Deere & Company. These transactions quickly followed regulatory changes to the U.S. crop insurance industry that were implemented through the 2014 Farm Bill (The Agricultural Act of 2014). In 2015, Congress cut $3 billion a year from the program (representing about a third of its total governmental funding) only to repeal that funding reduction one month later. Further changes to the crop insurance program could lead to additional M&A activity in the industry in future periods.

Enstar continued its M&A activity in 2015 with several transactions. It acquired blocks of run-off workers compensation and occupational accident business through reinsurance transactions with both Sun Life and ReliaStar. It also acquired two limited liability company subsidiaries of Wilton Re Holdings Limited that own interests in certain life insurance policies for $173 million. Notably, in May of 2015, the Canada Pension Plan Investment Board ("CPPIB") acquired a 9.9% stake in Enstar. Our readers may recall that CPPIB also acquired Wilton Re in 2014.

Other notable transactions in the sector were the acquisition by Berkshire Hathaway's MedPro Group of PLICO, Inc., a medical malpractice insurer in Oklahoma, and AmTrust Financial Services Inc.'s entry into an agreement to acquire Republic Companies, Inc. from Delek Group for $233 million and its acquisition of F&I product provider Warranty Solutions from Wells Fargo for $152 million. This last transaction, along with the sale of RCIS to Zurich later in the year, together represent the exit by Wells Fargo from the ownership of active insurance underwriting businesses, at least at the current time. Wells Fargo continues to operate its insurance agency and related businesses.

In late 2015, two new start-up property and casualty insurance fronting providers, Clear Blue Financial Holdings LLC (through its subsidiaries, Clear Blue Insurance Company and Clear Blue Specialty Insurance Company), and Spinnaker Insurance Company, were formed and each insurance company received an A.M. Best rating of "A-". Each of these companies will offer fronting services that will enable traditional and non-traditional reinsurers to access the U.S property and casualty insurance market. These companies will compete with State National in this growing segment of the P&C market.

5. Other Potential Drivers of Future Activity

a. Regulatory Changes

We believe that regulatory changes in the insurance industry may spur additional M&A activity. We discussed some examples of this above, such as the potential effect of SIFI designations and increased M&A activity evidently resulting from the implementation of the Affordable Care Act and changes to the federal crop insurance program in the United States. Other regulatory changes could similarly inspire M&A activity in the industry. One notable example is that developments with respect to the applicability to the insurance industry of certain of the anti-inversion rules could open the door to additional insurance M&A activity. We discuss these rules and related developments during 2015 in Section VII.C. below. Another example is the proposal by the U.S. Department of Labor of regulations relating to the identification of "fiduciaries" under the Employee Retirement Income

Security Act of 1974. If finalized in their proposed form, the regulations could transform the way financial services firms, including insurance companies, market and sell their products and services. This transformation could lead to M&A activity as industry participants adjust to the implementation of the regulations. We discuss these proposed regulations in Section VI.G.3 below.

Internationally, the effectiveness of Solvency II as of January 1, 2016 will have an impact on the European insurance industry, and we expect that, over time, the Solvency II dynamic could spark M&A activity in relevant markets. We discuss this dynamic and its potential effect on the M&A market in Section I.B.4 below. The potential implementation of international group capital standards, a topic we discuss in Section VI.E below, could also be a regulatory driver of M&A activity in the coming years.

b. Changes in Technology

Another potential driver of M&A activity in the sector over the longer term could be the extent to which technology and data and predictive analytics are changing the operation of insurance businesses. While for many years commentators have speculated about the effects of these developments on the industry, only recently has the industry begun to undergo significant changes as a result of these factors. Distribution models increasingly rely on direct-to-consumer marketing and technology-based solutions, and further changes to the market could be expected in this regard in the coming years. Technological advancements in other areas of the economy and manufacturing could also fundamentally alter insurance products that have been a staple of the industry for several decades.

Notably, in 2015, Alphabet launched "Google Compare" for auto insurance, which seeks to serve as an online marketplace where individuals can shop for car insurance from multiple carriers using a single digital form. Also grabbing headlines in 2015 was the creation of startup company Figo Pet Insurance, which allows customers to use cloud technology to acquire a pet insurance policy issued by an affiliate of Markel Corporation and automates the policyholder experience over the Internet. Automobile insurers have also developed similar applications to enhance the policyholder experience using the Internet and smartphone applications.

Some commentators have speculated that these developments will significantly change the industry, while others have suggested that prognostications regarding the impact of technology on the insurance industry may be overblown. It is too early to tell exactly how significantly or how fast developments such as these will alter the insurance industry or lead to M&A activity in future periods, but we will certainly be watching these trends as they continue to develop.

B. Market Trends – Europe

1. The Return to Large Deal-Making

After several years of a quieter M&A market in Europe, 2015 saw a return to growth in deal-making, including several blockbuster transactions involving both U.K. life businesses and specialty Lloyd's businesses, an up-turn in broker M&A, and divestments of assets by several insurers which have led to opportunities for other market participants.

Most notably, U.K.-based Aviva plc completed its £5.6 billion all-share acquisition of Friends Life Group Limited in April 2015. This transaction was structured as a court-sanctioned scheme of arrangement under Guernsey law, requiring approval by Friends Life's shareholders holding at least 75% of the outstanding share capital and, under the UKLA class tests applicable due to the London Stock Exchange listing of Aviva's shares, the approval of shareholders holding at least a majority of Aviva's outstanding share capital. As a result of the merger, the combined group has 16 million customers in the U.K. and has realized certain operational synergies.

The combination of U.K. life and savings businesses could help to position the larger groups to address customer needs following new pension rules in the U.K, which have significantly affected the sector. Under the new rules, policyholders no longer are required to use pension lump sums to purchase annuities. More recently, the U.K. government has suggested that annuity policyholders sell them back to insurers. These developments have led U.K. life insurers to a significant re-calibration of what has traditionally been a core product. These changes reportedly have also prompted the £1.8 billion merger of two retirement-specialist insurers, Just Retirement and Partnership Assurance.

Another large transaction completed in 2015 in Europe was XL Group plc's acquisition of Catlin Group Limited, a U.K.-listed group with syndicate and managing agency operations at Lloyd's with additional international underwriting platforms. The recommended share and cash offer was valued at $4.1 billion and completed in May 2015 by means of a Bermuda scheme of arrangement. The transaction added immediate scale in specialty insurance and pre-empted the structural changes expected in the P&C sector in relation to consolidation.

These deals were followed by Fairfax Financial Holdings Limited's acquisition of U.K.-listed Brit plc, a specialty insurer and reinsurer with a presence at Lloyd's. The transaction was effected through a recommended cash offer. It was completed in July 2015 with an on-sale of 29.9% of the Brit shares to Ontario Municipal Employees Retirement System ("OMERS"), with Fairfax retaining 70.1% of the shares in Brit and the ability over time to repurchase the shares owned by OMERS. Fairfax noted at the time of completion that Brit's growing U.S. and international reach was complementary to Fairfax's existing worldwide operations and that the acquisition would allow Fairfax further to diversify its group risk portfolio. The transaction was valued at £1.22 billion.

Continuing the trend of Asian investment in North American and European insurance assets, which we discussed in Section I.A.2 above, another U.K.-listed Lloyd's specialty insurer, Amlin, was the target of a takeover by Japan's Mitsui Sumitomo in a deal valued at £3.47 billion. The transaction was announced in September 2015 and approved by Amlin's shareholders in November 2015. Amlin's CEO, Charles Philipps, said that the transaction would safeguard Amlin's future in an insurance market that is increasingly dominated by giant businesses and by a reliance on technology, which is driving consolidation. The transaction is being effected by means of a scheme of arrangement under English law and is expected to be completed by the end of the first quarter of 2016, once all regulatory approvals have been obtained.

Zurich's potential offer to buy the U.K.-listed insurance group RSA would have been another large deal, if it had come to fruition. Although circumstances meant that no formal offer was made to shareholders under the U.K. Takeover Code on this occasion, the existence of the discussions was another sign that the U.K. insurance industry is in the midst of an M&A revival. RSA itself has also been active in the M&A markets, with the completion of the sale of its Italian operations to ITAS Mutua. The disposition marked the latest in a string of asset divestments aimed at allowing RSA to focus on its core U.K., Canadian and Scandinavian operations.

This upsurge in activity was mirrored to some extent in continental Europe, albeit on a smaller scale. France-based AXA acquired Genworth's lifestyle protection business in a deal valued at €465 million. AmTrust Financial Services, Inc. was also able to benefit from Genworth's decision to exit European markets by purchasing the latter's European mortgage insurance business in a deal worth approximately $55 million. AmTrust had a busy year in terms of European M&A, as it also purchased Nationale Borg, a Dutch insurer and reinsurer of surety and trade credit insurance for approximately €154 million. In addition, Direct Line completed the sale of its Italian and German operations to Mapfre for €550 million. The fact that there are fewer headline deals in continental Europe is perhaps an indication that the larger European insurers are biding their time while they adjust their portfolios and adapt to the implementation of Solvency II (for further commentary, see Section I.B.3 below).

2. International Interest and Innovation at Lloyd's

Lloyd's carriers remain highly attractive to potential purchasers, both strategic and financial purchasers alike, and have drawn significant interest from international investors. The Catlin, Brit and Amlin acquisitions were driven in no small measure by the target companies' platforms and operations at Lloyd's of London. Also in 2015, Bermuda-based Hamilton Insurance Group, Ltd. acquired Sportscover Underwriting Limited and Lloyd's broker Kinetic Insurance Brokers Limited from Wild Goose Holdings Group. This sustained interest in Lloyd's carriers has caused the pool of potential targets to decrease. As a consequence, we predict that any Lloyd's operations that come to market in 2016 will be the subject of increasingly competitive auctions that could yield valuations calculated using ever higher multiples of book value.

Given the increasingly limited M&A opportunities to buy a Lloyd's vehicle, potential entrants to the market continue to explore special purpose syndicates as an alternative means of accessing Lloyd's. Special purpose syndicate approvals for the 2016 year of account include Norway's Skuld SPS 6126, which will write a book of direct and facultative non-marine business. The Mexican group, Patria Re, also received approval from Lloyd's to establish a special purpose syndicate for the 2016 year of account, which will be managed by Pembroke Managing Agency. Meanwhile, Bermuda-based Everest Re received approval for a full syndicate, Syndicate 2786, which will have stamp capacity of £102 million.

Investment with Lloyd's underwriters was also provided by innovative capital providers in 2015, including Credit Suisse Asset Management, which received approval for Arcus Syndicate 1856 to begin trading on January 1, 2016 with £90 million stamp capacity backed by CSAM's ILS funds and managed by Barbican. This marks an evolution of CSAM and Barbican's special purpose syndicate by which the former took a quota share of the latter's portfolio across several classes. Further to this trend, Novae Group plc, a U.K.-listed Lloyd's insurer, and Securis Investment Partners LLP, an ILS fund manager, have launched SPS 6129 with a stamp capacity of $75 million with a focus on U.S. property excess and surplus lines business, which will be capitalized by Securis arising out of an expansion of its LCM fund.In response to the increasingly limited M&A routes into Lloyd's, we expect that an increasing number of market entrants and capital providers will use special purpose syndicates and partnerships with other market participants as a first step into Lloyd's prior to the establishment of full syndicates and integrated Lloyd's vehicles.

Lloyd's itself is playing a key part in the international growth and innovation of the market. For several years, Lloyd's has been developing an Asian hub in Singapore, and by the end of 2015 nearly half of the syndicates had established operations there. In addition, in March 2015, Lloyd's China, Beijing Branch, was officially launched, which means that Lloyd's is able to provide non-life insurance and reinsurance services within the Beijing Municipal Administrative region. In October, Lloyd's also signed a memorandum of understanding with the China Taiping Insurance Group, including a mutual commitment to establish a broader and closer relationship, such as deepening collaboration and support for Chinese enterprises internationally. The development of the Lloyd's platform in China is significant because it will allow insurance groups or integrated Lloyd's vehicles to conduct business in China in a way that may be easier to achieve than via the establishment of a standalone presence in the jurisdiction or via a direct investment in a local insurer.

The international expansion of Lloyd's is not limited to the Asia-Pacific region; it also established a presence in Dubai's International Financial Centre during the course of 2015, with eight syndicates taking advantage of this initiative. The advantages noted above relating to Lloyd's China are also likely to apply equally to its development in the Middle East.

There are continued signs that Lloyd's is looking to innovate and expand in other areas under the strategy outlined by its new CEO, Inga Beale. These strategies include increasing the use of information technology in its processes and embracing alternative forms of capital, which Ms. Beale suggested at the Monte Carlo Rendezvous are growing areas of interest in the market.

3. Consolidation of Intermediaries

A further emerging trend during 2015 was an upturn in broker and intermediary M&A within the European markets. Numerous smaller scale acquisitions of insurance agents by risk carriers occurred, as insurers sought to maximize their distribution potential. Some larger deals suggest that strategic consolidation is also continuing. One notable cross-border transaction was the acquisition of the major wholesale broker Miller by Willis. Willis itself has had a particularly significant year in M&A having also announced a merger with Towers Watson on June 30, 2015 with the aim of creating a leading broking, advisory and solutions firm. In addition, Willis acquired the remaining 70% stake it did not previously own in Gras Savoye, a French insurance broker. The transaction was valued at €550 million and was aimed at extending Willis's presence in France.

The European intermediary market, in particular the group of specialist London brokers, remains less consolidated than the related risk carrying sector. For example, at Lloyd's there are more than 180 registered brokers working in the market and, although there have been challenges to consolidation in what is regarded as a very relationship-focused business, our prediction is that other benefits of scale will become increasingly important and we expect further consolidation within the broker and intermediary market in 2016.

4. Future M&A Trends and Drivers in Europe

We expect that several drivers will affect in-bound and out-bound European insurance M&A into 2016. Of paramount significance across the U.K. and the continent will be the arrival of the Solvency II regime, which the European insurance industry has been anticipating for many years, given the original target implementation date of October 2012. The new rules have now come into effect on January 1, 2016 and insurers have begun to live with the much-anticipated approach to risk, regulation and capital management. For the past several years Solvency II has been cited as a driver of consolidation and reorganization. Now, with the implementation of the rules in full force and in light of the regulators' responses to such rules, the full implications of the new regime for insurers will become evident. It is important to note that there will be winners and losers under the Solvency II risk-based regime. Insurers with the best corporate governance and well-managed portfolios of business will be best placed to take advantage of the market.

We believe that, over time, the Solvency II dynamic will spark additional M&A transactions, including sales of subsidiaries and portfolios of specific types of business. These transactions may be partly in response to pressures identified from working within the new regulatory and risk-based capital regime, but also for insurers to benefit fully from the operation of such a risk-based regime. For example, we expect to see more transactions where insurers sell non-core businesses and acquire complementary assets in portions of the market where they have a leading market position. Insurers could also exchange portfolios of policies in order to benefit from the diversification of insurance risk, the increased use of alternative investment strategies and innovative capital management proposals from reinsurers. In addition, we can expect further activity from European insurance groups in the emerging markets in order to create diversification from their more mature European operations, notwithstanding that they may face fairly tough competition from increasingly expansionist local insurance groups in those emerging markets.

Political factors may well also affect European M&A in general, such as continuing economic uncertainty in several Eurozone economies and the prospect of a referendum on whether the U.K. should remain a member of the European Union (what is being dubbed the potential "Brexit"). At the time of this writing, it is anticipated that the U.K. referendum could take place as early as June 2016, with the possibility of consequential uncertainty in the markets until the result is known.

Finally, underlying market conditions, including low growth in mature markets, abundant capital and inexpensive financing, remain geared towards an active M&A market. The prevailing soft market environment across the insurance industry could continue to spur M&A transactions. The lower returns for insurers and reinsurers and their ability to deploy surplus capital could make synergies that may be achieved by M&A attractive to particular insurance groups. Other European insurance groups may continue to hold their fire and manage their core businesses until the cycle turns toward a harder market.

Many of the drivers identified will be worth revisiting during the course of the year, particularly in the light of developments relating to the stability of the Eurozone, the possibility of the U.K. exiting the European Union and any intervening factors impacting the soft market or availability of capital.

II. Developments in Corporate Governance and Shareholder Activism

The year 2015 was marked by a resurgence in the number of shareholder proposals, most notably led by the efforts of the New York City Comptroller's Boardroom Accountability Project, which as discussed below presented proxy access proposals at 75 large cap companies. For public insurance holding companies, however, the most interesting development on the shareholder activism front undoubtedly has been the continuing situation at AIG. We discuss that first, followed by the overall governance and activism trends.

A. AIG Situation

As most readers know, in the wake of the financial crisis that began in the latter part of the last decade, Congress passed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Among the many measures included in the Dodd-Frank Act were provisions establishing the Financial Stability Oversight Council ("FSOC") and permitting it to designate certain non-bank financial institutions as "systemically important financial institutions." These "non-bank SIFIs" are subject to regulation by the Federal Reserve, which may eventually result in higher levels of capital being required to be held by them. Those capital requirements may in turn result in the designated companies becoming uncompetitive in certain business lines, or at minimum require them to hold capital at levels that depress their returns on equity compared to their non-SIFI peers. To date, three insurers have been designated as non-bank SIFIs – MetLife, Prudential and AIG. MetLife filed suit in early 2015 to contest its designation, while Prudential and AIG have accepted their designations.

Industry insiders have wondered since the Dodd-Frank Act was passed whether designation as a SIFI would lead insurers to make structural changes in their operations to eliminate or minimize the impact of such designation. In late October 2015, Carl Icahn commenced an attempt to push AIG in this direction. In an open letter to AIG CEO Peter Hancock, Icahn urged AIG to spin off its P&C, life and mortgage insurance operations on a tax-free basis into three stand-alone businesses. In Icahn's words, "We believe all three companies would be small enough to avert the increased capital requirements and regulations associated with non-bank SIFI status. In the face of a changing and potentially punitive regulatory framework, you must realize that insurance businesses of AIG's caliber are more valuable to shareholders if held directly than they are as part of a SIFI conglomerate." Icahn's push did not stop there, however; he also urged AIG to bring down its operating costs, citing a perceived "lack of cost control." Notably, Icahn's letter quoted investor John Paulson, who agitated for change at The Hartford in early 2012, as also supporting a break-up and lower costs, although Icahn did not make any statements suggesting that he and Paulson were working together.

Icahn's letter unleashed a storm of publicity around AIG, with a number of pundits, analysts and investors endorsing his proposals. On November 23, 2015, Icahn spoke again. In a public statement, he said that he did not believe that AIG management would ever endorse his proposals for change, and as a result "we intend to commence shortly a consent solicitation that will enable shareholders to express their views directly to the board, which may include a proposal to add a new director who would agree in advance to succeed Mr. Hancock as CEO if asked by the board to do so."

Despite Icahn's clear statement of intent to launch a consent solicitation prior to AIG's annual stockholders' meeting, as of the current writing Mr. Icahn has not taken any steps to do so. His inaction is puzzling. Did Icahn get a call from the Fed or another regulator warning him off of a consent solicitation? As experienced insurance lawyers know, merely holding proxies covering more than 10% of the outstanding shares of an insurance holding company can be an event that requires making a Form A filing in advance. His proposed consent solicitation may have been seen in some quarters as crossing the line into an illegal attempt to control the AIG insurers. Or is he merely waiting until January 26, the date on which AIG will, according to a recent announcement, hold an open listen-only call to explain its current strategic vision in detail? On January 19, 2016, Icahn posted another letter on his website, in which he continued to push for structural changes at AIG, and suggested he was waiting to see what the call on the 26th will hold. Regardless of the answer, we believe Mr. Icahn will find it harder to influence affairs at AIG than at his previous non-insurance targets.

B. Shareholder Proposals in 2015

The number of shareholder proposals in the 2015 proxy season was higher than in 2014, reversing a trend that had spanned several years. According to information compiled by Georgeson Inc., the number of shareholder proposals received by companies in the S&P 1500 increased by 5.5% overall. The number of proposals actually voted on increased even more dramatically, by approximately 34%, to 333 proposals. Proxy access proposals, which are further discussed in Section II.C below, were the main reason for the increase, with 72 coming to a vote in 2015 compared to 13 in 2014.

As in the past, shareholder proposals fall into two broad categories: those relating to corporate governance, and those relating to social or political goals. In the former category are proposals to require companies to have a board chairman independent from the chief executive officer, the most common governance proposal after proxy access. In 2015, 58 such proposals came to a vote, comparable to the 59 such proposals that were voted on in 2014. Of these, only two proposals received more than a majority of the votes cast, and none received the vote of a majority of the outstanding shares. These proposals overall received an average of 30% of the vote, lower than in 2014 but continuing to show the importance of this issue to a range of institutional investors. As in prior years, shareholder proposals to eliminate classified boards, adopt majority voting for directors and eliminate supermajority voting provisions were more successful. These are the only types of proposals that routinely receive a majority of votes cast. However, the number of such proposals was lower than last year, likely reflecting the extent to which these governance changes have already been adopted by the S&P 1500, or perhaps reflecting activist focus on other issues, particularly proxy access. Proposals on majority voting for directors declined to only seven in 2015, compared to 24 in 2014. The level of support for such proposals at companies that had not adopted any form of majority voting was higher in 2015 than in 2014, at 76% as compared to 66%. However, at companies that had already implemented some form of majority voting (typically, retaining a plurality vote standard for election, but adopting a majority vote policy that calls for directors to submit a resignation if they fail to receive a majority of the vote), these proposals received less than a majority of votes cast. This is consistent with the results in past years (other than, notably, 2014); in general, such proposals routinely fail at companies that have adopted such "majority voting lite" protections.

Social or environmental proposals remained popular in 2015. Typical examples include proposals to require issuers to make disclosures about political contributions or about sustainability. The level of favorable votes for proposals about political contributions was up slightly in 2015, to 24% from 20% in 2014. At least one proponent of greater transparency in respect to political contributions, the New York State Common Retirement Fund ("NYSCRF"), adopted a new strategy in 2015 for dealing with companies that are reluctant to accede to its proposal and disclose greater information about contributions. NYSCRF made a DGCL Section 220 books and records demand on Oracle Corp. to force it to make public information about political contributions it made in 2015. Oracle resisted, and in October 2015 NYSCRF filed suit in Delaware Chancery Court for inspection of the relevant books and records. This sort of adjunct litigation in support of a social proposal continues to be rare, but could increase if NYSCRF is successful in that case.

C. Proxy Access

As our readers know, proxy access refers to the ability of shareholders to include their candidates for election to the board in the issuer's own proxy statement. Proxy access does not mean that insurgent candidates will necessarily be elected; rather, it is intended to reduce the costs of running a proxy fight by allowing proponents of board candidates to avoid the costs of printing and distributing their own proxy statements. In 2011, the SEC's own proposed proxy access rule was vacated by the federal courts. The SEC's proposed rule would have permitted holders of more than 3% of the company's stock, who had held such stock for at least 3 years, to nominate up to 25% of the company's board (a so-called "3/3%/25%" formula). However, in the wake of that proposal, shareholder activists began to seek so-called "private ordering" solutions to proxy access, in which issuers would adopt their own rules allowing access to the issuer's proxy statement, generally through a bylaw amendment. Until 2015, the subject had not taken off as an issue.

In the latter half of 2014, the NYC Comptroller's office announced that it would make proxy access proposals following the 3/3%/25% formulation at 75 large cap companies in 2015. These companies were selected by the Comptroller's office because of perceived concerns at the issuers related to one or more of three issues: (i) the issuer's contribution to climate change; (ii) a lack of board diversity, including gender and racial diversity; and (iii) excessive CEO pay. These proposals are precatory only – that is, they do not amount to a binding change, but request the submission to shareholders of a binding bylaw amendment that would require proxy access. Other activists got on the bandwagon; according to Georgeson, a total of 110 proxy access proposals were submitted to the S&P 1500 in 2015 (approaching 10% of all such companies), of which 88 came to a vote.

The number of shareholder proposals voted on was undoubtedly made greater by the SEC's announcement, on January 16, 2015, that it was suspending the application of Rule 14a-8(i)(9) for the 2015 proxy season (the "Directly Conflicts rule"). The suspended rule provides an exclusion from the obligation to run a shareholder proposal in management's proxy statement when it directly conflicts with a management proposal. The SEC Staff had for many years interpreted this rule liberally. In the proxy access context, the Staff had permitted companies to exclude, for example, a 3/3%/25% proposal if the board itself was proposing proxy access requiring 5% ownership for at least 5 years, with a right of such holders to nominate up to 10% of the board. The SEC's announcement stated that it would be reviewing the Directly Conflicts rule to evaluate whether it was being properly applied. In mid-2015, the SEC released Staff Legal Bulletin 14H, which announced the results of that review. Going forward, the SEC will only permit exclusion of a proposal under the Directly Conflicts rule if a person voting in favor of the shareholder proposal would by definition vote against the management proposal. The example cited by the SEC is a situation where management proposes a vote in favor of a merger, and the shareholder proposes a vote against the same merger. In this case, the proposals are in essence mutually exclusive and therefore, the shareholder proposal would be excludable.

Notwithstanding the great interest on the part of proponents in these proposals, the average vote in favor was relatively lukewarm. The 3/3% formulation continued to get the highest vote totals, but even that approach only received an average vote in favor of approximately 53% of those voting, with just over half of the proposals receiving majority support. Some institutional investors do not support proxy access as a general matter, while others do, but at levels other than 3/3%. It is useful to bear in mind that any shareholder that really wants board representation can just prepare its own proxy statement; proxy contests have been with us forever. Nevertheless, proxy access was 2015's hot topic, and is shaping up to be hot again in 2016.

For insurance holding companies, proxy access raises additional issues not present for many other types of issuers. Insurance holding company laws require persons who are presumed to have "control" of an insurer to file change of control approval filings or to effectively "disclaim" control before acquiring the rights that create a presumption of control. Although whether control actually exists is a question of facts and circumstances, having a representative on the board of directors of an insurance holding company is a significant fact for many insurance regulators. Insurers moving towards proxy access would be well-advised to require that any nominee have obtained all necessary regulatory approvals for board service.

Finally, despite adoption of proxy access by a few companies to date, we are not aware of any issuers that have actually had a candidate proposed to be included in the issuer's proxy statement. This will undoubtedly be the next frontier in proxy access.

D. Say-on-Pay and Director Elections

As in the three prior years, in 2015 shareholders once again overwhelmingly voted in favor of executive compensation in companies' annual "say-on-pay" votes. Even at companies that received a negative recommendation on the topic from Institutional Shareholder Services ("ISS"), votes in favor averaged 65%. Adverse recommendations by ISS and Glass, Lewis & Co. ("Glass Lewis"), the two largest proxy advisory firms, once again greatly outnumbered failed votes. In the U.K., "mandatory say-on-pay" came into force in 2014. Listed issuers have since been required to submit their pay policies for vote by shareholders at their Annual General Meetings, and further may not pay any amounts outside the parameters of the adopted policies. None of the 26 FTSE 100 companies that submitted a remuneration policy for approval (which must be done every three years, or sooner if the company needs to change the policy, or fails to obtain shareholder approval of its annual remuneration report) failed to get less than the majority support for its policy at its 2015 AGM; in fact, only one company failed to get at least 90% support. In addition, only one FTSE 100 company failed to receive approval of its remuneration report, an annual event for UK-listed issuers, despite a number of negative recommendations from ISS and Glass Lewis.

In addition, the number of directors who received more than a majority of "no" or "abstain" votes with respect to their election in 2015 was equal to 2014, according to Georgeson. 27 directors fit into that category in each of 2014 and 2015. As in 2014, more than half of these directors in 2015 serve at just three companies. Such votes often result in so-called "zombie directors" when the candidates' boards of directors do not accept resignations from the board offered by the directors whose support from shareholders was lacking. However, this is not always the case; three directors of bedding maker Tempur Sealy International stepped down in 2015 after a very successful "vote no" campaign run by activist H Partners.

III. Insurance-Linked Securities

A. Overview

Insurance-Linked Securities ("ILS"), is the name given to a group of capital markets-based risk transfer products that are an alternative to traditional reinsurance. This group includes catastrophe bonds ("Cat Bonds"), sidecars, industry loss warranties, collateralized reinsurance facilities, extreme mortality derivatives and bonds, XXX/AXXX excess reserve financing facilities, embedded value securitizations and insurance-based asset management vehicles. With over $65 billion now committed to the ILS market by capital markets participants, the benefits of favorable pricing and collateralization for sponsoring ceding companies, together with relatively non-correlated yield for investors, has resulted in robust and consistent transaction activity in 2015 in most segments of this increasingly important market.

The overarching trend of convergence between traditional reinsurance and ILS continued in 2015. Several commentators have noted a prolonged "soft" market in traditional reinsurance due to excess supply of risk-taking capital, particularly in short-tail catastrophe-exposed markets most accessible by ILS participants. Historically, one of the most profitable segments of the reinsurance market has been the reinsurance of natural catastrophe risks for peak perils, such as U.S. hurricanes. As noted above, the competition among P&C reinsurers that is one of the main drivers of the wide-spread consolidation of P&C reinsurers in recent years is in major part a consequence of these sustained soft pricing conditions resulting from the further commoditization of risk-taking capital from ILS. We discuss these trends in more detail below.

B. ILS Market Update

2015 was a year of consistency and continued entrenchment for the Cat Bond market, with approximately $7.5 billion in new issuances and total outstanding volume reaching approximately $26 billion at year-end, an all-time high for the market. In addition, over 30 different insurance, reinsurance and corporate sponsors offered Cat Bonds in 2015, including new entrants Amtrak, China Re and UnipolSai Assicurazioni, as well as long-time participants USAA, SCOR, Swiss Re, AIG and Munich Re. While overall deal volume has decreased from 2014, which saw a record issuance of almost $9 billion, much of the difference is due to two large multi-year issuances completed in 2014: Florida Citizens $1.5 billion Everglades III transaction and Allstate's $750 million Sanders Re transaction. Overall, the pace of transactions was brisk in 2015, with continued favorable pricing and a deepening of the risk transfer pipeline. Other highlights in 2015 include the following.

- U.S. "peak" risk remains the focus of the Cat Bond market, with over 70% of outstanding Cat Bonds exposed to U.S. tropical cyclones and earthquakes, according to industry sources. Although these perils in particular continue to drive the ILS market, it is possible that Cat Bonds issued in 2016 and future periods will cover new perils and utilize different transaction structures.

- As spreads have remained near historic lows, sponsors have continued to push on coverage terms to further replicate traditional indemnity reinsurance protection. Almost 60% of 144A cat bonds in 2015 utilized an indemnity trigger compared with fewer than 40% in 2009-2012. In addition, several sponsors have sought coverage in 2015 for unmodeled perils, such as volcanic eruption or U.S. wildfire outside of California. We believe it is only a matter of time before the first "all perils" Cat Bond emerges, which will further narrow the difference in coverage terms between ILS and traditional reinsurance.

- Several catastrophe bonds were structured with four-year or longer-dated maturities, which traditionally only went out for three years. A longer duration bond permits cedents to lock in pricing and amortize transaction costs over a longer period. In April 2015, Allstate sought seven years of Cat Bond protection, although the transaction was ultimately not completed. In 2016, we expect four- and five-year bonds to become increasingly common.

- Opportunities remain in the market for life and health catastrophe risks. Among other transactions completed in 2015, AXA Global Life placed €285 million in U.S. and European extreme mortality coverage through Benu Capital; Swiss Re placed $100 million in Australian, Canadian and U.K. extreme mortality coverage through Vita Capital VI; and Aetna placed $200 million medical benefit ratio coverage through their sixth Vitality Re transaction. As the ILS market has grown in size and sophistication, discussions about transferring non-traditional risks to the capital markets has accelerated. We would not be surprised to see a continued deepening of the market to other risk categories in 2016.

- In July 2015, AIG sponsored $300 million of mortgage insurance-linked securities by Bellemeade Re. The ground-breaking offering, which combines diverse structural features from both the catastrophe bond and RMBS markets, enabled AIG to access the capital markets for up to ten years of collateralized reinsurance protection for a portfolio of mortgage loans it insures. Unlike a traditional catastrophe bond that provides coverage for natural catastrophes, investors in Bellemeade Re are exposed to the risk of defaults on a pool of residential mortgage loans insured by AIG and its subsidiaries. As both a cat bond and a synthetic mortgage-backed security, this unique 144A offering required first-of-its-kind structures and disclosure and was designed to permit the release of PMIERs capital.

- Reinsurance side-cars continued to be a consistent component of the ILS market, with many of the existing structures renewed for the 2015/2016 underwriting year. In 2015, Munich Re renewed its 144A Eden Re II reinsurance sidecar at $360 million; Aspen renewed Silverton Re for $125 million; PartnerRe renewed Lorenz Re; and Argo renewed Harambee Re, among other transactions. Soft market conditions did have an impact on sidecar transactions, as the shareholders' equity of Everest's Mt. Logan Re declined in the third quarter of 2015 and Markel did not renew its New Point sidecar for 2016.

- Interestingly in 2015, the same pricing pressures transforming the reinsurance industry also had an impact on ILS funds, many of which have achieved a scale consistent with offshore property catastrophe reinsurers. Set forth below is a list of selected ILS fund managers and offshore reinsurers, together with their assets under management[5] and market cap, respectively. Alternative capital has become mainstream and is no longer "alternative" to traditional reinsurance.

SELECTED ILS FUND MANAGERS (AUM)	
Nephila	$9.5 billion
Credit Suisse	$6.5+ billion
LGT	$5.2 billion
Fermat	$4.7 billion
Stone Ridge	$3.7 billion
Securis	$3.3 billion
Twelve Capital	$3.1 billion
Elementum	$2.0-2.5 billion
Leadenhall	$2.0 billion

SELECTED REINSURERS (MARKET CAP)	
XL Group	$12.0 billion
Arch	$8.1 billion
PartnerRe	$6.7 billion
SCOR	$6.4 billion
Axis	$5.5 billion
Amlin	£3.4 billion*
Endurance	$4.4 billion
Validus	$3.9 billion
Ironshore	$1.8 billion^

^ Purchase price paid by Fosun   * Under offer

5 AUM amounts are those reported by www.artemis.bm.

In response to these market pressures, many of the larger ILS-dedicated funds have sought to replicate insurance and traditional reinsurance structures to achieve returns, including collateralized reinsurance and MGA fronting transactions. As capital becomes a commodity, larger funds have sought positions closer to the underlying risk. For example, in 2014 and 2015, certain funds established a Lloyd's syndicate and entered into various fronting arrangements and MGA structures. ILS funds have also deepened their reliance on collateralized reinsurance placed outside of the bond market. We expect fund-driven deals and structures to be the emerging story of 2016, as the clout and market presence of the largest ILS funds continue to crystalize in the highly competitive property catastrophe market.

C. Section 4(a)(2) Private Placements

As the sophistication and modeling expertise of ILS investors has grown in recent years, interest in private placement Cat Bonds and other ILS structures under Section 4(a)(2) of the Securities Act of 1933 (the "Securities Act") has increased. While Cat Bonds are (and will remain) principally offered pursuant to Rule 144A under the Securities Act, the popularity of private placements under Section 4(a)(2) as a streamlined alternative is beginning to take hold. For instance, AIG completed its $300 million Compass Re II transaction in 2015, the largest Section 4(a)(2) private placement Cat Bond since the financial crisis. The transaction was particularly interesting because AIG has also been a committed participant in the Rule 144A Cat Bond market, with over $1 billion in aggregate principal outstanding, and because of the involvement of start-up broker Rewire Holdings. In addition, several other market participants have recently established proprietary platforms to take advantage of the private placement market, including Aon Benfield Securities's CATstream, Horseshoe/JLT's Market Re, Kane's SAC program, Tokio Solution's Tokio Tensai Platform and Willis's Resilience Re, among others. See "Cat Bond Lite Platforms" in Section III.D below for further detail.

As an alternative to more traditional Rule 144A transactions, private placement Cat Bonds offer sponsors the benefits of a streamlined structure, modeling and subject business disclosure, as well as decreased transaction costs. This is especially important for first time sponsors, particularly smaller insurance companies who may not have adequate internal resources to undertake a full Rule 144A offering process, or for whom traditional reinsurance may be competitively priced on an "all-in" basis. Consequently, we expect these private placement structures to continue to increase in popularity in 2016.

Section 4(a)(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering." To qualify for this exemption, the purchasers of the securities must, among other things, either have sufficient knowledge and experience in finance and business matters to be "sophisticated investors" (i.e., be able to evaluate the risks and merits of the investment), or be able to bear the investment's economic risk. They must also have access to the type of information normally provided in a prospectus for a registered securities offering.

Because Section 4(a)(2) exempts the initial sale of securities directly from the issuer, an investor will need to rely on another exemption, such as Rule 144A, in connection with the resale of securities (Rule 144A applies to downstream sales by non-issuers to qualified institutional buyers).

As a purely technical matter, a Section 4(a)(2) private placement can be resold under Rule 144A if the investor qualification and information requirements under Rule 144A have been satisfied. There are often structural and legal considerations to address, however, before broader resale should be permitted by an issuer, particularly in book-entry format. We highlight two of these considerations below.

- Any offer and sale of securities with sufficient nexus to the United States, whether the initial sale by the issuer or an investor resale, remains subject to the anti-fraud provisions of Rule 10b-5 under the Securities Exchange Act of 1934 (the "Exchange Act"). In order to establish a claim under Rule 10b-5, an investor must demonstrate, among other things, that the defendant made a misstatement or omission of a material fact upon which the investor justifiably relied. A principal legal consideration for a Section 4(a)(2) private placement is analyzing the scope, granularity and form of subject business and modeling disclosure that should be provided to primary and secondary investors in order to mitigate 10b-5 risk.

- Cat Bonds issued pursuant to Section 4(a)(2) often receive the moniker of "cat bond lite" because they seek to simplify the structure and more closely replicate traditional reinsurance. While streamlining is often beneficial, one must be careful not to strip away important structural elements for capital markets risk transfer. In particular, the counterparty relationship for securities offerings is fundamentally more diffuse and impersonal than for traditional reinsurance. Consequently, catastrophe bonds are more susceptible to collective action problems, such as inherent difficulties in monitoring claims payments and reserves. In addition, the cedent may not always know the identity of the underlying investor providing protection, which can lead to increased litigation risk.

We do not mean to suggest that these challenges are insurmountable or should dissuade parties from utilizing the Section 4(a)(2) private placement format. Quite the contrary. As with most things, a competing set of elements and consequences must be balanced appropriately.

D. Cat Bond Lite Platforms

The establishment of private issuance platforms can offer cost-effective solutions for newer, smaller sponsors to enter the ILS area of the capital markets. The growing acceptance, understanding and demand for smaller catastrophe bond issues and privately placed transactions during 2015 broke all previous records, with more than $537 million of private Cat Bonds completed in the first half of 2015, via 17 deals, consisting of 20 tranches of notes. Investor appetite and perception of cat bond lite (or private cat bond) issuance has increased significantly. Sponsors can take advantage of this "lite" route to catastrophe bond-backed reinsurance protection, while investors seem to appreciate the liquidity of Cat Bond notes that can be brought to market by a wider array of cedents.

Further evidence that the cat bond lite issuance platform division is growing rapidly was marked by the establishment by Willis Capital Markets & Advisory in October 2014 of the Resilience Re platform and the issuance of its inaugural tranche of private cat bonds in December 2015. Other cat bond lite platforms include the Kane SAC Limited platform operated by independent insurance manager Kane and launched in August 2013, the Market Re platform, operated by Jardine Lloyd Thompson Capital Markets and launched in May 2014, the Tokio Tensai platform, operated by Tokio Solutions Management Ltd. and GC Securities and launched in June 2013, and the Kaith Re platform, which is operated by Hannover Re and previously used for the reinsurer's K Cession capital markets retro reinsurance transactions. By the end of the first half of 2015, Kane had issued $271.19 million, Market Re had issued $111.58 million, Tokio had issued $47.6 million and Kaith Re had issued $3.75 million.[6]

E. ILS Fund Activity

2015 saw the continuing development of ILS/capital management arms of traditional reinsurance companies, as well as ILS fund launches by global investment managers. Among others, Kiskadee Investment Managers (Hiscox), Lancashire's Kinesis, RenaissanceRe's Upsilon, and Aeolus Capital Management each raised capital for new or existing reinsurance/ILS funds in 2015. Schroder Investment Management North America, which has teamed with Geneva-based Secquaero Advisers, launched an ILS fund in 2015 for U.S. investors to complement its existing offshore ILS fund platform. Deutsche Asset & Wealth Management, an investment management division of Deutsche Bank, launched an ILS fund in 2015, having previously secured seeding for the strategy from Tages Capital. We expect to see additional ILS fund launches from both traditional reinsurers and global asset managers in 2016, as projects begun or incubated during 2015 are rolled out to investors.

We also saw the announcement in 2015 of a few notable startup ventures backed by industry heavyweights. Vario Global Capital Ltd. was launched in late 2015 by specialist insurance analysis and modelling firm Vario Partners LLP

[6] Amounts are those reported by www.artemis.bm.

and reinsurance broker Guy Carpenter. Michael Millette, the former global head of structured finance at Goldman Sachs Group Inc.'s underwriting unit, initiated the launch of Hudson Structured Capital Management to focus on re/insurance and transportation assets.

Also in 2015, RenaissanceRe sidecar DaVinci Re raised debt capital in a private offering of senior notes, with the proceeds being used to repay a loan made by RenaissanceRe to the venture and repurchase DaVinci Re shares, and for general corporate purposes in support of the vehicle's alternative capital activities. DaVinci Re writes a quota share of RenaissanceRe business, largely focused on its catastrophe reinsurance portfolio. The 10-year rated notes provide further support for the capitalization of RenaissanceRe's rated alternative capital platform.

There were a few significant exits from the ILS fund space in 2015. Third Point Re wound up Third Point Reinsurance Opportunities Fund Ltd. as part of a realignment of its partnership with Hiscox Insurance Company (Bermuda) Limited. AQR Capital Management announced the wind-down of its AQR Re unit and the closure of its related ILS funds. In connection with these closures, spokespersons from both firms cited changing market fundamentals and the increasing difficulty in putting larger amounts of capital to work, noting the importance in the current market of diversification across multiple lines of business, a theme that resonated around the industry in 2015.

With concerns about sourcing business at the fore, many fund managers sought to expand their business lines, loosen investment restrictions and broaden their investment programs in 2015. We have also seen a number of ILS fund managers (e.g., Nephila and Twelve Capital) make strategic investments in onshore carriers with the potential benefit of sourcing more risk. Furthermore, several new funds being organized for 2016 are expected to offer greater exposure to property & casualty, mortality, longevity and other risks in addition to property catastrophe risks.

We continue to see both open-end and closed-end fund structures, with many closed-end structures in particular utilizing segregated accounts of Bermuda segregated account companies to isolate portfolios of reinsurance risks as between different classes of investors or risk periods. Some closed-end funds redeploy the available capital from one renewal period into the next available renewal period, whereas other funds require investors to commit a fixed amount to future renewal periods, which must then be funded with additional investor contributions if rollover proceeds are insufficient or not in time to collateralize new transactions. In either case, investors are typically given the opportunity to increase or decrease their continuing investment in future renewal periods as they see fit.

In addition, open-end ILS funds continue to be organized. These funds generally allow for more frequent subscription and redemption activity into an existing portfolio of risks, subject to side pockets, slow-pay redemption shares (redeemable based on portfolio run-off rather than at net asset value) and other restrictions principally designed to maintain liquidity and protect new investors from pre-existing events affecting the portfolio. We saw several open-end structures brought to market in 2015 and several others are targeting launches in early 2016. Open-end vehicles are being used both for funds with liquid portfolios comprising principally Cat Bonds, as well as for funds that invest almost exclusively in traditional reinsurance contracts.

The Alternative Investment Fund Managers Directive, which we discuss in more detail in Section III.H below, came into effect in July of 2014 and continues to be a major consideration for managers looking to raise capital in the European Union. As many ILS funds are managed by fund managers located outside the European Economic Area ("EEA"), the marketing and other activities of ILS Funds in the EEA are directly impacted by this directive. Given the complexities associated with this directive, many such fund managers located outside the EEA, such as in Bermuda and the United States, opt for a streamlined marketing plan into just one or only a few EEA countries, if any. Where permitted, such as in the U.K., managers engage in limited pre-marketing efforts to ascertain better the capital raising opportunity before registering and taking on any additional regulatory burdens.

F. Hedge Fund Re

In 2015, the start-up hedge fund reinsurer model continued to diverge from the "greenfield" model of Third Point Re, Hamilton Re and Greenlight Re, where a single asset manager controls the investment of almost all of the reinsurer's funds. As discussed in our 2014 Year in Review, Watford Re was established as a sidecar-style hedge fund reinsurer that would allow the new venture to operate as a "pure" sidecar through quota shares with the reinsurer sponsor or as a "market facing" sidecar with business produced by an affiliate of the reinsurance sponsor to be written directly on the new venture paper (whether side-by-side with the sponsor or on its own). As concerns with obtaining an A.M. Best rating grew, a new, unrated model evolved with the formation of ABR Re, a joint venture between ACE and Blackrock, which essentially acts as a sole cedent captive reinsurer tied to ACE with respect to all of the new venture's business. Richard Brindle and Neil McConachie developed yet another rated model in the formation of Fidelis Insurance, where the business accepts and calibrates risk on either the investment or insurance side based on return profiles over time. Multiple investment managers selected by Goldman Sachs Asset Management will be used to manage the reinsurer's asset portfolio. Finally, Enstar and UBS O'Connor announced that they will create Aligned Re as an unrated vehicle that will reinsure prospective business generated by Enstar's "live" business platforms as well as run-off business owned by Enstar.

A number of other hedge fund reinsurance vehicles remain in the pipeline, although the timing of future capital raises remains uncertain. Beset by investment headwinds, a fiercely competitive underwriting environment, rating agency skepticism and the uncertainty for U.S. investors based on proposed regulations and legislative proposals aimed at eliminating any perceived U.S. tax advantage as discussed in Section VII below, a number of the ventures have been delayed and the hedge fund reinsurance companies currently represent a small (i.e., low single-digit percentage) slice of the overall reinsurance market. If there is an improvement in the underwriting and investment environment or more clarity for U.S. investors, we would expect more hedge fund reinsurers to enter the market in 2016.

G. U.K. ILS Legislation

The London market is one of several hubs, together with Bermuda, Guernsey, Zurich, Ireland and the Cayman Islands, for the expansion of activity involving ILS, funds and collateralized structures. While London has benefitted from the presence of talented underwriters and professionals and the Lloyd's and London market generally, the City has not been a leading destination of choice for onshore ILS structures such as transformers or sidecars due mainly to the longer process in obtaining regulatory approvals and the current tax regime as compared to other jurisdictions.

In 2015, the London Market Group established an industry taskforce in response to the pledge by the U.K.'s Chancellor of the Exchequer, George Osborne, in his 2015 Budget Statement, to attract ILS business into the U.K. The London Market Group has teamed up with the U.K. government to investigate ways in which more ILS business could be attracted to London, with the primary task of looking at potential changes to the U.K.'s tax, regulatory and company law regimes that could make the U.K. a more attractive domicile for ILS business and managers.

In November 2015, the U.K. government commenced the legislative process relating to the legal framework for facilitating ILS and collateralised reinsurance business, beginning with amendments to its Bank of England and Financial Services Bill, which would provide it with the power to both regulate and facilitate ILS business, including collateralized reinsurance. The amendments would amend the Financial Services and Markets Act 2000 and give the government and Her Majesty's Treasury ("HM Treasury") the ability to enact legislation to create a legal framework for transformer companies. The proposed transformer company would feature a protected-cell-type structure, with different parts of the transformer vehicle allowed to be legally segregated and to be separate from the overall vehicle. This move is a vital first element in developing the legal and tax frameworks needed for London to increase its presence as a hub of ILS activity, particularly as a destination for domiciling legal entities.

H. Marketing ILS to E.U. Investors — AIFMD

The Alternative Investment Fund Managers Directive ("AIFMD") represents the most significant European regulation of investment funds in recent times and directly impacts investor marketing and fund-raising for ILS structures, including for ILS funds, many sidecars and other collateralized reinsurance structures where an exemption is not available. AIFMD is broad in scope and covers the management, administration and marketing of a wide range of asset managers, whether they are based in the E.U. or outside of it. AIFMD affects:

(i) alternative investment fund managers ("AIFMs") in the EEA who manage alternative investment funds ("AIFs"), whether or not those AIFs are marketed in the EEA and whether or not the particular securities in question are marketed directly by the AIFM or through a placement agent; and

(ii) non-EEA AIFMs who manage AIFs within the EEA, or who market AIFs within or into member states.

All sponsors of third-party capital management vehicles in the alternative reinsurance and convergence markets that are collective investment schemes must now consider if they are AIFMs managing AIFs before commencing marketing activities to investors based in any E.U. country.

AIFMD regulations currently vary depending on whether either the manager or the funds are established in the E.U. There is currently no "passport" regime where authorized non-E.U. AIFMs can market to investors throughout the E.U., although E.U.-based AIFMs can benefit from a harmonized framework. The lack of harmonization for non-E.U. managers and funds has impacted the convergence market because a large number of fund managers, ILS funds and collateralized structures are located in offshore jurisdictions such as Bermuda and the Cayman Islands.

Without passporting rights, non-E.U. AIFMs must currently contact investors and market under the private placement regime on a country-by-country basis and typically by considering exclusions from AIFMD and related regulations. For most Cat Bonds and some sidecars, the exclusion from AIFMD that is most useful is a provision for closed-end structures issuing non-convertible debt, similar to typical capital markets securitizations. This exclusion is not generally available for ILS funds or sidecars, or other ILS structures that issue preferred shares or other forms of equity.

AIFMD also includes requirements for the authorization or registration of AIFMs in order to perform the functions of portfolio management and risk management and for the marketing of AIFs to professional investors within the EEA.

As has been the case with other E.U. directives such as Solvency II, E.U. member states are at various stages of their implementation of AIFMD and many have chosen to "gold plate" the provisions of AIFMD to add local requirements. Some also do not have co-operation agreements in place with particular non-E.U. countries, making it difficult for those AIFMs to market non-E.U. ILS structures.

In some member states such as the U.K., the Netherlands and Luxembourg, short-form AIFM notification has proved useful for non-E.U. managers wishing to market ILS structures in those member states immediately. In certain jurisdictions, such as the U.K., there are accommodations in place for AIFMs who manage an AIF with assets below certain thresholds, whereby the sub-threshold AIFM is not subject to the full operational requirements imposed by AIFMD. In addition, in reliance on existing national private placement regimes, some AIFMs are able to accept particular investments under a limited reverse-inquiry investor approach, although this is dependent on specific facts and is not available in many E.U. countries.

Given the lack of passporting rights, in the 2015 convergence fund-raising many managers of ILS structures balanced the regulatory burdens against the potential benefits of marketing their funds in the E.U. and declined to market to investors in particular E.U. countries. This limitation on third-country AIFMs contacting and marketing to E.U. investors in ILS structures will change when a non-E.U. AIFM marketing passport is introduced.

Towards the end of July 2015, the European Securities and Markets Authority ("ESMA") produced its first opinion and advice on the extension of an AIFMD marketing passport to managers from non-E.U. countries. ESMA has taken a "country-by-country" approach and, using certain AIFMD-mandated criteria (e.g., level of investor protection and oversight over systemic risk provided for by the non-E.U. jurisdiction's legal/regulatory framework), first considered the following six non-E.U. jurisdictions: United States; Guernsey; Jersey; Hong Kong; Singapore; and Switzerland. ESMA gave "positive" recommendations in respect of the extension of the passport to Guernsey and Jersey, as well as Switzerland after the enactment of pending legislation, but delayed its decision in respect of the other three jurisdictions assessed. E.U. lawmakers are required to take steps necessary to extend the passport to non-E.U. managers within three months of receiving a "positive" opinion from ESMA.

In October 2015, ESMA confirmed that, alongside its continued assessment of Hong Kong, Singapore and the U.S., it would begin to assess a second group of non-E.U. jurisdictions: Australia; Canada; Japan; the Cayman Islands; the Isle of Man; and Bermuda. The selection of all of these jurisdictions was made after taking into account a number of factors, including the amount of activity already being carried out by entities from these countries under existing national private placement regimes and further efforts made by stakeholders in these countries to engage with the process. It is expected that ESMA will be given a deadline of approximately March 2016 for its next opinion and advice, which is expected to include its recommendation with respect to this second group of non-E.U. jurisdictions.

I. ILS Participation at Lloyd's

As the U.K. government has announced plans to become a more attractive domicile for ILS business, it is worth examining how alternative capital currently participates at Lloyd's. At present, an ILS sponsor has a number of options for accessing the Lloyd's market, each of which presents its own set of challenges.

A sponsor can set up its own syndicate and corporate member and underwrite business in line with its own business plan. This requires a managing agent to manage the underwriting and business of the syndicate on its behalf. The current practice is for new entrants to partner with a "turnkey" managing agent that agrees to warehouse the new entrant, with the intention that the sponsor will have its own managing agent within three to five years. The syndicate pays the managing agent a standard fee for its services and a profit commission based on the syndicate's overall profitability. Nephila took the turnkey route into Lloyd's in establishing its standalone syndicate, Syndicate 2357. While Nephila partnered with Asta for operational purposes, the fund manager's own staff underwrites the syndicate's portfolio of property catastrophe industry loss warranties.

Lloyd's has indicated that it is open to accepting syndicates from well-regarded alternative market reinsurers. In addition to standalone syndicates, special purpose syndicates, which are set up solely to underwrite a quota share reinsurance of another syndicate's business for a year of account, continue to be a popular, less expensive entry route for ILS players into the Lloyd's market. The most recent special purpose syndicate to evolve into a full-fledged syndicate in the alternative capital space was backed by China Re (launched with Catlin in 2012). Barbican and Credit Suisse may apply for full syndicate status for their SPS 6120. If the Credit Suisse-backed SPS did become a standalone syndicate, the firm would become the second ILS fund manager to back its own syndicate.

Alternatively, a sponsor can set up its own corporate member to participate on one or more existing syndicates, allowing its investors to take a synthetic equity share in their overall results. This is an attractive option pursued by ILS fund managers who want to provide their investors with access to insurance risks coming into the Lloyd's market, while at the same time diversifying their existing ILS funds. However, this approach depends on obtaining access to the desired syndicates and, at times when there is overcapacity in the market, syndicates may not be willing to accept new investors. The Securis corporate member, for example, signed up to support a number of Lloyd's syndicates in 2015.

ILS players want to be able to offer their investors access to the Lloyd's global brand, license network and capital-efficient framework. It will be interesting to see whether the plans to promote London as an ILS hub will make it any easier for ILS players seeking to access the Lloyd's market. Even if tax and regulatory reforms prove difficult to implement, ILS players will at least continue to have options to participate within the Lloyd's market, which is a key factor setting London apart from other insurance or reinsurance jurisdictions.

J. Other U.K. Developments

1. Lloyd's Insurance Index

In December 2015, Lloyd's announced its plans to launch its own insurance-based index, the Lloyd's Index, in the middle of 2016. The index will be based on loss ratios reported by syndicates at the corporation. The index will provide managing agents, brokers and other insurers with new options for managing risk through index-linked hedges and form the basis of index-related products that could attract the interest of the wider capital markets. The whole-market index is intended to be available to subscribers on a quarterly basis, with plans to add data sets broken down by class of business at a later date. We understand that Lloyd's will spend the first few months of 2016 discussing the initiative with the market and regulators.

2. Bank of England Study

According to the latest U.K. Financial Stability Report, published and prepared by the Financial Policy Committee of the Bank of England ("FPC") and released in December 2015, the FPC has, as a result of the potential for risk being distributed outside of the re/insurance market and the potential for it to create connections between insurance or reinsurance risks and other financial intermediaries, tasked the Bank of England's staff with reviewing ILS and alternative capital during the first half of 2016. The FPC cites Cat Bonds as an example of risk being distributed outside of the insurance and reinsurance industry and into other parts of the financial system and notes that the growth of alternative reinsurance capital, while contributing to increasing levels of competition, "could give rise to new risks going forward." We understand that this is the first time the Bank of England is to review the risks that it sees as potentially associated with the entry of alternative capital into the reinsurance market-place.

3. Update on Mariah Re

Although the litigation risk profile of Cat Bonds has historically been low, disputes do arise from time to time as in any risk transfer market. To our knowledge, only two transactions have been subject to litigation or arbitration, and in neither case did investors make a claim of securities fraud. Rather, the disputes involved idiosyncratic questions of coverage under the underlying risk transfer contract rather than claims of inadequate disclosure. We believe the relative absence of ILS transaction-related litigation results from several factors, including well-developed documentation and disclosure standards, transfer restrictions limiting the offering and secondary re-sales to sophisticated investors and the remote nature of the underlying risk (typically modeled at 1-in-50 to 1-in-100 year return period), which has resulted in a limited number of triggering events.

One transaction that is subject to litigation was American Family's Mariah Re transaction, which utilized an industry loss index to cover severe U.S. thunderstorm risk. The dispute involved a coverage question of whether index-provider Property Claim Services ("PCS") was permitted to supplement a catastrophe bulletin, thereby resulting in a total loss of the bond and a recovery by American Family. In particular, the complaint by Mariah Re alleged: (i) breach of contract against PCS, modeling firm AIR Worldwide Corporation, and American Family; (ii) unjust enrichment against American Family; (iii) conversion against American Family; and (iv) tortious interference with contract against American Family. It sought a declaratory judgment against all defendants and specific performance against all defendants.

The U.S. District Court for the Southern District of New York dismissed the investor claim in late 2014. In June 2015, the U.S. Court of Appeals for the Second Circuit upheld the lower court's dismissal of the claim, thereby bringing to a close the investor challenge. In dismissing the complaint with prejudice, the District Court cited the unambiguous documentation standards and the underlying bargain of risk transfer:

> At bottom, the Reinsurance Scheme formulated by the parties was a highly sophisticated and integrated set of agreements whereby investors and insurers gambled on the likelihood and severity of catastrophic weather events. If storms were infrequent and mild, investors in Mariah stood to realize significant earnings on their investment at the expense of the ceding insurer, American Family. If, on the other hand, the weather turned fierce, as was the case with Catastrophe 42, American Family gained a hedge on its policyholders' claims by accessing the funds in the special purpose vehicle, Mariah. PCS, AIR, and the Banks were engaged solely to facilitate the arrangements between the risk-taking parties and had no skin in the game. Having gambled and lost on the weather—and there appears to be no dispute that Catastrophe 42 was a "severe" weather event that "ranks as one of the top [weather] outbreaks of all time"—Mariah now attempts to convert its unsuccessful risk venture into a game of "gotcha" on the contracts. Unfortunately for Mariah, the documents themselves are unambiguous and provide no basis for the relief sought in the Amended Complaint.

Willkie had no involvement in the Mariah Re transaction or the subsequent litigation.

K. Excess Reserve Financings

The year 2015 continued the previous year's trend of a decrease in the number of new excess reserve financing transactions. As in the prior year, the likely cause was caution from both regulators and life insurance companies as a result of activities by the NAIC's[7] Captive's and Special Purpose Vehicle Use (E) Subgroup, and in particular the adoption by the NAIC in late 2014 of Actuarial Guideline 48 ("AG 48"). AG 48 applies to all policies issued after December 31, 2014 that fall under regulation XXX or AXXX. Even with the continued slowdown, however, a few life insurance companies restructured existing transactions to take advantage of lower lending rates and the continued interest by reinsurance companies to act as credit providers, and another cautious few closed new transactions in 2015. In addition, there was an interest in financing XXX and

[7] If not otherwise defined in the text, references and acronyms are defined in the glossary attached as Annex A to this Year in Review.

AXXX without the use of a captive by adding admitted assets to the balance sheet of the insurer. Many more companies are either sitting on the sidelines, having adopted a "wait and see" attitude, or have actively begun the process of addressing the complexities of AG 48 issues with a goal of closing new transactions involving AG 48 covered policies in 2016, or adding a block of AG 48 policies to an existing transaction.

1. Summary of Deal Activity

a. AXXX Market Remains Open

Several 2015 transactions were designed to provide reserve financing for universal life policies subject to Regulation AXXX. The growth in the number of lenders willing to provide financing to fund AXXX reserves that started in 2012 continued in 2015. In most transactions in both the XXX and AXXX markets, commitments were for 10 to 20 years, although it is still common to see shorter terms intended to act as a financing bridge until other expected sources of funding become available.

b. Will Non-Recourse Transactions Remain the Structure of Choice?

In 2014, prior to the effective date of AG 48, the vast majority of deals were secured by non-recourse letters of credit, contingent notes or collateral notes, as those transactions had essentially replaced traditional letters of credit among lenders and reinsurance companies active in the AXXX/XXX market. In 2015, we saw a return of, or at least a heightened interest in, traditional letters of credit. In the past, the obligation to reimburse the bank for any draw on the letter of credit was guaranteed by a parent holding company, thus being known as a "recourse" transaction. In a non-recourse transaction, no such guaranty is required. Rather, the ability to draw on the letter of credit or contingent note is subject to certain conditions precedent. These conditions typically include the reduction of the funds backing economic reserves to zero and a reduction in a prescribed amount of the captive's capital, and a draw limited to an amount necessary for the captive to pay claims then due. Because of these conditions, lenders and other funding sources became more comfortable assuming the risk of relying for repayment on the long-term cash flows from a block of universal life policies. With the advent of AG 48, it is uncertain how regulators will approach a non-recourse transaction where the proposed "Other Security" is a conditional draw letter of credit or a contingent draw note. Although they are not expressly forbidden by the new rules, it remains to be seen how regulators will perceive these bespoke sources of contingent funding in the age of AG 48. Collateral notes are demand notes backed by pools of assets, such as K-Notes insured utilizing the Karson Management (Bermuda) Limited platform. They may, but typically do not, contain these contingent features and therefore should remain acceptable for financing under AG 48, at least as "Other Security".

c. Choice of Domicile for Captives and Limited Purpose Subsidiaries

Vermont remained the preferred domiciliary jurisdiction for captive life insurers in 2015. Although several states have adopted captive insurer laws or have amended and expanded existing captive insurer laws over the past few years to facilitate reserve funding transactions, 2015 saw a reversal in the trend of seeing multiple jurisdictions being utilized as captive insurer domiciliary jurisdictions, undoubtedly reflecting the overall reduction in the number of transactions in 2015 from previous years. We expect that, once the market adapts to AG 48 and the related Model Law and Model Regulation (as defined and further described in Section III.K.3.a below), we will again see several other states—including Arizona, Delaware, Nebraska and Iowa—being utilized as captive insurer domiciliary jurisdictions. We understand that the use of the recently enacted "Limited Purpose Subsidiary" statutes in several states has cooled off and, due to what some regulators have perceived as overly flexible and minimal capital requirements, the Limited Purpose Subsidiary may not currently be the captive of choice, at least for new AG 48 transactions. The Limited Purpose Subsidiary statutes permit a ceding company to form a captive insurer, or "LPS," in the same domiciliary state as the ceding insurer, which has proven to provide for a more streamlined regulatory approval process for a transaction.

d. Canada

During 2015, the first XXX/AXXX financing transaction utilizing collateral notes closed under the Canadian capital requirement resolutions companies.

2. Structures Utilized for Excess Reserve Financing

a. Limited Purpose Subsidiaries

We are not aware of any new transactions closed in 2015 that employed the use of the LPS laws in AXXX transactions. Georgia, Indiana, Iowa and Texas have each promulgated an LPS statute. The advantage of an LPS over a captive insurer is that an LPS, once licensed, may provide its ceding company parent with full credit for reinsurance without posting any security in the form of a letter of credit or a credit for reinsurance trust. Under the LPS statutes, an LPS is permitted to take statutory financial statement credit for the face amount of letters of credit as well as parental guaranties by statutory authority; the LPS need not seek regulatory approval for a permitted practice or other dispensation to use this accounting treatment. Although the promulgation of the LPS statutes was a major development in the ability to finance Regulation XXX/AXXX reserves, we have not seen the use of the LPS statutes take off as expected, likely as a result of the generally lackluster market activity in the past three years brought on by general caution on the part of insurers and regulators alike.

b. Credit-Linked Notes and Collateral Notes vs. Letters of Credit

As mentioned above, it remains to be seen whether the use of contingent credit-linked notes in a role that may be analogous to a "synthetic letter of credit" will continue, along with collateral notes, to be the structure of choice for excess reserve financing transactions. In credit-linked note transactions, an SPV issues a puttable note to a captive insurer. The captive insurer's right to "put" a portion of the note back to the SPV in exchange for cash is contingent on the same types of conditions that would otherwise apply in a non-recourse contingent letter of credit transaction. In the recent past, the use of these notes, rather than letters of credit, has provided a means for reinsurance companies, which contractually agree to provide the funds to the SPV to satisfy the put, to enter a market that was once available only to banks. In collateral note transactions, demand notes backed by pools of assets are issued by an SPV to a credit for reinsurance trust on behalf of the captive. Collateral notes are typically rated and qualify as admitted assets. The assets that back the collateral notes can be provided by banks, reinsurance companies or other providers of collateral.

c. Funding Sources Beyond Banks

As outlined above, the market for funding sources in AXXX transactions has expanded beyond banks in recent years through the use of contingent credit-linked notes and collateral notes. Large reinsurance companies have shown a keen interest in participating in these transactions through support of the SPVs that issue the contingent notes and collateral notes. With the expansion of the group of potential funding sources for these transactions, life insurance companies can seek more competitive pricing and terms. With the limited activity in the market in 2015, it is difficult to predict with any accuracy if the market will see a continuation of the trend started in 2012 of reinsurance companies surpassing banks as the primary "risk taker" in these transactions. Because of the regulatory scrutiny over the past few years and the approaching XXX/AXXX Credit for Reinsurance Model Regulation, bank issued letters of credit may well see a comeback in 2016.

d. Alternative Approach to Funding

During 2015 several transactions were completed in which collateral notes were issued directly to insurers and held as admitted assets, thereby financing XXX/AXXX reserves directly on the balance sheet of such insurers. Given the regulatory attention to captives, this approach may become more common.

3. Regulatory Environment

a. NAIC

As discussed in more detail in Section VI.H.2 below, a very important development in the world of reserve financing transactions was the NAIC's adoption in 2014 of the XXX/AXXX Reinsurance Framework (the "Framework") and AG 48, which are parts of the NAIC action plan to develop further regulatory requirements with respect to XXX and AXXX transactions. Importantly, the Framework and AG 48 aim to set standards applicable to XXX and AXXX transactions, instead of restricting them outright. Although certain insurance regulators, such as the New York State Department of Financial Services (the "NYDFS") and the California Department of Insurance (the "CA Department"), are not satisfied with this approach and have continued to call for a nationwide moratorium on these types of transactions, the NAIC's actions are a significant development that provides guidelines on how these transactions should be structured.

The NAIC Reinsurance (E) Task Force (the "Task Force") spent much of the latter half of 2015 discussing the proposed amendments to the Credit for Reinsurance Model Law (the "Model Law") and the Credit for Reinsurance Model Regulation (the "Model Regulation"), which are designed to enact the substantive provisions of the Framework/AG 48.

The Task Force's original goal was to finalize the amendments to both the Model Law and the Model Regulation in 2015. However, given the volume of comments received with respect to these items, this timeline proved to be unrealistic. The revisions to the Model Law were adopted by the NAIC on January 8, 2016, so state action enacting these revisions can commence at any time now. However, the revisions to the Model Regulation are now planned to be finalized at (or, perhaps, before) the NAIC Spring 2016 National Meeting. See Section VI.H.1 below for a more detailed discussion of these developments.

b. New York

As discussed in more detail in Section VI.H.1 below, the steps taken by the NAIC to address XXX transactions and AXXX transactions have by no means received uniform support from state regulators. Indeed, the regulators of several commercially important states—including California and New York—have voiced vehement opposition. Former Superintendent Benjamin Lawsky of the NYDFS in particular has criticized XXX/AXXX financing transactions, calling them a "shadow insurance" industry because of what he perceives to be a lack of regulatory oversight. In the wake of the NYDFS's year-long investigation of XXX and AXXX captive transactions (which culminated in June 2013 with a report entitled "Shining a Light on Shadow Insurance – a Little-Known Loophole that Puts Insurance Policyholders and Taxpayers at Greater Risk"), the NYDFS had urged other state regulators to adopt a national moratorium with regard to future XXX and AXXX transactions. The CA Department has likewise urged the adoption of a nationwide moratorium on XXX transactions and AXXX transactions. However, the NAIC did not heed these calls for a nationwide moratorium and rather focused its attention on the Model Law and the Model Regulation.

L. Embedded Value Securitization

Although late 2014 saw the return of a life insurance embedded value securitization sponsored by Reinsurance Group of America, Incorporated ("RGA"), which announced in mid-December 2014 that its subsidiary, Chesterfield Financial Holdings LLC, completed an offering of $300 million of 4.50% asset-backed notes in a securitization of U.S. life insurance embedded value, the market for similar embedded value transactions did not materialize in 2015 as hoped. Embedded value securitizations take advantage of the capital markets to monetize the future expected profits from a defined block of life insurance policies and can be an attractive way for both insurance companies and reinsurance companies to manage their capital and mortality risk efficiently.

Following closely on the heels of the RGA "Chesterfield Financial" U.S. dollar embedded value transaction, Aurigen Capital Limited announced in mid-January 2015 the private placement of C$210 million of asset-backed notes issued by Valins I Limited, marking the second life insurance policy embedded value transaction to close in a four-week period, and the first Canadian Dollar embedded value transaction since Aurigen Capital Limited's "Vecta I" transaction in late 2011. The transaction covers a closed block of Canadian life insurance policies reinsured by Aurigen Reinsurance Limited, a subsidiary of Aurigen Capital Limited, between 2008 and 2013 and consists of 26 life reinsurance treaties from 12 life insurance companies. A unique feature of the offering structure is that it allows for the increase and extension of the notes, providing flexibility to add future new life insurance business and access to capital funding.

Although the market for embedded value transactions was not as robust as hoped in 2015, we would not be surprised to see more embedded value transactions hit the market in 2016.

IV. Developments and Trends in Longevity, Pension Close-outs and De-risking Transactions

The longevity risk and buy-out markets continued their robust performance in 2015, as global deal volume exceeded $40 billion for the second consecutive year. The 2015 market was characterized by a diversity of participants and a continued increase in deal size at the market's high end, where the average deal now exceeds $3 billion.

The market achieved a significant milestone in March with the execution by The Bell Canada Pension Plan and Sun Life Financial ("Sun Life") of the first longevity transaction in North America. The buy-in transaction transferred C$5 billion in pension liabilities from Bell Canada to Sun Life, which reinsured a portion of the liabilities with SCOR Global Life and RGA Life Reinsurance Company of Canada.

The largest transaction in this year's longevity market was the €12 billion index-based longevity swap between Delta Lloyd Levensverzekering N.V., the Dutch life insurance arm of the Delta Lloyd Group, and RGA Re. The deal, which was executed in June, will mitigate the longevity risks relating to Delta Lloyd's Dutch life insurance portfolio for a period of six years. The two parties executed a similar €12 billion deal in 2014. A further European transaction followed in July, when Aegon passed the longevity risk associated with a €6 billion portfolio of Dutch annuity business to Canada Life Re. The latter transaction represents the first 40% of a €15 billion package deal. In December, the Dutch insurer ASR Nederland N.V. transferred €200 million of longevity and asset risk to Legal and General Re, with Hannover Re acting as an intermediary. This is the first transaction executed by Legal and General Re, which is registered in Bermuda. These European transactions evidence the spread of activity outside of the U.K. and the U.S and during 2016 we expect there to be a strong desire for further geographical market expansion and diversification.

The U.K. market continued its strong performance in 2015. The market grew to include nine active insurers—a new high—and featured several noteworthy transactions. The Prudential Insurance Company of America ("Prudential") and Pension Insurance Corporation ("PIC") executed deals in April and June, pursuant to which Prudential will provide PIC with an aggregate of approximately $2.4 billion of longevity protection. The April transaction covers the pension liabilities of approximately 6,700 retirees, while the June transaction covers a block of 74 pension schemes. Each of Prudential and PIC was also active in other transactions. In August, Prudential entered into a transaction with Legal & General Group Plc ("L&G") pursuant to which Prudential Retirement Insurance and Annuity Company will provide longevity reinsurance for approximately $2.84 billion of liabilities associated with L&G's bulk annuity business. The deal follows a similar 2014 transaction between Prudential and L&G that involved approximately $2.16 billion in liabilities. In November, PIC concluded a £2.4 billion buy-out transaction with Philips UK Pension Fund and the simultaneous reinsurance of the associated longevity risk with Hannover Re. The deal covers pension benefits for approximately 26,000 U.K. pensioners and was notable as the largest full buy-out transaction to date in the U.K. and for the unprecedented number of non-retired members covered by its terms.

The year 2015 was notable not only for new entrants and structures, but also because we saw a repeat of structures initially developed during 2014, such as the use of a sponsor's own insurance company as an intermediary (namely, the £5 billion transaction announced during March 2014 whereby Aviva's own insurance carrier acted as a conduit to transfer longevity risk from the Aviva Staff Pension Scheme to Munich Re, Swiss Re and SCOR SE). During July it was announced that the AXA U.K. Group Pension Scheme accessed reinsurance capacity on offer by RGA Re by using its own insurance vehicle. The £2.8 billion longevity swap covered approximately 11,000 members, which is approximately half of the scheme's total liabilities. In November, Aviva extended its 2014 transaction to the RAC (2003) Pension Scheme, another Aviva sponsored pension scheme. £600 million of longevity risk was passed via Aviva's insurance carrier to French reinsurer SCOR SE. This transaction is also noteworthy as it illustrates that transaction structures initially developed for the very largest pension schemes can be accessible to smaller schemes.

Also following a trend from 2014, we have seen sponsors establish their own special purpose vehicles for longevity transactions (namely, the 2014 transaction whereby the BT Pension Scheme established its own Guernsey-based captive and transferred £16 billion in pension liabilities to the captive, which were then reinsured with Prudential). 2015 kicked off with an announcement that the U.K.'s Merchant Navy Officers Pension Fund established its own Guernsey-based cell company and entered into a £1.5 billion longevity swap with Pacific Life Re. Industry professionals have noted that the use of cells has grown, as more pension schemes see them as a means to reduce the transaction costs associated with intermediated structures.

In February, Abbey Life Assurance Company Limited concluded a £2.0 billion longevity swap with ScottishPower UK plc. In September, Friends Life Limited (now part of the Aviva Group) executed a £2.4 billion longevity hedge and reinsurance transaction with Scottish & Newcastle Pension Plan covering approximately 19,000 defined benefit pensioners. Aviva partnered with Swiss Re for reinsurance cover. In December, Zurich Assurance and Pacific Life Re entered into a parallel insurance and reinsurance agreement covering £90 million of longevity exposure associated with 200 "named" members of a U.K. pension scheme. This transaction also illustrates the trend among small pension schemes to adapt transaction structures initially developed by larger schemes.

During 2015, and driven by the approaching Solvency II implementation date, many U.K. insurers made use of the global reinsurance capacity to hedge their own longevity exposure, not only through reinsurance of large scale bulk annuity deals (many of which are referred to above) but also through reinsurance of existing backbook transactions. There are many such transactions that have not been publicly announced.

Although not as robust as the U.K. market, the U.S. market built upon the uptick of activity that began in the fourth quarter of 2014. In January, Prudential entered into a pension-risk transfer transaction with The Timken Company pursuant to which it agreed to assume responsibility for the administration and payment of an estimated $600 million of retirement benefits to approximately 5,000 Timken retirees. In February, Kimberly-Clark Corporation executed a "split" pension-risk transfer transaction with Prudential and Massachusetts Mutual Life Insurance Company ("MassMutual") covering an aggregate of $2.5 billion of pension liabilities. Prudential and MassMutual will evenly share financial responsibility for the pension benefits of approximately 21,000 Kimberly-Clark retirees. November saw the execution of a pension-risk transfer between Lincoln Electric Co. and The Principal Financial Group covering 1,900 Lincoln retirees. In December, Prudential concluded a pension-risk transfer transactions with Philips Electronics North America Corporation covering $455 million of pension liabilities and a split deal with L&G's Banner Life Insurance Company ("Banner Life") covering $3.6 billion of J.C. Penney Corporation's pension liabilities. Prudential will act as the annuity administrator for the split transactions with MassMutual and Banner Life.

Industry professionals anticipate that the market will expand significantly in the coming years, particularly in North America, Australia and Europe. Surplus insurer capacity and the implementation of Solvency II, which encourages insurers to hedge more of their longevity risk, are also anticipated to fuel further growth in the U.K. As a result, in 2016 we expect the number of market participants to grow and the level of activity to increase in both the longevity-only and the broader pension risk transfer market as a whole. In previous years we have witnessed a lack of standardization of terms in the market. However, with the large number of executions, and as structures are repeated, we expect this to change and for longevity transactions to become more streamlined. This is already apparent in the U.K. bulk annuity and longevity-only reinsurance markets, where "umbrella" or "master" agreements are entered into and tranches of business are added from time to time following agreement by the parties of the relevant deal-specific terms. This significantly decreases the deal execution time and related costs. We expect such structures will be a key feature of the market in 2016.

V. Capital Markets

A. Equity Offerings

There were two small initial public offerings in 2015, Conifer Holdings, Inc. and Patriot National, Inc., but 2015 generally was a quiet year for IPOs in the insurance industry.

AmTrust Financial Services, Inc. had a busy 2015 in the capital markets and conducted two follow-on equity offerings, along with a preferred stock issuance through depositary shares, and two debt offerings to finance its acquisition strategy.

In June 2015, MetLife, Inc. issued 1,500,000 shares of its 5.250% Fixed-to-Floating Rate Non-Cumulative Preferred Stock, Series C, for total proceeds of $1.5 billion. The Series C Preferred Stock was structured to qualify for additional Tier 1 capital treatment under the capital guidelines of the Federal Reserve Board from and after January 1, 2019, when certain features of the security, including a mandatory deferral trigger, fall away. MetLife used the proceeds from the offering and available cash to fund the repurchase of all 60,000,000 shares of its 6.500% Non-Cumulative Preferred Stock, Series B, through a tender offer followed by a redemption.

B. Surplus Notes

Surplus notes, which are issued by insurance operating companies under Rule 144A and Regulation S, are subordinate in right of payment to the insurance company's indebtedness and to policyholder claims. Similar to a standard debt security, surplus notes include a stated maturity and have periodic interest payments; however, principal, interest and redemptions of the surplus notes are subject to the prior approval of the insurance regulator of the issuer's state of domicile. If the regulator decides that the insurance company has insufficient funds to make a payment on the surplus notes without putting the insurance company or policyholders at risk, the regulator can cause the company to defer the scheduled payment.

Following a peak issuance of $5.7 billion in 2014 when a number of the large mutual companies came to the market, particularly TIAA-CREF in connection with the financing of its acquisition of asset manager Nuveen Investments, substantially fewer surplus notes were issued in 2015. In April, MassMutual issued $350 million in fixed rate surplus notes due 2065, the proceeds of which were for general corporate purposes. On a smaller scale, in February Palomar Specialty Insurance Company raised $17.5 million in new surplus capital through a private placement of surplus notes to RenaissanceRe Ventures Ltd. and certain managed asset funds, and in November National Guardian Life Insurance Company issued $47 million of 6.45% surplus notes. Also in February, Farmers Insurance Exchange renewed its $500 million contingent surplus loan note facility. The facility is structured to provide Farmers the option to quickly access capital while preserving the long-term capital strength of Farmers by obtaining regulatory capital relief. The facility gives Farmers the ability to issue five-year surplus notes at pre-agreed interest levels during a two-year commitment period (followed by three annual extensions), in the event that loss claims from predefined catastrophe events reach a specific level.

C. Debt

With interest rates only beginning to rise gradually at year-end from the very low levels of the past six years, 2015 saw a healthy number of investment-grade debt deals from the insurance industry. In particular, companies took the opportunity presented by low spreads and investor interest to repurchase or redeem outstanding debt with high coupons and replace it with debt with lower coupons.

In connection with its acquisition of Chubb, ACE issued four series of senior notes totaling $5.3 billion in November. The notes are guaranteed by ACE Limited. The same structure had been used by ACE in March in connection with an issuance of $800 million in senior notes.

AIG established a registered medium-term note program with $1.0 billion in capacity in August 2015, along with standalone issuances of five series of senior notes of $4.5 billion in the aggregate in January and July. The proceeds of the $2.5 billion in senior notes sold in July, along with cash at the holding company, were used to purchase 11 series of senior notes and junior subordinated debentures of AIG Life Holdings, Inc., a wholly owned subsidiary of AIG, and 12 series of senior notes of AIG.

In May, Prudential Financial, Inc. ("PFI") issued another series of fixed-to-floating rate junior subordinated debentures with an aggregate principal amount of $1.0 billion, which were structured with a similar regulatory capital call feature to the multiple series of junior subordinated debentures issued by PFI in the second half of 2013 and the start of 2014.

MetLife issued four series of senior notes during the year totaling $2.75 billion ($1.5 billion in March and a further $1.25 billion in November) in order to repay two series of existing senior notes upon their maturities.

There were a number of other debt issuances during the year, including by Marsh & McLennan ($1.1 billion), Aflac ($1.0 billion), Aon plc ($1.0 billion), Principal ($800 million), Progressive ($400 million), Travelers ($400 million), Radian ($350 million), RenaissanceRe ($300 million), Unum ($275 million) and Third Point Re ($115 million).

D. Funding Agreement-Backed Notes

Funding agreement-backed notes are designed to generate regular cash flows to service the debt on short- or medium-term notes issued through a securitization vehicle, and transfer credit quality of a policyholder claim at the insurance company to the notes of that vehicle.

In 2015, the market for funding agreement-backed notes continued to recover steadily following the financial crisis. The year saw Protective Life Insurance Company ("Protective"), following its acquisition by The Dai-ichi Life Insurance Company, Limited, re-enter the market. In October Protective formed Protective Life Global Funding and conducted its first issuance the following month. This return came soon after Protective agreed in September to acquire certain in-force blocks of term life insurance from Genworth Life and Annuity Insurance Company through a reinsurance transaction.

The market once again was led by MetLife and New York Life Insurance Company ("New York Life"), but witnessed increased issuances from Principal Financial, Jackson National, MassMutual, Prudential, AIG, Protective and Reliance Standard. MetLife has been the leading issuer of funding agreements in each of the last seven years, with New York Life the next largest. Yet again issuances were dominated in a strong mix of domestic and foreign currencies (Euro, Sterling, Japanese Yen and Norwegian Krone and Canadian Dollar).

Capacity may now exist for additional issuances based on stronger balance sheet positions, a reduction in operating leverage and a strengthening of statutory capital.

E. Solvency II Impact on Subordinated Notes and Preference Shares of Insurance Groups

In 2015 insurers across Europe accelerated sales of perpetual subordinated debt ahead of the implementation of Solvency II, driven by the possibility of grandfathering perpetual subordinated debt as Tier 1 capital. While perpetual subordinated debt provides better protection to policyholders than other types of debt and costs less to issue, it is not as high quality as equity under rating agency and regulatory capital models. With Solvency II going into effect on January 1, 2016, perpetual debt will now need particular loss-absorbing features to qualify as Tier 1 capital (for example, default events will not be triggered where interest or redemption payments are declined by the regulator); otherwise it will be considered Tier 2 capital. These features make perpetual debt more expensive capital for insurers.

As a result of grandfathering concessions designed to help insurance companies transition to the new capital structure, some older forms of debt could nonetheless count as Tier 1 capital for a decade in many E.U. jurisdictions, as long as the funds were raised by particular dates in 2015. The U.K. Prudential Regulation Authority did, however, warn insurance groups that it expected to anticipate the enhanced quality of capital that will be needed when issuing or amending capital instruments, and that it would object to insurers issuing regulatory capital instruments in 2015 that were deliberately structured to meet the letter but not the spirit of the new criteria coming into effect in 2016 under Solvency II.

The treatment of subordinated debt and preference securities issued prior to 2015 by other E.U. regulators, as well as those jurisdictions which are seeking equivalence under the Solvency II regime (which we discuss in Section VI.K.1 below), could be an interesting development in 2016. Yet to be seen is how rating agencies will respond to the treatment of such capital by regulators; depending on the rating agencies' responses, some insurance groups might be required to review their own issued debt and engage in liability management activities.

F. SEC Disclosures

In 2015, the staff of the SEC (the "SEC Staff") continued to concentrate its comments on insurance company Exchange Act disclosure on some of the topics we discussed in the 2014 Year in Review. These include disclosures regarding investments, compliance and regulatory matters, reserves, acquisitions and dispositions, and captives. We discuss each of these in more detail below.

1. Investments

Given the importance of investment portfolios to most insurance companies, the SEC Staff has requested that companies expand or further explain the level of fair value disclosure by class of assets and liabilities, and support the determination of major security types and classes of fixed maturity securities under ASC 320-10-50-1B and ASC 820-10-50-2B. Classes should be determined based upon the nature, characteristics and risk of the assets and liabilities, and by consideration of the level of disaggregated information required under other accounting topics. The SEC Staff has also focused on disclosures surrounding valuation techniques, inputs and assumptions used to determine fair values for each class of assets and liabilities included in the disclosures.

The SEC Staff has also questioned companies' disclosures about the main factors that affect net derivative results, especially if there have been multiple periods of significant volatility in results, and asked companies to enhance disclosure on the drivers of net derivative gains and losses.

2. Compliance and Regulatory Matters

The SEC Staff continues to review and comment on statutory and regulatory disclosures required by ASC 944, Financial Services-Insurance, and Rule 4-08(e) of Regulation S-X, relating to dividend restrictions and required statutory capital and surplus levels and the amount by which the companies' statutory capital and surplus exceed such levels. One of the points that the SEC Staff has consistently emphasized for several years now is that disclosures regarding statutory financial statements should not be labeled "unaudited," "approximate" or "preliminary" because such statutory financial information is required by U.S. GAAP or SEC regulations and must be audited.

In addition, as some insurance companies have expanded their operations internationally, they have come into direct or indirect contact with countries that the U.S. government has identified as state sponsors of terrorism. The SEC Staff regularly asks companies, especially those with global operations, to provide incremental disclosure about business activities that occur in or with these countries, and qualitative and quantitative factors that a reasonable investor would regard as important in making investment decisions. Any companies with global operation must also consider any foreign insurance regulatory restrictions on capital and surplus and compliance with such restrictions.

3. Reserves

Disclosure regarding insurance companies' reserving processes continues to be a focal point for both the SEC Staff and investors. The SEC Staff has again requested that companies expand and enhance disclosures related to changes in reserve estimates so that investors are better able to understand the nature of assumptions, the extent of changes in reserve estimates and the reasons for the changes to reserves. Disclosures should explain the impact of certain events, new information or additional experience since the last reporting date that have resulted in a change in estimates, so that it is clear to investors why recognition of losses or changes to reserves occurred in the periods in question rather than in prior periods. If a previously announced or regular review of reserves, estimates or assumptions was not completed on time, companies should disclose this fact, the reasons for the delay and the current status of the review.

The SEC Staff has also commented that companies should discuss in the critical accounting policy section of the MD&A the drivers of changes to loss reserves, including any assumptions that have changed and assumptions that are reasonably likely to change going forward.

4. Acquisitions and Dispositions

As discussed in Section I above, M&A activity and consolidation transactions have been prevalent in the insurance industry over the last couple of years, especially for P&C companies. Acquisition-related accounting and disclosure requirements under ASC 805 vary based on the nature of the transaction, the type of the assets acquired and the liabilities assumed. The SEC Staff has focused comments on enhancing disclosure around the methodology and key assumptions used for the impairment of assessments, the sensitivity of assumptions used to determine fair value, and a description of actual or potential facts, events and circumstances that did or could have an effect on goodwill impairment charges. If any interim goodwill impairment testing has been conducted, the registrant should disclose the results of such tests. If such testing has not been conducted, the registrant should explain why.

5. Captive Subsidiaries

Consistent with the enhanced scrutiny from some state insurance regulators (which is discussed in Sections III.K.3 above and VI.H.1 below), the SEC Staff has continued to request expanded disclosures regarding transactions with captive insurance subsidiaries. The captives are used by companies to insure specific risks for the company and its affiliates. They provide many advantages, including capital management benefits. The SEC Staff has recently commented that sufficient information should be disclosed regarding the nature, purpose and number of transactions with captive insurance companies, how such transactions are accounted for in the company's financial statements and the risks and uncertainties associated with using captives.

VI. Principal Regulatory Developments Affecting Insurance Companies

A. Overview

Global capital standards and regulatory convergence took center stage in 2015, driven by several factors including the IAIS's development and testing of capital standards applicable to global systemically important insurers; the U.S. and E.U.'s commitment to negotiate a covered agreement; U.S. efforts to develop an approach to a global insurance capital standard in order to meet the ongoing efforts of the IAIS; and the lead up to the launch of Solvency II on January 1, 2016. Insurance regulators and the industry also prioritized cybersecurity in 2015, particularly in light of significant cyber-attacks. 2015 also saw continued focus on principle-based reserving for life insurers. Finally, the U.S. Department of Labor's proposed regulations clarifying who would be considered a "fiduciary" of an employee benefit plan under ERISA were of particular interest to the industry and other lawmakers.

B. Influences of Federal and International Standards on Insurance Regulation

In 2015, the second Financial Sector Assessment Program ("FSAP") report on the U.S. system of insurance regulation was issued by the IMF. The report measures a jurisdiction's regulatory performance against the IAIS's Insurance Core Principles ("ICPs"). The 2015 FSAP report noted substantial U.S. compliance with the ICPs but also highlighted perceived deficiencies related to the complex system of state regulation, absence of group-wide capital standards and insufficient insurance expertise at the Federal Reserve Board. As discussed in further detail below, the IAIS is actively involved in developing a global capital standard and faces the significant challenge of reconciling differences among international regulatory bodies—most significantly, the E.U. and the U.S.

International developments on global standards and group capital are now being addressed in the U.S. through collaborative efforts of the NAIC, Federal Reserve Board and FIO. In sum, the Federal Reserve Board and FIO generally favor a global capital standard, provided it takes account of U.S. law and is not imposed on the U.S. by international regulatory bodies. Even the U.S. Congress has encouraged federal and state regulators to develop capital standards that will be adopted by the international regulatory community.

Although the concept of group-wide capital is a fundamental aspect of E.U. insurance regulation, it is not a feature of U.S. solvency regulation. Whereas the E.U. applies a consolidated capital standard on the insurance group as well as an entity level capital standard, U.S. state insurance regulators focus on entity-based capital standards. The E.U. standard views capital as potentially fungible and subject to deployment to group members where required. U.S. regulators are uncompromisingly focused on protecting the solvency of the insurance company member of any group. Also, U.S. and E.U. regulatory approaches to group supervision differ significantly. The NAIC favors a less prescriptive approach to group supervision that prioritizes international communication and coordination, whereas the E.U.'s approach is prescriptive, favoring a single group regulator.

Over the last few years the U.S. and E.U. have worked together through the E.U.-U.S. Dialogue Project to develop a better understanding of one another's regulatory policies and priorities. Their negotiations of a covered agreement in 2016 may well set the stage for mutual recognition, equivalence and potentially a foundation for group supervision. For the U.S., those negotiations will be led by FIO and the USTR, with input from the NAIC. It is too early to tell how the multitude of national and international insurance regulators will address the many aspects of the proposed global convergence of insurance regulation. Actions set in motion during 2015, however, may set the stage for significant international developments in 2016. Although the E.U.-U.S. Dialogue Project focuses on international insurance groups and systemically important groups, developments in global convergence of insurance regulation could have a direct or indirect effect on all insurers and therefore should be followed by all members of the industry.

C. Covered Agreement

With Solvency II now effective in Europe as of January 1, 2016, the issue as to whether the United States will be granted equivalence under Solvency II has become a topic of major concern for the U.S. insurance and reinsurance industry. As discussed in more detail in Section VI.K.1 below, equivalence for an insurance regulatory regime of a non-E.U. country under Solvency II is determined by the European Commission for three purposes: (i) the group solvency calculation; (ii) group supervision; and (iii) reinsurance. In June 2015, the E.U. granted to the United States provisional equivalence for a 10-year period exclusively with respect to group solvency. Since that date, the E.U. and the United States have engaged in a dialogue in order to better understand each other's regulatory systems. Such understanding was considered a prerequisite to either jurisdiction determining the other's regulatory equivalence.

On November 20, 2015, Treasury/FIO and the USTR announced their intention to exercise their authority under the Dodd-Frank Act to negotiate a "covered agreement" with the E.U. This announcement is particularly significant because it is expected that the covered agreement negotiated with the E.U. would likely serve as the basis for preempting certain state insurance laws (e.g., laws relating to credit for reinsurance ceded to a reinsurer domiciled in the E.U.), as described below. The Dodd-Frank Act generally provides that any state law that affords to non-U.S. companies fewer rights and protections than such state law affords to U.S. insurers would be subject to preemption under a covered agreement.

The covered agreement negotiations will address the following five areas:

- Obtaining "equivalent" treatment of the U.S. insurance regulatory system by the E.U. under Solvency II, effective as of January 1, 2016, so as to allow for a level playing field for U.S. insurers and reinsurers operating in the E.U.;
- Obtaining recognition by the E.U. of the "integrated state and federal" insurance regulatory and oversight system in the United States (including with respect to group supervision);
- Facilitating the exchange of confidential regulatory information between lead supervisors across national borders;
- Affording nationally uniform treatment in the United States of reinsurers based in the E.U., including with respect to reinsurance collateral requirements; and
- Obtaining permanent (rather than provisional) equivalent treatment for the solvency regime in the United States applicable to insurance and reinsurance undertakings.

A covered agreement with the E.U. will be of particular interest to E.U.-domiciled reinsurers and to U.S.-domiciled ceding insurers. Under state insurance laws, a non-U.S. reinsurer has been required to collateralize fully its reinsurance obligations to U.S. ceding insurers. In 2011, the NAIC adopted amendments to the Credit for Reinsurance Models permitting a non-U.S. reinsurer qualified as a "certified reinsurer" to post reduced collateral with respect to business assumed from U.S. ceding insurers. Approximately five years later, only 32 jurisdictions had adopted the revisions to the Credit for Reinsurance Models—and, as a result, a non-U.S. reinsurer that has qualified as a certified reinsurer is still obligated to post 100% collateral with respect to business assumed from U.S. cedents domiciled in the 19 remaining jurisdictions.

Importantly, the covered agreement with the E.U. could preempt the credit for reinsurance laws in these 19 remaining jurisdictions with respect to business ceded to reinsurers domiciled in the E.U. As a result, a reinsurer domiciled in the E.U. would potentially be able to post reduced collateral with respect to business assumed from an insurer domiciled in any U.S. state.

The covered agreement is also expected to remove certain barriers currently applicable to the operations of U.S. reinsurers operating in the E.U.

According to FIO Director Michael McRaith, if negotiations with the E.U. are successful, FIO and the USTR may also pursue covered agreement negotiations on similar or identical insurance and reinsurance topics with other non-U.S. jurisdictions soon thereafter.

State regulators oppose covered agreements, arguing that the amended Credit for Reinsurance Models form a basis for equivalence and fair treatment of non-U.S. reinsurers, and that no covered agreement with the E.U. was necessary for the United States to obtain provisional equivalence with respect to group solvency. The NAIC has also questioned the need for the drastic step of covered agreements negotiated by federal authorities and potentially preempting state laws—especially given that the federal government has not demonstrated the benefits that a covered agreement would provide to U.S. insurers or consumers.

The letters notifying the U.S. Congress concerning the intended negotiations with the E.U. with respect to the covered agreement expressly state that the Treasury and the USTR support the "U.S. integrated system of state and federal insurance regulation," including the primary role of state insurance regulators as supervisors of the business of insurance. The letters go on to promise that state insurance regulators will have a "meaningful role" during the negotiations of the covered agreement with the E.U. The extent of this "meaningful role" remains to be determined. Additionally, it is understood that interested stakeholders will also have the opportunity to engage through a public process with those participating in the negotiations. The timing of the negotiations of the covered agreement remains uncertain.

D. Financial Sector Assessment Program

As noted above, the 2015 FSAP recognized improvements since the 2010 U.S. FSAP and acknowledged broad compliance with the ICPs. The 2015 FSAP noted that many criticisms from the 2010 FSAP had been addressed and commended the contribution of risk-based capital ("RBC") rules to regulation and the high degree of transparency evident in the U.S. insurance regulatory system. However, the following areas were noted as needing improvement: (i) objectives, powers and responsibilities of supervisors; (ii) supervisors' independence, accountability, and resources; (iii) corporate governance; (iv) valuation (i.e., updating the valuation methodology for life insurers based on principles-based reserving); and (v) group-wide supervision. In particular, the 2015 FSAP called for the U.S. to set up an "independent insurance regulatory body with nationwide responsibilities and authority."

In November, the NAIC's International Insurance Relations (G) Committee adopted a plan to assign some of the recommendations of the 2015 FSAP to certain NAIC sub-groups for consideration. The Committee noted that: (i) some of the recommendations are already being addressed by existing NAIC work streams (such as the NAIC's effort to make the Corporate Governance Model Act (the "CG Model Act") and the Corporate Governance Model Regulation (the "CG Model Regulation" and, together with the CG Model Act, the "CG Models") an accreditation standard; this is discussed in Section VI.H.3.c below); (ii) the NAIC disagrees with some of the recommendations in their entirety (for example, the NAIC strongly disagrees with the recommendation that a federal insurance regulatory body with nationwide oversight authority be created); and (iii) some of the recommendations require further consideration by the appropriate NAIC sub-group.

E. Developments Related to Group Capital

1. SIFIs and Federal Reserve Board Capital Standards

The Dodd-Frank Act created FSOC and authorized it to designate a non-bank financial company, which could be an insurer, as a SIFI, thereby subjecting it to consolidated federal supervision by the Federal Reserve Board and enhanced regulatory standards. To date, four non-bank SIFIs have been designated, including three insurers.

No new non-bank SIFIs were designated in 2015. Rather, the primary activity with respect to insurance SIFIs has been the development of group capital standards. In late 2014, the Insurance Capital Standards Clarification Act gave the Federal Reserve Board the ability to tailor group capital standards to the business of insurance companies rather than applying bank capital standards. There is no deadline for completing the new standard, but Thomas Sullivan, a senior advisor for insurance to the Federal Reserve Board, reported to the NAIC in November that this is a priority for the Federal Reserve Board, which expects to come out with a proposed rulemaking "soon." It is also worth noting that the 2015 FSAP also urged the Federal Reserve Board to develop a valuation and capital standard "speedily." The 2015 FSAP further recommended that the Federal Reserve Board should "continue to increase its insurance expertise (particularly in the area of actuarial methods, insurance accounting and underwriting risk), including in senior positions, to ensure the effectiveness of its insurance group supervisory work."

Mr. Sullivan said that the Federal Reserve Board has been highly deferential to the work of the states and suggested that he does not expect to see conflict between state-based insurance regulation and the proposed rulemaking. Mr. Sullivan stated that because the Federal Reserve Board became a member of IAIS in 2013 and recently joined the IAIS Executive Committee, it has been and will continue to be engaged in the development of global regulatory standards that are consistent with the domestic regime to be proposed by the Federal Reserve Board. Similarly, FIO Director McRaith testified before the Senate Committee on Banking, Housing and Urban Affairs in April and stated that FIO, the Federal Reserve Board and state insurance regulators "work together extensively and regularly coordinate," as the U.S. participants of IAIS. Finally, a House Appropriations Committee report accompanying the federal omnibus appropriations bill, which was signed into law on December 18, 2015 as the Consolidated Appropriations Act, 2016 (the "Appropriations Act"), noted the importance of developing a domestic capital standard for insurance SIFIs pursuant to the Dodd-Frank Act "that is based on the existing domestic regulatory structure," and that is established "before approval of any international standard that will or could ultimately be applied to U.S. insurers."

It remains to be seen how the Federal Reserve Board's domestic capital standard will interact with both the IAIS global capital standard and the group capital calculation being developed by the NAIC, which is discussed below.

2. IAIS and FSB

The IAIS's Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame") is intended to provide basic standards for internationally active insurance groups ("IAIGs") and a means through which supervisors of IAIGs around the world may cooperate in the process of group supervision. The two main areas of work currently underway by the IAIS with respect to ComFrame are field testing and the development of a global insurance capital standard ("ICS") for IAIGs. Along with ComFrame, a key focus of the IAIS, in consultation with the FSB, is identifying international global systemically important insurers ("G-SIIs"), which will be subject to enhanced supervision and capital standards.

The following group capital standards are being developed with ComFrame: (i) Basic Capital Requirements ("BCR"), which was approved by the IAIS and the G-20 last year, and is scheduled to go into effect for G-SIIs in 2019; (ii) Higher Loss Absorbency ("HLA"), which is also scheduled to go into effect for G-SIIs in 2019; and (iii) ICS, which will serve as the base group capital standard applicable to all internationally active insurance groups.

HLA is intended to require higher loss absorbency for G-SIIs to reflect the greater risk that these institutions pose to the global financial system compared to other IAIGs. On October 5, 2015, the IAIS released an initial methodology for HLA, which was subsequently endorsed by the G-20. In 2016, HLA will be reported by G-SIIs on a confidential basis and will be shared with the IAIS for purposes of approving a final HLA.

From 2019, G-SIIs will be expected to hold regulatory capital that is not less than the total required by the sum of the BCR and HLA requirements. ICS will eventually replace the BCR component of the standard for G-SIIs. In December 2014 the IAIS released a preliminary document for consultation as a first step toward developing ICS, and is expected to develop an initial version of ICS by June 2017.

As noted, federal regulators and the NAIC have engaged with the IAIS in the development of the global capital standards. However, concerns remain about how such global standards will interact with the existing U.S. regulatory regime and the proposed rulemaking being developed by the Federal Reserve Board. For instance, the House Appropriations Committee report accompanying the Appropriations Act stated that the Committee "believes the U.S. agencies party to those negotiations must appropriately fulfill their duties to advocate for the U.S. insurance market and state-based regulatory regime." The Appropriations Committee also reminded "those Federal agencies party to IAIS or FSB negotiations not to support consolidated group-wide insurance capital standards for domestically-chartered [IAIGs] that are inconsistent with current state-based insurance standards."

3. NAIC Group Capital Calculation

In early 2014, the NAIC formed the ComFrame Development and Analysis (G) Working Group ("CDAWG") to review and provide input on ComFrame and the international group capital developments. CDAWG has also been evaluating possible insurance group capital standards in the United States and working on developing regulatory tools for group capital assessment and oversight for all U.S.-based insurance groups.

CDAWG considered several possible approaches to group capital assessment, each of which incorporated RBC principles, and ultimately recommended an approach based on RBC aggregation, which calculates group capital as the sum of existing regulatory capital calculations for all entities within the holding company system (including, for example, RBC for U.S. insurers and Basel capital requirements for banking entities). CDAWG rejected other possible approaches, such as (i) consolidating Statutory Accounting Principles ("SAP") rules for all entities in an insurance holding company system and using consolidated SAP financial statements in the RBC formula, and (ii) using existing GAAP consolidated financial statement results in an adjusted RBC formula. The RBC aggregation approach adopted by the NAIC was considered to have the least impact on the industry and regulators because it is most similar to, or compatible with, U.S. RBC.

The NAIC's Financial Condition (E) Committee will now construct the group capital calculation tool for U.S.-based insurance groups using the RBC aggregation approach, and has been directed by the NAIC Executive Committee to "liaise as necessary with [CDAWG] on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation." Commissioner Kevin McCarty (FL), Chair of CDAWG, has stated that the group capital calculation is intended to serve as a tool to complement the work regulators do on an individual entity level and will be a valuable solvency enhancement. McCarty emphasized that it is not intended to be a capital requirement or standard and noted that the NAIC will make an effort to coordinate with the IAIS's development of a global capital standard that is inclusive of the U.S. system. The NAIC and Federal Reserve Board are also reportedly coordinating with respect to their parallel developments of group capital initiatives.

F. Systemically Important Insurance Groups

1. SIFIs and FSOC Transparency

FSOC has been subject to criticism, most notably from Congress, with respect to the perceived lack of transparency in its process for designating SIFIs. In response, in February 2015, FSOC adopted certain revisions to its practices, including: (i) giving companies earlier notice that they have come under consideration for SIFI designation; and (ii) implementing certain procedures allowing for greater company involvement in the designation process, such as allowing a SIFI to meet with FSOC's staff to discuss its annual review and to provide relevant information, thereby giving the company an opportunity to describe changes made so as potentially to demonstrate that SIFI designation is no longer necessary.

Despite such changes, a House Appropriations Committee report included with the Appropriations Act once again criticized FSOC for lack of transparency, particularly with regard to conversations between FSOC and international organizations like the FSB. The legislative report also expresses a concern that FSOC is "overusing its authority" by designating certain SIFIs, and notes that FSOC would benefit from early and close consultation with primary regulators of companies before determining a SIFI designation. 2016 could potentially see further criticisms from Congress and, perhaps, attempts to curtail the authority of FSOC.

2. New G-SII List

On November 3, 2015, the FSB, in consultation with the IAIS, identified a list of nine G-SIIs. The list was the result of the FSB's third annual assessment and differed from the previous years' lists by removing Italy-based insurer Assicurazioni Generali SpA and adding life insurer Aegon NV. The current G-SII list also includes American International Group, Inc., MetLife, Inc., Prudential Financial Inc., Prudential plc, Allianz SE, Aviva plc, AXA S.A., and Ping An Insurance (Group) Company of China, Ltd. The FSB postponed a decision regarding the G-SII status of major reinsurers pending further refinement of the G-SII assessment methodology.

The IAIS is working on two projects related to G-SIIs—an update to the G-SII assessment methodology (including as the methodology relates to reinsurers) and a review of the definition of "non-traditional non-insurance activities" as relates to G-SIIs—and has released consultation documents on these topics.

G. Other Federal Developments

1. Policyholder Protection Act

Demonstrating the effort on the part of some in Congress to limit federal regulatory authority over the insurance industry, the Appropriations Act included a provision known as the "Policyholder Protection Act" (the "PPA"). Under the PPA, federal bank regulators are prohibited from using an insurance company's assets that are designated to pay insurance claims for the purpose of "bailing out" an affiliated financial institution. The legislation also amends provisions of the Dodd-Frank Act and limits the ability of the FDIC to seize insurance company assets intended to pay claims when an affiliated financial institution is subject to liquidation—it requires the FDIC to notify state insurance regulators of its intent to take a lien on an insurance company's assets, and to consult with them on the impact such a lien would have on the insurance company and its policyholders. The PPA's passage was supported by industry groups as well as the NAIC, which has long sought to protect insurance companies' assets and thereby protect policyholders.

2. NARAB II

The National Association of Registered Agents and Brokers Reform Act of 2015 ("NARAB II") was signed into law on January 12, 2015 in the latest effort to simplify and streamline non-resident insurance producer licensing. These efforts initially arose in response to the mandate of the Gramm-Leach-Bliley Act of 1999 ("GLBA") to simplify non-resident insurance producer licensing through the enactment of certain reforms.

The provisions of NARAB II will become effective on the later of (i) two years from enactment of NARAB II (i.e., January 2017) and (ii) incorporation of the National Association of Registered Agents and Brokers ("NARAB") as a non-profit corporation under the laws of the District of Columbia. NARAB II is expected to establish reciprocity and further streamline non-resident insurance producer licensing processes through the establishment of NARAB.

NARAB will be an independent non-profit corporation, not a federal regulator for insurance producers, controlled by a 13-member Board of Directors, which will include industry representatives as well as insurance regulators. Members of the Board of Directors must be appointed by the President and confirmed by the Senate. Notwithstanding enactment of NARAB II in January 2015 and NARAB II's requirement that such appointments be made within 90 days, the President has at the time of this writing appointed only four individuals to NARAB's Board of Directors. On January 13, 2016, President Obama nominated two current state insurance commissioners (Raymond Farmer, Director of the South Carolina Department of Insurance, and Michael Rothman, Commissioner of the Minnesota Department of Commerce), and two industry representatives (Thomas McLeary, founder and president of Endow Insurance Brokerage, a Chicago life insurance and benefits brokerage, and Heather Ann Steinmiller, general counsel of Conner Strong & Buckelew, a Philadelphia insurance benefits brokerage firm). Each of the nominated individuals is still subject to Senate confirmation. Until such time as all 13 members of the Board of Directors have been appointed and confirmed, progress in establishment of NARAB and implementation of true insurance producer reciprocity will remain on hold.

3. DOL Re-Proposed Fiduciary Rule

On April 14, 2015, the U.S. Department of Labor (the "DOL") issued proposed regulations (the "Proposed Regulations") clarifying who would be considered a "fiduciary" of an employee benefit plan under the Employee Retirement Income Security Act of 1974 ("ERISA") by virtue of providing investment advice to a plan or its participants. The Proposed Regulations also apply to the definition of a "fiduciary" for purposes of IRAs under the Internal Revenue Code of 1986 (the "Code"). Further, the Proposed Regulations propose two new, and amend certain existing, class exemptions from the prohibited transaction rules (including Prohibited Transaction Exemption ("PTE") 84-24, which has particular relevance to the insurance industry for the sale of insurance products and mutual funds by "fiduciary" insurance agents, brokers and consultants).

The Proposed Regulations, if finalized, will likely transform the way financial services firms—including insurance companies—market and sell their products and services. Under the proposed fiduciary definition, most insurance advisors would be considered fiduciaries and required to comply with the "best interest" standard of care when advising IRAs and small plans. Advisors to these plans and IRAs will need to examine whether their existing compensation structures would remain compliant if final regulations are adopted.

a. Re-Proposed Fiduciary Definition

In issuing the Proposed Regulations, the DOL sought to broaden the scope of the types of advice relationships that would give rise to fiduciary status, as compared to the current regulations. In support of the Proposed Regulations, the DOL cited the increased significance of the financial advice being provided to employee benefit plans and their participants and the increasing share of retirement funds that are held by participant-directed plans and IRAs.

The DOL issued the current regulations in 1975, employing a five-part test for determining whether a person is providing investment advice for a fee—a so-called investment advice fiduciary. It is the DOL's position that the current regulations have the effect of improperly narrowing the statutory scope of the definition. The current regulations provide that a person without discretionary authority or control with respect to the management of a plan or its assets is a fiduciary if that person renders advice as to the value of securities or other property or make recommendations as to the advisability of investing in, purchasing or selling securities or other property on a regular basis pursuant to a mutual agreement, arrangement or understanding with the plan or plan fiduciary that the advice will serve as a primary basis for investment decisions of the plan's assets and that the advice is individualized and particularized for the plan.

The Proposed Regulations clarify and broaden the definition of fiduciary investment advice, but also provide for specific carve-outs for particular types of communications that should not be considered fiduciary in nature. Under this new definition, a person would be deemed to be an investment adviser fiduciary if, for a fee, that person provides investment or investment management recommendations or appraisals to an employee benefits plan, a plan fiduciary, participant or beneficiary or an IRA owner or fiduciary, and either (a) acknowledges the fiduciary nature of the advice, or (b) acts pursuant to an agreement, arrangement or understanding that the advice is "individualized to, or specifically directed to" the advice recipient.

The DOL recognized that the revised definition of fiduciary advice could be overbroad, so the Proposed Regulations include several "carve outs" to the general definition, including, among others, (1) statements or recommendations made to large plan investors with financial expertise, (2) marketing or making available a platform of investment alternatives to be selected by a plan fiduciary for an individual account plan, and (3) information and materials that constitute "investment education."

b. Best Interest Contract Exemption

The Proposed Regulations also include a new exemption from the prohibited transaction rules under ERISA and the Code—the Best Interest Contract Exemption. If the conditions of the Best Interest Contract Exemption are satisfied, certain investment advice fiduciaries, including insurance agents, brokers and consultants, and financial institutions would be allowed to receive fees and compensation that, without the exemption, would be prohibited.

The Best Interest Contract Exemption applies only to advice given to non-participant directed small plans (fewer than 100 participants), plan participants and IRAs, and only for advisor services provided in connection with the purchase or sale of certain assets (including insurance and annuity contracts and mutual funds). The exemption also has several onerous conditions, including written contract requirements and extensive disclosure requirements.

c. Impact of Amendment to PTE 84-24

PTE 84-24 provides relief from the prohibited transaction rules under ERISA and the Code for the receipt of sales commissions by "fiduciary" insurance advisors in connection with the sale of (among other products) fixed and variable insurance products to plans and IRAs, provided that certain disclosure requirements are satisfied. However, for IRAs, relief under PTE 84-24 will not be available for mutual fund shares or insurance products that are considered securities under federal securities laws (e.g., variable annuity contracts and other annuity contracts).

Under PTE 84-24 as amended, the insurance advisor and insurance company will need to adhere to the "Impartial Conduct Standard," which includes acting in the best interest of plans and IRAs when providing advice, refraining from issuing any misleading statements concerning recommended investments, fees and material conflicts of interest, and other relevant matters. As noted, insurance advisors and their affiliates will be able to receive commissions (including renewal fees and trailers), but not revenue sharing payments or administrative and marketing fees. As a consequence of the amendment to PTE 84-24, sales of variable annuity products to IRAs would have to rely on the Best Interest Contract Exemption described above.

d. Expected Publication Date for the Final Fiduciary Rules

While the DOL has not provided a definitive publication date, it is expected that the final fiduciary rules will be published in the Federal Register in late first quarter of 2016, or early in the second quarter of 2016. It is our understanding that the DOL intends for any final rules to become effective prior to the end of the Obama administration on January 20, 2017. We will circulate a client alert once the rules are finalized and published in the Federal Register.

H. Other U.S. Regulatory Developments

1. Cybersecurity

After emerging as a hot topic at the end of 2014, the topic of cyber risk and cybersecurity has continued to be a major area of interest in 2015, with developments at the NAIC, federal and state levels.

a. NAIC Developments

In December 2015, the NAIC adopted the NAIC Roadmap for Cybersecurity Consumer Protections (the "Roadmap"). The Roadmap is intended to create standards and protocols for consumers if their personal information is compromised and includes the consumer's right to know the kinds of information maintained by an insurer, and to receive timely notice of a data breach as well as assistance from the insurer in addressing issues arising from such data breach. Interested parties expressed objections to the Roadmap throughout the drafting process due to concerns that it could confuse consumers and lead them to think they are protected in ways in which no protection currently exists. As a result of such concerns, the Roadmap's name was changed from the "Cybersecurity Bill of Rights," prior to its adoption.

The NAIC has made clear that the Roadmap is a starting point for converting the consumer protections set forth in the Roadmap into a new full NAIC Model Law (the "Cyber Model"). However, the adoption of the Roadmap itself did not bind any state to adopt any laws or regulations or to agree in substance with all of the provisions of the Roadmap. The NAIC will begin working on the new Cyber Model and hopes to have it completed by the end of 2016 (although it has acknowledged that this may be a difficult goal). As part of the development of the Cyber Model, the NAIC will also revisit certain existing Model Laws that touch upon cybersecurity issues in order to remove any conflicts with the provisions of the new Cyber Model.

The NAIC also adopted, in summer 2015, the "Principles for Effective Cybersecurity: Insurance Regulatory Guidance" (the "Principles"), which set forth 12 guiding principles for the protection of insurance customers. The Principles, which are based on the federal National Institute of Standards and Technology's Cybersecurity Framework, state in part that insurance regulators should ensure that personally identifiable consumer information held by insurers, producers and other regulated entities is protected from cybersecurity risks, and that insurers must appropriately safeguard sensitive information and provide notice of data breaches.

Finally, in September 2015 the NAIC IT Examination (E) Working Group adopted guidance intended to modernize IT protocols for financial examiners and enable examiners to determine whether an insurer has significant exposure to cybersecurity risks and to assess an insurer's level of controls and processes for managing such risks. The new guidance will be included in the 2016 version of the Financial Condition Examination Handbook and will be updated thereafter.

b. U.S. Congressional Developments

In addition to the insurance-related items discussed above, the Appropriations Act included the passage of the "Cybersecurity Act of 2015," which enables the federal government, state governments and private entities to share information with each other regarding cyber threats voluntarily. The law, which was supported by insurance industry groups, establishes a framework for such information-sharing that includes certain protections to prevent the sharing of individuals' personal information that is not directly related to a cyber threat. The Cybersecurity Act of 2015 was among many pieces of cybersecurity-related legislation that Congress considered this year, demonstrating heightened interest in legislating in this area at the federal level.

c. New York Developments

Prior to the NAIC's announcement that it is working on a Cybersecurity Model, on November 9, 2015, the Acting Superintendent of the NYDFS sent a letter to the members of the federal Financial and Banking Information Infrastructure Committee (the "FBIIC") to describe the NYDFS's preliminary views on a potential cybersecurity regulation, and to invite feedback from the FBIIC members (including the NAIC). The FBIIC was chartered by the President's Working Group on Financial Markets to improve coordination and communication among financial regulators, among other things. The NYDFS letter described policies and procedures that "covered entities" could be required to undertake with respect to information security and data privacy, including taking measures to protect data accessible to third-party service providers, adopting multi-factor authentication procedures, designating a Chief Information Security Officer who would annually report to the NYDFS, conducting annual audits, and immediately notifying the NYDFS of any material cybersecurity incident. The letter stated that such proposals do not represent a complete list of all the components of a potential cybersecurity regulation that the NYDFS is considering.

Earlier in the year, the NYDFS demonstrated its particular interest in cybersecurity issues when it sent a letter to a sizable group of insurers requesting a report on a variety of items relating to their institutional cyber risk. The NYDFS has also been conducting targeted cyber risk assessments of certain financial institutions under its authority.

The extent to which the NAIC and other financial regulators will coordinate with the NYDFS's efforts, in light of the NAIC's own planned Cybersecurity Model, remains to be seen.

2. Life Insurance Developments

a. Principle-Based Reserving

For over a decade, the NAIC has been working on developing a principle-based approach to life insurers' reserving methods, in which actuarial judgment and the risks faced by a life insurer would have greater weight on that insurer's reserves than the current formulaic approach. The result of these efforts, the implementation of principle-based reserving ("PBR"), the result of these efforts, now appears to be less than one year away. It was reported by the NAIC in late November that 39 states have now enacted the amendments to the NAIC Model Standard Valuation Law (the "SVL"), that the amendments were under consideration in one further state, and that bills proposing to enact the SVL amendments would be introduced shortly in several further states. These states represent more than 75% of total industry premium volume. In order for PBR to become effective as of January 1, 2017 (which is the current target date), no fewer than 42 states representing 75% of the total industry premium must enact laws "substantially similar" to the amended SVL by July 1, 2016. We note that the NAIC is currently determining whether the 39 states discussed above have, in fact, enacted laws "substantially similar" to the amended SVL. The criteria for making this determination were adopted by the NAIC in November 2015.

When PBR was first proposed, two states immediately voiced their opposition to the concept of principle-based reserving: California and New York. California's stance towards PBR has since changed; indeed, California became one of the states to enact the amendments to the SVL in late 2015. New York, on the other hand, has continued to oppose PBR—although, as discussed in Section VI.I.1, we understand that the NYDFS has discussed with the NAIC the possibility of the NYDFS supporting PBR if the NAIC were to agree to make certain revisions to the net premium reserve/formulaic floor in the Valuation Manual.

b. Captive Update

i. XXX/AXXX Framework, AG 48 and XXX/AXXX Model Regulation

Over the last two years, state insurance regulators and the NAIC have devoted significant energy to reassessing their regulation of captive XXX and AXXX transactions, leading to the adoption in 2015 of a new regulatory framework for such transactions (defined above as the "Framework") and AG 48. The Framework and AG 48 aim to set standards applicable to XXX and AXXX transactions, instead of restricting them outright. The purpose of AG 48 was to implement the substantive requirements of the Framework effective as of January 1, 2015, pending the development and adoption by the states of the new Model Regulation.

The NAIC originally planned to adopt during 2015 both the Model Regulation and the amendment to the Model Law necessary for state regulators to implement the Model Regulation. However, this timeline proved to be too ambitious. Instead, it is now expected that the Model Regulation will not be finalized until the next NAIC national meeting in April of this year at the earliest. One aspect of the Model Regulation that was finalized by the NAIC in 2015 is the noncompliance penalty provision. As decided by a 12-to-8 vote of the NAIC Reinsurance (E) Task Force, the Model Regulation will incorporate the "All or Nothing" approach to the noncompliance penalty, pursuant to which a cedent would receive no credit for reinsurance in the event of a shortfall in "Primary Security" assets as defined in AG 48 (i.e., the types of "hard assets" required to collateralize the portion of the total statutory reserve approximately equal to the PBR level) or "Other Security" as defined in AG 48. The "All or Nothing" approach is not consistent with AG 48—which, instead, provides for a so-called "Dollar-for-Dollar" approach, pursuant to which credit for reinsurance would be reduced by the amount of shortfall in Primary Security assets, while giving full credit for Other Security assets.

The revisions to the Model Law were adopted by the NAIC on January 8, 2016. These revisions grant authority to state insurance regulators to adopt not only the Model Regulation, but also regulations with respect to: (i) variable annuities with guaranteed death or living benefits; (ii) long-term care policies; and (iii) such other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance. Such regulations would not apply to: (1) an alien reinsurer that has qualified as a "certified reinsurer" in the state (or, if the state has not adopted the "certified reinsurer" concept, an alien reinsurer that has qualified as a "certified reinsurer" in at least five states); or (2) a reinsurer that maintains at least $250 million in capital and surplus (without the impact of any permitted or prescribed practices) and that either is licensed in at least 26 states or is licensed or accredited in at least 35 states (and licensed in at least 10 of such 35 states). Further, these revisions to the Model Law contain a grandfathering provision, specifying that the version of the Model Regulation adopted in the state may apply to any treaty containing: (A) policies issued on or after January 1, 2015; or (B) policies issued before January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

In late 2015, Delaware urged the NAIC to consider further the potential consequence of the adoption by the states of the Framework and the Model Regulation. In particular, Delaware has proposed that the NAIC conduct a study of the impact of the Framework and the Model Regulation on consumer prices. Due to the fact that the NAIC has thus far not heeded Delaware's request, Delaware presented the solitary vote of opposition to the revisions to the Model Law that were adopted by the NAIC on January 8, 2016.

ii. Accreditation

During 2015, the NAIC Financial Regulation Standards and Accreditation (F) Committee (the "Accreditation Committee") revised the preamble to Part A of the NAIC accreditation standards (which are applicable to "multi-state insurers") to expressly apply to captive insurers reinsuring XXX and AXXX business. The revised preamble expressly does not apply to: (i) a state's domestic insurers licensed or organized under special purpose vehicle statutes or other similar statutory constructs; or (ii) a captive insurer that reinsures policies subject to the grandfathering provision under AG 48 (i.e., policies that were both (a) issued prior to January 1, 2015 and (b) ceded as part of a reinsurance arrangement as of December 31, 2014). The regulation of a captive insurer is deemed to satisfy Part A of the NAIC accreditation standards if the applicable reinsurance transaction satisfies the Framework.

The Accreditation Committee has also adopted revisions to Part A of the NAIC accreditation standards applicable to captive insurers reinsuring variable annuities and long-term care insurance business, although such adoption was accompanied by a note that: (i) the revisions to the preamble are not yet effective; (ii) the effective date for applicability has yet to be determined; and (iii) the application of the preamble to in-force variable annuity and long-term care business requires further discussion. The Accreditation Committee will continue to monitor the work of the NAIC Variable Annuities Issues (E) Working Group (the "Variable Annuities Working Group") as it considers the inclusion of grandfathering provisions and the effective date for applicability of the preamble to variable annuity and long-term care captives.

iii. Variable Annuities

With its XXX/AXXX captive project nearly completed, the NAIC has now turned its attention to variable annuities captive transactions. FSOC identified in its 2014 Annual Report variable annuity and long-term care captive transactions as areas of particular concern potentially warranting regulatory attention. The NAIC responded by forming the new Variable Annuities Working Group to study, and provide a recommendation for addressing, variable annuities captives. The Variable Annuities Working Group has drafted a preliminary framework (the "VA Framework") based on a report by an outside consultant, which currently proposes revisions to Actuarial Guideline 43, the C3 Phase II component of the life RBC formula and state laws, as well as statutory accounting rules pertaining to hedging activities. In addition, the VA Framework is intended to make changes that will apply retrospectively, and recommends that, once the revisions recommended by the VA Framework are effective, domestic regulators of insurers ceding variable annuities business to captives should request that such business be recaptured and the captives be subsequently dissolved. The substantive provisions of the VA Framework are subject to the results of a quantitative impact study, which will be conducted by the Variable Annuities Working Group's outside consultant during 2016. The Variable Annuities Working Group has set an aggressive timeline of having all of its work completed by December 31, 2016.

3. Model Law Adoption

States continued to adopt recently developed or amended NAIC model laws while, at the same time, the NAIC moved forward with the process of making certain NAIC model laws, or amendments to such laws, into accreditation standards. As noted below, much of this model law activity arose out of the 2010 FSAP review of the U.S. insurance regulatory system or in preparation for the 2015 FSAP review.

a. ORSA

In 2012, the NAIC adopted the Risk Management and Own Risk and Solvency Assessment Model Act (the "ORSA Model Act"). The ORSA Model Act included a proposed effective date of January 1, 2015 as part of a concerted effort to strengthen domestic insurance supervision in advance of the recently completed 2015 FSAP review. Due to the January 1, 2015 effective date, the first ORSA Summary Reports were submitted by insurers in 2015. As of November 17, 2015, the NAIC's SMI dashboard reported that 34 states had adopted the ORSA Model Act. Interested parties and the NAIC continued to debate the appropriate level of confidentiality that should be granted to an ORSA summary report under a state's implementing legislation that would satisfy the NAIC for accreditation purposes. Due to the sensitive nature of information included in ORSA Summary Reports, interested parties initially sought for states to be required to adopt language "identical or functionally equivalent to" the confidentiality language included in the ORSA Model Act. Interested parties later clarified that they would accept a requirement that states adopt "substantially similar" confidentiality provisions, so long as such a standard would require a state's confidentiality provisions to accomplish the same level of protection for information submitted to and in the possession of an insurance commissioner as the provisions in the ORSA Model Act. Ultimately, the NAIC adopted a proposal to make the ORSA Model Act an accreditation standard beginning January 1, 2018. The proposal requires states to adopt substantially similar confidentiality provisions applicable to information submitted to and in the possession of insurance commissioners.

b. Holding Company Act

In 2010, the NAIC adopted revisions to its Model Insurance Holding Company System Regulatory Act (the "Model HCA") which incorporated, among other items, requirements relating to filing an enterprise risk report, also known as a Form F filing. The 2010 revisions to the Model HCA, which became an accreditation standard on January 1, 2016, have been adopted in all states.

In 2014, the NAIC adopted further revisions to the Model HCA to authorize state regulators' participation in the supervisory colleges and other authorities related to the group-wide supervision of IAIGs. As of November 17, 2015, the NAIC's SMI dashboard reported that the 2014 revisions to the Model HCA have been adopted in Arkansas, California, Delaware, Florida, Louisiana, New Jersey, North Dakota, Pennsylvania, Rhode Island and Vermont. The NAIC exposed for a one-year comment period a proposal to make the 2014 revisions to the Model HCA an accreditation standard. When considering such a proposal, the NAIC may consider whether to make the 2014 revisions to the Model HCA an accreditation standard for all jurisdictions or only those jurisdictions that (i) are the group-wide supervisor of an IAIG or (ii) have a domestic company that is a member of an IAIG where the IAIG's group-wide supervisor is another U.S. state. The NAIC will next consider this accreditation proposal at the 2017 Summer National Meeting. If adopted by the NAIC in 2017, the proposal will become effective January 1, 2020.

c. Corporate Governance Model Act

In 2014, the NAIC adopted the CG Models following a lengthy process that began in part to address findings in the 2010 FSAP report. The CG Models will require all insurers to file a Corporate Governance Annual Disclosure to provide regulators with a deeper understanding of an insurer's corporate governance framework. The first such filings will be required in 2016. As of November 17, 2015, the NAIC's SMI dashboard reported that the CG Model Act has been adopted by only California, Indiana, Iowa, Louisiana and Vermont. The NAIC exposed for a one-year comment period proposals to make the CG Models accreditation standards. It is expected that such proposals will, if adopted by the NAIC, become effective January 1, 2020.

d. Model Audit Rule Revisions

In 2014, the NAIC adopted revisions to the Annual Financial Reporting Model Regulation (the "Model Audit Rule") to respond to a finding in the 2010 FSAP report that the Model Audit Rule did not require insurers to maintain an internal audit function. The 2014 revisions to the Model Audit Rule thus require insurers meeting certain premium thresholds to maintain an internal audit function. As of November 17, 2015, the NAIC's SMI dashboard reported that the 2014 revisions to the Model Audit Rule have been adopted in Georgia, Indiana, and Ohio. The NAIC exposed for a one-year comment period a proposal to make the 2014 revisions to the Model Audit Rule an accreditation standard. It is expected that such proposal will, if adopted by the NAIC, become effective January 1, 2020.

I. New York Developments

1. NYDFS Opens the Door to Compromise on PBR

In November 2015, it was reported by a trade association that the NYDFS has discussed with the NAIC the possibility of the NYDFS supporting PBR if the NAIC were to agree to make certain revisions to the net premium reserve/formulaic floor in the Valuation Manual. It is not yet known what changes would be required to satisfy the NYDFS.

2. Significant Legislative Changes for New York Domestic Life Insurers

a. Independent Board Member Requirements

On December 22, 2015, the Governor of the State of New York signed legislation that authorizes the independent board members of a parent insurance company, mutual insurance holding company, or publicly held corporation to fulfill the independent board requirements of the New York Insurance Law on behalf of a domestic life subsidiary. This legislation was intended to conform to the independent audit committee requirements of the Model Audit Rule. However, the Governor signed this legislation with the understanding that a "Chapter" amendment will be passed by the legislature early in 2016, which will revise the enacted law to restrict this authorization of such parent or holding companies to those that are based in the U.S. The amendment will also clarify that the parent board must meet the standards that would have applied to the board at the subsidiary insurer level.

b. Amendment of Dividend Test

On December 28, 2015, the Governor signed into law legislation that expands the limitations on the distribution of dividends by domestic stock life insurers from a "lesser of" test to a "greater of" test. The "lesser of" test limited the aggregate amount of dividends in any calendar year to the lesser of (i) 10% of surplus to policyholders as of the prior calendar year and (ii) net gain from operations for the prior calendar year, not including realized capital gains. The "greater of" test limits the aggregate amount to the greater of (i) and (ii), but includes a cap on (ii). However, the Governor signed this legislation with the understanding that a "Chapter" amendment will be passed by the legislature early in 2016, which will revise the enacted law to require that any dividend distribution made as a result of utilizing the "greater of" dividend standard must come from "earned surplus," while domestic stock life insurers that have no "earned surplus" may continue to distribute dividends acceptable under the current "lesser of" dividend test. This amendment is intended to resolve the Governor's concern that the initially enacted law does not support the NYDFS's accredited status with the NAIC.

3. Amendments to New York's "Doing Business" Laws

On July 2, 2015 a new law went into effect that permits New York-licensed brokers to perform specified activities in New York with regard to sales to multinational clients of coverage issued by unauthorized alien insurers. Prior to this legislation, New York insurance law prohibited anyone from acting on behalf of an unauthorized insurer in the state of New York. The new law was promoted by industry members in order to allow a limited exception to that prohibition with respect to a "multinational entity," defined as a member of a multinational group operating globally where (i) at least one institution in the group is formed under the laws of the United States or has significant operations here and (ii) at least one institution in the group has offices outside of the United States.

The new law allows New York licensed brokers to engage in specified activities in New York with respect to (a) "alien" (i.e., non-U.S.) unauthorized insurers and (b) group life, accident and health insurance or annuities where the policyholder, or proposed policyholder, is a multinational entity (as defined above) resident outside the United States and the policy covers employees residing outside the United States. The specified activities set forth in Section 2117(k)(2) of the New York Insurance Law permit a broker to provide certain information to multinational entities regarding unlicensed alien insurers and policies issued by such insurers, make referrals to unlicensed alien insurers, and manage a multinational entity's employee benefits program. The broker must provide written notice to the multinational entity regarding the unregulated nature of the insurance coverage before doing any of the activities specified in Section 2117(k)(2).

The new law does not permit a policy to be underwritten or negotiated in New York, or a policy to be issued or delivered in the United States. Other than as specifically permitted, brokers are not permitted to call attention to the unauthorized insurer in New York. The law also does not permit an unauthorized alien insurer to maintain an office in New York.

4. Personnel Changes

In 2015 the senior staff of the NYDFS underwent a number of significant changes. Benjamin Lawsky left his role as Superintendent of the NYDFS and was succeeded in an acting capacity by Anthony Albanese, who in turn has been succeeded in an acting capacity by Shirin Emami, who was previously the Executive Deputy Superintendent and the General Counsel of the NYDFS Banking Division. Additionally, Robert Easton left his position as Executive Deputy Superintendent of the Division of Insurance of the NYDFS and has been succeeded in an acting capacity by Troy Oechsner. We expect permanent replacements for these positions to be named in 2016.

J. 2016 Forecasting

Looking to 2016, we expect that FIO and the USTR, on one hand, and the E.U., on the other hand, will soon begin negotiations on a covered agreement; negotiations which may set the stage for mutual recognition, equivalence and potentially a foundation for multinational group supervision in the future. Group capital will continue to be a focus of U.S. state, federal and international regulators in 2016: IAIS will continue developing the HLA and ICS global capital standards for G-SIIs, the NAIC will begin work on its group capital assessment tool for U.S. insurers, and the Federal Reserve Board will likely unveil a proposed rule as to minimum capital standards for U.S. insurance SIFIs. With respect to the SIFI designation process, it remains to be seen how FSOC will respond to renewed criticisms about its lack of transparency, and whether Congress will take action to limit FSOC's authority. Cybersecurity will also be a continued focus, with the development of a Cyber Model by the NAIC, a cyber-related regulation by the NYDFS, and, potentially, the consideration of further federal legislation by Congress. Finally, in 2016 we expect that the threshold for adoption of PBR will be reached, with PBR becoming effective as of January 1, 2017.

K. Solvency II Developments

The regulatory marathon that is known as Solvency II is nearing the finish line. Formal implementation began in April 2015 and the new rules came into effect on January 1, 2016. There are still some loose ends to tie up and some fairly significant transitional periods to get through but for all intents and purposes the new regime is now in place. Solvency II has significance beyond Europe for a number of reasons. First, Solvency II affects international groups and how their group solvency is calculated, and therefore affects the assessment of groups that have insurance companies both within and outside of the E.U. Second, it insists that there is a form of group supervision. While group supervision is a concept that is common in many insurance regulatory regimes, it is not universal—the U.S. is a notable exception. Again, international insurance groups with an insurer located in the E.U. will be affected. Third, it affects reinsurers outside of the E.U. that wish to reinsure European insurance companies.

The commencement of the Solvency II phasing-in period from April 2015 and a series of publications and announcements from E.U. legislators and regulators during the course of 2015 have cleared up lingering uncertainty regarding a number of important matters, including the issues of equivalence and group supervision, that are of particular interest to international groups.

1. Equivalence

Equivalence refers to the concept whereby the European Commission determines whether the insurance regulatory regime of a non-E.U. country ("third country") is equivalent to Solvency II for three purposes:

(i) Group Solvency Calculation: This applies to any insurance group that operates in a third country but the ultimate holding company of which is headquartered in the EEA. If an EEA group has an insurance subsidiary in a third country that is deemed equivalent, the EEA group can use the "alternative method" to calculate group solvency. This means that the local capital requirement rules of the third country—rather than Solvency II capital rules—can be applied in respect of insurance subsidiaries operating in that third country.

(ii) Group Supervision: This is relevant where the ultimate holding company of an insurer with EEA activities is headquartered in a third country. If the third country's rules are deemed equivalent in this area, EEA supervisors can rely on the group supervision by the regulator in that third country rather than apply Solvency II group supervision rules (see Section VI.K.5 below).

(iii) Reinsurance: This applies to third country reinsurers where the solvency regime of a third country is deemed equivalent to the E.U. In these circumstances, the E.U. regulators must treat reinsurance contracts between EEA insurers and reinsurers in the third country in the same way as reinsurance contracts concluded between EEA firms.

A number of countries are in the first "wave" of assessment for equivalence, but some others, including the U.S. and Canada, have chosen not to engage in the formal equivalence assessment process. E.U. institutions have, in the latter half of 2015, made a number of important decisions regarding the equivalence of the regulatory regimes of eight countries.

2. Switzerland

On June 5, 2015 the European Commission granted Switzerland full equivalence in all three areas of Solvency II for an indefinite period.[8] The Commission's decision was then passed to the European Council and European Parliament for scrutiny and those institutions confirmed their non-objection in July[9] and September,[10] respectively.

Switzerland was the first country to be granted full equivalence. The decision to grant Switzerland full equivalence was not surprising given the country's close relationship with the E.U., its prominent insurance and reinsurance market and the steps taken by Swiss authorities in recent years to align the Swiss regulatory regime with Solvency II.

3. Bermuda and Japan

The European Commission also adopted third country equivalence decisions in respect of Bermuda[11] and Japan[12] on November 26, 2015. Bermuda had been granted provisional equivalence in June 2015, but following the adoption of new domestic insurance legislation, it was granted full equivalence in all three areas of Solvency II. However, the Bermudian systems for regulating captive insurers and special purpose insurers were not found to be equivalent.

The decision will come as a relief for the Bermudian lawmakers and regulators who have substantially reformed the Island's insurance regulation over the past six years, in part to bring it into line with Solvency II. The decision will enable Bermuda's commercial reinsurers, which cover a significant portion of

8 European Commission. Press Release. *Insurance: European Commission adopts a first package of third country equivalence decisions under Solvency II.* Web 16 December 2015. http://europa.eu/rapid/press-release_IP-15-5126_en.htm and 2009/138/EC of the European Parliament and of the Council http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D1602&from=EN

9 Council of the European Union. *Outcome of the Council Meeting - 3403rd Council Meeting -Economic and Financial Affairs Brussels, 14 July 2015*.

10 The European Parliament updated its procedure file on September 12, 2015 to note that it will not object to the discussion to grant full equivalence to Switzerland. European Parliament procedure file 2015/2741(DEA). *Equivalence of the solvency and prudential regime for insurance and reinsurance undertakings in force in Switzerland*. Web 16 December 2015. http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2015/2741%28DEA%29&l=en

11 European Commission. *Commission Delegated Decision C(2015) 8145 of November 26, 2015 on the equivalence of the supervisory regime for insurance and reinsurance undertakings in force in Bermuda to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council and amending Delegated Decision C(2015) 3740*. Web 16 December 2015. http://ec.europa.eu/finance/insurance/docs/solvency/international/151126-bermuda_en.pdf

12 European Commission. *Commission Delegated Decision C(2015) 8147 of November 26, 2015 on the equivalence of the solvency regime for insurance and reinsurance undertakings in force in Japan to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council*. Web 16 December 2015. http://ec.europa.eu/finance/insurance/docs/solvency/international/151126-japan_en.pdf

European reinsurance and catastrophe risks, to compete on an equal footing in Europe with EEA companies.

However, the exclusion of special purpose insurers from the equivalence assessment means that European cedents will have to insist that the arrangements comply with Solvency II rules in order for them to count reinsurance with such vehicles for solvency purposes. Most notably, compliance with rules on collateral are likely to be key.

The Japanese Financial Services Agency sought to achieve equivalence only in respect of reinsurance so as to allow Japanese reinsurers to assume business in Europe without collateral requirements for unearned premium or reinsurance recoverables. Japan has been granted (i) temporary equivalence in respect of reinsurance and (ii) provisional equivalence for group solvency purposes. Temporary equivalence is granted for five years and this may be extended for an additional year. Provisional equivalence is granted for third countries that may not meet all the criteria for full equivalence but where an equivalent solvency regime is expected to be adopted and applied by the third country in the foreseeable future. Provisional equivalence is granted for a period of 10 years and may be renewed for an additional 10-year period.

The equivalence decisions in respect of Bermuda and Japan are subject to a three-month review by the European Council and European Parliament, with a potential extension of up to three additional months. Since the review periods will not end until after the Solvency II implementation date, the decisions of the Council and Parliament will apply retroactively from January 1, 2016.

4. The U.S. and Other Countries Granted Provisional Equivalence

The U.S., along with Australia, Brazil, Canada and Mexico, has been granted provisional equivalence for group solvency purposes only.[13] As such, these jurisdictions will be treated as equivalent for purposes of group solvency for a period of 10 years from January 1, 2016. At the end of this period, the European Commission will need to reassess each country's regime to decide whether to grant full equivalence or grant an additional period of temporary equivalence.

In practice, provisional equivalence means that EEA headquartered insurance groups that are active in one of these countries can either (i) use the default capital requirement calculation method by assessing group solvency using Solvency II rules on an accounting consolidation basis or (ii) use the alternative method by disaggregating group operations and applying local capital requirement rules of equivalent jurisdictions to operations in such equivalent jurisdictions while applying Solvency II rules to other operations of the group. However, in order to apply the alternative method the group must first demonstrate to its group supervisor that the exclusive application of the default method is inappropriate.

As noted and discussed in Section VI.C above, on November 20, 2015 the Treasury and the USTR announced plans to initiate negotiations to enter into a covered agreement with the E.U. The covered agreement will be negotiated to address reinsurance collateral, cross-border regulatory information exchange issues and group supervision issues between the E.U. and the U.S.

The covered agreement is of particular interest to U.S. and E.U. reinsurers. E.U. reinsurers have long been subjected to U.S. reinsurance collateral requirements, which result in them having not only to satisfy E.U. solvency rules, but also local requirements as well when underwriting business in the U.S. Likewise, U.S. reinsurers operating in the E.U. will face similar duplication of capital requirements between U.S. requirements and Solvency II requirements. The negotiations of a covered agreement may be a tool for achieving a set of measures for ensuring that U.S. and E.U. reinsurers are not subject to multiple sets of capital requirement rules.

However, as detailed further in Section VI.C above, U.S. state insurance regulators generally consider a covered agreement to be a drastic step because it could potentially preempt state law and undermine the U.S. system of state regulation of insurance.

[13] European Commission. Press Release. *Insurance: European Commission adopts a first package of third country equivalence decisions under Solvency II.* Web 16 December 2015. http://europa.eu/rapid/press-release_IP-15-5126_en.htm

5. Group Supervision

When an insurance group headquartered in a non-EEA jurisdiction has operations in the EEA, the question arises as to whether EEA insurance supervisors can rely on the group supervision exercised in the third country jurisdiction or whether supervision has to be duplicated by a group supervisor in Europe. Guidance from the European Insurance and Occupational Pensions Authority ("EIOPA")[14] has helped set supervisor's expectations and criteria for applying Solvency II requirements regarding sub-group supervision.

EIOPA's guidance notes that where the ultimate parent company of a group is headquartered outside the EEA and is subject to "equivalent" third country supervision (for example, in Switzerland or Bermuda), the EEA group supervisor should rely on the group supervision exercised by the equivalent third country supervisory authorities and exempt the third-country group from group supervision by an EEA regulator on a case-by-case basis, where this would result in a more efficient supervision of the group and would not impair the supervisory activities of the EEA supervisory authorities concerned in respect of their individual responsibilities.

However, EIOPA's guidance notes that where the ultimate parent company is headquartered outside the EEA and is not subject to equivalent third country supervision (for example, in most states of the United States), group supervision should be applied at the level of the ultimate parent undertaking in the E.U.

If there is no E.U. holding company, then the issue for international groups is whether they should consider a group reorganization in order to create an E.U. sub-group that will be supervised by the relevant E.U. regulator, or whether they should negotiate with the relevant E.U. regulator on appropriate "other methods" for exercising group supervision. The latter is an option where there is no equivalent group supervision. In the course of 2015, we saw clients adopt both approaches as it suited their particular facts and circumstances. Thus, some international insurance groups underwent a reorganization to create an E.U. sub-group headed by an E.U. holding company within which the E.U. insurers were placed while the non-E.U. insurers were moved outside of the sub-group. This meant that the Solvency II group supervision and solvency capital rules would largely be limited to the E.U. sub-group. In other cases, we have seen international groups seek and obtain regulatory consent to a set of measures that will take the place of formal group supervision. Such measures vary from group to group but typically include additional reporting requirements and regulatory pre-notification of proposed dividend payments, capital extraction or intra-group transactions involving E.U. insurers in the group.

L. New U.K. Regulatory Framework on Holding Approved Persons Accountable

1. The Senior Managers and Certification Regime

Directors and senior managers of insurance companies are likely to have been relieved by news in October 2015 that a new rule, which will hold senior financial sector managers to account for failings on their watch with the threat of criminal liability, has been softened in its applicability. The rule is part of a broader package of measures known as the Senior Managers and Certification Regime ("SMCR"), which will take effect on March 7, 2016 in respect of banks, building societies, credit unions and certain investment firms, and is intended to be extended to insurers and other regulated entities in 2018.

The original plan, which is set out in the Financial Conduct Authority's ("FCA") and Prudential Regulation Authority's ("PRA") July 30, 2014 consultation paper on strengthening accountability in banking[15] proposed a "reverse burden of proof," whereby it would be incumbent on individual senior managers to prove that they took reasonable steps to avoid any issue of regulatory misconduct that has occurred. However, on October 15, 2015, HM Treasury announced[16] that it was dropping the "reverse burden of proof" plan and that senior managers would instead be subject to a "duty of responsibility" clause requiring them to take appropriate steps to prevent a regulatory breach. The burden will be on the regulators to prove that a senior manager has failed to do this.

[14] European Insurance and Occupational Pensions Authority. *Guidelines on group solvency* - EIOPA-BoS-14/181 EN. 2 February 2015. https://eiopa.europa.eu/Publications/Guidelines/GRS_Final_document_EN.pdf

[15] United Kingdom. The Bank of England and Prudential Regulation Authority. *Strengthening accountability in banking: a new regulatory framework for individuals.* (PRA CP14/14, FCA CP 14/13). July 2014. Web 16 December 2015. http://www.bankofengland.co.uk/pra/documents/publications/cp/2014/cp1414.pdf

[16] United Kingdom. HM Treasury. *Senior Managers and Certification Regime: extension to all FSMA authorised persons.* October 2015. Web 16 December 2015. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468328/SMCR_policy_paper_final_15102015.pdf

In practice, the new statutory duty of responsibility is not a significant departure from current rules, and the PRA and FCA are likely to expect senior insurance staff to be subjected to thorough questioning about steps they took to avoid any issues of regulatory misconduct. In the same publication in which HM Treasury announced the rules regarding the statutory duty of responsibility, HM Treasury confirmed that it intends to extend the SMCR to other regulated entities, including insurers, in 2018.

2. The Senior Insurance Managers Regime

From March 7, 2016 and until the SMCR is extended to insurers, insurers will be subject to a new bespoke regime, the Senior Insurance Managers Regime ("SIMR"), which will replace the PRA's current Approved Persons' Regime ("APER") in respect of senior insurance staff. The SIMR aims to (i) ensure that insurance entities have clear and effective governance structures and (ii) clarify and enhance accountability of senior insurance managers. The new regime serves to implement requirements under Solvency II relating to governance and fitness and propriety and also serves to include some aspects of the SMCR.

A key feature of the SIMR is the requirement of firms to identify key functions in the business and individuals who are in charge of these key functions. Such individuals should be fit and proper for their roles and will need to be pre-approved by the PRA, and the FCA must also give its consent. Chief executive officers, chief financial officers, chief risk officers, heads of internal audit, chief underwriting officers and chief actuaries will be included. Furthermore, in relation to international insurance groups, the PRA will also need to pre-approve individuals employed by a parent or group entity where those individuals are involved in decisions affecting the firm's U.K. business. This applies where the individual exercises direct influence over the U.K. regulated entity and not merely a strategic influence. The existing APER will continue to apply in respect of less senior insurance staff.

In connection with the implementation of the Solvency II requirement that there be appropriate and transparent allocation of oversight and management responsibilities within each firm, firms will be required to draw up and maintain a "Governance Map" which sets out the names and roles of the individuals who effectively run the firm as well as individuals with key functions within the firm. Firms will be obliged to update the Governance Map at least quarterly and also when there is a significant change to the firm's governance structure or to the responsibilities of a key function holder.

Senior managers within scope of the SIMR and employees within the scope of the FCA's regime for approved persons will be subject to a new set of conduct rules in place of the existing Statements of Principle and Code of Practice for approved persons under the APER. These rules take the form of short statements of high-level principles and standards of behavior. Most employees of insurers who are based in the U.K. or who deal with customers in the U.K. will also be subject to application of these rules by the FCA. Three generic standards will apply to all such persons, namely: acting with integrity; acting with due skill, care and diligence; and dealing with the PRA and other regulators in an open and co-operative way.

The insurance industry will experience a significant shift in organizational structures as a result of the introduction of the SIMR. In 2015, senior managers in insurance firms with operations in the U.K. have been making progress in preparing for the key 2016 transition dates. There are four key deadlines:

January 1, 2016: firms must have Governance Maps in place and must have submitted a scope of responsibilities form for new senior insurance manager applications.

February 8, 2016: firms must have submitted grandfathering notifications to the PRA and FCA in respect of existing significant influence function holders.

March 7, 2016: the new conduct rules will apply to FCA-approved persons and senior managers within the scope of the SIMR.

September 7, 2016: firms must have submitted a scope of responsibilities form for grandfathered individuals to the PRA.

VII. Tax

A. U.S. Insurance Federal Excise Tax

As discussed in our 2014 Year in Review, in *Validus Reinsurance, Ltd*. v. *U.S*., the United States District Court for the District of Columbia granted the taxpayer's motion for summary judgment with respect to the application by the IRS of a "cascading" theory to the U.S. federal insurance premiums excise tax ("FET") on retrocession premiums. On May 26, 2015, the United States Court of Appeals for the District of Columbia Circuit affirmed this grant of summary judgment in favor of the taxpayer on narrower grounds, concluding that the FET would not be imposed on a retrocession from one foreign reinsurer to another. The appeals court reached this result by applying the presumption against extraterritoriality—that is, a court must presume that a statute has no extraterritorial application absent a clearly expressed affirmative intention of Congress to give the statute extraterritorial effect.

The taxpayer in *Validus* was a Bermuda reinsurance corporation that entered into retrocession transactions whereby it bought reinsurance from other foreign reinsurers to protect itself in the event that it is required to pay claims under one or more reinsurance policies it had issued to direct insurers. Based on the IRS's FET "cascading" theory (which imposes the FET on every insurance and reinsurance contract covering certain U.S. situs risks even if premiums related to such risks were previously subject to the FET), the taxpayer paid the FET on certain retrocession contracts it entered into with other non-U.S. reinsurers. The district court ruled that the plain language of both the FET active taxing provision and the definition of "policy of reinsurance" in the relevant sections of the Internal Revenue Code restricts the application of the FET to reinsurance transactions that cover certain insurance contracts, and not to retrocession transactions that cover reinsurance contracts.

The appeals court found that the government and the taxpayer offered plausible interpretations of the application of the FET to wholly foreign retrocessions and, consequently, concluded that the statute was ambiguous in this regard. The appeals court, relying on the presumption enunciated by the U.S. Supreme Court against extraterritorial application of a statute absent a clearly expressed affirmative intention of Congress to apply the statute extraterritorially, found that the text, context, purpose and legislative history of the FET did not evince an unambiguous congressional intent to apply the FET to wholly foreign retrocessions.

Although the decision of the appeals court reached a favorable result for the taxpayer, the decision left a number of questions unanswered. For example, it is not clear whether the appeals court would have reached the same result in a foreign-to-foreign reinsurance transaction, although it would appear that the presumption against extraterritorial application should apply in the context of wholly foreign reinsurance (as opposed to retrocession) transactions. Further, if premiums on foreign-to-foreign retrocession transactions related to U.S. risks are not subject to the FET, would the IRS take the position that a 30% withholding tax would apply?

The government did not appeal the decision of the appeals court in *Validus*, and in Revenue Ruling 2016-3 the IRS revoked its "cascading" theory. In Revenue Ruling 2016-3, the IRS concluded that the FET would not apply to premiums paid in a foreign-to-foreign reinsurance or foreign-to-foreign retrocession transaction, a welcome result for the offshore insurance sector.

B. Insurance Defined for Federal Tax Purposes

On September 21, 2015, the Tax Court, in *R.V.I. Guaranty Co.* v. *Commissioner*, provided taxpayer-friendly guidance on the definition of insurance for federal tax purposes by rejecting an IRS argument that residual value insurance, which protects against an unexpected decline in the market value of specified assets, was not "insurance" for tax purposes because the relevant contracts only transferred investment risk. The taxpayer issued contracts that insured against the risk that the actual value of leased assets would be significantly lower upon the termination of the lease than the expected value. The leased assets included passenger vehicles, commercial real estate and commercial equipment. The Tax Court held that the taxpayer was exposed to underwriting risk because there was risk that the premiums charged would not be enough to cover claims paid, so that the taxpayer's business model did not depend simply on its investment returns but on the ability of its underwriters to price the residual risks borne by its insureds adequately. In so ruling, the Tax Court also relied on a consensus of insurance regulators, insurance auditors and the insurance marketplace that the contract was insurance. The Tax Court rejected as having no basis in law IRS arguments that insurance risk could only involve "pure" risk (that is, a situation where the only possible outcome was loss or no loss) and the residual value contracts were analogous to put options that only involved investment risk.

C. 2015 Inversion Developments

As discussed in the 2014 Year in Review, the Treasury Department and the IRS issued Notice 2014-52 (the "2014 Notice") as a result of congressional inactivity on inversions in an effort to rein in inversion transactions by expanding the universe of cross-border transactions that would be subject to the anti-inversion rules. For example, the 2014 Notice attempted to expand the cases where the acquisition of a domestic target ("DT") by a foreign acquirer ("FA") would result in the application of the anti-inversion rules by introducing the "cash box" rule, which applies in cases where more than 50% of the assets of the FA group are passive assets. In any such case, the "cash box" rule would exclude shares of FA from the denominator of the inversion ownership fraction to the extent attributable to the FA group's existing passive assets, which would result in a corresponding increase in (1) the ownership of the combined entity by the former shareholders of DT and (2) the likelihood that the anti-inversion rules would apply. The 2014 Notice, acknowledging that banks and insurers had large passive asset portfolios, carved out exceptions to the definition of passive assets for banks and insurers—however, while the exceptions for foreign banks referenced the passive foreign investment company ("PFIC") and controlled foreign corporation ("CFC") rules, the carve-out for non-U.S. insurers was limited to the CFC rules that effectively require an FA insurer to write 50% home country risks and also treat all of the assets held by U.S. affiliates of FA as passive. This seemingly inexplicable disparate treatment of non-U.S. banks and non-U.S. insurers was brought to the attention of Treasury and the IRS and was addressed in Notice 2015-79 (the "2015 Notice").

The 2015 Notice acknowledges that the 2014 Notice could lead to inappropriate results and extended the exclusion from passive assets of an FA insurer to (1) assets that would not be considered passive for purposes of the PFIC rules and (2) assets of any U.S. affiliate that is subject to tax as an insurance company, provided the assets are used to support, or are substantially related to, the active conduct of an insurance company. The 2015 Notice certainly is a step in the right direction—however, the 2015 Notice makes reference to the PFIC Insurance Company Exception rules proposed earlier this year (discussed below), which have been widely criticized and create substantial uncertainty as to whether assets of a non-U.S. insurer would be considered non-passive for purposes of the Insurance Company Exception to the PFIC rules. For example, the proposed PFIC regulations provide that a non-U.S. insurer would be treated as engaged in the active conduct of an insurance business (which is needed to qualify for the Insurance Company Exception) only if its officers and employees carry out substantial managerial and operational activities. As some foreign reinsurers house their underwriting personnel and others in related services companies, it is not clear that these companies would qualify for the PFIC Insurance Company Exception. In addition, the IRS and Treasury are trying to develop a methodology for determining whether assets held by a foreign insurer are held to meet its obligations under insurance and annuity contracts and limiting the PFIC insurance company exception to such assets, and it is unclear what form this methodology will ultimately take. Certain legislative proposals (with the latest, as of the date of this writing, being the proposal by Senator Wyden, which is discussed below) have looked to the ratio of insurance reserves to assets. Although these efforts have been aimed at the hedge fund reinsurers, they do cast a wider net and can be a trap for the unwary. Although the expectation is that new PFIC Insurance Company Exception regulations will be proposed in place of the regulations proposed earlier this year, there can be no assurance that Treasury and the IRS will act in accordance with the expectations of the industry.

D. PFIC Exception for Offshore Insurers

On April 24, 2015, the IRS issued proposed regulations "clarifying" the application of the PFIC rules to non-U.S. insurers by providing rules related to the insurance company exception (the "Proposed 1297 Regulations"). Although the proposed regulations were intended to target a perceived abuse by so-called non-U.S. hedge fund reinsurers that are considered overcapitalized or not assuming significant insurance risk, the proposed regulations cast a much broader net, drawing significant criticism and commentary from the industry.

A U.S. taxable investor in a non-U.S. insurer is generally able to defer U.S. taxation until a sale of its shares in the non-U.S. insurer and to pay tax on such sale at long-term capital gain rates, if, among other things, the non-U.S. insurer qualifies for an exception to classification as a PFIC because it is treated for U.S. tax purposes as an insurance company that is predominantly engaged in the insurance business and is engaged in the active conduct of an insurance business (the "Insurance Company Exception").

Legislative proposals were introduced in 2014 that sought to broaden the PFIC definition in an effort to deny the Insurance Company Exception to insurers that were not writing enough insurance business. Further, former Senate Finance Committee Chairman, now ranking minority member, Senator Ron Wyden (D. Ore.) encouraged the Treasury Department and the IRS to develop a test to distinguish insurance companies that qualify for the Insurance Company Exception from those operating as offshore investment vehicles. The Proposed 1297 Regulations define types of activities in which a non-U.S. insurer must engage for it to qualify for the Insurance Company Exception by defining the terms "active conduct" and "insurance business"—two terms that had not been previously defined for purposes of this analysis.

The Proposed 1297 Regulations import the definition of active conduct from another section of the regulations—Treasury Regulations Section 1.367(a)-2T(b)(3) (the "367 Active Conduct Regulations"). This definition utilizes a facts-and-circumstances test for determining when business is actively conducted, but provides that a corporation generally will be in the active conduct of a trade or business only if its officers and employees carry out substantial managerial and operational activities. Although incidental activities can be carried out on behalf of the foreign corporation by independent contractors, the activities of independent contractors are disregarded for purposes of determining whether the foreign corporation is engaged in the active conduct of a trade or business. Furthermore, while the 367 Active Conduct Regulations explicitly permit the activities of officers and employees of related entities to be considered in determining whether a corporation is in the active conduct of a trade or business, the Proposed 1297 Regulations do not permit consideration of the activities of officers and employees of related entities in the determination of whether a non-U.S. insurer is a PFIC.

The Proposed 1297 Regulations define the term "insurance business" as the business of issuing insurance and annuity contracts and the reinsurance of risk underwritten by insurance companies, together with those investment activities and administrative services that are required to support or are substantially related to insurance and annuity contracts issued or reinsured by the non-U.S. insurer. For these purposes, investment activities will be considered required to support or substantially related to insurance and annuity contracts issued or reinsured to the extent that income from the activities is earned from assets held by the non-U.S. insurer to meet obligations under the contracts. The preamble to the Proposed 1297 Regulations acknowledges that a methodology to determine the portion of assets held to meet obligations under insurance and annuity contracts has not yet been determined; comments are requested on how this determination should be made. However, the preamble suggests that the test could be based on a specified percentage of the non-U.S. insurer's total insurance liabilities for the year.

Although legislative proposals introduced would have defined the Insurance Company Exception with reference to the non-U.S. insurer's reserve levels and premium income, the Proposed 1297 Regulations impose no requirement relative to the level of reserves or the amount of premium income necessary for an offshore reinsurer to be eligible for the Insurance Company Exception. Consistent with prior industry positions on this issue, we note that the preamble to the Proposed 1297 Regulations does clarify that any non-U.S. insurer that is treated as an insurance company for U.S. tax purposes (i.e., is taxable under subchapter L of the Code as an insurance company) is necessarily predominantly engaged in an insurance business for purposes of the statutory test.

The Proposed 1297 Regulations raise many difficult interpretive issues and questions that could affect hedge fund reinsurer structuring, and that extend beyond the hedge fund reinsurer context. For example:

- What test would be applied to determine whether someone is acting in the capacity of an officer or employee of the non-U.S. insurer? Would a leased or seconded employee of a non-U.S. insurer suffice? How would an insurance management arrangement be treated if the employees of the insurance manager are named officers of, or leased employees to, the non-U.S. insurer, and would the degree of control by officers and employees of the non-U.S. insurer over the insurance manager employees matter?

- As the Proposed 1297 Regulations treat investment activity as part of the insurance business to the extent such activities are required to support, or are substantially related to, the issuance of insurance, annuity or reinsurance contracts, what degree of control must the officers and employees of the non-U.S. insurer exercise over an investment manager that invests substantially all of the non-U.S. insurer's assets pursuant to a multiyear contract to satisfy the Insurance Company Exception?

- What tax policy objective is served by altering the 367 Active Conduct Regulations definition of "active conduct" to exclude officers and employees of related entities for purposes of the Proposed 1297 Regulations?

- What impact will the Proposed 1297 Regulations have on non-U.S. captive insurers and segregated cell companies?

- What impact will the Proposed 1297 Regulations have on a non-U.S. catastrophe reinsurer in a year in which reserves are relatively low?

Many of these issues and questions could be avoided if the Proposed 1297 Regulations adopted a more objective test as found in other areas of the tax law, rather than the Section 367 Active Conduct Regulations test requiring a non-U.S. insurer to have its own officers and employees, a test which was designed to ensure that transfers of appreciated assets outside the United States were undertaken for sound business reasons and not purely for tax avoidance. The legislative history of the Insurance Company Exception indicates a congressional concern over abuse of this exception by overcapitalized non-U.S. insurers that generate investment income in excess of the reasonable needs of its insurance business, and this concern could be addressed without resorting to the 367 Active Conduct Regulations test.

Treasury has received significant public comments on the Proposed 1297 Regulations and conducted a public hearing on September 18, 2015. Treasury and the IRS have informally indicated that regulations may be re-proposed in relatively short order.

On June 25, 2015, Senator Wyden introduced a bill that would require a non-U.S. insurer to maintain insurance liabilities of more than 25% of total assets to qualify for the Insurance Company Exception, unless the insurer can qualify for a temporary Insurance Company Exception which would require its insurance liabilities to equal or exceed 10% of its total assets and the satisfaction of a facts and circumstances test. The likelihood of passage of the Wyden bill in this Congress appears slim.

E. Implementation of BEPS Recommendations in the U.K.

1. Introduction

International tax planning continues to be at the forefront of government thinking around fiscal policy. During 2014, the Organisation for Economic Cooperation and Development ("OECD") released draft papers in relation to its Base Erosion and Profit Shifting Project ("BEPS Project") and the U.K. introduced the Diverted Profits Tax ("DPT").

In October 2015, the final BEPS reports were released. This was a significant achievement, given that the detailed discussions and recommendations come after just two years of consultation with every G20 and OECD country, along with input from the European Commission and a number of developing economies. Some detailed work is still to be done at the inter-governmental level, but the main burden has shifted to national governments to implement the recommendations.

The U.K. strongly supports the BEPS Project and is chairing the group that will be responsible for drafting the multilateral instrument to update the bilateral tax treaties. The U.K. government has already begun to implement the BEPS recommendations to the extent it can do so unilaterally, but some measures require international cooperation.

2. OECD BEPS Project

a. Definition of Permanent Establishment

U.K. corporation tax is chargeable only if a company is either a U.K. resident for tax purposes or it has a "taxable presence" in the U.K. A taxable presence exists where trade is carried on through a permanent establishment ("PE"), which is either a fixed place of business in the U.K. or a dependent agent who does business in the U.K. on the company's behalf.

As addressed in our 2014 Year in Review, in October 2014, the OECD released a discussion paper which contained proposals on widening the definition of a dependent agent PE from a person who "concludes contracts" to a person who negotiates the material elements of contracts or "engages with specific persons in a way that results in the conclusion of contracts." Further, the discussion paper considered following the lead of the United Nations Model Double Tax Convention of deeming an insurance enterprise to have a PE in a state in which it collects premiums or insures local risks through an exclusive agent.

These proposals were put forward to address the concern that insurance companies could do large-scale business in a state without being taxed in that state on the basis that it is possible to do so without having a fixed place of business or a dependent agent PE within the existing terms of most treaties.

In June 2015, the OECD published a revised discussion draft, noting that the vast majority of comments received put forward the view that there should be no special rules applicable to the insurance industry. Taxation based on premiums collected would create a misalignment with the existing insurance regulatory framework and create risks of double taxation (e.g., tax on insurance premiums).

While the OECD backs away from the more targeted changes proposed in the 2014 discussion draft, the OECD still believes that its concerns in relation to taxation in a typical insurance business model can be addressed in other ways, such as:

- member countries choosing to include a provision in their bilateral agreements that stipulates that insurance companies are deemed to have a PE in a state if they collect premiums in that state through an agent established there;
- through transfer pricing adjustments; or
- through the more general changes proposed to the definition of PE.

The OECD's final recommendation in relation to the general definition of a dependent agent PE is that it should include a person who "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise." This would capture the "rubber-stamping" of insurance contracts in low tax jurisdictions, while the real direction is provided by persons located elsewhere.

The new draft commentary explains that this wording is aimed at situations where the conclusion of a contract directly results from the actions that the person performs in a country on behalf of an enterprise even though, under the relevant law, a contract is not concluded by that person in that country. The intention is to supplement the "concludes contracts" test with a test focusing on substantive activities taking place in a country; the principal role leading to the conclusion of a contract will typically be associated with the actions of a person who convinced the third party to enter into a contract with the enterprise. This includes soliciting and receiving (even if not formally finalizing) orders, but does not include mere promotion of a product even though the marketing activity may indirectly result in an order being placed.

Given that the U.K. has recently enacted the DPT (which applies from April 1, 2015), it is not yet clear to what extent it will adopt the OECD recommendations. The work on the multilateral instrument that will form the basis to update the bilateral instruments is ongoing. However, the U.K. could unilaterally adopt the recommendations in its domestic law, which would apply where no treaty is in force with a particular jurisdiction (for example, Bermuda).

In addition, the OECD recommends that if an agent acts exclusively or almost exclusively for connected persons, it will not be capable of being an independent agent. Combined with the expanded definition of dependent agent PE, this is potentially relevant to structures involving a U.K. sales and marketing function for the benefit of an affiliate non-U.K. insurance carrier.

b. Country-by-Country Reporting

In the 2014 Year in Review, we outlined the country-by-country reporting regime that was proposed under Action 13 of the BEPS Project. The regime is designed to help tax authorities gather information on multinational groups' global activities, profits and taxes, so as to enable them to identify possible mismatches and risks and hence concentrate their anti-avoidance efforts. A final report has since been released, confirming the OECD's three-tiered approach to transfer pricing documentation:

(i) Local files;

(ii) Master file; and

(iii) Country-by-country reporting ("CBCR").

The U.K. government published draft regulations on October 5, 2015 to implement the last tier, the CBCR. The consultation period closed in November 2015. It is not yet clear whether any changes will be made to the regulations as a result of the submissions.

Under the draft regulations, multinational groups ("MNE groups") with a U.K. resident parent entity and a combined annual consolidated group revenue of £586 million or more in any 12-month accounting period are required to submit an annual report to H.M. Revenue & Customs ("HMRC") for the following period. The regulations are effective for accounting periods beginning on or after January 1, 2016, so the first filing will be due by December 31, 2017. The template report follows the OECD format. For each jurisdiction in which the MNE group operates, the following information will have to be detailed and filed electronically:

- revenues (split between related and unrelated entities);
- profit (or loss) before income tax;
- income tax paid (on a cash basis);
- income tax accrued (for the current year);
- capital;
- retained earnings;
- number of full-time employees; and
- tangible assets (other than cash and cash equivalents).

The CBCR will automatically be shared under the U.K.'s international agreements for the exchange of information, such as the U.S./U.K. Double Tax Treaty or the U.K./Bermuda Tax Information and Exchange Agreement.

Groups may wish to carry out a trial run, using 2015 data, to make sure that the systems are in place to gather the relevant information, and also to see what picture is presented by the data and anticipate any queries from the local and overseas tax authorities.

c. Common Reporting Standard

In March 2015, the U.K. government issued the International Tax Compliance Regulations 2015 ("Regulations") (along with draft guidance notes in September 2015), giving effect to the three separate international agreements to which it is a party:

- Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information, implementing the OECD's Common Reporting Standard ("CRS");

- Revised European Directive on Administrative Cooperation ("DAC"), which establishes procedures for implementing the CRS in the European Union; and

- U.S. Foreign Accounting Tax Compliance Act ("FATCA").

The Crown Dependencies and Gibraltar Regulations, which imposed due diligence and reporting obligations for U.K. businesses in relation to accountholders who are tax resident in the Isle of Man, Guernsey, Jersey and Gibraltar, will shortly be disapplied. The U.K. agreements for the automatic exchange of information on financial accounts with Bermuda, the British Virgin Islands, the Cayman Islands, Anguilla, Montserrat and the Turks & Caicos Islands will remain in place.

All three reporting regimes are very similar in nature and terminology, and the Regulations attempt to unify, as much as possible, the due diligence and reporting requirements. Those entities familiar with FATCA will find that similar outcomes arise under CRS and DAC.

The regimes essentially impose an obligation on the U.K. financial sector to review and collect details of accounts held by individuals that are tax resident elsewhere. The information is reported to HMRC, which may then forward it under reciprocal exchange of information arrangements with other jurisdictions.

This may impact insurance companies in several ways. For example, companies regarded as financial institutions that issue cash value insurance contracts (being investment products with an element of life insurance attached to them) will need to review these arrangements to determine if they are reportable accounts. Retirement and pension accounts, individual savings accounts and certain share option schemes are excluded accounts for reporting purposes. Insurance companies that sponsor investment vehicles in which individuals can invest may also need to review the arrangements for disclosure purposes. More generally, there may be disclosure obligations whenever a bank account is opened in London, including in relation to custody accounts and paying agent accounts.

3. Corporate Tax Strategy

The draft Finance Bill 2016, published on December 9, 2015, contains provisions requiring large businesses to publish their tax strategies online. It was stressed in the consultation paper that these measures are separate from CBCR and the BEPS Project. The measures apply to companies and partnerships (but not open-ended investment companies and investment trusts) that satisfy any of the following conditions:

- any U.K. partnership with turnover of more than £200 million or a balance sheet total of more than £2 billion;

- a standalone U.K. company that, in the previous financial year, had turnover of more than £200 million or a balance sheet total of more than £2 billion;

- a group (meaning a group of relevant bodies at least two of which are companies and includes all 51% subsidiaries) headed by a company incorporated in the U.K. (a "U.K. group") that, in the previous financial year, had group turnover exceeding £200 million or a group balance sheet total over £2 billion;

- a U.K. sub-group of a qualifying MNE group that is not a U.K. group. A qualifying MNE group is any MNE group that has mandatory reporting obligations under CBCR (that is, a consolidated annual group revenue in the preceding year of £586 million or more);

- A U.S. sub-group of a qualifying group that is not a U.K. group. A qualifying group is any group that is not an MNE group with a group turnover of more than £200 million or a group balance sheet total more than £2 billion; or

- a U.K. company that is a member of a qualifying MNE group but not a member of a U.K. sub-group.

The U.K. company (or any U.K. company in the U.K. group or U.K. sub-group) must publish its corporate tax strategy for a financial year before the end of the following financial year. The information must be freely available to the public online for at least 12 months. It can be a separate document or a self-contained part of a wider document.

Corporate tax strategy refers to the U.K. company's (or U.K. group's or U.K. sub-group's) approach to risk management and governance in relation to U.K. taxation, attitude towards tax planning so far as it affects U.K. taxation, the level of risk in relation to U.K. taxation that the company or group is prepared to accept and the approach to dealings with HMRC.

F. Solvency II Compliant Tier 1 and Tier 2 Capital – Clarification of U.K. Tax Treatment

To coincide with the coming into force of Solvency II, new legislation has been introduced to ensure that Tier 1 and Tier 2 compliant Solvency II instruments that are issued in the form of debt will be treated as debt instruments, and their coupon as interest, for U.K. tax purposes. As discussed in our article in the 2013 Year In Review, the tax treatment of these instruments under general U.K. tax law, including in particular the tax deductibility of the interest payments, is uncertain. The Finance Act 2014 granted power to make regulations to give certainty. HMRC carried out a public consultation over the summer, and regulations have now been made effective as of January 1, 2016, subject to certain transitional provisions.

Parallel issues have already been addressed in the context of banks and the classification of capital under CRD IV. The Taxation of Regulatory Capital Securities Regulations 2013 came into effect on January 1, 2014 in respect of Additional Tier 1 or Tier 2 capital of a bank. Essentially, these provisions are now being extended to cover Tier 1 and Tier 2 capital, in debt form, issued by an insurance company (defined for this purpose as a "regulatory capital security").

These measures address the uncertainty caused by the fact that the features designed to boost permanence and loss absorbency (such as write-down or bail-in provisions, interest suspension or cancellation, perpetuity and convertibility into shares) place the instruments close to the borderline between debt and equity for U.K. tax purposes. The regulations:

- confirm that a regulatory capital security represents a loan relationship but excludes any tax charge in respect of a contingent conversion or write-down, or on an actual write-down;
- disapply the "results dependent" rule and confirm that the coupon on a regulatory capital security is characterized as interest, and not a (non-tax deductible) distribution, for U.K. tax purposes;
- treat a regulatory capital security as a "normal commercial loan" for the purposes of the rules determining tax group relationships on the basis of equity ownership; and
- confer an exemption from all stamp taxes on a transfer of a regulatory capital security.

In addition, interest on a regulatory capital security would in principle be subject to deduction of basic rate income tax at source. In practice, such a security would typically be listed on a "recognised stock exchange," so as to constitute a "quoted Eurobond," the interest on which is exempt from U.K. withholding tax as a matter of general law. However, the regulations helpfully confer a general exemption from withholding tax on regulatory capital securities, whether or not the security is listed. The tax regulations apply only to an instrument that takes the legal form of debt. However, the fact that the security may be recognized in equity or shareholders' funds for accounting purposes, in accordance with GAAP or IFRS, is irrelevant.

All the tax relief provided by the regulations is subject to an anti-avoidance provision. Relief is denied if there are arrangements the main purpose or one of the main purposes of which is to obtain a U.K. tax advantage for any person as a result of the application of the regulations.

Although the coupon will not be disallowed on the ground that it is re-characterized as a dividend, other provisions of U.K. tax law, which potentially restrict the tax deductibility of interest, could still apply, such as transfer pricing rules where the securities are issued to an affiliate. In addition, although regulatory capital securities are expected to be outside the scope of the main "hybrid mismatch" regime, when this comes into force in 2017, the U.K. government has noted that it is considering whether a tailored application of the hybrid rules to the financial sector may be appropriate.

Under the transitional provisions, securities that were issued before January 1, 2016 but are subject to the Prudential Regulation Authority transitional arrangements, set out at rule 4.2 in the Annex to the PRA Rulebook: Solvency II Firms: Transitional Measures Instrument 2015, are also covered by these new tax regulations.

Annex A | Glossary of Relevant Regulatory Bodies

FDIC
The U.S. Federal Deposit Insurance Corporation.

Federal Reserve Board
The Board of Governors of the Federal Reserve System of the United States, which oversees the central bank of the United States and helps to implement U.S. monetary policy.

FIO
The Federal Insurance Office. Established by Dodd-Frank as an office within the United States Department of the Treasury to monitor the insurance sector in the United States and to represent the United States on international insurance matters.

FSB
The Financial Stability Board. An international body formed by the G-20 in 2009 to promote reform of international financial regulation.

FSOC
The Financial Stability Oversight Council. Established under Dodd-Frank to provide comprehensive monitoring of the financial system in the United States.

IAIS
The International Association of Insurance Supervisors. A member of the FSB, the IAIS is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions.

IMF
The International Monetary Fund. An organization of 188 countries established in 1944 to work toward securing international financial stability, among other reasons.

NAIC
The National Association of Insurance Commissioners. The U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories.

SEC
The U.S. Securities and Exchange Commission.

Treasury
The U.S. Department of the Treasury.

USTR
The Office of the United States Trade Representative. Executive agency responsible for developing and recommending U.S. trade policy to the President.

Willkie's Corporate Insurance and Regulatory Group

Willkie's Corporate Insurance and Regulatory Group is one of the preeminent practices in the industry, representing insurance companies, investment banks, sponsors and other financial institutions in M&A, capital markets, ILS, tax and regulatory matters in the United States, London, Europe, Asia and Bermuda.

NEW YORK

Rajab Abbassi
Gregory Astrachan
Scott Avitabile
Elizabeth Bannigan
Serge Benchetrit
David Boston
Leah Campbell
Thomas Cerabino
Henry Cohn
Joseph Cunningham
Laura Delanoy
Alexander Dye
Mark Getachew
Michael Groll
William Gump
Donald Henderson, Jr.
Jeffrey Hochman
Arthur Lynch
Leslie Mazza
Vladimir Nicenko
Benjamin Nixon
Maria-Leticia Ossa Daza
Christopher Peters
Jeffrey Poss
Robert Rachofsky
Richard Reinhold
John Schwolsky
Steven Seidman
Robert Stebbins
Matthew Stern
Allison Tam
Adam Turteltaub

LONDON

Nicholas Bugler
Peter Burrell
Joseph Ferraro
Judith Harger
Andrew Tromans
Kirsty Maclean
Laura Marcelli
Stephen Murphy
Jennifer Tait

WASHINGTON

Christopher Petito

PARIS

Christophe Garaud
Daniel Hurstel
Paul Lombard
Daniel Payan
Annette Péron

FRANKFURT

Bettina Bokeloh
Verena Etzel
Stefan Jörgens
Georg Linde
Patrick Meiisel
Mario Schmidt

BRUSSELS

Xavier Dieux

MILAN/ROME

Maurizio Delfino
Gianluca Cattani
Massimo Chiais

NEW YORK
787 Seventh Avenue
New York, N.Y. 10019-6099, U.S.A.
T 212-728-8000
F 212-728-8111

PARIS
21-23 rue de la Ville l'Evêque
75008 Paris, France
T +33 1 53 43 4500
F +33 1 40 06 9606

BRUSSELS
Avenue Louise, 480 / 3B
1050 Bruxelles, Belgium
T +32 2 290 18 20
F +32 2 290 18 21

WASHINGTON
1875 K Street, N.W.
Washington, D.C. 20006-1238, U.S.A.
T 202-303-1000
F 202-303-2000

LONDON
CityPoint, 1 Ropemaker Street
London EC2Y 9AW, England
T +44 20 3580 4700
F +44 20 3580 4800

MILAN
Via Michele Barozzi, 2
20122 Milan, Italy
T +39 02 76363 1
F +39 02 76363 636

HOUSTON
600 Travis Street, Suite 2310
Houston, TX 77002, U.S.A.
T 713-510-1700
F 713-510-1799

FRANKFURT
An der Welle 4
D-60322 Frankfurt am Main, Germany
T +49 69 79302 0
F +49 69 79302 222

ROME
Via di Ripetta, 142
00186 Rome, Italy
T +39 06 68636 1
F +39 06 68636 363

For further information on Willkie Farr & Gallagher LLP, please visit www.willkie.com

Date of Publication: January 2016

WILLKIE FARR & GALLAGHER LLP

NEW YORK WASHINGTON HOUSTON PARIS LONDON FRANKFURT BRUSSELS MILAN ROME

in alliance with Dickson Minto W.S., London and Edinburgh

www.willkie.com