COMPLIANCE & LEGAL SECTIONS ANNUAL MEETING 2019

JULY 15-17

FORT LAUDERDALE MARRIOTT HARBOR BEACH RESORT & SPA

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ACLI

Financial Security...for Life.

Insurance Business Transfer and Corporate Division Transactions and Legislation

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What are these types of transactions?

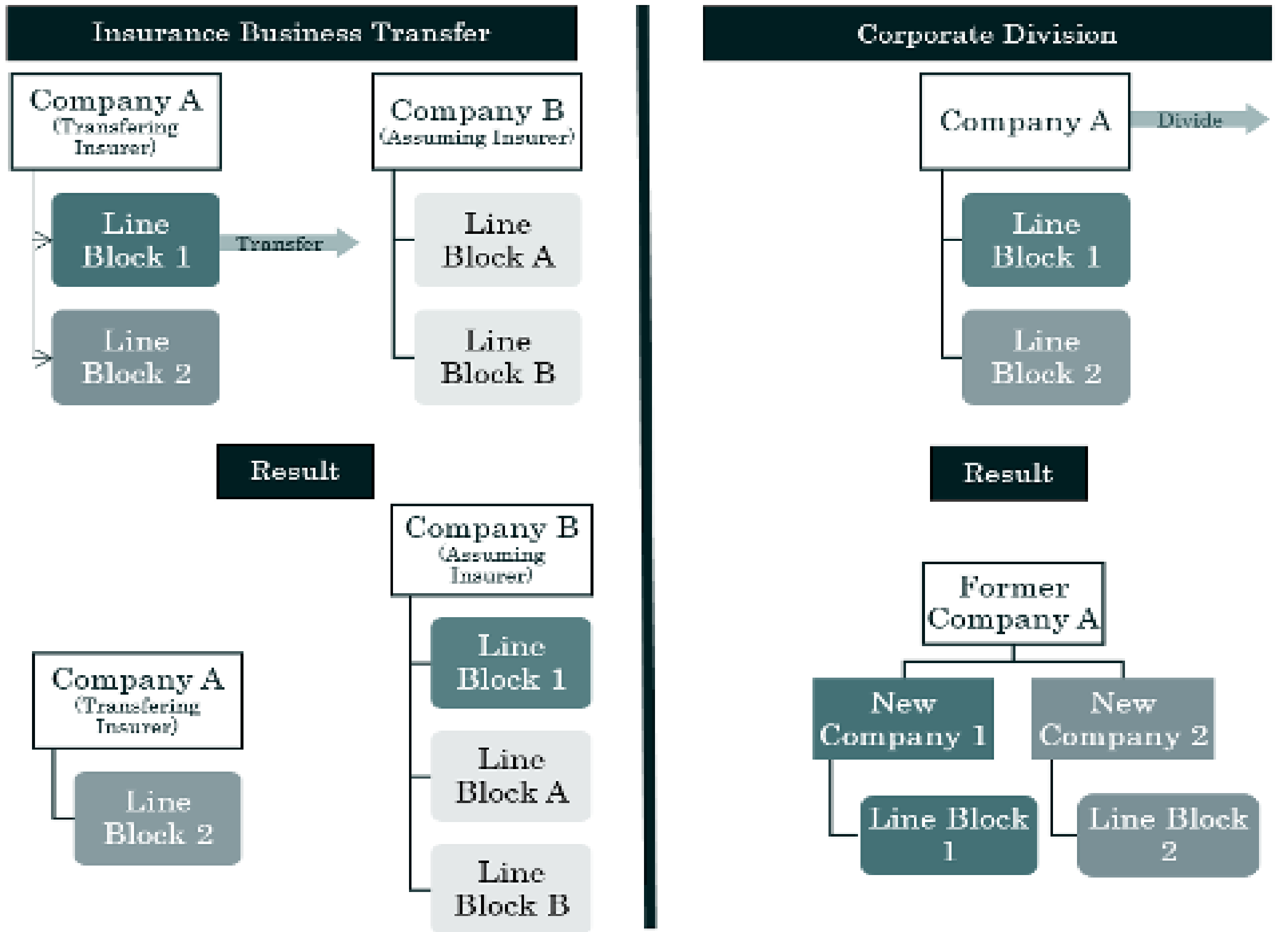
Insurance Business Transfer ("IBT")

- A transfer and novation by operation of law in which a company will transfer existing insurance obligations to an assuming insurer without policyholder consent
- The assuming insurer becomes directly liable to policyholders and the transferring insurer's obligations under the contracts are extinguished
- Legislation has been enacted in Oklahoma, Rhode Island, Vermont and Arizona
- The Oklahoma bill was based on legislation enacted in the United Kingdom (Part VII of its Financial Services and Markets Act of 2000)

What are these types of transactions?

Corporate Division

- A division of one insurer into two or more resulting insurers through a corporate level transaction
- Unlike an IBT, there is no transfer or novation by operation of law of existing insurance obligations
- Instead, the dividing insurer's assets and liabilities are allocated between or among the resulting insurers without policyholder consent
- Legislation has been enacted in Georgia, Illinois, Iowa, Michigan, Connecticut, Arizona and Pennsylvania
- Legislation is pending in Nebraska



Insurance Business Transfer
Company A
(Transfering Insurer)
Company B
(Assuming Insurer)
Line Block 1
Transfer
Line Block A
Line Block 2
Line Block B
Result
Company B
(Assuming Insurer)
Line Block 1
Line Block A
Line Block B
Company A
(Transfering Insurer)
Line Block 2
Corporate Division
Company A
Divide
Line Block 1
Line Block 2
Result
Former Company A
New Company 1
New Company 2
Line Block 1
Line Block 2

Why do some insurers support and/or promote these types of transactions?

- There is a growing need for solutions that provide legal and economic finality to insurance risks in order to improve the efficient allocation of capital and management resources
- Assumption reinsurance is not a practical option, and indemnity reinsurance does not provide legal or economic finality
- Policyholders benefit when the "run-off" of legacy business is a management's core focus, rather than a "distraction" for an ongoing enterprise's management, shareholders, and regulators

Why do some insurers support and/or promote these types of transactions?

- They permit an insurer to align its insurance business(es) with its current business strategy
- They allow an insurer to move policyholder obligations to a different qualified insurer and to extinguish its related obligations
- They allow for a company with specific expertise in managing legacy blocks of business to "run-off" closed blocks of business
- Policyholders may benefit when insurers are given flexibility to acquire and divest blocks of business

Why do some insurers oppose, or have concerns with, these types of transactions?

- Policyholders' contractual expectations to continue doing business with their insurers could be disrupted
- The transactions could be used to isolate poorly-performing and/or difficult-to-value lines of business
    - This could result in an assuming or resulting insurer inheriting and/or incurring financial difficulties, which could lead to its eventual insolvency

Why do some insurers oppose, or have concerns with, these types of transactions?

- An assuming or resulting insurer may be licensed in only one state or in fewer states than the original insurer was licensed
    - If that entity were to become insolvent, it could create “orphan” policyholders across the country and single-state guaranty association coverage, which in turn could result in capacity issues and a delay in payments to policyholders
- The industry’s long-standing credibility and reputation for keeping its promises could be jeopardized

What issues are regulators looking at with regard to these types of transactions?

- Appropriate financial and other standards for the original insurers and the assuming/resulting companies
- Policyholder and guaranty fund protections
- Legal issues relating to state reciprocity
- Potential constitutional challenges (e.g., due process, Contracts Clause)

Regulator Activity

NAIC

- Restructuring Mechanisms (E) Working Group
  - Review restructuring statutes and prepare a White Paper
  - Consider potential changes to the *Life and Health Insurance Guaranty Association Model Act* and the *Protected Cell Companies Model Act*
  - https://www.naic.org/cmte_e_res_mech_wg.htm
- Restructuring Mechanisms (E) Subgroup
  - Consider the development of financial surveillance tools for companies in run-off, including capital, surplus and reserve requirements
  - https://www.naic.org/cmte_e_res_mech_sg.htm

Regulator Activity

NCOIL

- Developing an IBT Model Act based on Oklahoma legislation
- Currently being addressed by its Joint State-Federal Relations & International Insurance Issues Committee
- Discussed at its Summer Meeting on July 11
- Discussion Draft can be found at: http://ncoil.org/wp-content/uploads/2019/02/IBT-Model-Law-Draft.pdf

ACLI Principles

Development and adoption of Principles

- Directive from ACLI's CEO Steering Committee on Prudential Issues
- Overseen by Receivership Committee, Reinsurance Committee and State Legislative Strategy Group
- A Drafting Group consisting of 22 ACLI member companies formulated potential Principles earlier this year
- Receivership Committee and Reinsurance Committee approved Principles in May
- Steering Committee adopted Principles on June 13
- Board of Directors adopted Principles on June 14

ACLI Principles

Overview of Principles

- Policyholders and other impacted stakeholders must have access to the process
- The regulatory review process must be robust
- Independent experts must be utilized as part of the process
- Court approval is required for IBT transactions, but not necessarily for corporate division transactions
- Policyholders and the state-based guaranty association system should be protected

ACLI Principles

Sources used in developing Principles

- IBT laws from Oklahoma and Rhode Island
- Corporate division laws from Illinois, Connecticut and Michigan
- NAIC's *Insurance Holding Company System Model Act* (including "Form A")
- NAIC's *Assumption Reinsurance Model*
- United Kingdom's Part VII transfer law

ACLI Principles

Topics addressed in developing Principles

- Policyholder consent
- Court approval
- Regulatory oversight
- Transaction approval process
- Potential impact to policyholders
- Financial condition review
- Balance sheet considerations
- Operational impacts
- Owner and management qualifications

ACLI Principles

Topics addressed in developing Principles (continued)

- Independent expert report
- Public hearing
- Notice to policyholders and the general public
- Licensing in other states
- Consideration of guaranty association coverage of policyholders

ACLI Principles

<u>The following handouts are available on our Meeting App</u>

- This Powerpoint presentation
- Overview of Principles
- Detailed chart of Principles
- Memorandum on U.K. Part VII Transfers

Any Questions?

If you need any additional information, please contact:

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