Draft Pending Adoption

Draft: 8/6/19

Financial Condition (E) Committee
New York, New York
August 5, 2019

The Financial Condition (E) Committee met in New York, NY, Aug. 5, 2019. The following Committee members participated: David Altmaier, Chair (FL); Kent Sullivan, Vice Chair, Doug Slape and Jamie Walker (TX); Ricardo Lara and Susan Bernard (CA); Michael Conway represented by Rolf Kaumann (CO); Robert H. Muriel and Kevin Fry (IL); Eric A. Cioppa, Vanessa Sullivan and Robert Wake (ME); Steve Kelley represented by Kathleen Orth (MN); Chlora Lindley-Myers and John Rehagen (MO); Matthew Rosendale represented by Steve Matthews (MT); Marlene Caride, John Sirotvetz and Diana Sherman (NJ); Glen Mulready and Joel Sander (OK); Raymond G. Farmer (SC); and Jeff Rude (WY).

1. Adopted its May 28 and Spring National Meeting Minutes

The Committee met May 28 and April 8. During its May 28 meeting, the Committee adopted the revised Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786), which incorporate the relevant provisions of the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (EU Covered Agreement) and the “Bilateral Agreement Between the United States of America and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance” (UK Covered Agreement).

Commissioner Sullivan made a motion, seconded by Ms. Bernard, to adopt the Committee’s May 28 (Attachment One) and April 8 (see NAIC Proceedings – Fall 2018, Financial Condition (E) Committee) minutes. The motion passed unanimously.

2. Adopted the Reports of its Task Forces and Working Groups

Commissioner Altmaier stated that items adopted within the Committee’s task force and working group reports that are considered technical, noncontroversial and not significant by NAIC standards—i.e., they do not include model laws, model regulations, model guidelines or items considered to be controversial—will be considered for adoption by the Executive (EX) Committee and Plenary through the Financial Condition (E) Committee’s technical changes report process. Pursuant to this process, which was adopted by the NAIC in 2009, a listing of the various technical changes will be sent to NAIC members shortly after completion of the Summer National Meeting, and the members will have 10 days to comment with respect to those items. If no objections are received with respect to an item, the technical changes will be considered adopted by the NAIC membership and effective immediately.

Commissioner Altmaier stated that included in the report of the Receivership and Insolvency (E) Task Force were proposed changes to the NAIC Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts (#1556), which would be considered separately.

Commissioner Caride made a motion, seconded by Commissioner Lindley-Myers, to adopt the following task force and working group reports: Accounting Practices and Procedures (E) Task Force; Capital Adequacy (E) Task Force; Examination Oversight (E) Task Force; Long-Term Care Insurance (E/B) Task Force; Receivership and Insolvency (E) Task Force; Reinsurance (E) Task Force; Risk Retention (E) Task Force; Valuation of Securities (E) Task Force; Group Capital Calculation (E) Working Group (Attachment Two); National Treatment and Coordination (E) Working Group (Attachment Three); NAIC/AICPA (E) Working Group (Attachment Four); Restructuring Mechanisms (E) Working Group (Attachment Five); and Group Solvency Issues (E) Working Group (Attachment Six). The motion passed unanimously.

The Financial Analysis (E) Working Group met July 10, June 19, May 15–16 and April 23–24 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings, to: 1) discuss letter responses related to first-quarter 2019 financial results; and 2) discuss year-end 2018 letter responses. Additionally, the Valuation Analysis (E) Working Group met July 22, July 1, June 3 and May 8 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings, to: 1) discuss questions regarding the economic scenario generator prescribed in the Valuation Manual and variable annuity risks; and 2) discuss the review approach for the 2018 Principle-Based Reserving (PBR) Actuarial Reports.
3. **Discussed a Preliminary Financial Condition Examiners Handbook Salary Update Recommendation**

Commissioner Altmaier summarized a memorandum from NAIC staff that provides an average recommended increase to the examiner salary recommendations in the *Financial Condition Examiners Handbook* based on the Consumer Price Index (CPI) for the year ending July 31. He noted that because the July CPI will not be finalized for a month, the memorandum is only a preliminary indicator. He stated that the number is not expected to change significantly once the figures are finalized and asked that state insurance regulators review the memorandum and let NAIC staff know if they have any concerns. He said that a final version will be distributed for consideration at the Fall National Meeting.


Commissioner Altmaier said that when the Restructuring Mechanisms (E) Working Group and the Restructuring Mechanisms (E) Subgroup were established in February, the Committee asked that more specific deliverables be developed and reported back to the Committee at the Summer National Meeting. He noted that the memorandum (Attachment Seven) from the Working Group provides such information, including the expectation that a white paper will be completed by the 2020 Summer National Meeting, and in the process consider the guaranty fund coverage issues as well as protected cell requirements issue. He discussed how the Subgroup appears to now be focused on developing best practices for the different types of transactions, which ultimately can be considered as possible accreditation requirements. Commissioner Altmaier stated he believes the proposed changes to the charges were reasonable and suggested they be incorporated into the 2020 proposed charges that the Committee considers on a separate conference call after the Summer National Meeting.

5. **Adopted a Request for Extension from the Mortgage Guaranty Insurance (E) Working Group**

Commissioner Altmaier discussed the work of the Mortgage Guaranty Insurance (E) Working Group and specifically recognized the leadership of Steve Junior (WI) for chairing the Working group for several years, as well as Kevin Conley (NC), who will be chairing the Working Group going forward. Commissioner Altmaier discussed how the Working Group was updating an NAIC model law but that it was recently focused on the development of a capital model, which appears to be close to be completed. He stated that it was his understanding that there still are some related details to be taken care of both in the model, as well as work outside of the model, and that the Working Group was requesting an extension (Attachment Eight) until the 2020 Spring National Meeting.

Commissioner Lara made a motion, seconded by Commissioner Lindley-Myers, to adopt the request. The motion passed unanimously.

6. **Considered Guideline #1556**

Commissioner Altmaier stated this item was pulled from the Receivership and Insolvency (E) Task Force report and would be considered separately. He asked that the issue be discussed and considered on an interim conference call. There were no objections.

Having no further business, the Financial Condition (E) Committee adjourned.

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The Financial Condition (E) Committee met via conference call May 28, 2019. The following Committee members participated: David Altmaier, Chair (FL); Kent Sullivan, Vice Chair, represented by Doug Slape and Jamie Walker (TX); Ricardo Lara represented by Susan Bernard and Kim Hudson (CA); Michael Conway represented by Rolf Kaumann (CO); Robert H. Muriel represented by Kevin Fry (IL); Eric A. Cioppa (ME); Steve Kelley represented by Kathleen Orth (MN); Chlora Lindley-Myers represented by John Rehagen (MO); Matthew Rosendale represented by Steve Matthews (MT); Marlene Caride (NJ); Glen Mulready (OK); Raymond G. Farmer and Daniel Morris (SC); James A. Dodrill represented by Jamie Taylor (WV); and Tom Glause represented by Jeff Rude (WY).

1. **Adopted Revisions to Model #785 and Model #786**

Committer Altmaier stated that the only item was to consider adoption of proposed changes to the *Credit for Reinsurance Model Law (#785)* and the *Credit for Reinsurance Model Regulation (#786)* for the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreement) and the same for the United Kingdom. He asked Mr. Rehagen to summarize the proposed action.

Mr. Rehagen stated that the Reinsurance (E) Task Force adopted revisions to Model #785 and Model #786 during its May 15 conference call to implement the reinsurance collateral provisions of the Bilateral Agreements with the European Commission and the United Kingdom, which both become operative 60 months after Sept. 22, 2017. He stated that the Task Force and its drafting group worked hard to accommodate the concerns of state, federal and international regulators and interested parties, and noted that he believes the final drafts achieve the goals as state insurance regulators.

Mr. Rehagen directed Committee members to the May 16 memorandum he submitted to the Committee (Attachment One-A). He described how during the Task Force’s May 15 conference call, the International Underwriting Association of London (IUA) raised an issue and suggested a specific change to Section 2F(7) of Model #785. He noted that the Task Force did not have adequate opportunity to review this language before it was proposed shortly before its May 15 conference call and, therefore, did not include the language in its adoption. However, the Task Force agreed to study this language further prior to today’s conference call and make a recommendation to the Committee. Mr. Rehagen stated that he polled the members of the Task Force, and there was unanimous agreement that the proposed change was clearer language of the Task Force’s original intent and, therefore, recommended that the Committee consider this friendly amendment to Section 2F(7) of Model #785 as it considers taking action on the model. He clarified that that the amendment is nonsubstantive in nature and, therefore, would not require any further exposure before adoption by the Committee.

Mr. Rehagen stated that the European Commission has continued to express concern with the language of Section 2F(7) of Model #785 and has concerns with Section 9C(2) of Model #786 because the $250 million capital and surplus requirement for European reinsurers does not address what it considers to be an applicable conversion rate to 226 million euros. He noted that the Task Force discussed these concerns on its May 15 conference call, but the Task Force decided against making these revisions. Mr. Rehagen stated the Task Force believes that the current drafts of Model #785 and Model #786 are consistent with the terms of the Covered Agreement.

Mr. Rehagen stated that a comment letter was received from the European Commission, noting that he and others discussed these comments with the Federal Insurance Office (FIO) April 25 and May 23. He stated that while the FIO cannot give the NAIC public assurances with respect to any potential federal preemption analysis, FIO staff did not express any concerns regarding the current language of these two provisions. He stated that the recommendation of the Task Force is that the current draft revisions to Model #785 and Model #786 are consistent with the provisions of the Covered Agreement, and it is not necessary to make the changes discussed by the European Commission in its comment letter.

Antoine Begasse (European Commission) expressed appreciation for the engagement with the NAIC on the proposed models. He reiterated the two previous concerns included in the European Commission’s comment letter. Mr. Rehagen responded that the Task Force previously considered these comments and believes the proposed models are consistent with the Covered Agreement.
Mr. Rehagen made a motion, seconded by Director Farmer, to adopt the May 15 draft revisions to Model #785 and Model #786, including the friendly amendment to Section 2F(7) of Model #785 as outlined in Mr. Rehagen’s May 16 memorandum (See NAIC Proceedings – Summer 2019 Executive (EX) Committee and Plenary). The motion passed unanimously.

Having no further business, the Financial Condition (E) Committee adjourned.
MEMORANDUM

TO: Financial Condition (E) Committee
FROM: John Rehagen (MO), Acting Chair, Reinsurance (E) Task Force
DATE: May 16, 2019
RE: Adoption of Credit for Reinsurance Models

During its meeting on May 15, 2019, the Reinsurance (E) Task Force adopted revisions to the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786). The Task Force adopted these revisions in order to incorporate the provisions of the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreement), as well as the Covered Agreement with the United Kingdom. Copies of these model revisions are attached for consideration by the Financial Condition (E) Committee. Copies of the “Project History” and the “Request for Model Law Development” are also attached to assist the Committee in its considerations.

On the call on May 15, an issue was raised in a comment letter received that day from the International Underwriting Association of London (IUA). Specifically, the IUA suggested revising Section 2F(7) of Model #785, as follows:

Credit may be taken under this subsection only for reinsurance agreements entered into, amended, or renewed on or after the date on which the assuming insurer has satisfied the requirements to assume reinsurance under this subsection on or after the effective date of the statute adding this subsection, and only with respect to losses incurred and reserves reported on or after the later of (i) the date on which the assuming insurer has met all eligibility requirements pursuant to Section 2F(1) herein, and (ii) the effective date of the new reinsurance agreement, amendment, or renewal.

The European Commission had also raised concerns with respect to this provision. The Task Force did not have adequate opportunity to review this new language, and adopted Model #785 in its current form. However, the Task Force also agreed to study this language further, and come back with a recommendation to the Committee for its May 28 meeting. The Task Force does not believe that it will be necessary for the Committee to re-expose Model #785 based on any recommendation on this issue.
The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met in New York, NY, Aug. 3, 2019. The following Working Group members participated: David Altmaier, Chair, and Ray Spudeck (FL); Kathy Belfi, Vice Chair, and William Arfanis (CT); Susan Bernard and Rachel Hemphill (CA); Philip Barlow (DC); Jim Armstrong and Mike Yanacheak (IA); Bruce Sartain (IL); Roy Eft (IN); Judy Weaver (MI); Kathleen Orth (MN); John Rehagen (MO); Jackie Obusek (NC); Justin Schrader (NE); Marlene Caride, John Sirovetz and Diana Sherman (NJ); James Regalbuto (NY); Dale Bruggeman and Tim Biler (OH); Joe Dimemmo, Kimberly Rankin and Melissa Greiner (PA); Trey Hancock and Patrick Merkel (TN); Doug Slape, Mike Boerner and Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. **Adopted its May 2 and Spring National Meeting Minutes**

Commissioner Altmaier said the Working Group met May 2 to provide an overview of its final group capital calculation (GCC) testing template and instructions before testing began.

Ms. Bernard made a motion, seconded by Mr. Bruggeman, to adopt the Working Group’s May 2 (Attachment Two-A) and April 6 (see NAIC Proceedings – Spring 2019, Financial Condition (E) Committee, Attachment Two) minutes. The motion passed unanimously.

2. **Discussed Draft Memorandum on Confidentiality Protections**

Commissioner Altmaier said the Working Group has always been clear that the GCC is intended to be a confidential document and, he had asked NAIC staff to draft a document on the topic that could be used to start the Working Group’s logistical discussions on the topic. He indicated that now was an appropriate time to have such conversations while field testing is being completed. Mariana Gomez-Vock (American Council of Life Insurers—ACLI) said the ACLI appreciated the Working Group’s recognition of the need for confidentiality of the GCC, and she indicated that as field-testing moves forward, confidentiality is important to her members. Michael Gugig (Transamerica), representing a coalition of 10 companies, summarized some of the more significant elements of their letter to the Working Group on the topic of confidentiality. He emphasized the need not only for confidentiality, but also a prohibition on allowing groups to voluntarily disclose the information or results. He emphasized that given that the GCC will be a tool, he could see no reason for any of its related information to be public. Commissioner Altmaier expressed his appreciation for the comments and suggestions, and he noted that the letter was received too late to include in the materials, but it had been posted to the Working Group’s website. Mr. Slape asked if there were any state laws that would prevent such an approach. Mr. Gugig responded that their proposed language includes key language taken from the Risk-Based Capital (RBC) for Insurers Model Act (§312) and the Risk Management and Own Risk and Solvency Assessment Model Act (§505); therefore, state laws should allow a similar approach for their proposed protections. Commissioner Altmaier suggested that the Working Group schedule a conference call for the end of August to begin more in-depth discussions on the topic, including the letter proposal from the coalition. He asked NAIC staff to distribute the comment letter to the Working Group.

3. **Received Feedback from Testers**

Jonathan Rodgers (National Association of Mutual Insurance Companies—NAMIC) reminded the Working Group of past comments that several non-volunteer NAMIC members have been testing the template since it was first exposed in November 2018. He noted that a great deal of time and resources have been spent by NAMIC members on analyzing various issues, and he provided a summary of some of those views (Attachment Two-B). He emphasized that NAMIC appreciates how the GCC is intended to be a quantitative tool in the state insurance regulator’s toolbox and how it is a natural extension of the other significant items that state insurance regulators have added to their toolbox for group supervision.

Mr. Rodgers’ discussion described how there were three different holding company structures of NAMIC testers, and there was some major take away from each of those different structures, specifically for groups that do not own a bank or other regulated entity, the lack of value for the company or state insurance regulator. He also noted that these groups had concerns...
about the timing of the filing requirement with other existing requirements, how it should be incorporated into existing annual statement software to reduce as much duplication of work as possible, and how other regulatory information is likely more valuable to state insurance regulators for these types of groups. Mr. Rodgers noted that for groups that are very small and hold an agency, many such members are so concerned about the calculation that such groups are considering dropping their agencies. He also discussed how small mutual, such as town, county and farm mutuals are generally not required to file a complete annual statement, and many do not file their statement electronically. Finally, there are groups that do not own any other entity besides the mutual insurer itself, where they question the value completely; requiring for these groups is missing the view that the focus should be on the big risks of groups; and for such groups, the GCC should equal the risk-based capital (RBC). Mr. Rodgers said his members are also concerned about how this may evolve, even knowing that there is a large learning curve for those that have not been closely involved. He emphasized the need for the instructions to be clear and complete.

4. **Discussed Other Matters**

Lou Felice (NAIC) provided an update on the field testing. He discussed how the process has allowed for continual improvement of the instructions by the issuance of multiple question and answer documents, which help solidify the intent of part of the testing. He described how some groups had already submitted their field-test template, and the process of lead states reviewing the GCC would begin soon. In summary, he suggested that the field testing was on-track, as envisioned.

Thomas Finnell (Finnell & Company), representing Americas Health Insurance Plans (AHIP), expressed some concern about the degree of work related to the de-stacking of companies within the calculation field-testing. Mr. Felice noted that this is one of the items the Working Group will need to evaluate coming out of the field testing, and it is possible that the Working Group may decide on a different approach that does not require this extent of de-stacking once the calculation is final.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.
The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met via conference call May 2, 2019. The following Working Group members participated: David Altmaier, Chair (FL); Kathy Belfi, Vice Chair (CT); Susan Bernard (CA); Philip Barlow (DC); Kim Cross (IA); Susan Berry (IL); Roy Eft (IN); John Turchi (MA); Judy Weaver (MI); Kathleen Orth (MN); John Rehagen (MO); Jackie Obusek (NC); Justin Schrader (NE); Dave Wolf (NJ); Edward Kiffel (NY); Tim Biler (OH); Joe DiMemmo (PA); Trey Hancock (TN); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. **Discussed Revised Field-Testing Template**

Commissioner Altmaier said this open conference call will be the last call before the group capital calculation (GCC) field test begins. He said the first agenda item will focus on revisions made to the GCC template since the Working Group’s last webinar in March 2019.

Commissioner Altmaier said NAIC staff will be providing an overview of the template today, and they will pause to allow for questions. He then turned the meeting over to Lou Felice (NAIC) and Ned Tyrrell (NAIC).

Mr. Felice said the biggest revision related to a proposal from the health industry for an alternative grouping output. That output will provide a lower level of granularity in the summary data than the main grouping, but it may provide some additional information for future development or field testing. Mr. Tyrrell then described the columns added to the template to accommodate the alternate grouping. He also described template changes related to the treatment of non-admitted entities.

Dan Daveline (NAIC) described some revisions to the instructions related to the testing of XXX/AXXX captives. Other more minor edits to instructions were also described.

The template or instructions were displayed as part of the webinar as the revisions were presented. As each revision was explained, that section of the template or instructions was displayed on the screen.

There were no questions. Commissioner Altmaier encouraged all involved in the field test to send their questions during the field test.

2. **Discussed Confidentiality of Field Test Data**

Commissioner Altmaier described the way in which data submitted via the lead states would be shared. He said the data will be submitted directly to the lead state, and no field test volunteer submission shared with the NAIC by a lead state will be further shared or provided to another lead state or to any other state by the NAIC. Some data will be viewed by the Working Group members in regulator-to-regulator session, but it will otherwise be aggregated or summarized. He said information-sharing agreements have been executed with 13 of the 15 lead states or are near completion, noting that an agreement must be in place before data can be shared with the NAIC.

Commissioner Altmaier encouraged any field test volunteer who has questions or concerns about the confidentiality agreement in place to contact their respective lead state or NAIC staff.

3. **Discussed Next Steps for Field Test**

Commissioner Altmaier said there are 31 field test volunteers from 15 lead states. He added that the field-testing template and instructions will be made public on the NAIC website so that non-volunteer firms and other interested parties could ask questions and stay engaged. He said the field test can begin and a kickoff call is being scheduled; however, given the logistics of getting all of the volunteers and states together at the same time, it may be necessary to schedule several kickoff calls.
Commissioner Altmaier noted that data through year-end 2018 would be used for the field test unless there is a particular hardship in using 2018 data. In such a case, he asked the volunteer to discuss that hardship with their lead state and NAIC staff, as it is desirable to have all volunteers using the same data year. He said the field test submissions are due on about Aug. 10. Mr. Felice added that the review of the submissions and summarizing results would take approximately 60 days, so the field test would run about 150 days overall and end in early to mid-October.

Commissioner Altmaier said there will be periodic interactions during the field testing between the Working Group and the field test lead states, field test volunteers and other interested parties. He added that there will be a kickoff call or calls with NAIC staff, lead state contacts and volunteer contacts. He asked that field test participants send any questions to their lead state and NAIC staff, requesting that lead states keep NAIC staff informed of any material discussions with a volunteer.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.
GROUP CAPITAL CALCULATION – SHADOW FIELD TESTERS

JON BOCCELLI
DIRECTOR OF FINANCIAL AND TAX POLICY, NAMIC

NAMIC OBTAINED FEEDBACK FROM 3 CATEGORIES OF MEMBERS

1. Holding Companies – That do NOT own a bank or other regulated entity;
2. Non-Holding Companies that own an agency;
3. Non-Holding Companies – That do NOT own any other entity;

HOLDING COMPANIES THAT DO NOT OWN A BANK OR OTHER REGULATED ENTITY

- Capital View – look to mutual at top of house for capital planning – do not see value for company or regulator
- Timing and Implementation – January/February very busy time – could do after audits complete; Needs to be incorporated into annual statement/RBC Software
- Regulatory Action – What is a good number? Concerns with evolving into a standard
- Non-Insurance Entities – Is treatment same as RBC or different?
- Resources – Finance/Accounting Departments have seen substantial growth over last 10-15 years; From bookkeepers to CFOs with advanced degrees
- ORSA/Holding Company Analysis/Enterprise Risk Reports – contains info about non-insurance and non-regulated entities
**NAMIC MEMBERS NOT PART OF HOLDING COMPANY THAT OWN AN AGENCY**

**PART I – ORGANIZATIONAL CHART**

**SCHEDULE V – INFORMATION CONCERNING ACTIVITIES OF INSURER MEMBERS OF A HOLDING COMPANY GROUP**

**NON-HOLDING COMPANIES THAT DO NOT OWN ANY OTHER ENTITY**

- There are 615 NAMIC mutual insurance company members that write $9.64 Billion in DWP
- This represents 1.43% of the $675 billion written in 2018
- Least able to fill out calculation and the least at risk

**GENERAL FEEDBACK**

- Transition — Once adopted and handed off to states – BIG learning curve
- Operational Risk — Still relatively new – RBC formula puts OP Risk outside covariance
- Instructions and Template — Needs to be clear and complete
- Focus should be on Big Risks — For most mutual insurance groups, a substantial amount of business is in one company
- Simple Calculation — For an underwriting entity at top of house that doesn’t own a bank or regulated entity, GCC should equal RBC; year 1 is the toughest
The National Treatment and Coordination (E) Working Group of the Financial Condition (E) Committee met via conference call July 17, 2019. The following Working Group members participated: Jeff Hunt, Co-Chair (TX); Joel Sander, Co-Chair (OK); Cindy Hathaway (CO); Maura Welch and Joan Nakano (CT); Virginia Christy and Alison Sterett (FL); Stewart Guerin and Tangela Byrd (LA); Debbie Doggett (MO); Victoria Baca (NM); Cameron Piatt (OH); Cressinda Bybee (PA); Jay Sueoka (UT); Ron Pastuch (WA); and Linda Johnson (WY).

1. **Adopted its May 15 Minutes**

Ms. Johnson said her name should be removed from the attendance on the Working Group’s May 15 minutes; she was not in attendance. Mr. Sander made a motion, seconded by Mr. Hunt to adopt the Working Group’s May 15 minutes (Attachment Three-A). The motion passed unanimously.

2. **Exposed Proposal 2019-04**

Ms. Johnson explained that the purpose of proposal 2019-04 was to include “statutory” before the home office address to provide clarity to the applicant company on the appropriate address to place on the consent to service of process form. Jane Barr (NAIC) added that there have been numerous questions from the industry and state insurance regulators on the state that should be identified on page 1 of the form. To provide additional clarity, Form 12 should include the state where the applicant company is regulated if different than the state where it is organized. Ms. Barr suggested that the Form 12 changes should be exposed for a 30-day public comment period ending Aug. 16.

3. **Exposed Proposal 2019-08**

Ms. Barr explained that when the Questionnaire, Form 8 was modified in 2012, several questions were moved and reworded; and during this update, the old question #24 was inadvertently deleted. It was suggested during the review of the *Company Licensing Best Practices Handbook* (Handbook) updates that this question be moved, renumbered as question #31, and made as an optional question for expansion applications. Ms. Doggett said this question pertains more towards the expansion application and not the primary application, but this information could also be found in the annual statement interrogatories. Ms. Belfi said the question should be required and Sub-Part B could be optional to provide copies of the investment management agreements and any investment guidelines. Ms. Barr suggested that the cover form for proposal 2019-08 be updated to reflect two options: 1) this question be placed back into the questionnaire in its original order and Sub-Part B be optional or, 2) this question not be placed back into the questionnaire since this information is already located in the general interrogatories of the annual statement, and it be exposed for a 30-day public comment period ending Aug. 16. The Working Group agreed.

4. **Received Comments to the Handbook**

Mr. Hunt said updates to the Handbook was exposed for a 30-day public comment period ending June 14. Comments were received by Ms. Bybee, and they were incorporated into the Handbook, except for the request to remove the links. Ms. Bybee explained that her comments were in question to where in the Handbook the links were located because they appear to link to the description of the Priority Levels that were recently updated and not to the specific instructions.

Ms. Barr said she will review the links and make any necessary corrections to the following updates:

- Pages 15: Changes that listed prioritization of a company’s standing, from risk-based prioritization 1–3 (1 being in good standing and 3 not ready for expansion) to levels 1–4 (1 not ready for expansion and 4 being in good standing/no issues). Priority 4 should include the statement “Priority 1 companies should not be considered for expansion.”
- Page 47: The reference to Form 8 Questionnaire may be removed once the comments are received on the exposure for Proposal 2019-18.
- Page 51: The link to the instructions for the corporate amendment change type should not include the Priority reference.
5. Discussed a Referral from the Financial Analysis (E) Working Group

Ms. Doggett summarized the referral from the Financial Analysis (E) Working Group (FAWG). She said it is intended to caution state insurance regulators when reviewing applications to not place reliance on parental guarantees to resolve capital issues with the insurer. She indicated that previous instances have dictated that it is not the case, and most parental guarantees are not worth the paper written on. Mr. Hunt said Texas has licensed a company with consent orders when capital infusion has been guaranteed for Medicare business. Ms. Doggett agreed that would hold more water than just a parental guarantee.

Mr. Hunt said the second part of the referral deals with acquisition, mergers and redomestications; and the surviving entity is still licensed appropriately in all the foreign jurisdictions. Ms. Doggett agreed and noted a recent situation where a company’s license through a merger was changed from a life and health company to one that is not regulated under most jurisdictions. This changed through a corporate amendment application where most states did not realize the impact it would make on the entity’s license. Missouri’s understanding is that the surviving entity must already be licensed in the state where the non-surviving company was licensed. Licenses do not automatically transfer from the non-surviving entity to the surviving entity if that surviving entity was not already licensed in that state. She added that the merger should not support changing the license of the non-surviving entity to a different type of license that may not be supported by the state where the non-surviving entity was already licensed. Mr. Hunt said the first level of a merger is authorized by the domiciliary state; and once approved, then a corporate amendment is filed with the foreign states to update their records of what happened. He indicated that it is difficult for the foreign state to revoke the license after the merger has been approved. Ms. Doggett said the FAWG struggled on where the referral should go to, and it selected the National Treatment and Coordination (E) Working Group since it deals with licensing as a place to start with additional guidance on reviewing these types of transactions. Ms. Barr said Appendix D is on the review of Form A’s, and it includes suggested language regarding the referral. She suggested exposing Appendix D for a 30-day public comment period ending Aug. 16.

6. Discussed Other Matters

Ms. Barr said during prior conference calls, there has been discussion on creating an electronic biographical database to submit a biographical affidavit. The internal process to receive approval is to scope the process out in a proposal form, and the project was approved. The Ad Hoc groups will begin their work later this year and interested participants can email Ms. Barr. Ms. Barr added that there have been several issues that arose in the past few weeks regarding the biographical affidavit, and the majority are consistency issues where a state has posted the biographical affidavit and the form had been recently updated, but the state’s version of the form had not. She suggested that the states should provide a link to the NAIC/Uniform Certificate of Authority Application (UCAA) website to direct the applicant company to the most recent version of the form. When the company uses an older version of the form, applies to multiple states, and one state contacts the company and requests that they use the most recent form, which the application instructions states to do, the company is questioning that the state’s request when other application states are accepting the older form. The uniform states should require the uniform instructions to avoid inconsistencies amongst the states.

Ms. Barr said another inconsistency has been on the interpretation of each question having a response. When the applicant company just enters “see attachment” as a response, then those attachments should include the affiant’s name and company information in the header, and the affiant should also sign those attached pages to attest to the validity and accuracy of those attachments. Ms. Barr suggested adding a Frequently Asked Question (FAQ) with this instruction.

Ms. Barr said she is aware that there is some concern on how often the biographical affidavit has been updated, and currently, the Biographical Third-Party Review (E) Subgroup has adopted additional changes to the form; but before those are sent to the Working Group for exposure, she suggested that any additional questions or concerns regarding this form be forwarded prior to exposure. Once those changes are adopted, that should be the last change made to the form until the electronic database is developed.

David Kodama (American Property Casualty Insurance Association—APCIA) agreed that inconsistency has been an issue. He asked who to contact regarding the biographical affidavit database and if it would be a central repository for the affidavit for all states to access. Ms. Barr concurred that it is the intent of the database to have one location for the form to be completed.
Mr. Kodama asked if this database would also include fingerprinting. Ms. Barr said it would not; there are a few states that require fingerprinting, and the software to capture this is too expensive.

Mr. Hunt announced that he will retire from the Texas Department of Insurance (DOI) effective July 31. He has worked with company licensing and this Working Group since 1999, and he will continue to participate as an interested party. Ms. Johnson has agreed to participate as co-chair for the remainder of the year.

The Working Group plans to meet in late August or mid-September via conference call.

Having no further business, the National Treatment and Coordination (E) Working Group adjourned.
National Treatment and Coordination (E) Working Group
Conference Call
May 15, 2019

The National Treatment and Coordination (E) Working Group of the Financial Condition (E) Committee met via conference call May 15, 2019. The following Working Group members participated: Jeff Hunt, Co-Chair (TX); Joel Sander, Co-Chair (OK); Maura Welch and Joan Nakano (CT); Alisa Pritchard (DE); Alison Sterett (FL); Tangelia Byrd (LA); Debbie Doggett (MO); Victoria Baca (NM); Dale Bruggeman (OH); Greg Lathrop and Ryan Keeling (OR); Cressinda Bybee (PA); Jay Sueoka (UT); and Ron Pastuch (WA).

1. **Exposed Updates to the *Company Licensing Best Practices Handbook***

Mr. Hunt said updates to the *Company Licensing Best Practices Handbook* (Handbook) were made to reflect recent updates to the Part D accreditation standards, the *Insurance Data Security Model Law* (#668), the *Financial Analysis Handbook*, inclusion of the withdrawal/complete surrender corporate amendment change type and speed to market.

Mr. Hunt focused on some of the significant updates, which are:

a. Page 13: Identifies the timelines for application reviews and Form A.

b. Pages 15–19: Changes the listed prioritization of a company’s standing, from risk-based prioritization 1-3 (1 being in good standing and 3 not ready for expansion) to levels 1-4 (1 not ready for expansion and 4 being in good standing/no issues).

c. Pages 23–25: Clarifies the state insurance department’s role in managing the biographical affidavits and Model #668. Jane Barr (NAIC) said she posed a question to the Working Group on Page 25 asking if there was a preference to either list items from Model #668 or instead reference the Financial Analysis Handbook and/or the Financial Condition Examiners Handbook. Ms. Doggett suggested referencing either handbook, so if future enhancements were made, the Company Licensing Best Practices Handbook would not need future edits.

d. Pages 36–38: Focuses on communication between the domiciliary states regarding redomestications and items to be addressed.

e. Page 77: Includes best practices for a corporate amendment change type for withdrawal/complete surrender of a certificate of authority. Mr. Hunt added that there have been times when a company cancels its license in its domiciliary states but has not canceled its licenses in the foreign states first, so this change type was added.

f. Best Practices: Adds the speed to market appendix.

Ms. Barr asked if interrogatory #23 on Page 50 states that this question pertains to the primary application; if that is a true statement, she asked whether this question should be removed from the expansion application questionnaire.

Ms. Doggett asked if there would need to be two separate questionnaires: one for primary and one for expansion applications. Ms. Barr explained that currently in the electronic application, question 31 through question 34 are hidden because those questions only pertain to redomestications and all other questions must be answered.

Ms. Doggett said this question could play in the decision if the state is concerned on how conservative the company’s assets are, noting that maybe the question should be renumbered and moved to group with the redomestication questions. Ms. Barr suggested leaving the reference as-is until after the comment period.

2. **Discussed Future Enhancements**

Ms. Barr said that on prior calls, there has been discussion on creating an electronic biographical database to submit a biographical affidavit. The internal process to receive approval is to scope the process out in a proposal form. During this internal process, she said she realized that it would be beneficial to include all applications that require a biographical affidavit and create an electronic process for those application submissions, as well. She added that there has been confusion on the electronic corporate amendment process, where a company would like to submit an electronic corporate amendment to its domiciliary state; currently, those submission must be done in hardcopy only.
Ms. Barr said the scope of this project will include an electronic process for:

- Primary applications to include startups.
- Primary redomestication application.
- Domiciliary state corporate amendments, with cloning optionality.
- Develop Form A and Form E applications for electronic submission.
- Biographical affidavit database.
- Filing fees collection.

Ms. Barr said if any Working Group members, as well as any interested regulators or interested parties, would like to participate, they should email their contact information so calls can begin in the fall. She added that surveys will be distributed during this process to streamline the requirements, and she asked the states to review the Uniform Certificate of Authority Application (UCAA) charts now for current information.

Ms. Welch asked what the priority is for this project. Ms. Barr explained that the driving project is the biographical database, but in order to make that database reliable, all applications should be in electronic format so that no hardcopy processes would still be in place. She added that, currently, issues have arisen with non-uniformity regarding how the biographical affidavit is completed, especially the background reports and the states’ adherence to the standards that will be eliminated with the creation of this database.

Ms. Doggett asked if this will be one database or several, or if it is yet to be determined. Ms. Barr said that because there is an existing Form A database, the creation of this new application will tie into that existing database. Ms. Doggett agreed that all domestic applications should be in electronic format, including the Form A process.

3. Discussed Other Matters

Ms. Barr reminded the Working Group that company licensing will be part of the NAIC/NIPR Insurance Summit, which is being held June 3–7 in Kansas City, MO. The company licensing sessions will be held June 3 and June 4.

The Working Group plans to meet later in June or by mid-July via conference call.

Having no further business, the National Treatment and Coordination (E) Working Group adjourned.
The NAIC/AICPA (E) Working Group of the Financial Condition (E) Committee met via conference call July 25, 2019. The following Working Group members participated: Doug Stolte, Chair (VA); Jim Armstrong, Vice Chair (IA); Laura Clements and Susan Bernard (CA); Ryllynn Brown (DE); Judy Weaver (MI); Levi Nwasoria (MO); Lindsay Crawford (NE); Doug Bartlett (NH); Dale Bruggeman (OH); James Borrowman (OR); Joe DiMemmo (PA); Johanna Nickelson (SD); and Jake Garn (UT). Also participating was: Shawn Frederick (TX).

1. **Discussed the Premium Threshold**

Mr. Stolte said the Working Group is responsible for reviewing the premium threshold amounts contained within the *Annual Financial Reporting Model Regulation (#205)* on an annual basis. Bruce Jenson (NAIC) gave an update on the results of the annual review, noting that as of Dec. 31, 2018, 92.1% of all direct written premiums and 93.7% of all gross written premiums would be subject to reporting requirements. Mr. Stolte noted that these results were within the Working Group’s expectations and that no action to adjust the threshold was deemed necessary at this time.

2. **Reviewed the States’ Adoption of Internal Audit Requirements**

Mr. Stolte stated that in 2014, the former Corporate Governance (E) Working Group developed and adopted revisions to Model #205 that require large insurers to establish and maintain an effective internal audit function. He said the NAIC/AICPA (E) Working Group assisted in the development of the revisions and is generally responsible for the review and maintenance of Model #205. Therefore, the Working Group is tracking the progress of the states in adopting these revisions.

Mr. Stolte stated that as of July 2019, 33 states have adopted the internal audit revisions, compared to 19 states that had adopted the revisions at the same time in 2018. He stated that the internal audit function requirements are scheduled to be required under the NAIC Financial Regulation Standards and Accreditation Program as of Jan. 1, 2020. Therefore, he encouraged the states to continue their efforts in enacting the revisions.

3. **Heard an Update on Recent Accounting and Auditing Pronouncements**

Jean Connolly (PricewaterhouseCoopers) provided an overview of recent accounting and auditing pronouncements affecting statutory audit reports. Ms. Connolly highlighted the new *Statement on Auditing Standards (SAS) No. 134—Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*. Ms. Connolly stated that SAS No. 134 will be effective for periods ending on or after Dec. 15, 2020, and significantly changes the form and content of the auditor’s report issued after auditing a set of financial statements. The SAS moves the audit opinion to the second paragraph of the auditor’s report and requires an expanded discussion of the auditor’s responsibility to form an opinion on the financial statements.

Ms. Connolly also provided an overview of other auditing standards that are currently under development and exposed for public comment, including a proposed SAS on amendments to the concept of materiality and a proposed SAS on audit evidence. Mr. Stolte thanked Ms. Connolly for her overview and encouraged Working Group members to continue to educate themselves on new auditing standards.

4. **Discussed Access to IT Workpapers**

Mr. Stolte said that examination teams have recently raised concerns regarding access to audit workpapers associated with the testing of an insurer’s information technology (IT) controls. Mr. Stolte asked state insurance regulators to share any experiences they have had in this area to help the Working Group determine how prevalent these issues are.

Ms. Clements stated that California has run into some issues in obtaining access to IT documentation and testing on a recent exam when the insurer claimed client/attorney privilege to protect the documents. However, Ms. Clements stated that this situation affected access to company documents and not external audit workpapers.
Mr. Nwasoria said that Missouri has faced a situation whereby the IT functions of a domestic insurer were outsourced to a foreign affiliate, which made it difficult to obtain copies of audit workpapers from a foreign audit firm. Mr. Stolte and Ms. Connolly encouraged state insurance regulators to work with the certified public accountant (CPA) firm’s national office in this situation for assistance in obtaining access to workpapers. Mr. Stolte said that the Working Group will continue to monitor developments in this area.

5. **Discussed the Completeness and Accuracy Testing of Reserve Data**

Mr. Stolte said that exam teams often face challenges in testing the completeness and accuracy of data used by actuaries in loss reserve calculations and estimates and meeting the expectations of the NAIC accreditation program in this area. As this testing is also an important element of external audits, Mr. Stolte asked whether the American Institute of Certified Public Accountants (AICPA) firm representatives might be able to work with state insurance regulators to provide training in this area.

Mr. Jenson provided additional background information on the challenges for examination teams in this area, noting that testing for property/casualty (P/C) insurers is different from testing for life insurers. Mr. Jenson also discussed the challenge of identifying and testing internal controls in this area.

Ms. Connolly stated that the AICPA firm representatives are willing to assist in this area and offered to work with NAIC staff to schedule a training webinar for state insurance regulators later this year.

6. **Discussed Issues Related to the Communication of Internal Control-Related Matters Noted in an Audit**

Ms. Connolly said that AICPA firm representatives have noted that the Texas requirements to communicate internal control-related matters noted in an audit to the Department of Insurance (DOI) appear to be inconsistent with the NAIC model in this area. Ms. Connolly stated that one section of the Texas code indicates that the auditor should report all “significant deficiencies” noted in an audit, whereas another section indicates that only “material weaknesses” should be reported. As all other states only require the communication of “material weaknesses,” the firms are asking for clarification regarding the expectations in this area.

Mr. Frederick clarified expectations by stating that Texas will require information on “material weaknesses” through a formal filing but will only require information on “significant deficiencies” upon request.

Having no further business, the NAIC/AICPA (E) Working Group adjourned.
Draft Pending Adoption
Financial Condition (E) Committee
8/5/19

Draft: 8/6/19

Restructuring Mechanisms (E) Working Group
New York, New York
August 4, 2019

The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met in New York, NY, Aug. 4, 2019. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair, Matt Gendron and Jack Broccoli (RI); Buddy Combs, Co-Chair, represented by Glen Mulready (OK); Mel Anderson (AR); Rolf Kaumann (CO); Kathy Belfi (CT); Judy Weaver (MI); Fred Andersen (MN); John Rehagen (MO); Matt Holman (NE); John Sirotez and Diana Sherman (NJ); Joe DiMemos (PA); Lee Hill (SC); Amy Garcia (TX); Doug Stolte and David Smith (VA); David Provost (VT); Doug Hartz (WA); and Amy Malm (WI).

1. **Adopted its July 8, July 1, May 16, Spring National Meeting, and Subgroup March 11 Minutes**

   The Restructuring Mechanisms (E) Working Group met July 8, July 1, May 16, April 6. During these meetings, the Working Group took the following action: 1) heard presentations from the respective departments of insurance (DOIs) related to corporate division laws adopted in Connecticut, Illinois and Pennsylvania; 2) discussed proposed changes to its charges; 3) heard a presentation from the American Council of Life Insurers (ACLI) on their adopted principles for restructuring mechanisms; 4) heard a presentation from Lloyds on the United Kingdom Part VII transfer requirements; and 5) heard presentations from the ACLI, Swiss Re America Holding Corporation, ProTucket Insurance Company (ProTucket), and the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and National Conference of Insurance Guaranty Funds (NCIGF). The Restructuring Mechanisms (E) Subgroup met on March 11 to discuss comments received on the definition of “run-off,” as well as its charges.

   Ms. Belfi made a motion, seconded by Ms. Weaver, to adopt the Working Group’s July 8, July 1, May 16, revised April 6 minutes, and March 11 Restructuring Mechanisms (E) Subgroup May 28 minutes (Attachments Five-A, Five-B, Five-C, Five-D and Five-E). The motion passed unanimously.

2. **Heard Presentations**

   a. **Enstar**

   Paul Brockman (Enstar) provided a summary of Enstar’s views on the need for restructuring mechanisms (Attachment Five-F). The summary included information on the insurance group’s balance sheet and related financial information, and he emphasized how it had a focus on non-life run-off business. Mr. Brockman described how these supported the legislation in Oklahoma and are like the types of legislation in other parts of the world, such as the United Kingdom (UK), Europe and Australia, and these can be valuable to companies in the U.S. He described how acquisitions were a cornerstone of Enstar’s business, with a breakdown on such transactions since being founded. He noted that Enstar has a wide range of books of business in its portfolio. The presentation also included information on why companies restructure, including the ability to divest of non-core business. Mr. Brockman said while this can be troubled business, much of it is simply trapped business and with the use of these restructuring mechanisms, the industry could have more opportunity to grow. This can also be for the benefit of policyholders where the business can be handled with more care than they may otherwise when they are considered non-core for a group. However, he said Enstar supported rigorous regulatory processes in considering such transactions with protections for policyholders. He described the novation processes and how the state laws vary across the states. He described loss portfolio transactions but noted how these did not provide legal finality. He highlighted a comparison of the methods of acquisition and noted that there was uniformity across the world except in the area of direct transfers of insurance business. He described how the UK had over 200 transactions that had been completed over the past 19 years. He described how none of those transactions had experienced any problems to date, and he touched on some of the requirements of the UK Part VII transfer. He emphasized the requirement of the independent expert and discussed his experience with Part VII transfers. He said the Oklahoma legislation provides a transparent and robust process of checks and balances, and it is very similar to the UK Part VII legislation, including the requirement for the independent expert and the information required to be provided to all stakeholders so that they can raise objections if they have any. He pointed to information on slide 9 and slide 10 of this presentation that provided a consolidated view of how the policyholders are currently served in multiple companies for Enstar, but doing so in one company would strengthen capital and operational cost savings, and it consolidates regulatory supervision,
Mr. Rehagen asked for transactions already completed and how Enstar dealt with states that require novation. Mr. Brockman responded that he would avoid discussion of legal or regulatory issues, and he focused instead on making sure policyholders were not adversely impacted. Mr. DiMemmo asked if Enstar did not already have a great deal of runoff blocks of business and what was the process. Mr. Brockman responded that most of them were through acquisitions and loss portfolio transfers. Mr. DiMemmo asked if Enstar had completed any through assumption reinsurance. Mr. Brockman responded no. Mr. Andersen asked if Enstar had a metric for determining if the policyholder was no worse off after a transfer. Mr. Brockman responded that many of the bigger companies taking this business on, such as Enstar, are concerned with long-term reputation, describing their large portfolio of workers’ compensation. He described how it was important that the policyholders can be properly serviced and pointed to the process where an independent expert, the state insurance regulator, and the process approval provide an opportunity for the appropriate parties to make that decision. Mr. Stolte asked if the independent expert was wrong, or the model used was wrong, and if guaranty fund coverage will be retained if the business fails. Mr. Brockman responded that part of the process of the independent expert includes looking at the company and whether the company can take the book of business on and service it. He pointed to the high number of successful transactions in the UK, and he suggested that if the view of the policyholder was considered, the policyholder may be in a better position after a deep dive has been done on the book of business. However, insurance companies are in the risk business, so it is possible that things could go different than planned. Mr. Brockman noted that the guaranty funds would be notified. Mr. Stolte pointed out that Virginia requires novation in all cases, unless the company is in a hazardous financial condition. Commissioner Mulready suggested that it was likely that at least one of the UK transfers involved a Virginia policyholder. Mr. Brockman agreed, noting that U.S. policyholders and U.S. parent companies would be involved. Superintendent Dwyer asked if any of the UK transactions involved guaranty funds. Mr. Brockman said he was not aware of any, but he could not be sure. Superintendent Dwyer asked if Enstar had done any legal analysis of guaranty funds and whether it would come with the policy if a new company was created, suggesting that it was more involved since it deals more with whether they still have coverage. Mr. Brockman responded that Enstar had looked at several issues, but it is focused on its specific transactions. Ms. Belfi asked if reinsurers are being notified and affirmed that they will move with the transfer or are terminating. Mr. Brockman did not have knowledge with respect to each of the approved transactions, but in his opinion, the reinsurers would have to demonstrate that they were adversely affected by the transfer. He indicated that he would try to research the issue. Superintendent Dwyer asked for more information on the one transaction Mr. Brockman opposed. Mr. Brockman said the company he was with raised its objection with the companies involved in the transfer, and the transaction was abandoned as a result, likely because the largest policyholder was in a worse condition. Superintendent Dwyer asked for more information on other UK transfers that had not been approved. Mr. Brockman said he did not have knowledge. Mr. Rehagen asked if Enstar avoided lines of business. Mr. Brockman noted a concern that long-term care (LTC) would be included or some other line of business where the company can get a transaction through. He said any difficult line of business where there are already sensitive views around policyholder protection and the treatment of putting them into at least as good of a position was highly important. He said he would not see LTC being part of a transfer. Mr. Kaumann asked who the strongest consumer protection laws and supervisors are that they have dealt with. Mr. Brockman said he believed that even though each of the countries used a different process, each of them used a rigorous process, and he said he would not make a comment that any one of them were stronger or weaker. Superintendent Dwyer asked how many of the UK transfers were personal lines. Mr. Brockman said he was not sure.

b. **Aon**

Kelly Superczynski (Aon) provided a summary of Aon’s views on the benefits of restructuring mechanisms (Attachment Five-G), mostly from the perspective of how it advises insurers on optimizing capital management. She said she just relocated from London and was involved in several Part VII transactions, and she would try to provide insights in those areas. She described some of the key benefits, including most notable operational efficiencies. She noted that being a policyholder of a small block of business provides no benefits given that they do not have the same dedicated resources. She also noted that bigger balance sheets also provide benefits, including more cushion for adverse development. She said prior to division statutes, there was no legal finality from other transfer options, and she described the challenges of other tools. She noted how the financial statements reflected that lack of legal finality, while the new laws provide economic finality. She described the inefficiencies from trapped
Ms. Superczynski discussed the historical record of UK Part VII transfers, noting that since 2002, not even one has gone insolvent. She described the significant amount of transactions current as a result of Brexit, including both personal lines and surplus lines; previously, most transfers were commercial lines. She briefly described the reasons for such transactions as a result of Brexit. She echoed the importance of the independent expert, like Mr. Brockman. She described how the expert is responsible for the protection of the policyholder, while the UK Prudential Regulatory Authority (PRA) is focused more on the qualifications of the expert and not the transaction itself. The expert is responsible for reviewing the reserves to make sure they are adequate, as well as spending a great deal of time understanding the risks, considering the capitalization of the new company and the old company. In practice, the new company is generally more well capitalized under the new company than the old company. Ms. Superczynski said while there are no hard and fast rules, and the expert can use judgement, this has been the case. She said this was because the transactions are generally approved, unless they are to the detriment to the policyholder. She said prior to Brexit, they were used to help consolidate the business into a smaller number of entities and better manage resources and claims. She noted that they have also been used to clean up the balance sheet. In these cases, the transactions have involved “toxic liabilities” such as asbestos. Ms. Superczynski noted that Japan was currently moving some of its toxic business into the UK to wall it off. She described how the process to review these often lasts 18–24 months. She noted that reinsurance is key during and after the transfer. She said in the UK Part VII, the reinsurer must stay and cannot be removed from the transaction. She said there have not been any issues with reinsurers for this reason. She said companies often use a loss portfolio transfer leading up to the transaction. She noted that the PRA is neither advocating these transactions nor denying them, but rather enforcing the law, but they do rely heavily on the independent expert since that person is to determine that the policyholder is not worse off after the transaction.

Ms. Superczynski said the presentation tracks the amount of capital available for these transactions, noting how it was as much as $600 billion available to support such transactions currently. She said there is likely more capital available to support, once pensions and other investors are considered who are looking for ways to take on more risk.

Ms. Superczynski demonstrated how the presentation shows how difficult it is to use loss portfolio reinsurance as an effective source of capital. She said while it is simple, the core message is that risk-based capital (RBC) does not give credit for adverse development covers. She described how some of the rating agencies consider both for cedents and reinsurers differently than RBC.

Ms. Superczynski summarized some of the key messages. She noted that this is an interesting time, with many UK deals that have been successful; capital is available to support; and companies are interested and legislation available. She recapped the RBC challenges and the need to consider changes in pre- and post-transactions, questioning if ranges should be an option within RBC, perhaps considering the quality of the capital. She recapped the issues with no easy answers for guaranty fund coverage, as well as seasoning requirements.

Superintendent Dwyer asked if the PRA can disagree with the independent expert on the needed amount of capital. Ms. Superczynski responded that she did not believe so, mostly because the PRA has said the expert’s reputation is on the line. Superintendent Dwyer asked about walling off toxic business and how the consumer would be in a better position. Ms. Superczynski responded that toxic may not have been the right word, but she referred to asbestos business as such an example. She described how the reserves have been booked and capital to support adverse development. She noted that the new capital is better than what would have been available before the transaction. In addition, dedicated claims and other staff would allow the administration of the business to be handled better. Superintendent Dwyer noted that while everyone has said there have been no insolvencies with Part VII transfers, however, asbestos has a long tail so insolvencies may not have yet materialized. Ms. Superczynski responded the point was fair, and she has noted that asbestos had been studied diligently and companies have analyzed their reserves carefully and reiterated the role of the independent expert. Mr. DiMemmo said he struggled with how the transfer to a new carrier brings the reinsurer with the transfer, noting that they were not part of the contract asking if the contract is amended. Ms. Superczynski said it is the same business, and she noted that business was being written with such a clause in the contract. Mr. DiMemmo said he struggled with the process to ensure that there was no non-payment with the reinsurer. He said in receiverships, when there was a transfer of business to a new carrier, the administration of the claims was different than with the company and, traditionally, a slowdown in payment. He asked Ms. Superczynski if she had developed a view of the timely payment and whether there had been an increase in unrecoverables. Ms. Superczynski responded that she
would have to research, but she noted that these are active reinsurers; it is not uncommon that personal claims are brought over with the transaction to make sure that the interest and resources are properly aligned and adequate. This often results in a transition to help with claims control. Commissioner Mulready noted that reinsurers in the U.S. would be allowed to object to the transaction. Superintendent Dwyer noted that the one transaction they have seen related to a reinsurer did involve a situation where the reinsurer objected.

Superintendent Dwyer suggested holding a conference call to allow further follow up and questions.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.
The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met via conference call July 1, 2019. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair and Matthew Gendron (RI); Buddy Combs, Co-Chair (OK); Mel Anderson (AR); Kathy Belfi (CT); Kevin Fry (IL); Judy Weaver (MI); Fred Andersen (MN); John Rehagen (MO); Matt Holman and Justin Schrader (NE); Marlene Caride and Steve Kerner (NJ); James Regalbuto (NY); Joe DiMemmo (PA); Daniel Morris and Lee Hill (SC); Amy Garcia (TX); David Smith (VA); and Amy Malm (WI). Also participating was Bob Wake (ME).

1. **Heard Presentation on Illinois Corporate Division Law**

Mr. Fry indicated that Illinois had adopted a law in late 2018 which provides a domestic stock company the ability to divide in accordance with two or more companies under an adopted plan. He discussed how the plan must disclose the allocation of assets and liabilities among companies. It has no limits in terms of lines of business or active versus closed blocks of business, with no policyholder approval or court approval required. He indicated a public hearing is required if the Director deems in the public interest but that they intend to always utilize a hearing unless they become some commonplace and not deemed helpful. It does require approval of the plan by the Director of the Illinois Department of Insurance although it must be approved unless the following characteristics exist: 1) policyholder/shareholder interest are not protected; 2) each company would not be eligible to receive a license in all states needed to retain the business; 3) division violates the uniform fraudulent act; 4) division is made for the purpose of hindering, delaying or defrauding other creditors; 5) any of the companies are insolvent after the division is complete.

Mr. Fry stated they expected to receive a transaction in the future but that they do not plan on developing regulations until they have worked through a few proposed division plans. He stated this was because they know they can take varied forms and therefore the need to develop flexibility in the regulation to avoid hampering flexibility to deal with such proposed transactions. He noted that there is recent legislation waiting for Governor approval that more clearly addressed how licenses must match up before and after the transaction to avoid orphan policies from being put on the Illinois life and health guaranty association. In response to a question from Mr. Rehagen. Mr. Fry stated he could provide to NAIC to circulate. Superintendent Dwyer asked if this language addressed the license of the new corporation. Mr. Fry responded that the paragraph requires all the places for which that business is being written must have a license to match where it was originally written. Superintendent Dwyer noted that it sounded like the new company would have to receive a new license. Mr. Fry noted that if there was already an existing license that may not be necessary if a shell company already exists with such licenses. Mr. Wake stated that it may be up to the NAIC what the new Cocode would be independent of the licensure and noted the similarities to other proposed transactions except how a division may have to consider whether there is a legal presumption that one or both of the resulting companies inherits the license. Mr. Wake stated that in Maine, they would look at each of the legal entities and decide if it still qualifies for licensure and if they decide that both still qualified to be licensed they would look for a way to process as a continuation of the predecessor license. He noted that each legal entity is a legal successor of the prior legal entity. He stated one cannot move a shell a company although you could merge with a shell company but unless the statute disallows, a may require a Form at the domestic level. He likened it to how up until 15 years ago, redomestications often involved merging with a shell company.

Mr. Fry stated he considered communication to be critical part of the process and that they have already established internal guidelines in terms of those communications with multiple expected involved parties, such as state regulators, policyholders, reinsurers and that the Department will want to engage with all such constituents. Mr. Fry stated that they will likely need to make a decision on all of these details before work is completed at the NAIC and do not plan on waiting until such work at the NAIC is completed and will follow this Working Group to try and consider some of the positions as they develop their procedures. Mr. Fry stated that they do not intend to be married to one capital standard or some other single measure of financial solvency to get a transaction over the line given the differences in expected transactions. He indicated there will however be a single project manager over all these transactions initially to help the Department allow flexibility but at the same time allow practices to emerge in time. Mr. Fry stated another key to the Illinois approach would be the use of outside experts, which they intend to leverage and expand their possible pool of experts to utilize over time. He stated in conclusion, ever since the proposed law was circulated, the Department was never opposed to the concept of allowing restructuring given it has occurred in different
forms for years and the fact that regulators already have experience with analyzing the issues to consider in such proposed transactions.

Superintendent Dwyer asked if the plan would be a public document or would it be confidential. Mr. Fry responded that it would likely be held confidential but they may consider modifying their framework around hearings to more appropriately address the transparency issue inferred in the question but there likely would be documents coming out of the hearing process that at least represents a skeleton of such information. Superintendent Dwyer asked how people would be notified of such a proposed transaction and who would receive such notice. Mr. Fry stated they have not decided the details of the public notices, but they acknowledge they would expect such notice either through the old method of newspapers or other methods that may be more effective with the intent of reaching all interested stakeholders if possible. Superintendent Dwyer asked about the process of considering opposition. Mr. Fry restated the need to improve their hearing process to allow these issues to be considered but that the legal representatives of the Department would have to be involved. Superintendent Dwyer asked the use of hearings from Form A transactions. Mr. Fry responded they do not have mandatory hearings today. Superintendent Dwyer asked what lines of business they expect. Mr. Fry responded he expects that while there are certain lines of business that will gravitate towards early, he expects all lines to utilize.

Ms. Belfi asked if as a result of a division, can the new company be a non-Illinois domestic company. Mr. Fry responded that he believes they would be an Illinois domestic at least initially but that they would consider a redomestication after some time. Mr. Wake asked how Illinois could create a company domiciled in another state. Ms. Belfi commented on how it could be part of a larger transaction where there would be multiple steps involved and some of those steps could involve a division and then a simultaneous merger outside of Illinois. Mr. Fry stated he thought their law was silent on the question raised by Ms. Belfi. Mr. Smith asked if the transaction outside of the corporate structure would require a Form A. Mr. Fry stated that if a company was sold outside of the corporate structure it would be a Form A itself even if filed outside of the proposed plan.

Mr. Schrader asked if Illinois had direct authority to retain outside consultants or expertise in considering the proposed transaction and if so, is that at the cost of the company. Mr. Fry responded they had the authority within the division section to bill the company for any work completed regarding hiring an outside consultant. Mr. Fry stated some of the transactions they have heard about might maintain the new company within the corporate structure while other new companies might be sold to an outside party specializing in a line of business.

2. **Heard Presentation on Pennsylvania Corporate Division Law**

Mr. DiMemmo described how the Pennsylvania law was created in 1990. He stated that their research indicated it had been used one to two times over that time period. The CIGNA Brandywine transaction in the mid 1990s and another health corporate that appeared to have used the division statute in 2013. He stated the law was four paragraphs and amounted to less than one page. In general, the division plan must be submitted in writing, and the standards for approval require an approval order from the Department. He stated the procedural regulations essentially are those that exist under the states equivalent of the NAIC Insurance Holding Company System Regulatory Act (Model 440). It does require reasonable notice and opportunity for a hearing and allows investigations and supplemental studies in order to meet a determination. The Department may impose such conditions that it deems reasonable. The order must document what has been approved and what has been denied. The approval is not approved by the court but it subject to judicial review.

Mr. DiMemmo described how under the CIGNA Brandywine order provides a chronology of events form the time the department received the proposed request to restructure their asbestos and environmental business, up until the time it was approved. He stated some of the major activities that the department included notification that gave all opportunities to voice opposition or provide comments. He stated there were three years that occurred to accept comments, hear objections and receive presentations from various parties that had an interest in the proposed transaction. He stated the hearings were conducted by the insurance department and were not a trial in the commonwealth court of subject to court protocol. He stated no policyholder of creditor needed to approve the restructuring and it was all up to the department to protect their interests. Numerous states were parties to certain parts of the provisions that needed to be considered before the department would approve. The transaction was subject to an examination, which included an actuarial review, a review of the financial information by a consultant, and participation by other states who had an interest to understand how he plan would be restructured. He stated there were four actuarial firms that opinioned on the transaction. He stated there we two opinions from investment banks, one contracted by the company and another contracted by the Department. Issues regarding guaranty coverage were not addressed, but it did require Pennsylvania policyholders to be covered by the Pennsylvania fund. He stated confidentiality was applied to any examination document prepared in the process, actuarial reports, questions and comments and company responses were made available to the public. Certain requirements including capital had to be complied with as well as others. He described
the general restructure that took place and how it still exists today under the Chubb Holding Company structure where the run-off business is a separate holding company structure. Ultimately it was approved by the Department in 1996 but unfortunately few employees are still around and none of which were involved in the transaction. Ms. Belfi described the size of the transaction, the reinsurance agreement, and how she believed the transaction provided relief from rating agency expectations but stated she did not believe any such benefit would be derived today as the rating agencies look at the entirety of the group and its intragroup transactions more significantly. She stated the real benefit with transactions today would only come from moving the risk out of the group. Mr. Stolte stated he remembered the transaction and how it was large commercial transactions and immaterial to the policyholders, therefore reducing some of the concerns that may have otherwise existed.

3. Consider Draft Status Update Memorandum to the Financial Condition (E) Committee

Superintendent Dwyer described how the draft memorandum to the Committee provides a status of work completed by the Working Group and Restructuring Mechanisms (E) Subgroup, and makes recommendations that are more specific in terms of the 2020 charges and their deliverables. With respect to the Subgroup charges, Mr. Smith noted that the changes are primarily designed to be more specific on the current point of emphasis on the development of best practices. Ms. Belfi stated she appreciated the changes as they provided her more clarity. Ms. Belfi requested a change to the first subgroup charge to add language to address liquidity, which is important for run-off companies. More specifically, she suggested adding the language “along with the adequacy of long-term liquidity needs “, after the phase “including among other things, the expected level of reserves and capital after the transfer”.

4. Follow-Up on July 1 Presentation from American Council of Life Insurers

Patrick Reeder (American Council of Life Insurers—ACLI) indicated that they had no items to add to the presentation they provided to the Working Group during a July 1 conference call but was willing to answer any questions. Working Group members had no other questions.

5. Any Other Matters

Dan Daveline (NAIC) summarized the agenda for the Summer National Meeting.

Mr. Smith announced that the Subgroup has distributed a survey to all states in order to gather information on best practices which will be used to the Subgroup in developing more formalized practices for restructuring transactions.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.
The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met via conference call July 1, 2019. The following Working Group members participated: Buddy Combs, Co-Chair, and Glen Mulready (OK); Elizabeth Kelleher Dwyer, Co-Chair, and Matt Gendron (RI); Bruce Sartain and Vincent Tsang (IL); Judy Weaver (MI); Fred Andersen (MN); John Rehagen (MO); Matt Holman (NE); Steve Kerner (NJ); James Regalbuto (NY); Joe DiMemmo (PA); Daniel Morris, Joe Cregan and Lee Hill (SC); Amy Garcia (TX); David Smith (VA); Joe DiMemmo (PA); Daniel Morris, Joe Cregan and Lee Hill (SC); Amy Garcia (TX); David Smith (VA); David Provost (VT); and Richard Wicka (WI). Also participating was: Robert Wake (ME).

1. **Heard a Presentation on Connecticut Corporate Division Law**

Mr. Kosky provided an overview of the Connecticut Corporate Division Law, as well as provided Connecticut's perspective on some of the concerns that have been raised. He said the law was not proposed or drafted by the Connecticut Department of Insurance (DOI) but rather was introduced by the Hartford Insurance Company and became effective late 2017. He said that they had yet to receive an application, and therefore his comments are based upon what they foresee.

Mr. Kosky said that the Connecticut Corporate Division Law allows a Connecticut domiciled insurer to divide into two or more insurers and allocate assets and obligations, including insurance policies, to the new company. It does this by creating a process that is legally distinct from a merger, consolidation, dissolution or formation. The resulting insurers are deemed legal successors to the dividing insurer, and any of the assets or obligations allocated are done as a result of succession and not by direct or indirect transfer. The law applies to Connecticut domestic insurers and covers all lines of business, as well as both active and closed blocks. The plan must include a number of things, including: the name of the domestic insurer; the resulting insurer(s); proposed corporate by-laws for new insurers; manner for allocating liabilities and reasonable description of policies; other liabilities and capital and surplus to be allocated, including the manner by which each reinsurance contract is allocated; and all other terms and conditions. All of this represents the plan, or step 1 of the process.

Mr. Kosky described that step 2 requires approval by the board of directors, stockholders and other owners before being considered by the DOI. He said that step 3 requires the plan being filed with the DOI. He said, however, that before this occurs, they do anticipate an initial meeting with the company to discuss elements of the plan, any complex issues, any proposed timetable and certain expectations by the DOI. The DOI is in the process of developing a checklist for the companies that will follow the law. He said they expect any plan of division to provide great clarity on business liabilities and policies being divided. The business liabilities and policies must be clearly defined and identifiable, and assumptions must be conservative based upon actuarial findings. While the law addresses Connecticut domiciled companies only, there may be policies in other states. Therefore, coordination with other states is something Connecticut values and will look to the Working Group for guidance. He discussed how their statute does not require an independent expert, but this is something the DOI is looking at and is interested in the Working Group’s stance on that issue. He said they do not intend to require a communication strategy as part of the application, but they will require certain notifications related to a hearing (e.g., newspaper or print publications). Additionally, they will look to their Form A statute for those requirements as a baseline for their requirements, although some of the specifics will be determined on a case-by-case basis.

Mr. Kosky said the next step requires notice of hearing. Their statute states the insurance commissioner may require a hearing if in the public interest, and they expect this to always be the case, particularly when the transaction is coupled with a merger. The standards for approval include that the insurance commissioner must approve a plan of division unless he or she finds that: 1) the interest of any policyholder or interest holder would not be adequately protected; or 2) the division constitutes a fraudulent transfer. He said they do intend to develop regulations on the interest of policyholders being adequately protected. He said what they develop may include some of the requirements of the United Kingdom (UK) Part VII or their own Form A requirements. With respect to the hearing, they expect it to be like Form A. Therefore, they will use existing regulations on such requirements, as well as practices and procedures maintained within the DOI and other requirements the Working Group develops. Confidentiality will be important; Mr. Kosky noted all documents related to the hearing are confidential except for the plan division itself and any materials incorporated by reference to that plan. All expenses are born by the company filing. For licenses, each new insurer created must have an adequate license to transact business in Connecticut, although this can be waived in the case of a simultaneous merger.
Mr. Kosky said that once the DOI has the notice, the hearing and the approval from the insurance commissioner, the company must file a certificate of division with the Secretary of State Office, which is effective when filed. The division itself must be effectuated within 90 days of the filing. He said the Connecticut statute itself discusses the effect on the dividing insurer and the new insurer, the effect on capital and surplus, other property and present causes of action. Of note, policies and other liabilities of the dividing insurer are allocated among the resulting insurers, and they are liable for those as successors. The resulting insurer is liable individually for policies and other liabilities it issues or undertakes in its own name for those taken place after the transaction. They are also responsible for policies allocated or remain liable to the extent specified in the plan and jointly and severely liable with other resulting insurers for the policies of the dividing insurer not specified in the plan. In addition, if the division breaches an obligation of the dividing insurers, all resulting insurers are liable jointly and severely for the breach, but the validity and effectiveness of the division shall not be affected by the breach. Mr. Kosky noted that a division itself is just a change in the corporate form of the insurance company. Any movement of policies out of the umbrella of the company is either through a subsequent acquisition or a subsequent merger, which may be by way of a simultaneous merger. Ms. Belfi said that what Mr. Kosky had been describing was creating another company within a group and moving business into that company, but it is still part of that company’s corporate structure. Mr. Kosky described this as a two-step process with the division itself but also the simultaneous merger outside of the corporate structure.

Mr. Kosky discussed how the insurance commissioner may permit the formation of a domestic insurer that is established for the sole purpose of then merging or consolidating with an existing Connecticut insurer and simultaneous with the division. He said that the insurance commissioner can waive this licensing requirement in connection with this transaction, but this is a waiver only of this entity that exists for a split second. The resulting insurer must be adequately licensed as a Connecticut domestic insurer. All insurance policies or reinsurance agreements become the obligation of the Connecticut domestic insurer that survives the merger.

Mr. Kosky discussed some concerns that have been raised. He said that one such concern was licensure, where admittedly the Connecticut law is silent on licensing requirements on the resulting insurer other than saying it must have an adequate Connecticut license. However, he said they understand that it would be inappropriate for a multistate licensed company to drop down to a single-state licensed company. He said they envision as part of the approval process requiring licenses or authorizations to conduct insurance business in each other’s state in which the allocated policies were issued or delivered. They are interested in where the Working Group falls on this issue with recommendations or positions it takes, including language that they may incorporate into regulations once they work on developing those.

Another concern is why there is no court approval like in an insurance business transfer (IBT). The simple reason is that unlike an IBT that operates like a novation, a division is just a change in a corporate form of a Connecticut entity and is not on its face a transfer. There is also the issue of joint liability, which can be an issue for the industry given its desire for finality. This issue deals with those policies not allocated by the plan of division, and while this can be challenging or difficult, the purpose is to encourage well-planned divisions. He said this is the consumer protection aspect of the corporate division statute, by establishing that if we do not know where the policy ended up, then both companies are on the hook. They want to make sure everything is covered in the plan and avoid carelessness.

The next issue is constitutionality with regards to contract clause and due process challenges. He said that while there are likely more detailed legal memorandums publicly available, he would summarize. He said that any challenge on either of these items would probably fail due to a lack of case of controversy to invoke jurisdiction. Under a due process challenge, the person must first identify the property of which they are being deprived. Assuming the company is sufficiently capitalized, a policyholder who has been reallocated and approved by the insurance commissioner, but alleges no additional harm, such as a payment of claim, may have a difficult time identifying any property interest they have been deprived of. He discussed the expected robust Form A-like process to be used and said that for all these collective reasons, any such due process claim would fail. If a policyholder’s risk of nonpayment has not changed, there should not be a constitutional impairment of the contract. He said the argument that comes up is that the policyholders’ expectations have not been displaced if the resulting insurers have demonstrated sufficient capitalization for the allocated business so long as expertise and interests continue to exist, which are all things the insurance regulator would consider in approving the transaction. They are interested in seeing what the Working Group comes up with and would consider incorporating into their regulation and expectations.

Superintendent Dwyer asked when Connecticut planned on completing their regulation. Mr. Kosky said they previously planned on working on regulations but are holding off until the Working Group completed its work. Ms. Belfi said that they have a good agreement within the DOI on what they would like to see, but would hold off until the Working Group has completed its work. Superintendent Dwyer said it would be equally helpful for the Working Group to receive from the
Connecticut DOI their views on such regulations. Superintendent Dwyer said there was a Rhode Island Supreme Court case on the constitutional issue, which is like the summary by Mr. Kosky.

Superintendent Dwyer asked with respect to the notification, what that would look like and if it included notification to individual policyholders. Mr. Kosky responded no to the last part of the question; policyholder notification is not required. He said that what he described earlier on notification would serve as a baseline, but they would differ on a case-by-case basis. Ms. Belfi said they believe the process would be similar to a Form A and would have a public hearing on this just like a Form A. Superintendent Dwyer asked if the type of filings they expected to receive would be those from life insurers that are books of business to other companies that are well-established in the market in order to get rid of the reinsurance agreements for this same purpose. Ms. Belfi responded affirmatively, although they had received inquiries on different types of strategies, some of which the DOI would never approve.

Mr. Regalbuto asked how the court would approach a situation where a diversified insurer would divide into what is essentially a monoline insurer. Superintendent Dwyer said they did not address this issue. Ms. Belfi asked if he believes that a monoline has more risk. Mr. Regalbuto discussed a company that writes life, annuity and long-term care (LTC), and if they want to create a monoline LTC company. He said going back to the financial capacity, he believes that a company with other profitable lines creates greater financial stability. Ms. Belfi agreed and said that is why she believes if you have seen one transaction, you have seen one transaction, and each must be evaluated on its own. She discussed an example to demonstrate why a case-by-case evaluation is critical. She also said they were approached by a company to move certain blocks and how they would deny such a proposal. Mr. Tsang asked if a company requested a company to move out its LTC, would that be denied. Ms. Belfi responded it would depend upon the business rationale, their plans going forward, would it ultimately be business to be sold, is it driven by requests from a rating agency, and a variety of other reasons. Mr. Tsang asked if the intent was to move the LTC business and the transaction was approved, would the new company be bailed out by the original company. Ms. Belfi responded that according to their law, they would have to stand on their own given they are primarily responsible for their own obligations.

Ms. Belfi said, however, that she does not understand why a company would segregate into one company given the way group supervision and rating agencies look at groups today. Mr. Tsang discussed how the transaction could involve keeping the new company above a higher risk-based capital (RBC). Ms. Belfi responded that they would look at the facts and circumstances but that it would not be unusual to make such a requirement. Mr. Wake said the situation is not different from other circumstances that state insurance regulators have been dealing with for years when the reputational risk for making a company work versus allowing the company to fail given its obligations are limited. He said this concept of relying on other companies as a source of strength is not unique but is unique given the way it was put in that place. Ms. Belfi said that for the reasons Mr. Wake noted, they may have to consider the facts in order to protect policyholders. Mr. Smith asked about the transaction when it occurs outside of the group and whether that would require a Form A. Ms. Belfi said that what Mr. Kosky described is two scenarios; however, when it involves a group outside the existing group, it would be a Form A. However, the other transaction was more akin to a merger and was not the sale of company and, therefore, they would use a Form A type process.

Mr. Gendron noted that the Connecticut law appears to require adequate protection of the policyholder and asked about other non-financial protections. Mr. Kosky said they would look to develop those through their regulation. Ms. Belfi provided examples such as claims paying ability, infrastructure, expertise, management, enterprise risk management (ERM) and governance, and any number of other items like a Form A.

2. **Heard a Presentation from American Council of Life Insurers on Insurance Business Transfers and Corporate Divisions Laws**

Patrick Reeder (American Council of Life Insurers—ACLI) and Wayne Mehlman (ACLI) provided a summary of the updated work completed by the ACLI (Attachment Five-B1) on the topic of insurance business transfers and corporate divisions laws. Mr. Reeder emphasized the principles that the ACLI and its member companies had developed. He described how the ACLI member companies asked each other about the way they should be thinking about these transactions as the statutes are adopted and noted how several the things Connecticut discussed were also discussed by the ACLI members as they had developed their principles. He described the push-pull that is occurring, knowing that member companies are working to manage their risks, assets, businesses and corporate structure. Mr. Reeder said that the tools that are available from a corporate structure standpoint are inefficient, with the existing tools being around for years and not without their own flaws. Therefore, the thought process from certain companies is that the corporate division laws and insurance business transfer laws provide an avenue to manage their business. However, ACLI members expressed the need for a robust process to make sure there are guardrails around such transactions. He discussed the process they used to develop their principles to address this need.
Mr. Reeder discussed the structure around Form A given that is something they are already familiar with and thought about its protections. He said they also looked at the assumption reinsurance process and the UK Part VII requirements, as well as other sources. In the end, the ACLI Board of Directors, including ACLI staff and chief executive officers (CEOs), had significant discussions to adopt the principles that the ACLI members expect to be part of the scheme used for IBTs and corporate divisions statutes. He pointed to the principles and emphasized certain aspects of the principles. Specifically, all policyholders and impacted stakeholders should have access to the process, including through a public hearing and a robust process to give individual policyholders notice. Mr. Reeder also discussed the need for a robust regulatory review and pointed to the multiple items they would expect to be used. The third highest principle is the need for an independent expert to be used in the process due to the complex nature of the transactions, including a list of specific things the expert would consider. The fourth highest level is that court approval should be required for IBT but not necessarily for insurance business transfer. He described how they approved the court approval as a proxy for policyholder, like the Connecticut comments in a description of their law. The fifth level is the need to protect the guaranty funds, but Mr. Reeder noted how a lot of the specifics got to the same point as Connecticut, where the license was the main issue.

Mr. Reeder discussed how they recognize that practices will develop over time, including state insurance regulators and actual transactions. He said their CEOs and members want the ACLI to stay engaged as the risks are real, but so are the tool’s importance. Mr. Tsang asked for the UK Part VII transfers, and the time of regulatory approval from start to finish. Mr. Reeder said he is not aware but that it depends and varies from transaction to transaction. Commissioner Mulready said that while the principles are generally in line with what he would expect, he did take note with the requirement that each player must be solvent. While he said his appreciation for the intent, he said he believes most state insurance regulators could envision a situation where a company had a book of business that could be more easily managed by a company focused on such and asked for the intent on that situation. Mr. Reeder said they view this as a bare minimum, but with respect to whether the transaction may be advantageous, they believe an independent expert is needed to address the complexity of the issues. Ms. Belfi asked about the use of an independent expert, noting that if you have seen one transaction, you have seen one transaction. She questioned the value of using an expert on every transaction and described how the two groups could be well-understood, well-run and well-capitalized, and it could be a waste of good money. Mr. Reeder said the ACLI sees this as important and considers it a must and not a may.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.
ACLI’s Principles and Guidelines (“Principles”) on Insurance Business Transfer & Corporate Division Legislation

Policyholders and Other Impacted Stakeholders Must Have Access to the Process

- All transactions must be subject to a public hearing.
- Individual policyholders, reinsurers, applicable state regulators, guaranty associations, and any other persons determined by the regulator must receive notice of the proposed transaction.

The Regulatory Review Process Must Be Robust

- The Commissioner’s review process must include certain findings, including:
  - The financial condition of an involved insurer will not jeopardize the financial stability of the insurers, or prejudice the interest of its policyholders or reinsurers;
  - An involved insurer will not have plans or proposals to liquidate another involved insurer, sell its assets, or consolidate or merge or to make any other material change in its business or corporate structure or management, that are unfair or unreasonable to policyholders, reinsurers or the public;
  - The involved insurers will be solvent at the time of the transaction;
  - The terms of the transaction will not be unfair or unreasonable to any involved insurer's policyholders or reinsurers;
  - The competence, experience and integrity of the persons who would control the operation of an involved insurer are such that it would be in the interest of the involved insurers’ policyholders and reinsurers and the general public to permit the transfer;
  - The transaction is not being made for purposes of hindering, delaying or defrauding any policyholders or reinsurers.
- In determining whether to approve the transaction, the regulator must consider, among other things, all assets, liabilities, cash flows and the nature and composition of the assets proposed to be transferred including, without limitation:
  - An assessment of the risks and quality (including liquidity and marketability) of the proposed transfer portfolio, and
  - Consideration of asset/liability matching and the treatment of the material elements of the portfolio for purposes of statutory accounting.

Independent Experts Must be Utilized as Part of the Process

- An independent expert is required for all transactions and the expert’s report must address:
  - Business purposes of the proposed transaction;
  - Capital adequacy and risk-based capital (including consideration of the effects of asset quality, non-admitted assets and actuarial stresses to reserve assumptions);
  - Cash flow and reserve adequacy testing (including consideration of the effects of diversification on policy liabilities);
Court Approval is Required for Insurance Business Transfer Transactions, but Not Necessarily for Corporate Division Transactions

- For insurance business transfer transactions, court approval is required.
- For corporate division transactions, court approval is not required, provided the Principles relating to public hearing, notice, and independent expert report(s) are included in the analysis.

Policyholders and the State-Based Guaranty Association System Should Be Protected

- Involved insurers must be licensed such that policyholders maintain guaranty association coverage in the same state in which they had it immediately prior to the transaction.

NOTE: Regulations and practices (legal, actuarial, etc.) will develop over time for both insurance business transfers and corporate divisions. The ACLI shall remain engaged to ensure that such development is consistent with these Principles. The ACLI shall look to the U.K. Part VII Transfer statutes, regulations, guidance and practices to guide its engagement and advocacy.
### INSURANCE BUSINESS TRANSFER

<table>
<thead>
<tr>
<th>Type of entities</th>
<th>Domestic, assuming insurers, including reinsurers</th>
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</thead>
<tbody>
<tr>
<td>Lines covered</td>
<td>ACLI member companies' covered lines</td>
</tr>
<tr>
<td>Active and/or closed blocks of business</td>
<td>Both</td>
</tr>
<tr>
<td>Policyholder consent</td>
<td>Not required</td>
</tr>
<tr>
<td>Court approval</td>
<td>Required</td>
</tr>
<tr>
<td></td>
<td>The applicant shall inform the court of the reasons why he or she petitions the court to find no material adverse impact to policyholders or claimants affected by the proposed transfer. If the court finds that the implementation of the transfer plan would not materially affect the interests of policyholders or claimants that are part of the subject business, the court shall enter an implementation order</td>
</tr>
<tr>
<td>Regulatory approval</td>
<td>Domestic regulator of the assuming insurer must approve; and the domestic regulator of the transferring company must either approve or provide a non-objection letter (if the latter, so long as it doesn't disturb other applicable appeal rights)</td>
</tr>
<tr>
<td></td>
<td>In addition, the transfer should not substantially lessen competition in insurance in this state or tend to create a monopoly in this state</td>
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<tr>
<td></td>
<td>As a condition to approval, statutes and regulations should require an adequate demonstration that the proposed transfer will protect adequately the interests of affected policyholders and reinsurers (with respect to the transferring and assuming companies, and originating and successor companies) as to a set of key criteria, including (i) capital adequacy and credit quality, (ii) efficacy of continuing operations support and management, (iii) continuity of contract rights and obligations and infrastructure, (iv) thorough analysis of</td>
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### CORPORATE DIVISION

<table>
<thead>
<tr>
<th>Corporate division</th>
<th>Domestic stock insurers and reinsurers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lines covered</td>
<td>ACLI member companies' covered lines</td>
</tr>
<tr>
<td>Active and/or closed blocks of business</td>
<td>Both</td>
</tr>
<tr>
<td>Policyholder consent</td>
<td>Not required</td>
</tr>
<tr>
<td>Court approval</td>
<td>Not required, so long as other requirements relating to public hearing, notice and independent expert report(s) are included. Subject to exhaustion of typical administrative remedies, aggrieved persons should have judicial recourse consistent with the Section 15 of the NAIC Insurance Holding Company System Model Act</td>
</tr>
<tr>
<td>Regulatory approval</td>
<td>Domestic regulator of the dividing company must approve</td>
</tr>
<tr>
<td></td>
<td>In addition, the division should not substantially lessen competition in insurance in this state or tend to create a monopoly in this state</td>
</tr>
<tr>
<td></td>
<td>As a condition to approval, statutes and regulations should require an adequate demonstration that the proposed division will protect adequately the interests of affected policyholders and reinsurers (with respect to the dividing and resulting companies, and originating and successor companies) as to a set of key criteria, including (i) capital adequacy and credit quality, (ii) efficacy of continuing operations support and management, (iii) continuity of contract rights and obligations and infrastructure, (iv) thorough analysis of</td>
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</tbody>
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1 As of June 20, 2019, insurance business transfer legislation has been enacted in Oklahoma, Rhode Island, Vermont and Arizona, while corporate division legislation has been enacted in Georgia, Illinois, Iowa, Michigan, Connecticut, Arizona and Pennsylvania and is pending in Nebraska.

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Attachment Five-B1

Financial Condition (E) Committee

8/5/19
<table>
<thead>
<tr>
<th>INSURANCE BUSINESS TRANSFER</th>
<th>CORPORATE DIVISION</th>
</tr>
</thead>
<tbody>
<tr>
<td>adequacy and credit quality, (ii) efficacy of continuing operations support and management, (iii) continuity of contract rights and obligations and infrastructure, (iv) thorough analysis of key issues concerning policy features and interests and (v) guaranty association coverage for affected policyholders. A rigorous application of the above, including but not limited to, Form A criteria should serve as an adequate basis on which to assess the advisability of transfer proposals.</td>
<td>key issues concerning policy features and interests and (v) guaranty association coverage for affected policyholders.</td>
</tr>
<tr>
<td>Regulator review of potential impact on policyholder interests</td>
<td>Required</td>
</tr>
<tr>
<td>The Commissioner shall approve the plan of transfer so long as the following requirements are met:</td>
<td>Required</td>
</tr>
<tr>
<td>(1) The financial condition of a transferring insurer, assuming insurer(s) and an acquiring party of an assuming insurer(s), if any, will not jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders or reinsurers.</td>
<td>(1) The financial condition of a dividing insurer, resulting insurer(s) and an acquiring party of a resulting insurer(s), if any, will not jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders or reinsurers.</td>
</tr>
<tr>
<td>(2) The terms of the plan of transfer will not be unfair or unreasonable to the transferring insurer’s or assuming insurer(s)’ policyholders or reinsurers.</td>
<td>(2) The terms of the plan of division will not be unfair or unreasonable to the dividing insurer’s or resulting insurer(s)’ policyholders or reinsurers.</td>
</tr>
<tr>
<td>(3) A transferring insurer, assuming insurer(s) and an acquiring party of an assuming insurer(s), if any, will not have plans or proposals to liquidate the transferring insurer or assuming insurer(s), sell its assets, or consolidate or merge the transferring insurer or assuming insurer(s) with a person, or to make any other material change in its business or corporate structure or management, that are unfair or unreasonable to the transferring insurer’s or assuming insurer(s)’ policyholders and reinsurers and not in the public interest.</td>
<td>(3) A dividing insurer, resulting insurer(s) and an acquiring party of a resulting insurer(s), if any, will not have plans or proposals to liquidate the dividing insurer or resulting insurer(s), sell its assets, or consolidate or merge the dividing insurer or resulting insurer(s) with a person, or to make any other material change in its business or corporate structure or management, that are unfair or unreasonable to the dividing insurer’s or resulting insurer(s)’ policyholders and reinsurers and not in the public interest.</td>
</tr>
<tr>
<td>(4) The competence, experience and integrity of the persons who would control the operation of a transferring insurer and an assuming insurer(s) are such that it would be in the interest of the transferring insurer’s and assuming insurer(s)’ policyholders and reinsurers or the general public to permit the transfer.</td>
<td>(4) The competence, experience and integrity of the persons who would control the operation of a dividing insurer and resulting insurer(s) are such that it would be in the interest of the dividing insurer’s and resulting insurer(s)’ policyholders and reinsurers or the general public to permit the division.</td>
</tr>
<tr>
<td>(5) The transfer is not likely to be hazardous or prejudicial to the insurance-buying public.</td>
<td>(5) The division is not likely to be hazardous or prejudicial to the insurance-buying public.</td>
</tr>
</tbody>
</table>

2 We recognize that many of the existing laws and proposed legislation follow the NAIC Insurance Holding Company System Model Act in providing that the Commissioner shall approve the transfer or division unless he or she finds that certain criteria are not met. Throughout this document, we note that so long as all of the required criteria are included in proposed legislation, such legislation would meet the ACU’s expectations.
<table>
<thead>
<tr>
<th>INSURANCE BUSINESS TRANSFER</th>
<th>CORPORATE DIVISION</th>
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<tbody>
<tr>
<td>(6) The interest of the policyholders of the transferring insurer that may become</td>
<td>(6) The interest of the policyholders of the dividing insurer that may become</td>
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<tr>
<td>policyholders of an assuming insurer(s) will be adequately protected by the assuming</td>
<td>policyholders of a resulting insurer(s) will be adequately protected by the resulting</td>
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<tr>
<td>insurer(s) or acquiring party of an assuming insurer(s), if any</td>
<td>insurer(s) or acquiring party of a resulting insurer(s), if any</td>
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<tr>
<td>(7) The transfer is not being made for purposes of hindering, delaying or defrauding any</td>
<td>(7) The division is not being made for purposes of hindering, delaying or defrauding</td>
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<tr>
<td>policyholders or reinsurers.</td>
<td>any policyholders or reinsurers.</td>
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<tr>
<td>Regulator review of financial condition</td>
<td>Required</td>
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<td>Required</td>
<td>Required</td>
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<tr>
<td>The Commissioner shall approve the plan of transfer so long as the following requirements</td>
<td>The Commissioner shall approve the plan of division so long as the following requirements are met:</td>
</tr>
<tr>
<td>are met:</td>
<td>(1) The financial condition of a dividing insurer, resulting insurer(s) and an</td>
</tr>
<tr>
<td>(3) The financial condition of a transferring insurer, assuming insurer(s) and an acquiring</td>
<td>acquiring party of a resulting insurer(s), if any, will not jeopardize the financial</td>
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<td>party of an assuming insurer(s), if any, will not jeopardize the financial stability of the</td>
<td>stability of the insurer, or prejudice the interest of its policyholders or</td>
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<tr>
<td>insurer, or prejudice the interest of its policyholders or reinsurers.</td>
<td>reinsurers.</td>
</tr>
<tr>
<td>(2) A transferring insurer, assuming insurer(s), and an acquiring party of an assuming</td>
<td>(2) A dividing insurer, resulting insurer(s) and an acquiring party of a resulting</td>
</tr>
<tr>
<td>insurer(s), if any, will not have plans or proposals to liquidate the transferring insurer or</td>
<td>insurer(s), if any, will not have plans or proposals to liquidate the dividing insurer</td>
</tr>
<tr>
<td>assuming insurer(s), sell its assets, or consolidate or merge the transferring insurer or</td>
<td>or resulting insurer(s), sell its assets, or consolidate or merge the dividing insurer</td>
</tr>
<tr>
<td>assuming insurer(s) with a person, or to make any other material change in its business or</td>
<td>or resulting insurer(s) with a person, or to make any other material change in its</td>
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<tr>
<td>corporate structure or management, that are unfair or unreasonable to the transferring</td>
<td>business or corporate structure or management, that are unfair or unreasonable to the</td>
</tr>
<tr>
<td>insurer’s or assuming insurer(s)’ policyholders and reinsurers, and not in the public</td>
<td>dividing insurer’s or resulting insurer(s)’ policyholders and reinsurers, and not in</td>
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<tr>
<td>interest.</td>
<td>the public interest.</td>
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<tr>
<td>(3) The transferring insurer and assuming insurer(s) will be solvent upon the consummation</td>
<td>(3) The dividing insurer and resulting insurer(s) will be solvent upon the consummation</td>
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<tr>
<td>of the transfer</td>
<td>of the division</td>
</tr>
<tr>
<td>(4) The assets allocated to the transferring insurer and assuming insurer(s) will not be,</td>
<td>(4) The assets allocated to the dividing insurer and resulting insurer(s) will not be,</td>
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<tr>
<td>upon the consummation of a transfer, unreasonably small in relation to the business and</td>
<td>upon the consummation of a division, unreasonably small in relation to the business and</td>
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<tr>
<td>transactions in which the transferring insurer and assuming insurer(s) was engaged or is</td>
<td>transactions in which the dividing insurer and resulting insurer(s) was engaged or is</td>
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<tr>
<td>about to engage.</td>
<td>about to engage.</td>
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<tr>
<td>Balance sheet considerations</td>
<td>In reviewing the proposed transaction, the regulator may consider, among other things,</td>
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<tr>
<td>In reviewing the proposed transaction, the regulator may consider, among other things, all</td>
<td>all assets, liabilities, cash flows and the nature and composition of the assets</td>
</tr>
<tr>
<td>assets, liabilities, cash flows and the nature and composition of the assets proposed to be</td>
<td>proposed to be transferred in support of the plan of transfer including, without</td>
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<tr>
<td>transferred in support of the plan of transfer including, without limitation, an assessment</td>
<td>limitation, an assessment of the risks and quality (including liquidity and</td>
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<tr>
<td>of the risks and quality (including liquidity and marketability) of the proposed transfer</td>
<td>marketability) of the proposed transferred portfolio, and consideration of asset/liability</td>
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<td>portfolio, and consideration of asset/liability matching and the treatment of the material</td>
<td>matching and the treatment of the material elements of such portfolio for purposes of</td>
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<td>elements of such portfolio for purposes of statutory accounting.</td>
<td>statutory accounting.</td>
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<tr>
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<td>CORPORATE DIVISION</td>
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<tr>
<td>-----------------------------</td>
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</tr>
<tr>
<td><strong>Regulator review of operational impacts</strong></td>
<td>Required</td>
</tr>
<tr>
<td>Any material changes in the transferring insurer's and assuming insurer(s)' business, corporate structure and/or management must not be unfair or unreasonable to the transferring insurer's or assuming insurer(s)' policyholders and reinsurers and must be in the public interest.</td>
<td>Any material changes in the dividing insurer's and resulting insurer(s)' business, corporate structure and/or management must not be unfair or unreasonable to the dividing insurer's or resulting insurer(s)' policyholders and reinsurers and must be in the public interest.</td>
</tr>
<tr>
<td><strong>Regulator review of owner and management qualifications</strong></td>
<td>Required</td>
</tr>
<tr>
<td>The competence, experience and integrity of the persons who would control the operation of the transferring insurer and assuming insurer(s) are such that it would be in the interest of the transferring insurer's and assuming insurer(s)' policyholders and reinsurers and the general public to permit the transfer.</td>
<td>The competence, experience and integrity of the persons who would control the operation of the dividing insurer and resulting insurer(s) are such that it would be in the interest of the dividing insurer's and resulting insurer(s)' policyholders and reinsurers and the general public to permit the division.</td>
</tr>
<tr>
<td><strong>Independent expert report</strong></td>
<td>Required, and the report must address, with respect to the transferring insurer, assuming insurer(s), and an acquiring party of an assuming insurer(s), if any, the following:</td>
</tr>
<tr>
<td>Business purposes of the proposed transaction</td>
<td>Business purposes of the proposed transaction</td>
</tr>
<tr>
<td>Capital adequacy and risk-based capital (including consideration of the effects of asset quality, non-admitted assets and actuarial stresses to reserve assumptions)</td>
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</tr>
<tr>
<td>Cash flow and reserve adequacy testing (including consideration of the effects of diversification and concentration of lines of business on policy liabilities)</td>
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</tr>
<tr>
<td>Business plans</td>
<td>Business plans</td>
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<tr>
<td>Management's competence, experience and integrity</td>
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</tr>
<tr>
<td><strong>Public hearing</strong></td>
<td>Required</td>
</tr>
<tr>
<td>Public notice must be provided, as well as specific notice to individual policyholders, reinsurers, applicable state regulators and guaranty associations, and any other persons determined by the Department</td>
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</tr>
<tr>
<td><strong>Licensing in other states</strong></td>
<td>Assuming insurer(s) must be licensed such that policyholders of the assuming insurer(s) maintain guaranty association coverage in the same state in which they had it immediately prior to the transfer.</td>
</tr>
</tbody>
</table>

\(^5\) With regard to group certificates issued under a group policy, the general view was that consistent with a bias towards transparency, if the insurance company was sending mailings to individuals (regardless of their status as a policyholder or a certificateholder) in the normal course of servicing the business, then the notice should be sent to the individual certificate holder.
Date        April 3, 2019
Memorandum to  New York Life Insurance Company
From        Debevoise & Plimpton

Insurance Business Transfers under Part VII of the UK Financial Services and Markets Act 2000
(a “Part VII Transfer”)

This note provides a summary of (i) the purpose of a Part VII Transfer, (ii) the principal elements of the
process, (iii) the role of regulators and independent experts, (iv) the approach and powers of the court,
(v) key considerations where a transferor is in financial distress, and (vi) the consultation process
between UK and other European Economic Area (“EEA”) regulators.

A. Overview

Purpose

1. A Part VII Transfer is a court sanctioned regulatory process to implement a statutory transfer of a
(re)insurance portfolio, along with its related assets and liabilities. Since the transfer is effected by
operation of law, the transferor and the transferee are not required to seek individual consents from
policyholders.

2. The court has broad powers, including the ability to order the transfer of outwards reinsurance
contracts and other ancillary assets and liabilities, even where those contracts contain terms
restricting their transfer.

3. The Part VII regime is mandatory for “insurance business transfer schemes” (as defined in the
legislation and subject to limited exclusions).

Process

4. Once the transferor and transferee have determined that Part VII applies and otherwise completed
their planning and diligence, the principal elements of the process are:

(a) Regulator engagement: Initial discussions with UK regulators, the Prudential Regulation
Authority (“PRA”) and Financial Conduct Authority (“FCA”), take place at an early stage.
Discussions will include the proposals themselves, consideration of likely issues arising
(including as to policyholder rights), notifications to policyholders/reinsurers and agreeing
the transfer timetable.

(b) Appointment of independent expert: A sufficiently qualified individual, approved by the
regulators, prepares the scheme report for the transfer. Typically, the relevant criteria the
proposed expert must meet are specified by the PRA. The expert is instructed at an early
stage in the process and the approval process includes confirmation of their independence.
(See Section B below for further details of the independent expert’s role.)

1 Note: This note sets out the position prior to the UK’s withdrawal from the European Union.

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(c) **Documentation:** Transferor and transferee work with advisors on detailed development of proposals and key documents. The independent expert also prepares their report at this stage, and if the Part VII Transfer involves long-term business, separate actuarial report(s) from each company’s actuaries are usually provided. The key documents prepared by the parties include:

i. the scheme document, setting out detailed terms of the transfer

ii. draft court orders, which will approve and give effect to the scheme once made by the court

iii. policyholder communications and notices to be published, which will be reviewed in detail by regulators and the court

iv. witness statements for the court process, explaining the proposals and any waivers sought

(d) **Further regulator engagement:** Regulators review draft documents and discuss any concerns with the parties. Final documents are approved prior to being submitted to court. The PRA and/or the FCA will also prepare report(s) for the court which include their assessment of the transfer. (See Section B below for further details of the regulators’ role.)

(e) **Court proceedings:** The transferor and/or transferee begin court proceedings by filing relevant documents, including the scheme document itself, with an initial “directions” hearing being held shortly after to deal with case management issues and any applications to waive notification requirements. The date for the final court hearing is set.

(f) **Consultation and notifications:** In the period before the final hearing, the PRA consults with other EEA regulators (if necessary) (see Section D below for further details of this process). The parties also make the agreed notifications to policyholders and reinsurers at this time; the regulators typically require notices to be sent to policyholders at least six to eight weeks before the final hearing. As well as providing notice of the application for the Part VII Transfer to such parties, the application must be generally publicized in specified newspapers. A copy of the independent expert’s report is to be given to any person who requests it; a statement setting out the terms of the scheme and a summary of the expert’s report is also made available to policyholders. (Certain notification requirements may be waived by the court if requested, for example due to practical difficulties of contacting all policyholders. The court generally looks to the regulators for guidance as to whether to grant the waiver request but may not always follow the regulators’ views.)

(g) **Submission of final documents:** Refreshed reports from the independent expert, actuaries and regulators are filed with the court, as well as additional witness statements from the parties which deal with any material objections received since the directions hearing, and certain other documents.

(h) **Final court hearing:** The PRA and/or FCA may attend the final open court hearing, at which any person alleging the Part VII Transfer would adversely affect them may argue their case. This includes policyholders of either party, reinsurers and others whose contracts are being transferred. The court can only approve a Part VII Transfer if (i) relevant certificates have been obtained, including a certificate of solvency from the transferee’s primary prudential regulator, (ii) the transferee has (or will have) requisite authorisations for the transferring business, (iii) all relevant procedural requirements have been complied with, and (iv) it considers that, in all the circumstances, it is appropriate to approve the transfer. (See Section B below for further details of the court’s approach and powers.) If approved, the
court will make its order, which, amongst other things, contains the “effective date” when the transfer completes.

(i) Publicity: Following the court’s approval, the order is publicized in relevant EEA states, either as specified by the EEA regulators, or as directed by the court.

5. The process is broadly the same whether general or long-term insurance business is being transferred.

6. The typical timeframe for completing a Part VII Transfer is between six and twelve months, given the time required for the court process itself, relevant notifications to be made and consultations with regulators in other jurisdictions.

B. Roles of Regulators and Independent Expert; the Court’s Approach and Powers

Regulators’ Role

1. The UK regulators have a significant statutory role in the Part VII process. The PRA acts as lead regulator but the FCA will also be involved (and may take a closer interest in long-term business transfers); in particular, the PRA must consult with the FCA before approving an independent expert’s appointment or form of report and before approving required notices.

2. One of the key roles of the regulators is producing report(s) for the court. The report sets out what the regulators have considered in relation to the Part VII Transfer and their assessment of the proposals in the context of their regulatory objectives. This means the transaction having been considered by the PRA in light of its objectives to promote the safety and soundness of insurers and secure an appropriate degree of policyholder protection, and by the FCA in light of its consumer protection objective and the promotion of competition between financial services providers (if relevant).

3. The regulators take all circumstances into account when assessing proposals. They are not obliged to object to a proposed Part VII Transfer if the proposal is not adverse to policyholder interests just because another possible scheme could result in a better outcome. However, they have indicated in guidance that “treating customers fairly” obligations could in some circumstances require the parties to consider or implement an alternative scheme.

4. Although the court considers the proposals separately, it would be rare in practice for it to override the views of the regulators. This may happen, however, in the context of a request to waive policyholder notification requirements, where the court may take a more pragmatic approach and agree to the waiver request against the regulators’ recommendation.

5. As noted in Section A above, the regulators are also involved in appointing the independent expert and approving the form of notices to policyholders, and have the right to appear in court. They must liaise with EEA regulators in the situations set out in Section D below. To the extent the PRA is consulted by another EEA regulator as the “home” regulator of a transferee under that state’s insurance business transfer regime, it will also provide a certificate of solvency in respect of the transferee.

Independent Expert’s Role

6. The independent expert acts as a witness for the court and his or her report carries significant weight. The report is significant in the regulators’ assessment of the parties’ proposals, and will also be relied on by policyholders and other affected parties.
7. For a Part VII Transfer involving general business, the independent expert will need to be competent in assessing technical provisions and understanding the relevant liabilities; where long-term business is being transferred, the expert should be an actuary familiar with the role of the actuarial function-holder/with-profits actuary preparing the actuarial report(s) noted above.

8. The contents of the expert’s report are detailed in regulatory guidance, and include (i) information about the expert, (ii) purpose of the scheme, (iii) summary of the scheme terms, (iv) information considered, (v) people and information relied on, (vi) opinion on likely effects on transferring policyholders, non-transferring policyholders and transferee’s policyholders, and (vii) opinion on likely effects on reinsurers of the transferor whose contracts will transfer. There is additional guidance where long term business is involved; in such case the report should also (i) describe the effect on policyholders’ rights to participate in profits, (ii) compare the value of any compensation offered if such rights are to be diluted, (iii) consider the effect on the approach to calculating non-guaranteed benefits and discretionary charges, (iv) describe various safeguards, and (v) assess whether the scheme is equitable to all classes and generations of the policyholders of each party.

9. The terms and conditions of the expert’s report typically contain a liability cap as well as a general disclaimer of responsibility in terms of who can rely on it; it is generally understood that the primary role of the expert is to inform the court, although regulators, policyholders and any other parties that may be adversely affected by the Part VII Transfer may well rely on the report in practice. As a general principle, the court is protective of independent experts; while challenges to a proposed scheme often focus on the expert’s independence, such challenges have not been successful to date. The regulators pay particular attention to ensuring that the expert is truly independent (other than payment of his or her fees by the parties) during the appointment process.

Court’s Approach and Powers

10. The court’s principal concern when assessing whether it is appropriate to approve a Part VII Transfer is whether policyholders (or certain other stakeholders) would be adversely affected by it. The key issue is whether the Part VII Transfer is, as a whole, fair as between the interests of the different classes of persons affected. In coming to a view, the court will consider the policyholders’ relative security and reasonable expectations with and without the transfer. It is not up to the court to assess if this is the best scheme possible but to assess whether the one presented to it is fair.

11. Under statute, the court has broad powers when approving a Part VII Transfer: its order can provide for the transfer of other contracts, assets and liabilities making up the transferring insurance business alongside the underlying policies. This includes the transfer of outwards reinsurance contracts and other contracts with terms that would usually require counterparty consent to be transferred. The court may also amend the terms of transferring policies, but additional scrutiny will be given to notifications made if significant changes are requested.

12. However, registration requirements to perfect the transfer of certain classes of assets (e.g. real property) will still apply, including local law steps to perfect transfers of foreign assets.

13. A judge presented with an application for a Part VII Transfer will have been selected as a Commercial Court judge in the usual way from a pool of Queen’s Counsel, and is not required to have previous experience with insurance generally or Part VII Transfers in particular.

C. Transferor in Financial Distress

1. In respect of a Part VII Transfer of an insurance business whose transferor is in financial distress, the regulators and court would be in favour of the business being held by an insurer of suitable financial strength so that the interests of policyholders are well protected. The focus will therefore
be on the standing of the transferee; approval is unlikely to be granted where the financial strength of
the proposed transferee is weaker than that of the transferor, since policyholders would be
adversely affected by the transfer.

2. In making their assessment of a proposed Part VII Transfer, the regulators and court will consider
policyholder protections and service standards. Where a transferor is in financial distress, the
protections and service standards are likely to be better in a transferee of superior financial
standing. As such, the proposal is likely to be viewed favourably and a transfer to a stronger
insurer is one of the methods favoured by the UK regime to ensure continuity of contracts where a
life insurer may be in financial difficulties.

3. Regulatory guidelines allow for benefits due under transferring policies to be reduced, for example
where the transferor is in financial difficulty. Although this is rare in practice, if such a proposal is
made, the independent expert would report on the reductions they consider appropriate. It would
also be possible for such reductions to be made by a post-transfer order, where the transfer is
urgent. The regulators would consider specified matters and may request the appointment of an
independent actuary in such circumstances to make an additional report on any post-transfer
reduction in benefits.

4. The position of a transferor in financial difficulty may also be taken into consideration by the
regulators when considering requests to waive policyholder notification requirements, given the
costs involved in such a process.

D. Consultation with Other Regulators

1. The Part VII Transfer regime is the UK’s method for transferring insurance portfolios, as required
to be established under the EU’s Solvency II Directive. The objective for the establishment of
similar regimes in each member state is that the “home” state regime of the transferor applies to all
EEA transferring policies, without the regimes of other member states being triggered.

2. As such, in the following circumstances, the PRA is obliged to notify and consult with the
authority responsible for regulating insurance business in the relevant EEA states:

(a) the UK transferor’s transferring business includes business carried on from a branch in
another EEA state

(b) the UK transferor’s transferring business includes insurance policies (not reinsurance
policies) where the risk is “situated” in (for general business) a non-UK EEA state or the
“state of commitment” (for long-term business) is a non-UK EEA state

(c) the transfer is from a UK branch or agency of a non-EEA PRA-authorised insurer and the
transferring business includes insurance policies (not reinsurance policies) where the risk is
“situated” in (for general business) a non-UK EEA state or the “state of commitment” (for
long-term business) is a non-UK EEA state

(d) the transfer is from a UK branch or agency of a non-EEA PRA-authorised insurer to a
branch or agency in a non-UK EEA state

2 Note: The same principles apply to the broader group of EEA states.

3 Note: For this purpose, the “state of commitment” is only used with respect to life insurance and refers to the
EEA state of an individual policyholder’s habitual residence (although this term is not defined, so a judgement
will need to be made); the state “in which the risk is situated” is used for non-life insurance and depends on the
nature of the insurance (e.g., for a policy relating to a building, the location of the building determines the
relevant state; for a policy relating to a vehicle, the state of registration of the vehicle is the relevant factor; and
for a liability policy, it is the state of the establishment to which the policy relates).
3. The consultation may involve sharing the expert’s report with the foreign regulator, particularly where the transfer involves long-term business. The foreign regulator has three months to confirm non-objection. If no response is received during that time, the foreign regulator is deemed to have consented. Relevant foreign regulators may, for example, advise of local rules for notifications to policyholders.

4. Where the transferee’s head office is in a non-UK EEA state, a certificate of solvency from the foreign regulator will need to be provided to the court before the Part VII Transfer can be approved.

***

This memorandum is solely for the benefit of New York Life Insurance Company and, without our prior written consent, neither our advice nor this memorandum may be relied upon by any other person or disclosed to any other person. This memorandum is limited to the matters stated herein and no views are implied or may be inferred beyond the matters expressly stated herein.

The advice expressed herein is rendered only as of the date hereof, and we assume no responsibility to advise you or any other person of facts, circumstances, changes in law or other events or developments that hereafter may occur or be brought to our attention and that may alter, affect or modify the process described or beliefs expressed herein.

***
Restructuring Mechanisms (E) Working Group
Conference Call
May 16, 2019

The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met via conference call May 16, 2019. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair, Matthew Gendron and Jack Broccoli (RI); Buddy Combs, Co-Chair, and Glen Mulready (OK); Rolf Kaumann (CO); Kathy Belfi (CT); Bruce Sartain (IL); Fred Andersen (MN); John Rehagen (MO); Matt Holman (NE); Steve Kerner (NJ); Joe DiMemmo (PA); Joe Cregan and Lee Hill (SC); Amy Garcia (TX); David Smith (VA); David Provost (VT); and Richard Wicka (WI).

1. **Heard Presentations**
   
a. **Lloyd’s**

   Timothy Grant (Lloyd’s) stated that the Lloyd’s oral presentation would focus on the United Kingdom (UK) Part VII statutory framework transfers requirements and would be presented by Claire Schrader (Lloyd’s).

   Ms. Schrader stated that Lloyd’s is in the part of submitting a UK Part VII request, noting that she would focus on the policyholder protection aspect of the law. She noted that, in addition, the UK regulators—the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA)—have developed regulatory procedures as a result of the statutory framework, which is a critical before the two hearings take place as part of completing the transaction. She stated the first hearing (directors) takes place partway through the process and is primarily focused on the construction of the scheme and the insurer’s expected communication of the transaction. This allows the insurer to begin the exercise and then come back to the court for a final sanctions hearing. She emphasized the importance of the regulators’ views during both hearings to make sure there are no objections from the regulators. She described how Lloyd’s is using this UK Part VII transfer as part of its Brexit plan, but the transfers are also often used in the context of sales of business, restructuring/efficiencies and winding up.

   Ms. Schrader stated that there are two primary ways in which the UK Part VII transfers protect policyholders: 1) the requiring of, and deference to, an independent expert; and 2) communication policy.

   Ms. Schrader discussed how the independent expert is crucial and noted that they are appointed by a firm sanctioned by the PRA, which also must agree they can act in such capacity. She stated that even though they are appointed by the transferee, they are not partial and are focused on how the transfer is going to affect policyholders and other affected parties. The expert spends significant time looking at the financial condition of the transfer and requires significant engagement with both parties, noting that the solvency of the transaction after the proposed transaction is assessed. They also need to consider any loss of benefits that could occur through a transfer outside of the UK, for example, or as a result of, how it will be serviced and whether there will be a deterioration in the level of service. The expert must also consider the impact on reinsurers of the transferor.

   The definition of “policyholders” is not narrow and specifically includes beneficiaries, which comes into play on the communication. Ultimately, the independent expert will have to issue a report and deliver to the directors hearing and the final sanctions hearing.

   Ms. Schrader stated that the transferrers must tell all its policyholders about the transfer, including those who are not part of the transfer. For example, in the Lloyd’s Brexit transfer, even though Lloyd’s is only transferring the small European book, it is required to notify all transferor and transferee policyholders. However, the statute provides an avenue for the company to request waivers that allow to whom the communications are distributed to be reduced with approval from the regulator and support from the independent expert. Once the scope is determined, the policyholders determined must be notified about the scheme and the independent expert report, and a frequently asked questions document and usually a link to a website that will provide all the documents to inform on each of these items must be provided. She noted that next steps require various specific newspapers (e.g. Financial Times) where the communication must also be made publicly, but requiring more niche publications is also a possibility. Also required is a series of help lines to policyholders so they can call with questions about the transaction. Policyholders can also specifically request their objections be heard by the court and they may also attend the hearing. Also required is a log of such calls. To the extent there are material objections, the transferrer must develop a plan to address such issues. The court would then have the benefit of the independent expert to provide their views on how well all such items are addressed. While not all objections must be accommodated, it must be determined to be fair.
Superintendent Dwyer asked if it is common for a waiver to be issued to not require all policyholders to be notified of the transaction when only a portion of them are having their policies transferred. Ms. Schrader responded this is common, but it gets harder to achieve as the amount of business being transferred in proportion to the rest of the business is higher.

Superintendent Dwyer asked if, in addition to the help lines and maintaining logs of objections, if people are also able to make their objections known via mail or email. Ms. Schrader responded that all forms of communication are acceptable.

Superintendent Dwyer stated that it sounds like there is a responsibility to provide the court with a complete list of all complaints and resolutions. Ms. Schrader responded affirmatively, although the court tends to focus on the overall themes of the reasons for the objections.

Superintendent Dwyer stated that it appears notification is also required to parties outside of the UK. Ms. Schrader responded that this happens over a period, but by the regulator and not by the company.

Superintendent Dwyer asked if the UK has guaranty funds in place. Ms. Schrader responded that retail policyholders can make claims on compensation funds in some scenarios and some European member states have something similar, although they all operate in different ways. Part of the independent expert’s review will consider the policyholder losing such benefits.

Ms. Belfi asked about the role of the reinsurer in the process and whether any issues or objections will be raised. Ms. Schrader responded that the independent expert is required to look at the impact on the reinsurers. She stated that they are expected to be included in the communication exercise.

Mr. DiMemmo stated that it sounds like a receivership process, where experts are used to make sure everyone is given notice and treated fairly. He asked if it is an expensive and lengthy process. Ms. Schrader stated that it is difficult for her to judge, given Lloyd’s is doing it for Brexit, but she said it is likely expensive given the need to use lawyers and pay for the independent expert. However, the process is quite useful and helpful, at least in the Lloyd’s case, and likely for other insurers that are in difficult situations.

Mr. DiMemmo asked about how long the process takes. Ms. Schrader responded that, for simple transactions, they can be done in less than 12 months, but Lloyd’s process will take longer because it is more complex. Mr. DiMemmo asked if the reinsurer is required to make the transfer. Ms. Schrader stated that the reinsurer could engage in the process and object—and that is part of the independent expert review—but, ultimately, it is up to the court.

Ms. Belfi asked if termination clauses in reinsurance contracts would terminate if the transfer occurs. Ms. Schrader stated that she has not heard of that occurring, noting that Lloyd’s is not transferring its outward reinsurance.

Mr. Broccoli asked about the capital requirements are actuarial requirements. Ms. Schrader said she would not be able to respond, as the Lloyd’s actuary is involved in those issues.

Mr. DiMemmo asked if the statutes are limited to commercial lines. Ms. Schrader responded it can be any type of insurance, primarily because of the policyholder protections.

Superintendent Dwyer asked if there have been any challenges for a transfer from other countries. Ms. Schrader stated that she is not aware of any, but noted that her involvement is more related to Brexit, where the need is well understood.

Superintendent Dwyer asked if there have been any failures. Ms. Schrader responded not that she is aware of any, noting that what is more common are questions at the sanction hearings that require some changes but, ultimately, they have been approved.

Carolyn Fahey (Association of Insurance & Reinsurance Run-Off Companies—AIRROC) stated that while she does not have a lot of data, she is aware that there have been 251 successful UK Part VII transfers from 2002 to 2017 and a significant number completed in 2018 and 2019 related to Brexit.

Superintendent Dwyer asked how many personal lines transfers there have been. Ms. Fahey responded she did not have such a breakdown, but estimated that about 30% have been life and annuity and the rest have been property/casualty. Ms. Schrader responded that she has a detail report produced by a firm that could be helpful.
b. **ProTucket Insurance Company**

Marvin Mohn (ProTucket Insurance Company—ProTucket) noted that the experience in the UK has also been experienced in other European jurisdictions under a European Union (EU) directive, noting that these have been done successfully and without prejudice to policyholders with tremendous advantages to restructure capital. He described how some of the EU transactions required trust funds in the U.S. to be moved, and they had been considered and moved forward in pretty much all states. He discussed the ProTucket business plan using Rhode Island law. He said the law limits to business runoff for five years or more and only applies to commercial business, noting that there are no guaranty fund issues because the business in reinsurance and surplus lines only and will not impact policyholders.

Mr. Mohn emphasized various aspects of the ProTucket white paper (Attachment Five-C1)—in particular, the Rhode Island process, which included significant disclosure, an independent expert and approvals from regulators—as well as various other views of the company on the related issues. He discussed how an insurance business transfer can basically be achieved through commercial agreements such as reinsurance agreements, outsourcing through a service agreement. He distinguished how an insurance business transfer (IBT) is not a novation, which is a third-party contract and pointed out the faults with arguments that it fails to distinguish between and contractual novation and a legal process that has a similar process by operation of law.

Mr. Mohn discussed the various ways in which state laws work and govern actions of corporations, noting that corporation are fictitious people and how they are organized is a product of state law. He discussed how the insurance limitation does not impact the basic organization or reorganization of the corporate entity under state law. He said the laws of other states may limit what a company can do, but those are limitations imposed on the insurance company as opposed to limitations on the state of domiciles laws and any related court order. He discussed how an IBT is a reorganization like a merger and is analogous to a corporate division. He summarized ProTucket’ s views on the contract clause as included in its white paper.

Mr. Kaumann noted that the white paper includes a double negative in its discussion of lines of business because long-term care insurance is not covered. Mr. Mohn agreed, noting that it should indicate personal lines are not covered, which would include long-term care insurance.

Mr. DiMemmo asked if the independent expert is similar under the Rhode Island law. Mr. Mohn responded that Rhode Island appoints its own expert, which the company pays for. Superintendent Dwyer agreed, noting that the insurance department’s job is to protect consumers and it works directly for Rhode Island.

Patrick Cantilo (Cantilo & Bennett, LLP) stated that he did not believe long-term care insurance business can be transferred as a possible solution for a deeply insolvent block of business. Mr. Mohn stated that if the book of business is a deeply insolvent block of business, then that raises a significant number of issues.

Mr. Andersen asked Mr. Mohn if he had thought about how the concept would work for a highly volatile line of business, where, for example, there is a possibility of reserve increases after the transaction. Mr. Mohn responded that a volatile block of business suggests a broader bell curve with the tail out much further and, as a result, the capital requirement would be considerably higher.

Superintendent Dwyer announced that the Working Group will be accepting presentations done via conference call, including anyone from the Working Group with specific issues they would like addressed or anyone specific they would like to hear from. As information is received, it is being gathered in order to develop the white paper. She stated that the Working Group has not yet received from information from the states that have corporate division laws or companies taking advantage of them, and she welcomed presentations on that topic.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.
ProTucket Insurance Company
Paper on Insurance Business Transfer Plans
Under Rhode Island Law

Introduction

ProTucket Insurance Company (“ProTucket”) respectfully submits this Paper to assist insurance regulators in their consideration of issues related to insurance business transfers (“IBTs”). ProTucket is a Rhode Island domiciled insurance company whose sole business is to engage in IBTs under applicable Rhode Island law, namely the Rhode Island Voluntary Restructuring of Solvent Insurers Act (1995), as amended1 (the “RI Act”) and regulations promulgated thereunder. The RI Act as it applies to IBTs is more narrowly focused than other comparable state laws; for example, it does not permit an IBT of personal lines business. Accordingly, this Paper will not address various issues that are raised by legislation in other states but are not relevant to the RI Act.

The RI Act addresses an increasingly evident need in the insurance industry and serves a public purpose for the benefit of transferring and transferee insurers, as well as policyholders. The history of IBTs outside the USA, principally in the UK, has demonstrated that such transfers strengthen the insurance sector through a more efficient allocation of capital and management resources and provide policyholders financial security and responsible claims management.

ProTucket is part of a larger group of companies focused on insurance services with a history going back to 1993 in the field of run off, having successfully managed several billion dollars of run-off business in that period, including several insurance pools in the U.K. that comprise some of the most complicated run offs seen in the last 30 years as well as run offs in the U.S. market.

1 R.I. Gen. Laws § 27-14.5-1 et seq.
The IBT Process Under Rhode Island Law.

Rationale and History.

There has been a growing need in the insurance sector for mechanisms to transfer books of legacy insurance business to dedicated and responsible run-off insurer managers. In recent years, surveys by PricewaterhouseCoopers, LLC; the publication The Insurance Insider; the Association of Insurance and Reinsurance Run-Off Companies (“AIRROC”) and others have indicated an industry view in favor of developing mechanisms in the US to permit the transfer of books of insurance business.2

Many U.S. reinsurers and insurers are looking for new solutions that provide legal and economic finality to legacy insurance risks as a means to improve the efficient allocation of capital and management resources to legacy and on-going insurance operations. Specifically, the segregation and transfer of legacy books of business can free up capital, better allocate specialized management resources currently being occupied with the oversight of disparate discontinued and on-going businesses and rationalize and facilitate the run-off of discontinued lines of business. Experience elsewhere, including in the UK as discussed below, has shown that prudent allocation of reserves and management of legacy books of business reduces volatility and improves capital efficiency with benefits for reinsureds/policyholders3 of both legacy and on-going books of business. Furthermore, run-off experts such as the Pro group of companies, including ProTucket, bring focused expertise to managing run offs compared to ongoing enterprises. The focus of an ongoing enterprise is the generation of increased premium growth, and legacy business is both a distraction to management and a poor step child in the regulatory and investor oversight of the company. A company focused on legacy business brings specific expertise in managing legacy problems, and the isolation of such business from ongoing business enhances the visibility of those operations, and hence the supervision of those operations, by both regulators and by investors in the owner of the legacy business.

In addition, the efficiencies that result from the segregation and specialized management of these disparate books of business have the ultimate result of releasing resources of the transferring insurers and allowing them to better focus on improving their current operations. Transferor companies can better focus on core areas, leading to better service for current and future policyholders and better service for policyholders on their run-off claims. In many cases, the run-off business consists of long-tail lines, such as mass tort, asbestos, environmental or general liability risks, which have tied up financial and management resources out of proportion to the size or importance of the run off book within the insurer.

Experience with IBTs elsewhere, especially in the UK, has proved that IBTs have been very successful over a substantial period of time. In the UK, IBTs are permitted under Part VII of the UK Financial Services and Markets Act 2000. Since 2002 there have been at least 253 “Part VII

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2 For example, the 2018 PwC Global Insurance Run-off survey showed: (a) PwC estimates the size of the US run-off market at $335 billion; (b) 68% of US survey respondents indicated they will undertake restructuring or exit activity in the next three years; (c) 41% of US survey respondents anticipate using an IBT as a restructuring tool in the next three years.

3 Hereinafter, references to policyholders includes reinsureds, where appropriate.
Transfers” under that statute with no insolvencies. Their success has led to adoption of directives of the European Union requiring similar laws throughout the EU, and as a result the adoption of legislation making available comparable transfer mechanisms throughout the EU. The US remains one of few large insurance markets with no ready mechanism to address the problem the RI Act is designed to solve.

The Part VII procedures and safeguards for prudent reserving, notice, and regulatory and judicial involvement are similar to those found in the RI Act. Furthermore, many prominent insurer groups with extensive operations in the US, including the UK operations of The Hartford, AIG, Fairfax, St Paul, Swiss Re, Zurich and Lloyd’s of London, have all engaged in Part VII Transfers. Many UK Part VII Transfers have also involved books of business covering US risks (either surplus lines or reinsurance) which have required review and been favorably acted upon by US insurance regulators in all 50 States, as well as the International Insurers Department of the NAIC. Again, there has been not any insolvency in any of these and other Part VII cases throughout the entire history of Part VII Transfer - over nearly two decades.

4 See “The Insurance Business Transfer Act restructuring option for insurance and reinsurance companies” (2019), available at http://ncoil.org/wp-content/uploads/2018/12/IBT-presentation-NCOIL.pdf. The PwC report counted only those transfers up to and including 2017. The number of 253 transfers to date would be greater if those effected during the year 2018 were included.

5 Directive 2002/83/EC provides for the transfer of all or part of the portfolio of life assurance business from one life assurer to another (see article 14), Directive 92/49/EC addresses the transfer of all or part of the portfolio of non-life insurance business (see article 12), and Directive 2005/68/EC addresses portfolios of reinsurance business (see article 18).

6 Other US states have adopted or are in the process of adopting laws similar to those of Rhode Island. These include Oklahoma and Vermont and others which have adopted laws permitting other methods to segregate insurer books of business, including division statutes which permit insurers to divide the corporate entity. Very briefly, the salient differences in these statutes are:

<table>
<thead>
<tr>
<th>State</th>
<th>Type of Restructuring</th>
<th>Some Salient Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rhode Island</td>
<td>IBT</td>
<td>• Minimum 5-years run-off.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No personal lines on admitted basis (excludes long-term care).</td>
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<tr>
<td></td>
<td></td>
<td>• No workers’ compensation.</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>IBT</td>
<td>• None of the Rhode Island restrictions.</td>
</tr>
<tr>
<td>Vermont</td>
<td>IBT</td>
<td>• Limited to commercial non-admitted policies and reinsurance agreements.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Provides for a transfer of policies as a result of an approval order from the Vermont Commissioner. A court-ordered approval is not required.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Policyholders can opt out of the transfer.</td>
</tr>
<tr>
<td>Illinois</td>
<td>Division</td>
<td>• Plan of division must be approved by the Director of the department of insurance after reasonable notice and a public hearing.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No court approval required.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No restrictions on lines of insurance.</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>Division</td>
<td>• No restriction on lines of insurance.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• A plan of division must be approved by the Department of Insurance.</td>
</tr>
</tbody>
</table>
The Rhode Island Law.

The Rhode Island law authorizing IBTs was modelled on the UK’s successful and long-standing regime of Part VII Transfers with the addition of safeguards in line with U.S. practices. The RI Act creates a comprehensive and detailed process for the transfer of some or all of the commercial run-off liabilities, with related assets, of a Rhode Island or foreign insurer to a Rhode Island insurer.

To effect an IBT, a special term of the Rhode Island court system, the Business Calendar of the Rhode Island Superior Court (the “RI Court”), is granted authority to transfer books of insurance business (policies and/or reinsurance contracts with related assets, reinsurance or retrocessional protections) to a Rhode Island insurer, such as ProTucket, from other insurers. The RI Court may approve an IBT only after notices are given to interested parties and after obtaining approvals from the Insurance Division of the Rhode Island Department of Business Regulation (the “RI Department”) and the domestic insurance regulator of the transferring insurer (the “Transferor Regulator”). Upon RI Court approval of the IBT transaction, the transferring insurer will have no further obligations under the transferred contracts or rights to related assets and the transferee insurer will become fully obligated under those contracts and fully entitled to the rights to the transferred assets. The transferee insurer will be responsible for those liabilities on the same terms as the original transferor, with the transferee insurer subject to the same solvency standards and insurance regulations as any other Rhode Island domestic insurer, and thus to the same solvency standards applicable to insurers throughout the U.S.

The RI Act authorizes IBTs only for reinsurance and commercial lines (including surplus lines), in each case only if the business has been in run-off for at least 5 years. Workers’ compensation, life insurance, long-term care insurance, other personal lines insurance (not including reinsurance), and any business currently being written or in run-off for less than 5 years are not eligible for transfer under the RI Act.?

<table>
<thead>
<tr>
<th>State</th>
<th>Division</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>Division</td>
<td>• Court order not required.</td>
</tr>
<tr>
<td>Arizona</td>
<td>Division</td>
<td>• A division shall not become effective until it is approved by the commissioner after reasonable notice and a public hearing.</td>
</tr>
<tr>
<td>Arizona</td>
<td>Division</td>
<td>• Court order not required.</td>
</tr>
<tr>
<td>Arizona</td>
<td>Division</td>
<td>• No restrictions on lines of insurance.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Division</td>
<td>• Must obtain approval from local governmental agency or office if the laws of that state or country of domicile require approval to perform a merger prior to the performance of a division.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Division</td>
<td>• No restrictions on lines of insurance.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Division</td>
<td>• The division plan must be approved by the insurance department of Michigan, after reasonable notice and a public hearing.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Division</td>
<td>• Notice must be sent by the dividing insurer to each reinsurer that is a party to a reinsurance contract allocated in the plan of division within 10 days of filing the division plan.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Division</td>
<td>• No restrictions on lines of insurance.</td>
</tr>
</tbody>
</table>

Both Nebraska and Iowa have legislation pending to enact division statutes. See Iowa House Study Bill 35; Nebraska Legislative Bill 62.

In addition to the approvals of the RI Department and the Transferor Regulator, the RI Act requires notice to all interested parties, who have a right to object, and expert financial and actuarial reviews. Regulators in states in which the transferor is authorized will be provided notice before the IBT goes to the RI Court. No IBT is presented to the RI Court for approval without the RI Department having already reviewed and approved the transaction and the Transferor Regulator having reviewed and not objected to the transaction. Once the RI Department has approved the transaction, the Transferor Regulator has reviewed and not objected to the transaction, and the RI Court has considered any objections and found that all requirements have been met, the RI Court can issue its order and effect the IBT transfer. There is no available opt-out provision that would allow any policyholder or other party to refuse to recognize the transfer once approved by the court.

An IBT in Rhode Island is effected via a “voluntary restructuring” as defined in the RI Act:

“the act of reorganizing the legal ownership, operational, governance, or other structures of a solvent insurer, for the purpose of enhancing organization and maximizing efficiencies, and shall include the transfer of assets and liabilities to or from an insurer, or the protected cell of an insurer pursuant to an insurance business transfer plan. A voluntary restructuring under this chapter may be approved by the commissioner only if, in the commissioner’s opinion, it would have no material adverse impact on the insurer’s policyholders, reinsureds, or claimants of policies subject to the restructuring.”

The RI Act requires that notice be provided to all policyholders, contract parties and other interested parties, including insurance regulators and guaranty funds of other states that may have interests in the IBT.

The IBT approval process also requires (1) extensive disclosure of financial information of the transferee insurer; (2) an expert report that will evaluate the impact on transferring and non-transferring policyholders and contract parties; (3) an independent evaluation by the RI Department; and (4) approval by the Transferor Regulator. Most importantly, there is complete judicial review of the IBT plan, and before the transaction will be approved, the transferee insurer must satisfy the RI Court that the transfer does not materially, adversely affect policyholders, reinsureds or claimants.

Any party who feels adversely affected by the transfer can file an objection with the RI Court for consideration. Once approved, the transferee insurer is subject to the continuing authority of the RI Department.

To become effective a proposed IBT in Rhode Island must undergo a review, including the following:

1. Summary of the IBT Plan, including the Business Transfer Agreement, if any;

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2. Identification and description of business to be transferred;

3. Most recent audited financial statements and annual reports of the transferring insurer filed with its domiciliary regulator;

4. The most recent actuarial report and opinion that quantifies the liabilities in the business to be transferred to the transferee insurer under the policies or reinsurance agreements;

5. Pro-forma financial statements demonstrating the projected solvency of the transferee insurer;

6. Plan Administration, including the form of notice to be provided under the IBT Plan to any policyholder or reinsured of the transferring insurer whose policies or contracts are to be transferred and to any reinsurers of any such policies or contracts;

7. Full description as to how such notice shall be provided.

8. Description of any guarantees or additional reinsurance that will cover the transferred business;

9. Description of any reinsurance arrangements that would pass to the transferee insurer under the IBT Plan;

10. If the transferred business is intended to be transferred into a protected cell, the requirements related to the plan of operation for protected cells must be included in the IBT Plan;

11. Approval of the IBT Plan obtained from the Transferor Regulator; and

12. An expert report providing an opinion on the proposed transaction.\(^\text{12}\)

The RI Act and the standards adopted by the RI Department are comparable to those used with success in the UK and in some respects are more conservative. Rhode Island requires that the Company have sufficient capital such that policyholders are not materially adversely affected,\(^\text{13}\) whereas a UK Part VII Transfer requires that the transaction not prejudice policyholders, which generally requires that the Company have sufficient capital to meet its regulatory solvency requirements under Solvency II.\(^\text{14}\) The RI Act, however, does not permit IBTs for current writings, for direct personal lines business, or for workers’ compensation, all of which are allowed for UK Part VII Transfers.\(^\text{15}\) Significantly, whereas under the UK procedure the independent expert is selected by the parties (albeit with regulatory approval) and subject to their direction (albeit within the constraints of independence imposed by the appointment), the Rhode

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\(^\text{12}\) 230-RICR-20-45-6.4(II)(A).

\(^\text{13}\) 230 RICR 20-45-6.4(B)(1)(p)(11).

\(^\text{14}\) See Re Norwich Union and other companies, [2004] EWHC 2802 (Ch); Re Sompo Japan Ins. Inc, [2011] EWHC 260 (Ch), ¶ 36.

\(^\text{15}\) R.I. Gen. Laws § 27-14.5-1(6); 230-RICR-20-45-6.3(A).
Island process allows for two experts, one of which is appointed directly by and under the control of the RI Department.16

**Constitutional Issues**

The US Constitution and general principles of contract law provide protections to assure the rights of parties to their contracts. Insurance and reinsurance contracts benefit from those protections, as well as varying degrees of insurance regulatory oversight depending upon whether the contracts are for direct insurance, surplus lines or reinsurance.

An IBT under the RI Act effects a corporate restructuring of insurers such that assets and contracts without any other modification are transferred from one to another insurer. Such a transfer complies with all Constitutional, contract law and regulatory requirements.

**Contract Clause.**

One potential argument against IBTs is that a transfer of an insurance contract impairs the policyholder’s rights in violation of the Contract Clause of the U.S. Constitution, which prohibits states from passing laws “impairing the obligation of contracts.”17 However, “not every modification of a contractual promise ... impairs the obligation of contract” under the Constitution.18 To violate the Contract Clause, a law must “substantially impair” a contract based on an analysis which must consider “the extent to which the law undermines the contractual bargain, interferes with a party’s reasonable expectations, and prevents the party from safeguarding or reinstating his rights.”19 And, even if a “substantial impairment” is found, the legislative enactment will continue to pass constitutional muster if “the state law is drawn in an ‘appropriate’ and ‘reasonable’ way to advance ‘a significant and legitimate public purpose.’”20 As to the effect of court orders, the Supreme Court has frequently stated that the Contract Clause does not limit judicial decisions, however erroneous, as they may impact existing contract rights.21

Consistent with the above, an IBT does not substantially impair any insurance contract, and therefore does not substantially impair any policyholder rights. No insurance policy is modified other than references to the transferring insurer being changed to references to the transferee insurer. The essence of the contractual obligations in question (i.e., to pay a claim according to the contract terms) will not have been changed or abrogated, but rather simply transferred to the transferee insurer pursuant to a procedure assuring the creditworthiness of the transferee.

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17 U.S. Const. art. I, § 10, cl. 1.
Most importantly, the IBT (and the limited modification of the policyholders’ contracts) offers an “appropriate” and “reasonable” way to advance “a significant and legitimate public purpose” as required by long-standing and recently reaffirmed Supreme Court precedent. In this case, the public purpose of the RI Act and its realization in a Rhode Island IBT will have been confirmed by the RI Department and the RI Court with all due, appropriate and reasonable protections set forth under Rhode Island law. The Rhode Island law promotes “a significant and legitimate public purpose” by facilitating the reorganization of a solvent insurer’s business in an orderly fashion and furthering efficiency and innovation in the insurance industry as a whole, implemented in conformity with the procedures and safeguards of the RI Act. Furthermore, it increases regulatory oversight of the run-off of legacy business by separating run offs from ongoing business enterprises, enhancing the regulatory oversight of the legacy operations.22

Significantly, the insurance contract itself is not being modified; it is being transferred pursuant to a reorganization that transfers an insurer’s assets and liabilities – a corporate transaction effected pursuant to the in rem jurisdiction of the RI Court over the insurers, as described below.

Due Process Clause.

The IBT contracts are being transferred by the RI Court by authority of that court’s jurisdiction over the insurers, not by reason of its jurisdiction over the contract parties. This jurisdiction of the RI Court over the insurers in rem is consistent with Constitutional due process guaranties and can be seen in other in rem cases involving bankruptcy, liquidation and other courts that adjudicate matters in rem. Those courts acquire legitimate jurisdiction to affect contract parties wherever they may be located, whether inside or outside the jurisdiction, by reason of their jurisdiction over the res present in the jurisdiction.

A proceeding in rem “is founded upon a right in the thing,”23 in contradistinction to personal actions, which are said to be in personam. In a strict sense, a proceeding in rem is one taken directly against property, and has for its object the disposition of property, without reference to the title of individual claimants; but, in a larger and more general sense, the term is applied to actions between parties, where the direct object is to reach and dispose of property owned by them, or of some interest therein. Examples include cases commenced by attachment against the property of debtors, or instituted to partition real estate, foreclose a mortgage, enforce a lien, or quiet title; also, proceedings to escheat a bank deposit, probate of a will, admiralty suits against a vessel to satisfy debts arising from the operation or use of the vessel, and certain marital actions.24 Bankruptcy jurisdiction, at its core, is in rem.25

The various types of proceedings that may be considered in rem have a common aim: “to reach a conclusive determination of all claims to the thing so that it may be transferred to, or confirmed

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23 The Maggie Hammond, 76 U.S. 435 (1869).
24 See Pennoyer v. Neff, 95 U.S. 714 (1878) (”[s]o far as they affect property in this state, they are substantially proceedings in rem in the broader sense which we have mentioned”).
in the hands of, a person who will then hold it free and clear of all claims.”26 Because in rem actions adjudicate rights in specific property (real or intangible) before the court, judgments in them “operate against anyone in the world claiming against that property” and a judgment in an in rem case “foreclose[s] any person from later seeking rights in the property subject to the in rem action.”27

U.S. courts generally will recognize a state’s exercise of jurisdiction “to determine interests in a thing if the relationship of the thing to the state is such that the exercise of jurisdiction is reasonable.”28 The prerequisites to a valid exercise of in rem jurisdiction are (1) presence of the property or res in the jurisdiction of the court adjudicating the matter, which in the case of intangible property means that there are at least minimum contacts between the transaction at issue and the state, and (2) notice procedures (i) reasonably certain to result in actual notice to persons who will be bound by the proceeding if they can be identified and located (such as notice by mail addressed to the person at his last reasonably discoverable address or to someone who could represent him), or (ii) that will have a practical possibility of reaching categories of persons who cannot be specifically identified or located (such as notice by publication).29

In this case, the res is before the RI Court, the res being the presence of the transferring and transferee insurers, each with the agreement of its domiciliary regulator (the RI Department and the Transferor Regulator). A restructuring of those insurers with appropriate notices to contract and other interested parties is properly within the in rem jurisdiction of the RI Court.

The Supreme Court has stated that so long as there are at least minimum contacts between the jurisdiction and the res, as well as adequate notice, in rem jurisdiction will be valid.30

Accordingly, just as in other cases of in rem jurisdiction, the presence of the res (here, the Rhode Island and the foreign transferring insurers) would be sufficient to allow a court to take action affecting parties outside the jurisdiction to effect a restructuring of the operations of these insurers.

**Comparable “Restructurings”.**

There are also practical regulatory reasons that argue in favor of recognizing the effectiveness of IBTs. Many forms of restructurings and other corporate transactions with a potentially equivalent impact on policyholders and other contract parties are routinely processed and approved by insurance regulators, often merely with the approval of the domestic regulator. The

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26 Restatement Second of Judgments, § 6, comment b.
27 *R.M.S. Titanic v. Haver*, 171 F.3d 943, 957-58 (4th Cir. 1999); see also *Goodrich v. Ferris*, 214 U.S. 71, 80-81 (1909) (“[i]t is elementary that probate proceeding by which jurisdiction of a probate court is asserted over the estate of a decedent for the purpose of administering the same is in the nature of a proceeding in rem, and is therefore one as to which all the world is charged with notice”).
29 Id. at comments a, b, e.
30 *Shaffer v. Heitner*, 433 U.S. 186 (1977) (“to justify an exercise of jurisdiction in rem, the basis for jurisdiction must be sufficient to justify ‘exercising jurisdiction over the interests of persons in a thing’; the standard for determining whether such exercise is “consistent with the Due Process Clause is the minimum-contacts standard” of *International Shoe Co. v. Washington*, 326 U.S. 310 (1945)).
The novelty of IBTs raises legitimate issues that call for answers, but many other more routine transactions can raise similar concerns. For example:

(i) **Mergers:** Insurer mergers can create conditions by which a more credit-worthy insurer becomes weaker after the merger. The merger itself is often subject merely to domestic regulatory approval without any say by that insurer’s policyholders or its regulator’s outside its domicile. The possible review by the non-domiciliary regulator of a license for re-issuance is often perfunctory. In effect, the domestic regulator is often the only one to have a say in protecting policyholders or reinsureds in other states.

(ii) **Divisions:** Regulatory procedures similar to those for mergers apply to division statutes as well. But, in these cases the comparison to an IBT is even closer. Different books of insurance business get attributed to each of the resulting entities in an insurer division, very similar to the result in an IBT. Again, the depth of review by non-domiciliary regulators is limited. A division followed by a merger of an insurer into one of the insurers resulting from a division would have the same result as an IBT, but without the procedural safeguards inherent in the Rhode Island IBT process.

Although these “restructurings” are more common and do not have the novelty of the RI Act, ProTucket believes that the RI Act, with its many protections, participation by both domiciliary regulators, notices to all interested parties, and judicial review, offers a comparable level of review and, in some respects, a heightened level of assurance of contract integrity to regulators and contract parties. It is also noteworthy that many states have started to consider the enactment of laws similar to the RI Act or with similar objectives. Whether to implement a regime similar to the RI Act or otherwise, it appears that the public policy of many states has now begun to move in the direction of recognizing and promoting legacy solutions.

**Conclusion.**

For some time, many reinsurers and insurers have been looking for new solutions that provide legal and economic finality to increase capital and/or operational efficiencies. All EU jurisdictions have laws permitting IBTs. The UK has been doing IBTs for decades, most recently pursuant to Part VII of their corporate law. There have been at least 253 Part VIIs completed in the UK to date with no insolvencies and, on average, there have been around 18 Part VIIs completed every year since 2004. Many large US insurers entered into IBTs in the UK or elsewhere in Europe to reorganize their European businesses and transfer books to unaffiliated third parties. As shown by industry surveys, and increasing legislative activity in the US, those

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31 Even acquisitions, which would appear to be the most routine of insurer corporate transactions, can lead to dramatic changes in insurer management, which sometimes implicate changes in capital structure, reserving and operations. Acquisitions typically are reviewed by the domiciliary state only. Policyholders rarely have any say when the insurer is sold and non-domiciliary states often play a negligible role.

32 In addition to the states listed in footnote 6 above, others are currently considering similar legislation.
large insurer groups have an interest in realizing these efficiencies here at home through the use of an IBT mechanism. The US needs such a mechanism.

All Rhode Island IBTs are subject to strict review and approval by the RI Department as well as the Transferor Regulator and the RI Court who will ensure the viability and legality of the transfer. By segregating legacy portfolios and dedicating specialized teams to the management and run off of these discrete books of business, these insurers can more efficiently operate their current business. Experience elsewhere has demonstrated that this can be done without sacrificing policyholder and claimant protections, and policyholder services.

ProTucket’s own business plan aims to facilitate transfers under Rhode Island law and bring the advantages of IBTs to the U.S. market. The broader Pro group has been involved in run offs since 1993, including Part VII transfers in the UK and run-off services in the U.S., and has worked closely with numerous clients on both sides of the Atlantic to successfully manage legacy business for the benefit of investors, policyholders, and regulators. ProTucket aims to continue that track record with IBTs in Rhode Island.

The long and successful history of IBTs in other countries demonstrates that such transfers benefit both industry and policyholders by enabling a more efficient allocation of capital and management resources while providing policyholders with financial security and responsible claims management. IBTs under Rhode Island law advance good public policy and are consistent with existing statutes and regulations.

ProTucket Insurance Company
March 27, 2019

cc: Jonathan Bank, Esq
    Robert Romano, Esq
    Norris Clark
The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met in Orlando, FL, April 6, 2019. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair, Matt Gendron and Jack Broccoli (RI); Buddy Combs, Co-Chair (OK); Michael Conway represented by Rolf Kaumann (CO); Kathy Belfi and Joshua Hershman (CT); Robert H. Muriel represented by Kevin Fry (IL); Judy Weaver (MI); Fred Andersen (MN); Shannon Schmoefer (MO); Matt Holman and Lindsay Crawford (NE); Marlene Caride represented by John Sirovetz (NJ); Stephen Doody (NY); Joe DiMemmo (PA); Raymond G. Farmer represented by Lee Hill (SC); Jamie Walker and Ludi Skinner (TX); Scott A. White, Doug Stolte and David Smith (VA); David Provost (VT); and Doug Hartz (WA).

1. **Adopted its March 11 Minutes**

The Restructuring Mechanisms (E) Working Group met March 11 and took the following action: 1) solicited presentations for the Spring National Meeting; and 2) solicited new members. Mr. Combs made a motion, seconded by Mr. Fry, to adopt the Working Group’s March 11 minutes (Attachment Four-A). The motion passed unanimously.

2. **Heard Presentations**

Superintendent Dwyer reminded the Working Group that she believes one of the most efficient ways for the Working Group to begin to address its charges is to begin hearing viewpoints from interested parties on the concept of restructurings and insurance business transfers.

a. **American Council of Life Insurers**

Wayne Mehlman (American Council of Life Insurers—ACLI) and Rich Bowman (New York Life) provided a summary of the work the ACLI has completed on the topic of insurance business transfers and corporate divisions laws as a result of some of the activity on each of these topics in various states over the past year.

Mr. Mehlman said, in response to the various insurance business transfer and corporate division bills, the ACLI formed a committee to develop member views, but said the ACLI is working across several groups and subgroups to form its views. He stated that the insurance business transfer rules have been enacted in Arizona, Oklahoma, Rhode Island and Vermont. He stated corporate division bills have been enacted in Arizona, Connecticut, Illinois, Michigan and Pennsylvania, with a bill in Iowa awaiting final approval.

Mr. Bowman described an insurance business transfer as transferring all or a portion of insurance obligations or liabilities under existing insurance or reinsurance contracts to another assuming insurer without policyholder consent, the assuming insurer becomes directly liable to the policyholders, and the transferee obligations are terminated by operation of the law. He described a corporate division as the division of one insurer into two or more resulting insurers, which allocates assets and liabilities including insurance policies and potentially any other corporate contracts, obligations or assets among the insurers that result after the division without policyholder or other stakeholder consent, where the resulting insurers are only liable to the policyholder obligations that are allocated to the resulting insurers. He stated while the methods are different, the result is practically the same.

Mr. Mehlman described the ACLI’s process for better understanding the impact on its member companies. He stated that as part of its review, the ACLI is also considering the Form A – Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer (Form A) requirements under the Insurance Holding Company System Regulatory Act (#440), the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450), the Assumption Reinsurance Model Act (#803), and the United Kingdom’s Part VII Control of Business (UK Part VII) requirements. All of this is being done to understand how all the various laws work and compare to one another. He stated that while the ACLI has not taken a formal position on the state bills, it has been working with several ACLI committees and groups in order to develop a list of principles that can be used to: 1) evaluate the bills; and 2) determine if the bills can or cannot be supported.
Mr. Bowman stated that because the ACLI New York Life is still developing its principles, he is not able to share any initial views, noting that the ACLI New York Life has been considering different guardrails, including among others: stakeholder access to the process; court approval; a robust regulatory review process; operational impacts; the role of an independent expert; and expert report contents. He said the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) has been involved in the ACLI New York Life discussions, including a whole day drafting and discussion session. He discussed the need to protect the state-based system of insurance regulation and how the guaranty fund system is part of that process.

Mr. Combs asked what the expected timeline is for the ACLI principles. Mr. Mehlman responded that he expected the ACLI’s work to be completed by the middle of June.

Mr. Hershman asked if it is necessary for a state to adopt both the corporate restructuring bill and an insurance business transfer bill. Mr. Bowman said he believes only Arizona adopted both types of bills, and said he does not know the reason why both would be adopted and needed. Mr. Mehlman stated that in either case, the ACLI would want certain guardrails in place to provide certain protections if there is a certain transfer or division.

Ms. Belfi asked for clarification between the treatment under the two bills. She described a situation in which a group divides under the corporate division bill. She stated that her understanding of the corporate division bill is that for that group to take such business out of the group, there would need to be some type of transaction through a Form A filing. She said she believes there would be some type of regulatory hearing for most of the corporate division bills. She said she is struggling with the difference between a Form A, selling a company, and appropriate division.

Mr. Mehlman said his understanding is that the Form A requirements relate to mergers and transactions, and there is a certain level of rigor of the proposed transaction. He stated there are differences between corporate divisions bills and insurance business transfers. He noted a difference in when a court approval is necessary. He said the ACLI is focused on developing a consensus view or critical mass on what is necessary in a transaction, including for example the requirement of a court approval.

Mr. Bowman said a Form A brings more assets together and, therefore, diversifies risk; but a corporate division is creating the opposite situation.

Superintendent Dwyer asked if there are differences between the UK Part VII requirements and the insurance business transfer laws in the U.S. Mr. Mehlman said the Oklahoma bill was enacted near the end of 2018 and was based off of the UK Part VII requirements, but he could not say for sure that it contains each element included in the UK Part VII requirements.

Mr. Mehlman said the ACLI has been developing a grid that contains various elements present within different bills and laws, and it could be made public soon.

b. Swiss Re America Holding Corporation

David Scasbrook (Swiss Re America Holding Corporation—Swiss Re) indicated that, as an international insurance company operating in numerous countries, including the UK specifically, Swiss Re has experience with the topics being considered by the Working Group. He said his comments apply both to corporate division bills and the insurance business transfer bills. He stated that outside of the U.S., Swiss Re has been involved in many such transactions in different countries, both for restructuring and portfolio transfer purchases. He stated that he became involved in such transactions in 2004 with Swiss Re Corporate Solutions; and, since 2009, he has been involved in global transactions. He said he has been involved in the run-off sector for more than 25 years.

Mr. Scasbrook stated that when he read the Working Group’s charge, he believed he could aid in the industry need, which he can attest is very real. He described investment returns, increased competition, and improved operation platforms as reasons to complete such transactions. He said the current U.S. rules do not allow an efficient means to address such issues. He stated that loss portfolio transactions are unable to achieve the same objectives desired because of retroactive and retrospective reinsurance rules, but that does not tackle the operating inefficiencies. As a result, U.S. insurers tend to hold the portfolio, thus prohibiting the operating efficiencies needed and the continued impact on capital maintenance.
Mr. Scasbrook said the run-off industry is often criticized for the potential impact on policyholders, but the regulatory instruments used in the UK, Canada, Australia and Hong Kong are all designed to protect policyholder interests. He discussed how run-off companies in such countries are still regulated and, in his opinion, the transactions he has been involved with have had a positive impact, with no issues yet to arise in any transactions he is aware of. He described the regulatory process used in Germany, which does not go through the courts, but does have a higher level of the scrutiny on the transactions to be certain the policyholders are not jeopardized. He said the insurance business transfer bills are like the UK Part VII requirements and seem to try and strike the correct balance of various stakeholders.

Mr. Scasbrook described that while reinsurance transactions are often used as the starting point for moving business in an insurance business transfer, and it can take some time for the transfer to become final. Such transactions can still be finalized relatively quickly compared to what is required under U.S. laws, under novation or similar laws. He said he is unaware of any situations where the assets transferred to the acquirer were insufficient to cover policyholder obligations.

Ms. Belfi asked about the process in which reinsurance is used to begin the transaction. Mr. Scasbrook said the acquiring parties were typically either specialists or run-off inquirers, but they are often initiated by a reinsurance transaction to transfer the economics while the insurance business transfer is in process.

Mr. Kaumann asked if the reason for the transfer has any impact on the process itself. Mr. Scasbrook responded that there are three main reasons for all transactions: 1) operational; 2) regulatory, capital and earnings volatility; and 3) finality of economic transfer.

Superintendent Dwyer asked about why the UK Part VII requirements are preferred over a loss portfolio transfer. Mr. Scasbrook responded that the finality is preferred.

Superintendent Dwyer asked about notice to policyholders when there is risk to policyholders in other jurisdictions. Mr. Scasbrook responded that the transferee proposes to the court its proposed communication, but he said the type of portfolio can impact the type of communication. He described his experience with receiving notifications on his rights to attend a court hearing from his life insurer, for which his life insurance policy had been transferred numerous times. He stated it is important for the policyholders to be able to attend a court hearing to make their concerns known, but the court has broad discretion.

Superintendent Dwyer asked if the European Union (EU) has any corporate divisions statutes like those passed in the U.S. Mr. Scasbrook responded that he is not sure.

Mr. Doody discussed how the UK Part VII requirements must correspond with the U.S. Bankruptcy Court that will not recognize such; therefore, it is not effective and cannot take effect. He described the public policy standards in the U.S. and the current novation requirements to the policyholders.

Mr. Scasbrook responded that there are different views, but he noted that, even in the UK, the court judgment will indicate that the judge is not sure about whether it will stand if it is challenged in another jurisdiction. While he stated he is not aware of this ever occurring, for all practical purposes, the transaction does not go back to the transferee.

Mr. Doody said, in cases where it has not been obtained, it leaves the consumer and the regulator to wonder what assets are available to attach to if there was a failure to satisfy policyholder obligations. While it is agreed that no such situations have occurred, he said with long-tail business, it is still possible that it could occur with previously approved UK Part VII transactions.

Mr. Stolte asked if the policyholder liabilities are discounted under a UK Part VII transfer. Mr. Scasbrook said the issue is related to the terms under which the liabilities are transferred, and this is not an issue he has seen occur in his experience.

c. ProTucket Insurance Company

Albert Miller (ProTucket Insurance Company—ProTucket) said, as an insurance company formed under the Rhode Island statutes, he is sharing his views (Attachment Four-B) on the topics being considered by the Working Group.
Mr. Miller provided a brief history of ProTucket, including that it is a newly formed company under the Rhode Island law definition of a run-off company. He said it is not allowed under Rhode Island law to write new business or form insuring or reinsuring personal lines risk, including specifically long-term care insurance (LTCI) or workers’ compensation insurance. He stated ProTucket formed a protected cell and subsequently received a $35 million capital contribution, the purpose of which was to permit ProTucket to pursue licensing to support its anticipated insurance transfer business. He indicated ProTucket expects that its first transactions will involve reinsuring books of business, and it hopes to add direct business as part of insurance business transfers in the future.

Mr. Miller said the reinsurance industry is interested in transferring run-off business to a solvent entity and described how he sees examples of divestiture transactions where parent companies can divest of their business. He stated he has also seen mergers that illustrate things; specifically, voluntary restructuring available today does not allow for the restructuring of books of business, only groups and companies. He said Rhode Island only allows run-off of certain business to be transferred where the UK Part VII requirements pretty much allow all types. He stated that PricewaterhouseCoopers estimates the run-off market is more than $335 billion, which provides a benchmark of the type and size of the transactions that state insurance regulators might see in the future.

Mr. Miller said Rhode Island limits to business that has been in run-off for five years, and it provides legal finality of risk. He said it assumes that the company is subject to the same laws as other companies. He discussed some of the legal protections available to policyholders, including notice requirements, as well as the ability to object subject to certain limits. He described the requirement for an independent expert report and why ProTucket approves or disapproves of a transaction and the required capital level. He discussed how the transaction is required to be reviewed by the state insurance regulator of the transferring company and the state insurance regulator of the transferee company.

Mr. Miller described the primary reasons for the proposed transaction, including focus on other business, either management or human resources, as well as capital certainty. He said the acquirer can focus on operating efficiencies while being capitalized to the level required by the state insurance regulator. He described how there have been more than 250 UK Part VII transfers completed over the past 20 years with no insolvencies in the UK. He said many U.S. companies have had subsidiaries or affiliates that have been involved in such transactions.

Mr. Miller said the issue is not if insurance business transfers will take place, but when they will take place. He said ProTucket wants to make sure the transactions are done properly and are well-regulated, so the transactions can be replicated and as successful in the U.S. as in the UK.

Ms. Belfi asked how the reinsurance treaties would be treated by ProTucket under an insurance business transfer and if they would transfer over to ProTucket. Mr. Miller responded yes; they would transfer over to ProTucket as the successor company.

Ms. Belfi asked if those reinsurers would have had the opportunity to voice any concerns they would have had over the proposed transaction. Mr. Miller responded the reinsurers would be interested parties under Rhode Island law and can object to the transaction.

Mr. Stolte asked if the insurance business transfer is done without policyholder consent. He said Virginia requires policyholder consent, with limited exception for a company in hazardous financial condition. Mr. Miller stated that ProTucket’s first transactions will involve reinsurance and not direct policyholders. Mr. Miller said the courts will have to apply their full faith and credit statutes and, under those, there are public policy exceptions. The question will be whether these statutes are public policy decisions for which he provided his opinion; in turn, this would not be an issue based on the fact that there is not a blanket prohibition in current laws.

Superintendent Dwyer clarified that there is no case law on the topic.

Mr. Doody explained the conflict between the state novation laws, noting that the regulatory process for approval by the state insurance regulator could be an issue. Mr. Doody asked if ProTucket asked for clarification on its intent to obtain a license in a state that they do not intend to write business in. He noted how some states have indicated they are unwilling to grant a license in such a situation. Mr. Miller noted how it is ironic, given that it is possible that the company could have instead begun as a shell and, therefore, the issue would have never come up.

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d. National Organization of Life and Health Insurance Guaranty Associations and National Conference of Insurance Guaranty Funds

Peter Gallanis (National Organization of Life and Health Insurance Guaranty Associations—NOLHGA) and Barbara Cox (National Conference of Insurance Guaranty Funds—NCIGF) presented their views (Attachment Four-C) of the topics being covered by the Working Group from the perspective of the potential impact on the guaranty funds.

Mr. Gallanis said NOLHGA has been following with interest the development of the new statutes permitting corporate division and insurance business transfers in the U.S., and it has not taken a position for or against such statutes. He stated he applauded the NAIC’s interest in these topics, because there are some solvency implications for these statutes if not appropriately structured. The concern for insurance consumers of personal lines business is particularly pronounced, and it seems obvious the state insurance regulators want consumers to avoid the inconvenience and issues related to insolvency.

Mr. Gallanis said he would focus his comments on the impact of such statutes on guaranty fund protections. He stated that the important point is that for there to be guaranty fund coverage if an insurer fails, there are several conditions that must be present. The first condition is that the consumer who seeks such protection must be an eligible person under the statute; typically, this is achieved by being a resident of a state who has a guaranty fund. The second condition is that the product must be a covered policy. The third condition is that the failed insurance company for which protection is being sought must be a member company of the guaranty association of the state where the policyholder resides. To be a member company, the company must be licensed in that state or have been licensed in the state. He said this issue can occur, sometimes with unlicensed companies or with health maintenance organizations (HMOs).

Mr. Gallanis described that in most states, coverage can be provided for so-called “orphans,” who are policyholders of a company in a state, but the individual has since moved to a state that is not a member. In this case, they are covered under the state in which the failed company is domiciled. This provision is designed to plug the gap of these rare situations, but it was never designed to provide coverage of all policyholders across the country. He said all the statutes previously referred to would allow this situation.

Mr. Gallanis said the problem with these statutes is one of inadequate capacity of the guaranty association to provide coverage on this basis. He said it is possible to solve this problem; but there is a quick fix, and ultimately devising such a fix involves weighing different legislative and regulatory priorities. He stated there could be conditions such as maintaining its certificate of authority in each state to ensure the company is a member company in each state. There are different reactions to this, including that such a requirement could kill all such deals, where others describe how there are legitimate deals where those involved are not opposed to such requirements.

Ms. Cox stated that the NCIGF does not take a position on a regulatory practice or a business practice, but its concern is that the guaranty fund claimants, who the system is designed to protect, are completely protected. She said there is no orphan statute coverage within the property/casualty guaranty funds. She stated that there is a consensus that, as a result, no such coverage could be provided. She said many states require that the policy be issued by the now-insolvent insurer; whether that is the case in this transaction is unclear. Also, when the insurer became a licensed insurer, it must have been licensed either at the time of issue or when the insured event occurred. Ms. Cox said this is a complex issue, and the NCIGF remains committed to the protection of the policyholder. She urged the Working Group to consider this related issue as it moves forward.

Mr. Combs asked if the guaranty fund models could be revised to suggest that guaranty fund protection exists not just for member companies in those states, but also for policies that premiums collected were done so by a member company when they were written. Ms. Cox said the NCIGF has not developed a position on this yet, but one of its legal committees is expected to have a position by August. She stated that Illinois recently made a change to its guaranty fund act to address this issue, at least in part.

Mr. Gallanis stated that there could be a path to address this problem for NOLHGA, noting that the legislative history for life insurance has requirements in place for regulatory reasons and was not an accident. He said, for the guaranty association of a state to provide protection, the state wants the company to be licensed in the state to give the state insurance regulator a window to the certificate of authority in order to ensure that if monitoring shows issues, the state could act. He described how some of this was also done to prevent unfair treatment of those who are paying for the guaranty fund claims. He said, in summary, there are regulatory oversight issues that may be an issue.

Ms. Cox stated that the NCIGF agrees with Mr. Gallanis’ comments on these points.
Mr. Combs provided a hypothetical example of a single line company writing business in multiple states, but the company decided to shut off that line of business and put it into run-off, and he questioned if it could give up its license. Mr. Gallanis stated he is not qualified to answer the question; but, under the circumstances, the insurer would remain a member of the guaranty fund association and would retain its coverage even though it has surrendered its license.

Mr. Combs said, given that there was no premium, he asked if there is a difference. Superintendent Dwyer said because the assessments were based on premiums and the business is transferred years later, in theory, the entire premium was subject to assessment. Mr. Gallanis stated the assessment is often based on a three-year period; therefore, he inferred that the premium may not have been subject to assessment.

3. **Requested Presentations and/or Papers**

Superintendent Dwyer emphasized to interested parties that presentations and/or papers submitted to the Working Group would serve as the basis for a significant portion of the white paper to be drafted in the future, and she suggested that interested parties consider if they want to provide presentations. She said the Working Group will likely have a conference call in May 2019, but it will decide after digesting this information, noting that they will also consider additional questions for presenters submitted today that should also be covered during a future conference call.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.
Restructuring Mechanisms (E) Subgroup
Conference Call
May 23, 2019

The Restructuring Mechanisms (E) Subgroup of the Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met via conference call May 23, 2019. The following Subgroup members participated: Doug Stolte and David Smith, Co-Chairs (VA); Jack Broccoli, Vice Chair (RI); Kathy Belfi (CT); Kevin Fry (IL); Fred Andersen (MN); John Rehagen (MO); Steve Kerner (NJ); Dale Bruggeman (OH); Andrew Schallhorn (OK); and Amy Garcia (TX). Also participating were Robert Wake (ME); Joseph Cregan (SC); and Dan Raddock (VT).

1. Hearing of Comments

Mr. Smith indicated that the first item on the agenda is to hear comments on the Subgroup charges and the definition of run-off companies. He noted that the charges are posted on the Subgroup web page and are as follows:

1. Consider the development of financial surveillance tools that are specifically designed for companies in run-off (companies that are no longer actively writing insurance business or collecting premiums).
2. Consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in run-off.
3. Review the various restructuring mechanisms and develop:
   a. Minimum standards of review
   b. Minimum capital requirements
   c. Specific actuarial guidance in determining initial reserving levels
   d. Protected cell reporting requirements
   e. Proposed accreditation standards

Mr. Smith noted appreciation for the number of comments that were received (Attachment Five-E1). He requested that the commenters focus on key points. He also noted that some of the comments received were presentations or other items, rather than comment letters on the topics requested. These were posted on the Subgroup web page as additional information.

a. Connecticut

Mr. Smith directed the Subgroup to Connecticut’s comments. Ms. Belfi noted that there is some confusion on the third charge regarding what the Subgroup should work on versus the charges of the Restructuring Mechanism (E) Working Group. She noted that the Working Group should make some decisions regarding what type of restructuring mechanisms should be reviewed by the Subgroup. She also noted that some of the broader comments should have been directed to the Working Group. She said at a minimum, the state insurance regulators should think about what best practices they would like to see for run-off.

b. Maine

Mr. Smith directed the Subgroup to Maine’s comments. Mr. Wake noted that the initial definition of run-off used by the Subgroup should be broad, open-ended and high level. He noted that narrowing the definition of run-off, such as focusing on when entire business entities are in run-off, may be premature. He thought it would be better to leave the issues somewhat open-ended as specific tools and procedures are being developed. Mr. Wake said the definitions should be narrowed as the tools are developed in the design.

Mr. Smith noted that if you talk to three different people about the definition of run-off, they will give three different answers. He said there is some need to define what we are dealing with in order to determine the population. Mr. Wake noted that narrowing the population will occur as you look at tools, the beginning work should be flexible to determine application, and changes will be needed as part of the design process.
Mr. Stolte noted that the Subgroup did feel it was important to have some idea of the population in order to move forward. He noted that some state laws of insurance business transfers are being reviewed by the Working Group, and the Subgroup co-chairs are proposing to start with those as they do not want the Subgroup to get ahead of the Working Group. He noted that there are a number of challenges for the Subgroup. Mr. Stolte noted that while he agreed that he did not want to be unnecessarily restrictive in defining run-off, he did feel it is important to have a working description of the topic under discussion. He also commented that since long-term care (LTC) has such great uncertainty in reserving the risk premium associated with determining the premium pricing, it was not a good candidate for insurance business transfers or corporate division. Mr. Wake agreed that it is better to start with a broad definition. He also reiterated that run-off should not be entirely measured at the business entity level.

Mr. Broccoli noted that restructuring through an insurance business transfer or a corporate division was often accomplished by transferring business to an entity whose purpose was to administer the run-off or existing business. He noted that it was important to develop tools to monitor these entities. These tools could be useful to monitor the run-off of business, particularly for entities that do not have access to additional capital. For example, state insurance regulators may want to require that reserving meet a higher confidence level or have periodic asset adequacy or feasibility reviews. Mr. Broccoli said they need tools to look at run-off, regardless of how an entity becomes a run-off entity. He noted that the Subgroup charge is about developing tools and standards instead of the process for accomplishing the transactions.

Ms. Belfi thanked Mr. Broccoli for the description and suggested that for charge three there could be a clarification from “Review the various restructuring mechanisms and develop;” to be “Review run-off mechanisms and develop:” Mr. Broccoli agreed.

Mr. Wake noted that Ms. Belfi’s suggestion was a helpful clarification, but he also thought the Subgroup should be reviewing entities that are in run-off but also have the ability to adjust rates. He noted that a one-size definition does not fit all. He noted concerns with transferring business into companies that have both active and inactive business. Mr. Smith noted that some of Mr. Wake’s concerns may be beyond the charge. Mr. Smith noted that the process of getting comfortable with the transaction was part of the charge. Mr. Stolte noted that because of the unique nature of every transfer, any guidance developed would likely be a principle-based approach. He stated that the comments from Northwestern Mutual and New York Life did an excellent job of identifying some principles for consideration.

c. South Carolina

Mr. Smith noted that the comments from South Carolina did not have any proposed edits to the charges. Mr. Cregan stated that South Carolina did not have any additional comments at this time.

d. Texas

Mr. Smith directed the Subgroup to comments from Texas. Ms. Garcia noted that Texas’s comments are somewhat consistent with Mr. Wake’s and others in that the definition of run-off should also include companies that are no longer actively writing insurance business but may be collecting premiums on existing business, such as LTC companies. She noted that Texas considers many LTC companies to be in run-off in that they are collecting premium but not actively writing new business.

Mr. Broccoli noted regarding Mr. Wake’s comments about companies that are still actively writing, state insurance regulators already have tools to monitor actively-writing entities and transfers between active entities. He noted that the Subgroup should focus on entities that are not actively writing but are instead focused on managing an existing book of business. Mr. Smith noted agreement with the comments of Mr. Broccoli. Mr. Smith noted that the Subgroup co-chairs would work with NAIC staff to take the feedback received and come up with a more appropriate description.

e. Vermont

Mr. Smith directed the Subgroup to comments from Vermont. Mr. Raddock noted that Vermont’s comments shared some existing statutory language that the state used.

f. ACLI
Mr. Smith directed the Subgroup to comments from the American Council of Life Insurers (ACLI). Wayne Mehlman (ACLI) said the ACLI has concerns with the proposed definition of run-off companies as companies that are no longer actively writing insurance business or collecting premiums, because it should include entities that continue to collect premiums. Mr. Mehlman noted that the ACLI is also working on a list of principles and guidelines regarding insurance business transfers and corporate divisions. He noted that a current draft, which identifies relevant laws, including NAIC models, United Kingdom (UK) Part VII laws, and various state laws, has been submitted to the Working Group. Mr. Mehlman noted that the ACLI anticipates its board to approve such principles in mid-June and subsequently share it with the NAIC. Robin Marcotte (NAIC) noted that the ACLI listing of laws is on the Working Group website. Mr. Smith noted that hopefully the ACLI proposed guidelines would be presented during one of the upcoming July conference calls of the parent Working Group.

Mr. Wake noted that he made a distinction between companies that were previously writing business, and those that were formed to hold run-off business and did not previously write business actively but might still be writing IBTs.

g. Association of Insurance and Reinsurance Run-off Companies

Mr. Smith directed the Subgroup to comments from the Association of Insurance and Reinsurance Run-off Companies (AIRROC). He noted that some of the information submitted was in the form of a slide presentation that was included in the materials as additional information. Carolyn W. Fahey (AIRROC) said the 2018 PricewaterhouseCoopers Global Insurance Run-off Survey, which AIRROC shared with the Subgroup, estimates that the size of the global run-off market is $730 billion, with $350 billion of those liabilities in the U.S.

Ms. Fahey noted that run-off originated in the insurance and reinsurance sectors as a means to distinguish contracts that are cancelled on a cutoff basis—in which the reinsurer is not liable for losses taking place after the date of termination—from cancellations on an ongoing or a run-off basis, where the reinsurer remains liable for losses until the conclusion of all activity on the contract. She said over the past two or more decades, the term “run-off” has been expanded to refer not only to the run-off of a particular insurance or reinsurance contract, but also to entire books of business, the insurance or reinsurance company itself, and the entire sector of the market in which such business is administered. She noted that insurance and reinsurance companies go into run-off for varying reasons. She noted that a state-assigned liquidation bureau or receiver administering an “involuntary run-off” is very different from a “voluntary run-off” where there is a conscious decision by management to cease underwriting or dispose of a certain line of business as a strategic step. She noted that after a line of business (or the business itself) is discontinued, the company stops writing new policies and pays any remaining liabilities until normal expiry.

Ms. Fahey noted that once the decision is made to go into run-off, a company has several options: execute an outright sale of the company or book of business; perform a loss portfolio transfer; or run-off the liabilities with an internal team. She stated insurance run-off is a different business than ongoing insurance enterprises in that the mission has changed from one that is marketing and underwriting driven to one that is focused on asset and liability management. She noted it is important to have expertise in several areas.

Ms. Fahey noted that run-off business is most widely defined as lines of business that are no longer written; however, the definition can vary widely by individual companies. She said as the Subgroup considers requirements related to the risk-based capital (RBC) formulas in context of the restructuring statutes, the fact that the definition of run-off can have different meanings should be remembered.

Ms. Fahey stated regarding the RBC requirements for run-off companies, AIRROC’s actuarial committee noted that the strict application of these standards present interesting challenges to run-off. She noted that the NAIC’s Risk-Based Capital (RBC) for Insurers Model Act (#312) allows for capital flexibility with a property and casualty insurer, and such flexibility should not be changed. She noted that Section 6 (Mandatory Control Level Event).B (2) (for Property and Casualty Insurers) allows “in the case of an insurer which is writing no business and which is running-off its existing business, may allow the insurer to continue its run-off under the supervision of the commissioner.” She stated support for allowing the supervising commissioner to determine what is best in each situation.

Ms. Fahey stated that on a high level, the most critical issue for run-off companies regarding insurance business transfers and retroactive reinsurance, is the availability of cash and liquid assets to satisfy policyholder claims and other obligations. Related to this, she noted that AIRROC recommended that it may be prudent for the state insurance regulator to separately consider significant amounts of retroactive reinsurance (currently outside of the RBC formula) when determining a run-off company's capital requirements.
Mr. Smith noted that the Subgroup would like to hear more about their particular RBC concerns in the future.

h. Cantilo & Bennett, LLP

Mr. Smith directed the Subgroup to the comments from Patrick Cantilo (Cantilo & Bennett, LLP). Mark Bennett (Cantilo & Bennett, LLP) summarized key points from Cantilo & Bennett, LLP’s comments. He noted that, consistent with the other comments received, the definition of “run-off companies” should not exclude companies that are collecting premium. He said there are many “closed blocks” and other entities comprised solely of “legacy” or existing business which continue to pay premium, including ongoing and required renewal premiums.

Mr. Bennett said regarding alternative restructuring mechanisms, including insurance business transfers and corporate division statutes, can serve useful purposes for solvent insurers and reinsurers in several types of circumstances. He noted that they should not be viewed in the same context for addressing financially troubled companies. He said if used for troubled insurers, then such transactions should be made part of a more comprehensive arrangement, such that the IBT or corporate division transaction should also require the contribution of additional capital devoted to the block in question. He stated these new mechanisms are simply new ways of accomplishing goals that have been possible through other mechanisms like loss portfolio transfers and assumption reinsurance transactions. He also noted that items which start out as solvent run-offs can become insolvent run-offs. He noted that mechanisms need to be carefully considered, as entities can morph very quickly. He noted that it is very important to ensure that the guaranty association protections are maintained. Mr. Smith noted agreement with the comment in the comment letter that the mechanisms do not add any new value. He noted that the comments regarding the guaranty association coverage were also an important point to keep in mind.

i. Northwestern Mutual and New York Life

Mr. Smith directed the Subgroup to the comments from Northwestern Mutual and New York Life. Douglas Wheeler (New York Life) summarized key points. He noted support for the Subgroup’s charges and the development of uniform minimum standards for restructuring mechanisms. He noted that several states have recently enacted new “division” and “insurance business transfer” laws that allow insurers to transfer and novate business without policyholder consent. He noted strong concerns about the dangers for policyholders. He voiced concerns about new structures which allow the original insurer to extinguish liability to policyholders without policyholder consent. He noted that they view the potential harm to policyholders and the state-based system as the greater concerns. He also noted solvency protection concerns. He suggested more focus on this aspect than on the definition of a run-off company.

Mr. Wheeler noted that it is important to ensure that guaranty association protections are maintained for policyholders. He noted that corporate divisions can create monoline entities, which can cost policyholders the benefits of diversification without their consent. He noted concerns with the lack of a nationally uniform financial standard or actuarial level of confidence for state insurance regulators to apply when reviewing the financial strength of a business included in a division or transfer. He said a strong, nationally uniform standard is necessary to ensure that policyholders are protected against the risk of insolvency.

Mr. Wheeler stated that some laws also allow the division of a multi-state insurer into a splinter company licensed in a single state, potentially overwhelming the state’s domestic guaranty association in the event of insolvency. He noted that some laws sanction the use of non-admitted assets to support policy liabilities. He noted that several of the new state laws lack other important procedural and substantive safeguards which are present in the UK Part VII process, like public notice, requirements to consult with other interested states, independent expert review, a hearing or court process, and requirements to assess corporate governance and owner qualifications. He noted that if IBTs and corporate division transactions are being considered, all of the protections in the UK Part VII process should also be in place to protect policyholders. He noted support for the state-based system of regulation, and he noted that if such transactions are being contemplated, it is important to ensure that strong policyholder and solvency protections are in place.

Andrew Vedder (Northwestern Mutual) noted that Northwestern Mutual and New York Life have strong preferences that such transactions should not be applicable to life, annuity and health business. He noted that the risks to the policyholders outweigh the benefits of additional flexibility. He noted that their comment letter is an attempt to list standards to ensure that policyholders are not disadvantaged. He noted that their comments suggest several principles that should govern the regulatory review of proposed division and business transfer transactions, and the comments were guided by what they have learned about the UK Part VII business transfer process. He stated support for the use of a valuation expert to establish at a high level of confidence that policyholders will experience no adverse effects before the state insurance regulator and the court signs off. He noted that such an approach would align the U.S. regulatory framework with well-established international precedents like the UK Part. 
Mr. Vedder noted that there should be uniform NAIC valuation and accounting standards required by the accreditation system. He stressed that policyholders should never be left worse off, and he said there should be a finding that the transaction is, at worse, neutral regarding the policyholder. He said monoline companies should not be allowed, as recent LTC company failures highlight the risks of not having a diversified entity. He said hard to value lines of business, such as LTC, should not be eligible for an IBT or corporate division transaction. He noted that a possible test that could be applied is if the state insurance regulator cannot confirm the sufficiency of the assets supporting the liabilities based on industry experience, the transaction should not be permitted. For example, if there are not standardized valuation tables available for the line of business, the transaction should not be eligible for transfer.

Mr. Vedder noted that even if a long-duration life or health business is determined to be eligible for inclusion in a transaction, state insurance regulators will still need a robust framework to evaluate the long-term solvency of the business. He noted that for long-duration life, annuity and health business, state insurance regulators should start with a focus on policy reserves, and they should require the stress testing of reserves at a “severely adverse” level. He said if reserves are not subjected to a high level of stress testing, a division or transfer may appear to leave a business adequately capitalized at the time of the transaction.

Mr. Vedder noted that starting from a basis of reserves meeting a “severely adverse” standard, formulaic application of RBC will, appropriately, result in a higher level of required capital for the business affected by the division or transfer. He noted that while RBC may provide a useful starting point to establish capital requirements, it is not designed to measure relative financial strength; therefore, it would be insufficient on its own to determine the minimum required financial position of a transferred business. He said they recommended that in addition to RBC, state insurance regulators should explore capital standards for long-duration life and health business that are based on a defined ratio of asset adequacy standards. Capital standards based on this type of cash flow projection technique can help ensure that enough capital is held in a transferred business, supplementing the existing RBC framework. Mr. Vedder said the confidence level should be set at a standard that ensures solvency over the life of the business so as to provide a robust backstop to the combination of reserves established to meet a “severely adverse” standard and RBC.

Mr. Vedder noted that there should be uniform NAIC valuation and accounting standards required by the accreditation system. He said when evaluating the solvency impact of a proposed transaction, state insurance regulators should not give credit for non-admitted assets. Decisions about these transactions should start from the NAIC’s uniform statutory valuation and accounting rules, and the use of nonadmitted assets to back policyholder liabilities would be deeply troubling. He noted that their comment letter also notes other procedural safeguards that are equally important for these transactions. He stated New York Life and Northwestern Mutual look forward to providing their views on this and other procedural safeguards to the Restructuring Mechanisms (E) Working Group and the Restructuring Mechanisms (E) Subgroup.

Mr. Smith asked Mr. Vedder if Northwestern Mutual and New York Life’s comments had been submitted to the Restructuring Mechanisms (E) Working Group. Mr. Vedder noted that they had shared a document on the UK Part VII procedures, which was currently posted on the Working Group’s website. Mr. Smith suggested that the Northwestern Mutual and New York Life comment letter also be shared with the Restructuring Mechanisms (E) Working Group because it raised many important policy issues that should be considered in any white paper that the Working Group will develop. Mr. Vedder stated support for forwarding the letter.

j. Nationwide

Mr. Smith directed the Subgroup to the comments from Nationwide. David Garman (Nationwide) indicated that Nationwide believes that as the Subgroup moves forward with its charges, it should consider not only the necessity of developing new financial surveillance tools for run-off insurers, but also whether the application of existing requirements and surveillance tools are appropriately applied to companies in run-off. He noted that one example provided in Nationwide’s letter is the property and casualty RBC trend test. He stated that a run-off company that accepts any premium will likely trigger that RBC trend test. He stated that Nationwide does not believe that the trend test is designed to apply to run-off insurers, and it can result in counter intuitive outcomes when applied to them.

Mr. Garman said regarding the definition of a company in run-off, consistent with other commenters, that it would be difficult to come up with a singular definition. Therefore, he noted that therefore, any definition recommended by the Subgroup and adopted by the NAIC should provide for a mechanism by which the company and its domiciliary regulator can agree that an insurer is operating as a run-off company.
Mr. Smith inquired as to how Nationwide would envision having standards developed for companies in run-off working with their proposed concept of having discretionary state application. Mr. Garman said he would envision having a company in run-off being excluded from certain tools if they met certain standards. Mr. Smith noted that Nationwide does not seem to be advocating full discretion. Mr. Garman noted that the discretion Nationwide is advocating is primarily regarding determining if a company is in run-off.

k. ProTucket

Mr. Smith directed the Subgroup to comments from ProTucket, which were provided in the form of a licensing paper. Albert Miller (ProTucket) noted that the focus of the licensing paper ProTucket submitted relates to protected cell accounting concepts. Al Bottalico (Locke Lord) noted that he was providing high level thoughts today, as the Subgroup is still developing charges. He noted that as the Subgroup looks closer at these issues, Locke Lord will be happy to provide additional input. He noted that some parallels could be drawn between the proposed accounting and the existing accounting in Statement of Statutory Accounting Principles (SSAP) No. 74—Insurance-Linked Securities Issued Through a Protected Cell, which is used for P&C entities, and SSAP No. 56—Separate Accounts for life companies. Currently, there is not specific accounting guidance to fit the new laws in Oklahoma and Rhode Island. He noted that specific guidance is needed regarding how the surplus would be reported.

Mr. Smith asked Mr. Bottalico how, if there are five different IBTs each within separate protected cells, Locke Lord envisions the surplus of the reporting entity would be determined. Mr. Smith asked if Locke Lord is proposing that the surplus would be based solely on the assets and liabilities in the general account or if “excess” assets in the individual protected cells would contribute to that surplus. Mr. Bottalico noted that if there are two or more IBTs and the surplus is dedicated to the individual IBT, there is some precedence for rolling up the surplus, but some type of segregated surplus may be needed. Mr. Stolte said he would view this as the purview of the Statutory Accounting Principles (E) Working Group to develop guidance. Mr. Stolte stated that he was not sure it would meet the definition of unassigned surplus if it was limited to use for only certain policies and liabilities. Mr. Bottalico agreed that the issue needs further discussion. He noted that the concepts in separate accounts allow the possibility of rolling up surplus.

Mr. Smith asked if Locke Lord envisioned a revision to an existing statement or the development of a new statement. Mr. Bottalico noted that both options would be viable; however, it might be best to simply revise the existing SSAP No. 74. He noted that there might be a need to also do some type of interim work.

Mr. Broccoli noted that this would ultimately result in a referral to Statutory Accounting Principles (E) Working Group. Mr. Smith agreed that there is no doubt that there is a need to develop guidance, but the Subgroup should develop initial recommendations. Mr. Stolte agreed that there would be a need to help refine an initial referral. Mr. Broccoli agreed that more discussion by the Subgroup should occur to develop an initial recommendation. He noted that ProTucket is a Rhode Island company, and at this time, it is following guidance that Rhode Island has provided. He noted that Rhode Island would like to codify guidance. Mr. Stolte asked if it is a prescribed Rhode Island guidance. Mr. Broccoli noted that Rhode Island modified its protected cell structure to include restructuring mechanisms like IBTs. Mr. Broccoli noted that the statute revisions did not include accounting guidance; therefore, the guidance that the Rhode Island department has provided is that each cell should be transparent regarding their status and funding and that otherwise, to the extent that it is feasible, statutory accounting should be used. Mr. Broccoli noted that he agreed that there is a need for more detailed statutory accounting guidance.

Mr. Bruggeman noted that the parent company hosting the protected cells would not benefit from excess funds in the individual protected cells, according to his understanding; therefore, counting excess funds in the individual cells as unassigned funds in the hosting company would not be appropriate in all instances. He agreed that as more information is gathered, there will need to be more discussions at Statutory Accounting Principles (E) Working Group.

1. R&Q

Mr. Smith directed the Subgroup to comments received from Regulatory & Quality Solutions LLC (R&Q). Ms. Marcotte summarized the comments from R&Q, noting that they first submitted an email stating that the outwards retroactive reinsurance follows the loss liability component of the RBC calculation. R&Q’s comments noted that this reflects the net reserve calculation for RBC more accurately, even though the statutory statements have the retroactive reinsurance as the write-in line. Ms. Marcotte summarized that the R&Q comments noted that there is a disconnect between the retroactive reinsurance write-in line (pursuant to SSAP No. 62R—Property and Casualty Reinsurance) and the balance sheet location of the assumed reserves,
which are on the loss liability line. The RBC only reflects the charges on the loss liability on the reserve RBC calculation and not the net impact of the retroactive protecting the loss liabilities.

Ms. Marcotte stated that NAIC staff requested clarification of the comments, noting that the statutory accounting principles (and U.S. generally accepted accounting principles [GAAP]) view of retroactive reinsurance is that it is more akin to the financing of a past event; therefore, the results are not reflected in the underwriting of the ceding entity, but instead reflected in other income. She noted that this result of not benefitting the underwriting results for financing transactions was intentional. Ms. Marcotte noted that R&Q responded that while they understood why it was created in the 1990s, but with the growth of the run-off and legacy protections in place of large values—i.e., retroactive—the resulting capital valuations are misleading. Ms. Marcotte summarized that essentially the comments are noting disagreement with statutory accounting requirements that exist regarding the treatment of retroactive reinsurance. She noted that although it is designated by accounting as financing and not transfer of insurance risk, R&Q would like to be able to report the results in underwriting.

2. Directed a Survey

Mr. Smith noted that while the Subgroup appreciates all of these comments, and they are certainly informative, the Subgroup needs key information from some of the states that already have laws on their books or are in the process of adopting laws on IBTs or corporate divisions. He proposed that NAIC staff develop a survey to gain more insight into these transactions and what the states have been doing or plan to do to evaluate the transactions. He noted that the Subgroup is not seeking information on the laws, as the NAIC is in the process of gathering those details for the Restructuring Mechanisms (E) Working Group. He noted that the survey would focus on how the states intend to review, approve and monitor the transactions. He noted that example questions might include:

1) What lines of business will the states consider?
2) Do the states have any specific standards or procedures for approving these transactions?
3) Do the states plan on using experts to help with the review?
4) Will the states have any minimum capital requirements or independent actuarial reviews?
5) How are those states defining companies in run-off?

As there were no objections, the chair directed NAIC staff to develop a survey. Mr. Smith noted that once the results are back from the survey, the Subgroup would hold a conference call to evaluate the survey results and determine next steps.

Having no further business, the Restructuring Mechanisms (E) Subgroup adjourned.
Connecticut Informal Comments

I thought I would informally send you some quick thoughts. First, I think charge 1 and 2 are very broad and regulators can come up with good best practices based on experience.

Charge #3- we should wait for the parent group for clearer guidance because it appears that the charges overlap. My comments are based on charges 1 and 2 at this point.

1. As liquidity is many times the highest risk companies face (and regulator’s when faced with dividend requests) the creation of a “best practices” liquidity report can be created for regulators to use if they choose to. This helps to create continuity around liquidity considerations;

2. Monitor expenses- ie as companies continue to strive to decrease claims and administrative expenses- how does it affect key personnel and possible outsourcing? This tends to create new operational risks- What is the company willing to give up in order to increase liquidity? (Cost/benefits should be analyzed).

3. Provide the regulator a list of all pledged assets and possible covenant triggers.

4. Cash flow analysis through claim payout period.

Again, very high level. I think this will be the easy part and will need direction from Working Group after they have sorted through the macro issues.

Kathy Belfi

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Informal Comments from Maine

Generally, looks good, but as we’re seeing in the long-term-care arena, some runoff companies are still collecting premium and regulators still need to deal with the resulting rating issues, and other actuarial complications relating to estimated premium collections. Also, the financial surveillance tools for runoff companies might also have application to blocks of legacy business in going-concern companies (and those blocks are often subject to or under consideration for restructuring). So, I would consider changing Charge # 1 to:

>>> 1. Consider the development of financial surveillance tools that are specifically designed for companies in runoff (companies that are no longer actively writing insurance business) and companies with large blocks of runoff business.

Bob Wake
South Carolina comments

On behalf of Director Raymond Farmer, South Carolina has no edits or changes to proposed charges for the Restructuring Working Group.

We look forward to working with the group on this very important matter.

Regards,

Joe Cregan
Assistant to the Director
South Carolina Department of Insurance
1201 Main Street, Suite 1000
Columbia, SC 29201

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Texas Comments

Please accept the Texas Department of Insurance comments for the Restructuring Mechanism exposure. Texas suggests the following edits to the definition of run-off: Run off companies are no longer actively writing insurance business or collecting premiums except where required to by law or contract, and have unpaid policyholder liabilities.

Amy Garcia, CFE
Chief Analyst – Associate Commissioner
Financial Analysis Section

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Vermont Comments:

Regarding the definition of run-off insurer, here are a couple of possibilities that might be a useful starting point:

1) In the captive context, a “run-off captive insurer” might be defined as “a captive insurer that has not underwritten insurance or reinsurance for at least five years”; and

2) In the case of Vermont’s Legacy Insurance Management Act, while it does not define “run-off companies”, it does define “closed blocks” that can be transferred/assumed, as follows:

“Closed block’ means a block, line, or group of commercial non-admitted insurance policies or reinsurance agreements or both: (A) which a transferring insurer has ceased to offer, write, or sell to new applicants; (B) for which all policy periods have been fully expired for not less than 60 months; (C) for which active premiums are no longer being paid; and (D) which is not workers’ compensation, health, life, or any other personal line of insurance.”

Thanks much,
Dan

Dan Raddock
Assistant General Counsel
Vermont Department of Financial Regulation
89 Main Street
Montpelier, VT 05620-3101

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April 26, 2019

Co-Chairs Doug Stolte (VA) and David Smith (VA)
Vice-Chair Jack Broccoli (RI)
Restructuring Mechanisms (E) Subgroup
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108

RE: Subgroup Charges and Definition of Run-Off

Dear Messrs. Stolte, Smith and Broccoli:

The American Council of Life Insurers (“ACLI”)\(^1\) looks forward to working with the Restructuring Mechanisms Subgroup as it addresses its charges relating to restructuring mechanisms and “runoffs” during the next few months.

We do, however, have concerns with the proposed definition of “run-off companies” that is contained in the first charge (on the development of financial surveillance tools) and in “II-Definition of Run-Off”. In both instances, “run-off companies” are defined as “companies that are no longer actively writing insurance business or collecting premiums”.

While we are not able to provide you with an alternative definition at this time, we do note that, traditionally, some companies that are considered to be in “run-off” continue to collect premiums. We will be offering our perspectives and suggestions on this definition as the Subgroup continues its important work.

If you have any questions, feel free to contact me at waynemehlman@acli.com or 202-624-2135.

Sincerely,

Wayne Mehlman
Senior Counsel, Insurance Regulation

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\(^1\) The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers’ financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers’ products for peace of mind. ACLI members represent 95 percent of industry assets in the United States. Learn more at www.acli.com.
April 26, 2019

Doug Stolte and David Smith, Chairs
Restructuring Mechanisms (E) Subgroup

Dan Daveline and Robin Marcotte
National Association of Insurance Commissioners

Please find attached a submission on behalf of AIRROC (the Association of Insurance and Reinsurance Runoff Companies) in response to the request for comments from the Restructuring Mechanisms (E) Subgroup.

The size of the global runoff market is $370 billion with $350 billion of that in the United States. AIRROC is the only U.S. non-profit organization representing the legacy insurance market. These materials are submitted for education purposes only to provide some background and context for the Subgroup on runoff and the runoff market.

Materials submitted:

1. A recording of a webinar titled “Overview of Runoff” that was presented by AIRROC on February 6, 2019. It can be viewed at: https://vimeo.com/316097460/5beab583dc The slides from this session have been placed in a Dropbox for access due to the size of the file.

2. The 2018 PwC - AIRROC - IRLA Global Insurance Runoff Survey. This can be accessed on the PwC website at: https://www.pwc.com/globalinsurancerunoffsurvey A PDF of this survey is also attached to this email.

AIRROC is pleased to be an educational resource to the Subgroup as well as the full Working Group. Please don’t hesitate to let me know if you have any questions or would like further information from us.

Respectfully Submitted,

Carolyn W. Fahey
Executive Director
Submission to the NAIC Restructuring Mechanisms Subgroup
April 26, 2019

What is Runoff?

The definitions of runoff vary greatly by company and even change over time due to factors such as changes in underwriting cycle, profitability, reinsurance availability, interest rates and structures to administer.

In a recent survey of the market respondents were asked “How does your organization define runoff business?”

Sample responses include:
• “All lines of business where premiums are no longer being written.”
• “Any discontinued line of business.”
• “Business that is being wound down and no longer underwritten.”
• “Closed book of business with no more underwriting.”
• “2001 and prior.”
• “Discontinued companies, affiliates or segments.”
• “Non-core to the group.”
• “No new written business.”

The Risk Based Capital Requirement and Runoff

The impact of the RBC on runoff depends on the definition of runoff. Using the general definition that the runoff market is comprised of A&E liabilities that reside mostly in prior accident years and that retroactive reinsurance is often used to managed these exposures, the RBC may not be suitable to evaluating their risk.

The NAIC Risk Based Capital Requirement attempts to summarize several areas of an insurer’s risk into a single value and the formula results have specific actions associated with them.

The six Categories of Capital Charges are:
R0 Investment in Affiliates and Off Balance Sheet Risks
R1 Fixed Income Charge
R2 Equity Charge
R3 Reinsurance/Credit Risk Charge
R4 Reserving Risk Charge
R5 Premium/Underwriting Risk Charge
The RBC requirement is calculated as $R_0 + \sqrt{(R_1^2 + (R_2^2 + ((.5*R_3)^2 + ((.5*R_3 + R_4)^2 + (R_5^2))}$

The RBC Ratio is calculated as Adjusted Surplus/RBC Requirement.

For Runoff Companies, those no longer actively writing new business, the R4 Reserving Risk Charge dominates the calculation. The RBC approach of using the latest 10 accident years may not be suitable for evaluating this risk of runoff companies for the following reasons:

a) In many of these companies the liabilities are comprised of A&E and mature WC liabilities that reside in prior accident years; therefore the RBC approach to using the latest 10 years may be not appropriate for evaluating this risk as liabilities often reside in accident years beyond the latest 10 years, and

b) Retroactive reinsurance is commonly used in the run-off space, and since these contracts are not required to be reported in Schedule P, the RBC approach that utilizes Schedule P data may not be practical in evaluating their risk.

The Premium/Underwriting Risk Charge, $R_5$, is much less of a risk area for Runoff Companies. Specific items, like the collection of premium on retrospectively rated policies may cause distortions in the calculation of Excessive Premium Growth charges and Combined ratio triggers without any change in the risk profile of the company.

With the increased use of Insurance Business Transfers and Retroactive Reinsurance, the most critical issue for Runoff Companies is the availability of cash and liquid assets to satisfy policyholder claims and other obligations. It may be prudent for the regulator to separately consider significant amounts of retroactive reinsurance (currently outside of the RBC formula) when determining a runoff company's capital requirements.
April 23, 2019

Mr. Douglas C. Stolte  
Mr. David Smith  
Co-Chairs  
Restructuring Mechanisms (E) Subgroup  
via  
Dan Daveline and Robin Marcotte  
NAIC Staff

RE: Request for Comments

Dear Messrs. Stolte and Smith:

I write solely on my own behalf and the views I express are not intended to reflect those of any client or other interested party. As you know, I have spent the last four decades working in insurance regulation, primarily on behalf of state insurance officials in matters affecting troubled insurance companies and complex insurance transactions. My views are informed by that experience and I disclose that my bias favors protection of policyholder interests and the state-based regulatory system. I offer two comments relevant to the Subgroup’s current deliberations. The first addresses the definition of runoff company and the second the role of certain restructuring mechanisms.

It is suggested that “runoff companies” exclude those that are collecting premium. I submit that doing so would be inconsistent with economic reality. There are in existence many “closed blocks” and other entities comprised solely of “legacy” or existing business much or all which continues to pay premium though they can be fairly characterized as being in runoff. Notable current examples are those of well-known long-term care insurance blocks. Certain companies holding these blocks typically do not seek to write new business and their role is solely to manage an existing book of liabilities to expiration. I propose that the term “runoff company” be defined as “an entity whose sole material business is the management in accordance with contractual and regulatory obligations of an existing group of insurance policies or contracts through their termination.”

Recently there has been much talk throughout many NAIC committees, working groups, and task forces of relatively new alternative mechanisms for the management of legacy blocks and other special transactional needs. Notable examples are Insurance Business Transfers (“IBT”) and corporate division statutes. While these and similar mechanisms can serve useful purposes for solvent insurers and reinsurers in several types of circumstances, they should not be confused with tools for addressing financially troubled companies. A common element of such transactions is that
they do not add new value. They are not investment vehicles and, properly used, do not increase assets or reduce liabilities. Rather, these types of transactions enable an enterprise to segregate a discrete group of liabilities (like a legacy long-term care insurance block) and place them either in newly created isolated entities (as through a corporate division) or in separate existing entities (as though and IBT).

In their pure form, such transactions do not improve the economic health of the block at issue. Of course, such transactions could be made part of a more comprehensive arrangement that can have that effect, such as an IBT or corporate division that also includes the contribution of additional capital devoted to the block in question. It has been observed that these new mechanisms are simply new ways of accomplishing goals that have been possible through other mechanisms like loss portfolio transfers and assumption reinsurance transactions. That may be the case but does not suggest that the additional flexibility of new potential structures cannot add value. My caution would be simply that these are not tools that can improve materially our ability to cope with troubled companies. They can be combined with such tools (like capital infusions or new reinsurance that includes material risk transfer) but by themselves do not relieve financial trouble.

I would be pleased to answer any questions about my comments.

Respectfully yours,

Patrick H. Cantilo
BY E-MAIL

April 26, 2019

Doug Stolte
David Smith
Co-Chairs, NAIC Restructuring Mechanisms (E) Subgroup

Attention: Dan Daveline (ddaveline@naic.org)
Robin Marcotte (rmarcotte@naic.org)

Re: The Restructuring Mechanism Subgroup’s Charges

Dear Messrs. Stolte and Smith,

The undersigned companies are grateful for the opportunity to comment on the charges of the Restructuring Mechanisms (E) Subgroup.

In general, we strongly support the subgroup’s charges. While we endorse all the charges, we ask that the subgroup give special emphasis to the development of uniform minimum standards for restructuring mechanisms.

The Importance of Strong, Uniform Standards for Divisions and Business Transfers

Several states have recently enacted new “division” and “insurance business transfer” laws that allow insurers to transfer and novate business without policyholder consent. While these laws offer new flexibility to companies and regulators, they also introduce new dangers for policyholders and the state-based system of insurance regulation. Because we believe there are existing alternatives that provide sufficient flexibility in nearly all circumstances and because we want to maintain policyholder protections, our strong preference is against the enactment or use of division and insurance business transfer statutes for life, annuity or health insurance. However, recognizing that regulators may wish to find a way to permit, in limited circumstances, transactions that are beneficial to all policyholders, our comments in this letter address the minimum standards required if life, annuity or health divisions or transfers are to be considered.

Unlike traditional indemnity reinsurance, where the original insurer remains liable, these new structures allow the original insurer to extinguish liability to policyholders. We have grave concerns about several aspects of these new laws:

- There is no nationally uniform financial standard or actuarial level of confidence for regulators to apply when reviewing the financial strength of a business included in a division or transfer. A strong, nationally uniform standard is necessary to ensure that policyholders are protected against the risk of insolvency. This standard should become an NAIC accreditation requirement. The development of this standard should be a critical area of focus for the subgroup.
• In some states, division and insurance business transfer laws are open to any line of business, even when it is difficult or impossible to arrive at a credible long-term valuation of the business involved. For example, a division could allocate distressed, hard-to-value long-term care liabilities to a newly created splinter company. In this scenario, healthier business and associated assets might remain with the original company, endangering policyholders relegated to the splinter company.

• Some laws also allow the creation of monoline insurers, potentially depriving policyholders of the benefits of diversification without their consent.

• Some laws also allow the division of a multi-state insurer into a splinter company licensed in a single state, potentially overwhelming the state’s domestic guaranty association in the event of insolvency.

• Some laws sanction the use of non-admitted assets to support policy liabilities.

• Several laws lack other important procedural and substantive safeguards like public notice, requirements to consult with other interested states, independent expert review, a hearing or court process, and requirements to assess corporate governance and owner qualifications.

At their worst, these new laws could enable transactions that enrich shareholders at the expense of policyholders, guaranty associations and the reputations of both the industry and state-based system of insurance regulation. Effective, nationally uniform oversight of solvency has long been a hallmark of state-based insurance regulation. It is essential that the NAIC act to preserve this strength of the state-based system. These new transaction structures must not be allowed to undermine fundamental solvency regulation and policyholder protections. We expect that the subgroup’s work will be a critical part of this effort.

In the discussion below, we suggest several principles that should govern regulatory review of proposed division and business transfer transactions.

Policyholders Should Never Be Left Worse Off

Regulators should never approve a division or insurance business transfer if it would leave any class of policyholders worse off. Instead, policyholders should be left in the same or a better position after completion of the transaction. Before the regulator signs off, a valuation should be undertaken by an expert to establish at a high level of confidence that policyholders will experience no adverse effects. The expert should be independent of any influence from the companies involved.

This approach would align the U.S. regulatory framework with well-established international precedents like the United Kingdom’s “Part VII” business transfer regime. A focus on policyholder protection has been fundamental to the success of the U.K. regime. In a Part VII transaction, the regulator must provide a detailed report to the court and certify the solvency of the resulting entity. An independent expert must also provide a detailed report. When there are
questions about the strength of the business involved, the U.K. regulators and the court will normally insist on ensuring that the business is transferred to a stronger insurer, not isolated in a weaker insurer.

Some state laws provide that a regulator should approve a division or business transfer if there is no “material adverse effect” on policyholders. This standard falls far short of what should be required. The standard endorses policyholder harm so long as the harm does not rise to a vaguely defined materiality threshold. For example, a transaction might accomplish nothing more than benefit shareholders at the expense of policyholders. Although the damage to policyholders may not rise to the level of a “material adverse effect,” the law should not call on the regulator to approve unless the effect on policyholders is neutral or there is some expected policyholder benefit.

No Monolines

Regulators should never permit a transaction that transforms a diversified insurance company into one or more monoline insurers, especially when the transaction involves long-duration life, annuity or health insurance business. It makes little sense to deprive policyholders the benefits of diversification. The wisdom of this principle is borne out by the recent experience of carriers like Penn Treaty that concentrated their offerings in long-term care insurance.

Hard-to-Value Business Like LTC Should Be Ineligible for Division or Transfer

It is important that standards for approval acknowledge fundamental differences among lines of business. A standard that may be appropriate for short-duration commercial property and casualty risks is likely to need significant adjustments before it can be applied successfully to long-duration retail life, annuity and health businesses.

As a threshold matter, some lines of business are best excluded from division and business transfer transactions. Long-term care offers the best example. The history of reserve deficiencies, rate increases and, in some cases, insolvencies, associated with this product demonstrates the challenges of arriving at satisfactory valuations. Given this history and the long duration of the liabilities, it is clear to us that long-term care blocks should not be separated from other businesses that provide financial stability and diversification for the entity overall.

The experience of long-term care leads us to suggest the following possible approach to similar long-duration life and health businesses: for each such business, the regulator should be able to confirm the sufficiency of assets supporting the liabilities based on a reasonable valuation relative to an industry standard of experience. To make this determination, the Commissioner should first compare the valuation of liabilities to what the valuation would be using standardized valuation tables adopted by the NAIC for each line of business. If such standardized valuation tables are not available, the business should not be eligible for division or transfer.
Require Strong Financial Standards and Stress Testing for Long-Duration Business

Even if a long-duration life or health business is eligible for inclusion in a transaction, regulators will still need a robust framework to evaluate the long-term solvency of the business. Regulators should consider the following principles in the development of this framework:

- For long-duration life, annuity and health business, regulators should start with a focus on policy reserves, and should require stress testing of reserves at a “severely adverse” level. If reserves are not subjected to a high level of stress testing, a division or transfer may appear to leave a business adequately capitalized at the time of the transaction. However, the picture can change over time as long-term experience diverges from assumptions. Again, consider the recent experience of long-term care.

- Starting from a basis of reserves meeting a “severely adverse” standard, formulaic application of risk-based capital will, appropriately, result in a higher level of required capital for the business affected by the division or transfer. However, while risk-based capital may provide a useful starting point to establish capital requirements, it is not designed to measure relative financial strength and therefore would be insufficient on its own to determine the minimum required financial position of a transferred business.

- Instead, in addition to risk-based capital, regulators should explore capital standards for long-duration life and health business that are based on a defined ratio of asset adequacy standards. Capital standards based on this type of cash flow projection technique can help ensure that enough capital is held in a transferred business, supplementing the existing risk-based capital framework.

- Regulators should establish a confidence level based on the greatest present value of accumulated deficiencies over a long-term horizon across stochastic scenarios. The confidence level should be set at a standard that assures solvency over the life of the business so as to provide a robust backstop to the combination of reserves established to meet a “severely adverse” standard and risk-based capital.

- Prescribed assumptions should be included in capital calculations to avoid the manipulation of capital thresholds.

- Actuarial reserve and capital calculations should be performed by an expert that is independent of the insurance companies involved.

Use Uniform NAIC Valuation and Accounting Standards

When evaluating the solvency impact of a proposed transaction, regulators should not give credit for non-admitted assets. Decisions about these transactions should start from the NAIC’s uniform statutory valuation and accounting rules.

The possibility that non-admitted assets might be used to back reserves and capital in these transactions is deeply troubling for the following reasons:
• Most non-admitted assets are classified that way because they are not readily available to satisfy policyholder claims.

• Put another way, many non-admitted assets are not readily marketable or do not produce future cash flows.

• Non-admitted assets can include anything a company owns, from illiquid and contingent letters of credit to office furniture, equipment, hardware and software.

• It makes sense to exclude these items from the pool of assets an insurance company can count toward the payment of future claims, as they are illiquid, unlikely to retain their value, and generally do not produce additional income.

• The distinction between admitted and non-admitted assets should not change in the context of a division or business transaction. In fact, given the risk that companies will use restructuring mechanisms to wall off distressed businesses, it is especially important that regulators scrutinize the quality of the assets involved.

Minimum Requirements Should Become NAIC Accreditation Standards

Ultimately, it will be essential that the NAIC establish strong minimum requirements for these transactions as accreditation standards. The strength of state-based system depends upon the integrity of solvency regulation across the country. Regulators will need to rely on their counterparts in other states to ensure that transferred businesses are uniformly supported by sufficient reserves and capital, and are run off in a solvent manner. Companies should not be allowed to arbitrage their way to diminished solvency oversight by choosing one domicile over another.

Other Procedural Safeguards Are Also Important

In this letter, we have focused primarily on the financial standards that should apply to divisions and insurance business transfers. We expect those standards will be a significant focus of the subgroup. However, there are other procedural safeguards that are equally important for these transactions. For example, since policyholders lose their normal right to consent, court oversight and approval should be required. Policyholders and other affected parties should always be given notice, access to all information needed to meaningfully review a proposed transaction, and an opportunity to be heard in court. Also, the process should require approval or non-objection of all affected states and the resulting entities should be licensed in all states needed so as not to impair policyholders’ access to their state guaranty associations. We believe these protections should also be considered for accreditation requirements. We look forward to providing our views on this and other procedural safeguards to the Restructuring Mechanisms (E) Working Group.

*   *   *
We appreciate the opportunity to comment on this important topic. Please let us know if you need any additional information or would like to discuss.

Sincerely,

Douglas A. Wheeler  
Senior Vice President, Office of Governmental Affairs  
New York Life Insurance Company

Andrew T. Vedder  
Vice President – Solvency Policy & Risk Management  
The Northwestern Mutual Life Insurance Company
Via email submission

April 26, 2019

Mr. Doug Stolte and Mr. David Smith, Co-Chairs
Restructuring Mechanisms (E) Subgroup
National Association of Insurance Commissioners
Via email: ddaveline@naic.org

Re: Request for Comments on the Definition of a “Runoff” Insurer and the Charges of the Subgroup

Dear Messrs. Stolte and Smith,

Nationwide Mutual Insurance Company, on behalf of its insurance subsidiaries and affiliates, including Nationwide Indemnity Company1 (collectively, “Nationwide”), appreciates the opportunity to comment on the request from the Restructuring Mechanisms (E) Subgroup (the “Subgroup”) for input on the definition of a runoff insurer and the charges of the Subgroup.

We understand that the Subgroup is charged with, among other items, considering whether to develop financial surveillance tools specifically designed for companies in runoff, including prospective changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff. To carry out this charge, the Subgroup is developing a definition of “runoff insurer”, starting with the working definition, “companies that are no longer actively writing insurance business or collecting premiums.”

Nationwide believes that it would be difficult to craft a singular definition of what constitutes a company in runoff. Therefore, any definition recommended by the Subgroup and adopted by the NAIC should provide for a mechanism by which the company and its domiciliary regulator can agree that an insurer is operating as a runoff company. We note that certain runoff insurers may no longer be actively writing new insurance business; however, they may assume runoff books of business from time to time from affiliated companies. In addition, runoff insurers may also accept immaterial amounts of premium on retrospectively rated policies that were written many years ago. In our view, the assumption of affiliated runoff books of business and the acceptance of immaterial amounts of premium due to retrospectively rated policies should not result in a runoff insurer no longer being deemed as such.

In light of the above, Nationwide proposes the following definition of a “runoff insurer”.

“Runoff Insurer” means an insurer that, in consultation with insurance commissioner of its state of domicile, has made an election to be treated as a runoff insurer or has been

1 Nationwide Indemnity Company is an Ohio domiciled captive run-off reinsurance company that does not write any new business and, as a result, is considered in “run off”. From time to time, Indemnity will also assume run-off books of business from affiliated companies but does not accept premium for these assumptions. However, Indemnity will accept premium from retrospectively rated policies, when appropriate.
deemed to be operating as a runoff insurer, based upon its satisfaction the following criteria:

(1) the insurer does not actively write new business;

(2) any assumed business is limited to the assumption of runoff books of business from affiliated companies; and

(3) any premium accepted by the insurer is determined to be immaterial and incidental to its status as a runoff insurer.

As the Subgroup carries out its charge of considering whether to develop financial surveillance tools specifically designed for companies in runoff, including prospective changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff, we respectfully request that the Subgroup also consider whether existing regulatory requirements and surveillance tools should no longer apply to companies in runoff because they were not designed for runoff insurers and, as a result, are not “fit for purpose”.

To highlight one example, Nationwide has previously raised to the NAIC’s Property and Casualty (P&C) Risk-Based Capital (RBC) Working Group concerns with the continued application of the P&C RBC trend test to runoff insurers. The P&C RBC trend test would require an insurer with a combined ratio exceeding 120% to hold regulatory capital at or above 300% of its authorized control level (ACL) RBC; rather than 200% ACL RBC for companies with a combined ratio below 120%. Runoff companies that generate a small amount of retrospectively rated premium from policies written many years in the past will almost always be within the scope of the RBC “trend test” due to combined ratios well exceeding 120%. As a result, they will be expected to maintain higher regulatory capital requirement, despite not posing any additional solvency risk, when compared to a runoff company that does not generate any premium (or even negative premium) and is not subject to the RBC trend test. In fact, the acceptance of any premium for these companies enhances their solvency position.

Therefore, as the Subgroup moves forward with its charges, we believe it should consider not only the necessity of developing new financial surveillance tools for runoff insurers, but also removing the application of requirements and surveillance tools, like the RBC trend test, that were not designed to apply to runoff insurers and can result in counter intuitive outcomes when applied to them.

We greatly appreciate the opportunity to comment on the definition of a “runoff insurer” and the Subgroup’s charges, and we look forward to future opportunities to engage with the NAIC on these issues.

Very truly yours,

David A. Garman
AVP, Governance and Corporate Regulatory Legal
R&Q Solutions Comments

Dear Mr. Daveline and Ms. Marcotte,

In response to the below request for comments, one item that we have raised is that the Outwards Retroactive follow the Loss Liability component of the RBC calculation. This then reflects the net reserve calculation for RBC more accurately even though the statutory statements have the retroactive as the write-in line.

Thank you,

Stephen Parisi
Senior Litigation Counsel
U.S. Insurance Services Division
R&Q Solutions LLC

NAIC Staff requested clarification

Thanks, for the comments, however, I am not sure I am completely following your comments below. Would you perhaps, elaborate a bit more?

Robin Marcotte | Senior Manager Accounting

R&Q Response

This is an issue with a disconnect of the retroactive reinsurance write-in line (pursuant to SSAP 62) and the balance sheet location of the inwards reserves which are on the loss liability line. The RBC only sees the loss liability on the Reserve RBC calculation and not the net impact of the retroactive protecting the loss liabilities.

Pamela Sellers-Hoelsken
President
U.S. Insurance Services Division
R&Q Solutions LLC
Two Logan Square, Suite 600

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Why do Companies Restructure?

**Desire to use capital more efficiently**
- Ability to divest non-core business and redeploy capital more strategically
- Saves costs and protects financial solvency of seller entity
- Internal reorganization can reduce management and other costs

**Focus on management of non-core lines**
- Specialized live or run-off carrier can handle the business more efficiently
- Better policyholder service can be provided through transfer of business

Current Restructuring Options in the US

- Companies are broadly limited to sale, reinsurance/loss portfolio transfer, or novation when restructuring
- Non-core or run-off business remains embedded with the ongoing business, with no effective option to segregate the business
- Frequently, companies use loss portfolio transfers to transfer blocks of business, but ultimately, liability remains with the original insurer
- The only way to effectively transfer a block of business across the US is by way of a policy novation process, but the current process of novating policies is inconsistent among the states, cumbersome, time-consuming and expensive
- In most instances it will be impossible to obtain positive consent to a novation from all policyholders, especially on older books of business

Non-Life Run-off

**Methods of Acquisition for Run-off Companies**

Most jurisdictions have similar methodologies to enable business to be placed into run-off:

<table>
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<tr>
<th>Method of Acquisition</th>
<th>Bermuda</th>
<th>USA</th>
<th>UK</th>
<th>Europe</th>
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</table>

Overseas Legislation

- In the European Union, member states are required to have mechanisms for the transfer of insurance business, many of which have been used successfully for a number of years
  - For example, a UK Part VII transfer
    - Allows for the transfer of a block of business by way of a statutory novation
    - Transfers outwards reinsurance with the policies (as well as other assets and liabilities where required)
    - Needs UK regulator approval
    - Requires court approval and independent expert report
Benefits of Division Statutes and Insurance Business Transfers
NAIC Restructuring Mechanisms Working Group – Summer Conference

Kelly Supranzynski
Prepared by Aon

Key Benefits

- Release management resources currently being occupied with the oversight of related business
- Prior to Division Statutes, certainty only possible through the sale, monetization or commutation
- Legacy run-off liabilities can “trap” capital, creating inefficiencies
- Increase administrative, claims, regulatory, etc. efficiency under a focused entity
- Increase capital, reduce risk

Track Record of Success in the UK via Part VII Transfers

- Division statute laws are modeled after UK’s Part VII transfers
- Over 250 Part VII transfers have been done since 2002 (Source: Baily Audis)
- Often driving increased use of Part VII transfers
- Allow industry to identify more efficient structures to drive capital optimization and pricing
- Key Attributes include:
  - Use of independent expert to represent policyholder interests in evaluating liabilities
  - Often used to tidy up corporate structure and resources of large organizations (e.g., post M&A)
  - There is no benefit for policyholders to be trapped in a smaller, run-off division of a large company. Minimal resources and run-off is often expensive
  - Capital inefficiencies, especially if like liabilities are spread across legal entities throughout the group
  - Policyholder must be in an equal or better position post-transfer
  - Reinsurance is often used to provide additional protection in determining capital (“belt and suspenders”)

Ample Reinsurance Capital to Support Divisions / Transfers
### Reinsurance as an Effective Source of Capital

<table>
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<th>Company</th>
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<th>Risk Based Capital (RBC) $M</th>
<th>Adjusted Capital $M</th>
<th>Probability of Exceeding Surplus %</th>
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### Key Messages

- As business and markets evolve over time, use of Divisions or Transfers reflect a healthy, innovative market to properly match risk and capital that facilitates:
  - Capital management, Economic certainty, Management focus, and Operational efficiency
  - Use of Divisions / Transfer is tested and well developed in the global market
- Capital requirements based upon risk-based capital (RBC) to ensure consistency with regulatory model:
  - Set target RBC to ensure policyholders are in a similar or more favorable position post-transaction as a well-capitalized company
  - Incorporate reinsurance capital more explicitly in RBC calculation, specifically as respects adverse development covers that protect against reserve development
  - RBC target range for the industry should be set to ensure less-capitalized companies are not held to a lower standard while a well-capitalized company requirements are prohibitive
- Develop model law that carries existing state licenses on policies divided or transferred into new company so policyholders maintain same protection under guaranty funds
Group Solvency Issues (E) Working Group
New York, New York
August 3, 2019

The Group Solvency Issues (E) Working Group of the Financial Condition (E) Committee met in New York, NY, Aug. 3, 2019. The following Working Group members participated: Justin Schrader, Chair (NE); Doug Slape, Vice Chair (TX); Emma Hirschhorn and Kim Hudson (CA); Kathy Belfi (CT); Dave Lonchar (DE); Virginia Christy and Carolyn Morgan (FL); Jim Armstrong and Mike Yanacheak (IA); Cindy Andersen and Eric Moser (IL); John Turchi (MA); Judy Weaver (MI); Debbie Doggett (MO); John Sirovetz and Diana Sherman (NJ); Mark McLeod (NY); Tim Biler and Dale Bruggeman (OH); Joe DiMemmo (PA); David Smith and Doug Stolte (VA); and Amy Malm (WI).

1. Received an Update from the ORSA Implementation (E) Subgroup

Ms. Belfi provided an update of recent activities of the ORSA Implementation (E) Subgroup, noting that the Subgroup met July 31 via conference call. The conference call was held in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff members) of the NAIC Policy Statement on Open Meetings.

Ms. Belfi said the Subgroup received an update from NAIC staff on Own Risk and Solvency Assessment (ORSA) support services that are being provided to the states, including a recent training program on how to review internal capital models used in Section 3 of ORSA Summary Report filings.

Ms. Belfi said the Subgroup discussed the latest consultation document of the International Association of Insurance Supervisors (IAIS), which proposed several revisions to Insurance Core Principle (ICP) 16 – Enterprise Risk Management for Solvency Purposes. The consultation period ends on Aug. 15, and the IAIS plans to finalize and adopt the revisions in November. The NAIC is drafting a formal response to the consultation that will be approved and adopted by the International Insurance Relations (G) Committee, and the Subgroup discussed language to be included in the response. The language states that it is important to ensure that the proposed revisions do not lead to overly prescriptive regulatory requirements in this area, which could reduce the effectiveness of the ORSA process.

Ms. Belfi said the Subgroup discussed the recent adoption of Actuarial Standard of Practice (ASOP) No. 55, Capital Adequacy Assessment, by the Actuarial Standards Board (ASB). The ASB sets standards of practice for all actuaries that are members of one of the five actuarial organizations in the U.S. and are binding. ASOP No. 55 becomes binding for actuaries involved in capital adequacy assessments starting Nov. 1.

2. Heard a Report on IAIS Activities

Mr. Schrader provided a report on recent group-related activities of the IAIS, including the status of ongoing projects of the Insurance Groups Working Group. He said a supervisory college workshop is in development to assist supervisors in learning best practices for use in conducting college sessions. He said other ongoing projects are focused on the implementation of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). This includes the development of an aide memoire to assist in post-implementation review, as well as a frequently asked questions (FAQ) document for supervisors.

3. Discussed a Referral from the Operational Risk (E) Subgroup

Mr. Schrader said the Working Group received a referral from the recently disbanded Operational Risk (E) Subgroup in February. The same referral was also provided to the Risk-Focused Surveillance (E) Working Group, and it was discussed briefly at the Spring National Meeting. The referral recommends ongoing studying and monitoring of methodologies used in measuring, quantifying and mitigating operational risks. Mr. Schrader said the Working Group is under no time commitment to address this referral, and it will likely continue to monitor developments in this area before taking any specific action. He said an upcoming NAIC Peer Review session will focus on utilizing ORSA in financial analysis and examination, and it may be able to provide some insight into how companies are incorporating operational risks into their ORSA processes.
4. **Discussed Comments Received on Group-Related Analysis Guidance**

Mr. Schrader said the Working Group has been participating in a joint project with the Financial Analysis Solvency Tools (E) Working Group to respond to questions on group analysis topics that have come up in recent peer review sessions. He said the Working Groups developed proposed additions to the NAIC *Financial Analysis Handbook* (Handbook) to address the questions. Topics addressed include how to efficiently document analysis of pooled insurance groups, as well as insurance groups where the ultimate controlling person (UCP) of the group is an insurance entity. Other topics include expectations for non-lead states in reviewing Form F (Enterprise Risk Report) filings and the Corporate Governance Annual Disclosure.

The guidance was exposed for a 45-day public comment period, which ended on July 12, with one comment letter being received from Wisconsin. Ms. Malm summarized the Wisconsin comments, which suggested allowing the legal entity and group analysis documentation to also be combined in situations where the UCP is a mutual holding company whose only significant function is holding company system governance. Mr. Schrader, Ms. Weaver and Mr. Slape raised concerns that broadening the exception in this area could have unintended consequences, and they recommended that the proposed Handbook language be retained. They also indicated that Wisconsin should still be able to take such an approach on an ad hoc basis by documenting their rationale within the file. Ms. Malm asked whether the accreditation team would allow for this interpretation. Mr. Slape said the accreditation team should allow for this treatment if the rationale was documented and reasonable.

Mr. Schrader said the proposed guidance would be referred to the Financial Analysis Solvency Tools (E) Working Group for consideration of adoption.

5. **Discussed the Effectiveness of the Implementation Guide**

Mr. Schrader said the NAIC’s *Form F Implementation Guide* (Implementation Guide) was adopted by the Working Group at the 2018 Spring National Meeting after being discussed and developed over a period of two years. The purpose of the Implementation Guide is to assist insurers and state insurance regulators in maximizing the usefulness of the Form F – Enterprise Risk Report filing by proposing best practices for consideration in preparing and reviewing the filing.

The best practices outlined in the Implementation Guide include examples of topics to be addressed under the various categories outlined for the Form F filing in the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)*, as well as a caution against insurers stating that no enterprise risks have been identified.

Mr. Schrader said as it has now been over a year since the Implementation Guide was adopted, another round of Form F filings have been received and are currently being reviewed. He said Nebraska is in the process of reviewing the filings, and it is hoping to see improvements based on the Implementation Guide. He asked for comments on how useful the Implementation Guide has been in clarifying expectations regarding the filing and improving its overall effectiveness and value. As no comments were made, he said it may be too early to make a determination regarding effectiveness at this point. He said the Working Group would revisit this topic in the future, and he encouraged state insurance regulators and insurers to continue utilizing and referencing the Implementation Guide to improve the effectiveness of Form F filings.

6. **Discussed Other Matters**

Mr. Schrader said the Group Capital Calculation (E) Working Group has begun discussions on how to collect and protect the confidentiality of data received through a potential group capital calculation (GCC) filing. As one of the primary options would be to include the GCC as a required holding company filing, he said the Group Solvency Issues (E) Working Group could receive a referral asking it to revise the *Insurance Holding Company System Regulatory Act (#440)* in accordance with this approach.

Having no further business, the Group Solvency Issues (E) Working Group adjourned.
MEMORANDUM

TO: Commissioner David Altmaier (FL)
Chair of the Financial Condition (E) Committee

FROM: Superintendent Elizabeth Kelleher Dwyer (RI) & Buddy Combs (OK)
Co-Chairs of the Restructuring Mechanisms (E) Working Group

DATE: July 8, 2019

RE: Update and Proposed 2020 Charges

During its Feb. 19, 2019 conference call, the Financial Condition (E) Committee formed the Restructuring Mechanisms (E) Working Group & Restructuring Mechanisms (E) Subgroup and adopted charges for each of these groups. However, the charges developed at that time did not set forth specific due dates for each of the charges which are now expected of any new NAIC group or any new charges for an existing NAIC group. The Committee agreed to temporarily waive such due dates at the time, but only under the expectation that they would be established by the 2019 Summer National Meeting. This memorandum summarizes the activity of the Working Group & Subgroup and sets forth proposed 2020 charges intended to meet such specific deliverables.

Restructuring Mechanisms (E) Working Group
The primary charge of the Restructuring Mechanisms (E) Working Group is to prepare a White Paper which includes not only a summary of the current restructuring statutes, but also discusses the perceived need for restructuring statutes and the issues those statutes are designed to remedy as well as the alternatives that insurers are currently employing to achieve similar results. As such, the Working Group has primarily been focused on gathering information and viewpoints on the various issues which will become the core text included in the White Paper. The Working Group has already received a great deal of information from various presenters and regulators and as co-chairs we are beginning to develop an outline of the White Paper. We recognize the intent of timely deliverables within charges and at this juncture we intend to draft, discuss and finalize the White Paper by the 2020 Summer National Meeting, which includes having a draft available for public comment by early 2020, and then working with any feedback that the Working Group receives.

The Working Group is also charged with reviewing and proposing changes to the Guaranty Association Model Acts (Model #520 & #540) to ensure that policyholders that had guaranty fund protection prior to a restructuring continue to have it after the restructuring. In addition, the Working Group is also charged with reviewing and proposing changes to the Protected Cell Companies Model Act (Model #290) to allow for restructuring mechanisms. While the importance of these topics cannot be diminished, it is difficult to imagine the Working Group being able to complete that within the expected one-year time period, and as such we would not be opposed to removing these charges until after the Working Group has completed the White Paper. Alternatively, we have proposed instead that...
those charges be removed but be replaced with a charge that contemplates requesting to begin such work in 2020. We believe the Working Group is likely to discuss these issues during the development of the White Paper, and as such will likely be in a position to request development of those models shortly after completion of the White Paper, but the existing process to change a model already requires approval from the parent Committee and Executive Committee, therefore removal of these charges at this time is likely appropriate.

As such, the following represents our proposed changes to the 2020 Charges for the Working Group only:

1) Evaluate and prepare a White Paper that:
   a. Addresses the perceived need for restructuring statutes and the issues those statutes are designed to remedy. Also, consider alternatives that insurers are currently employing to achieve similar results;
   b. Summarize the existing state restructuring statutes;
   c. Addresses the legal issues posed by an Order of a Court (or approval by an Insurance Department) in one state affecting the policyholders of other states;
   d. Considers the impact that a restructuring might have on Guaranty Associations and on policyholders that had Guaranty Fund protection prior to the restructuring;
   e. Identify and addresses the legal issues associated with restructuring using a protected cell.

   Complete by the 2020 Summer National Meeting

2) Consider requesting approval from the Executive (EX) Committee on developing changes to specific NAIC models as a result of findings from the development of the White Paper

   Complete by the 2020 Fall National Meeting

3) Review and propose changes to the Guaranty Association Model Act to ensure that policyholders that had guaranty fund protection prior to a restructuring continue to have it after the restructuring

4) Review and propose changes to the Protected Cell Companies Model Act to allow for restructuring mechanisms

Restructuring Mechanisms (E) Subgroup

While the Restructuring Mechanisms (E) Subgroup has not yet had the same level of discussions as the Working Group, much of this can be attributed to the difficulty of delivering on the charges without more clarity on the details of how these companies are expected to operate. More specifically, while regulators have practices that assist them in understanding how to conduct the review of the proposed transactions themselves, it’s been difficult to begin other conversations about the solvency risk these transactions may have on the companies after the transaction. This specifically includes RBC, where it’s difficult to imagine what changes would be made to the RBC formula (or other capital requirements) for companies that may have a different risk profile after the transaction. This is not to suggest that such a change cannot be made, but the Subgroup has yet to receive enough information that will allow it to even begin those discussions. Similarly, with respect to developing protected cell accounting and reporting requirements, it is unclear at this point whether each protected cell should be subject to RBC as if the protected cell was a standalone company or whether RBC should apply to the Protected Cell Company as a whole based on the combined capital level.

However, to be clear, the Subgroup appreciates that laws have been adopted in states and is currently in the process of developing best practices that could be used by states that have adopted such laws for their use in both: a) considering whether the proposed transaction should be approved; and b) monitoring the financial condition of a company after a transaction has been executed. The Subgroup will aim to develop these best practices in a manner that it can recommend them as accreditation standards as inferred by the current charges. To emphasize this point, the below proposed changes to the charges emphasize the development of such best practices as a new charge, but one that incorporates many of the aspects of the previous final charge, which has now been proposed to be deleted. The other proposed changes are clarifying either as to the estimated timeline for completion or reflective of the discussions that have taken place thus far within the Subgroup.
1) Develop best practices to be used in considering the approval of proposed restructuring transactions including, among other things, the expected level of reserves and capital expected after the transfer along with the adequacy of long-term liquidity needs, and also develop best practices to be used in monitoring the companies after the transaction is completed. Once completed, recommend to the Financial Regulation Standards and Accreditation (F) Committee for their consideration. **Complete by the 2020 Summer National Meeting**

2) Consider the development of financial surveillance tools that are specifically designed for companies in runoff (companies that are no longer actively writing insurance business or collecting premiums). Minimum standards of review.

3) Consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff. **Complete by the 2020 Fall National Meeting**

4) Review the various restructuring mechanisms and develop, if deemed needed, protected cell accounting and reporting requirements for referring to the Statutory Accounting Principles (E) Working Group. **Complete by the 2020 Fall National Meeting**
   a. Minimum capital requirements
   b. Specific actuarial guidance in determining initial reserving levels
   c. Protected cell reporting requirements
   d. Proposed accreditation standards
To: Commissioner David Altmaier (FL), Chair, Financial Condition (E) Committee

From: Kevin Conley (NC), Chair, Mortgage Guaranty Insurance (E) Working Group

Date: July 2, 2019

Re: Updated Request for Extension

As you may recall, the Mortgage Guaranty Insurance (E) Working Group is in the process of fulfilling its charge to update the Mortgage Guaranty Insurance Model Act (Model #630), and it had previously hoped to complete its work by the Summer National Meeting. As chair, I would like to update that request to the Financial Condition (E) Committee in accordance with NAIC procedures.

The NAIC engaged Milliman to assist the Working Group in finalizing a Mortgage Guaranty Insurance Capital Model that would become the new capital standard for mortgage insurers. That work has been ongoing for some time, partly because Milliman was originally engaged to validate a model previously developed by the mortgage industry, and it identified a significant amount of data and documentation-related problems. Since last fall, Milliman’s focus shifted to produce a more simplified model preferred by the state insurance regulators. I am happy to report that Milliman has completed its work, and the Working Group hopes to make the proposed Mortgage Guaranty Insurance Capital Model publicly available for finalization.

While the proposed Mortgage Guaranty Insurance Capital Model seems to meet the needs of the Working Group, the Working Group will soon be shifting gears to coordinate with the Property and Casualty Risk-Based Capital (E) Working Group and the Blanks (E) Working Group. Finally, the Mortgage Guaranty Insurance (E) Working Group will finalize the actual language used in Model #630 since it is intended to provide the legal authority over the Mortgage Guaranty Insurance Capital Model.

At this time, we believe we can complete this work by the 2020 Spring National Meeting. Again, a request for additional time is largely the result of the significant work that had to be completed by Milliman to meet the needs of the state insurance regulators. Regardless, we are mindful that we have been unable to complete our work within the one-year time period expected under the NAIC model law process; therefore, we request an extension until the 2020 Spring National Meeting in order to finalize a product that can be adopted by the domestic states of the mortgage insurers, as well as any other state also wishing to adopt the same.