



# Recent US Regulatory Developments Effecting Legacy Insurance Liabilities

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FEEF Symposium

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# Agenda



- Introduction
  - Recent Developments
  - Regulatory Overview
  - Comparing Legacy Alternatives
- Overview of Regulatory Alternatives
  - Rhode Island’s Voluntary Restructuring Statute
  - Oklahoma’s Business Transfer Act
  - Division Statutes Adopted in Connecticut, Illinois, Michigan, Iowa and Georgia
  - Vermont’s Legacy Insurance Management Act
  - Assumption Reinsurance Model Act
  - Insurance Receivership Model Act
- The Rhode Island Voluntary Restructuring Statute
  - Case Study – GTE REinsurance Company
- Application to Insolvents
  - Westmoreland Casualty Company

# Introduction

## *Recent Developments*



- Rhode Island has enacted House Bill 8163 amending certain provisions of its Voluntary Restructuring Statute
- Oklahoma passed a portfolio transfer statute modeled on the UK's Financial Services Act Part VII Transfer
- Division Statutes became effective in:
  - Connecticut (October 2017)
  - Michigan (December 2018)
  - Illinois (February 2019)
  - Georgia (March 2019)
  - Iowa (April 2019)
- Traditional solutions – sale or reinsurance – remain the default alternatives for owners of legacy risk

# Introduction

## *Market Opportunities and Recent Developments*



### Historic Restructuring Mechanisms

Pennsylvania	<ul style="list-style-type: none"><li>• Entity Transactions Act allows companies to divide business</li><li>• Process successfully used by CIGNA</li></ul>
Vermont (LIMA)	<ul style="list-style-type: none"><li>• Non-admitted only; novation-only</li><li>• Policyholders can opt out</li></ul>
Insurance Receivership Model Act	<ul style="list-style-type: none"><li>• Allows insolvent companies to establish values to close estate</li></ul>
Assumption Reins Model Act (1993-1999)	<ul style="list-style-type: none"><li>• Nine states adopted</li><li>• Policyholders can accept or reject</li></ul>

### Recent and Emerging Restructuring Mechanisms

Rhode Island (2002 - 2018)	<ul style="list-style-type: none"><li>• 2015 IBT amendment makes RI the standard for facilitating novation and commutation strategies. 2018 statutory amendments increase flexibility</li></ul>
Connecticut (2017) Michigan (2018) Illinois (2019) Georgia (2019) Iowa (2019)	<ul style="list-style-type: none"><li>• Division statute passed and signed into law in 2017</li><li>• Division statute effective December 2018</li><li>• Veto overridden in November 2018 - division effective February 2019</li><li>• Division statute effective July 2018</li><li>• Division statute effective July 2018</li></ul>
Oklahoma (2018)	<ul style="list-style-type: none"><li>• Insurance Business Transfer Statute effective November 1, 2018</li></ul>

# Introduction

## *Traditional Exit Strategy Alternatives*



Alternative	Considerations
Run off to expiration	<ul style="list-style-type: none"><li>• No legal or financial finality</li><li>• Potential for exposure tail to go out 25+ years</li><li>• Continued expense, distraction, reserve deterioration</li></ul>
Reinsurance	<ul style="list-style-type: none"><li>• Costly premiums</li><li>• Limited transfer of risk</li><li>• Potential loss of control of claims</li></ul>
Sale	<ul style="list-style-type: none"><li>• Can lead to legal and financial finality if and when the subject business is novated or divided into a discrete legal entity</li><li>• Discount to NAV</li></ul>

# Introduction

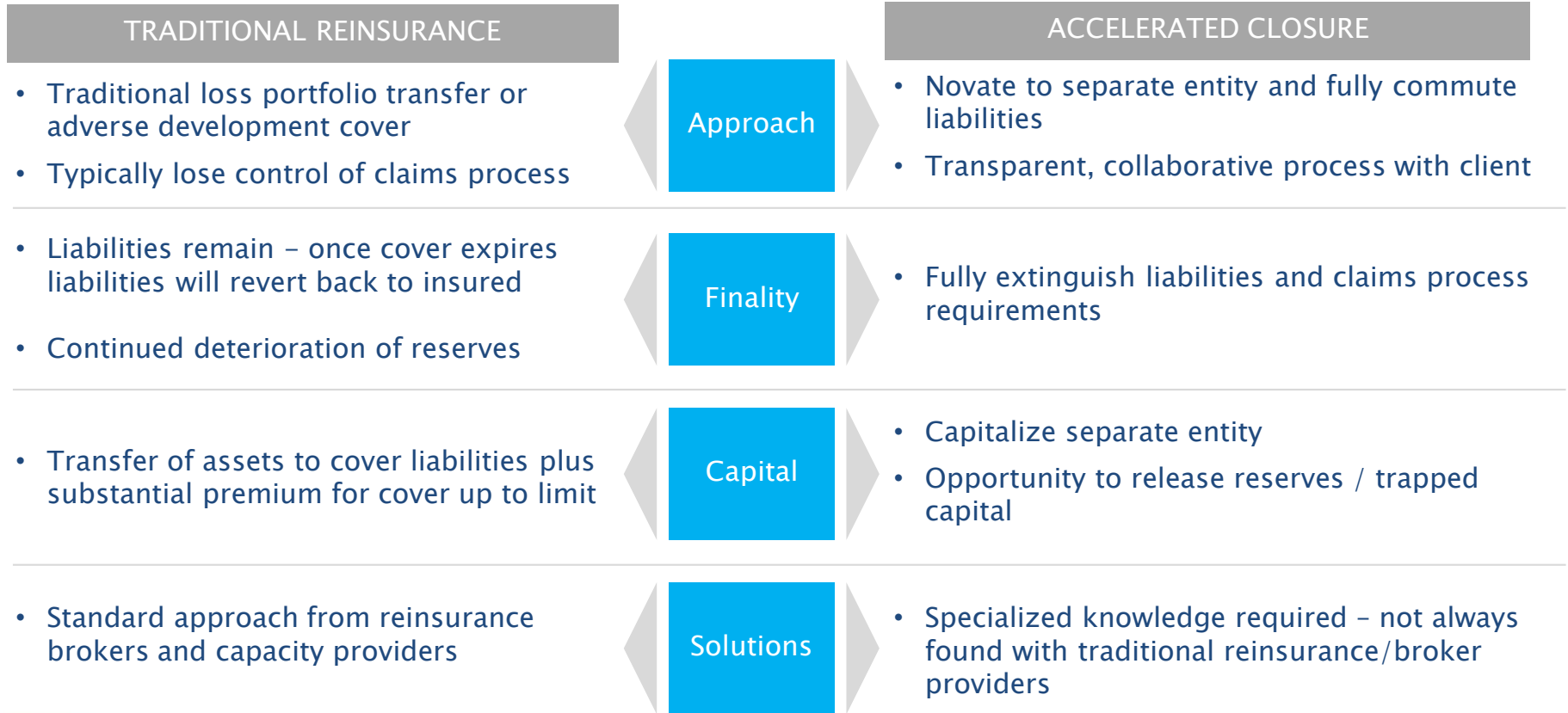
## *Proactive Exit Strategy Alternatives*



Alternative	Considerations
<b>Rhode Island Voluntary Restructuring Alternatives</b>	<ul style="list-style-type: none"><li>• Regulatory and court supervised novation of “commercial run-off insurance”</li><li>• May be followed by implementation of closure plan</li><li>• Successful conclusion leads to legal and financial finality</li></ul>
<b>Division</b>	<ul style="list-style-type: none"><li>• PA Entity Transaction Act/AZ Entity Restructuring Act</li><li>• 2017 regulatory process allows Connecticut domiciled carriers to “divide” thus separating legacy from active business</li><li>• Could increase optionality. Allows for legacy business to be run off to expiration, sold, or moved to Rhode Island for closure</li></ul>
<b>OK Business Transfer Act</b>	<ul style="list-style-type: none"><li>• Regulatory supervised novation of broad range of insurance risks into an OK domiciled insurer</li><li>• Intended to separate liabilities and place them on new balance sheet</li></ul>

# Introduction

## *Comparing Legacy Alternatives*



# Overview of Regulatory Alternatives

## *Rhode Island Voluntary Restructuring*



- “Voluntary Restructuring of Solvent Insurers” – Chapter 27–14.5, and accompanying implementing regulations, applies only to commercial carriers domiciled in Rhode Island
  - Regulatory and court monitored process that allows for termination of liabilities, elimination of ongoing expense, and extraction of capital in limited time
- Applicable only to entire eligible Rhode Island domiciled company
- 2007 statutory and 2015 regulatory amendments allow for portfolio transfers of eligible legacy exposures to newly created or existing shell entities
- 2018 statutory amendments have clarified the portfolio transfer process created in the 2007 statutory amendments



# Overview of Regulatory Alternatives

## *Rhode Island Voluntary Restructuring*



### Advantages:

- Allows for greatest flexibility in creation of proposed RI entities
  - Flexible segmentation of defined portfolio into separate cells or legal entities
  - If third party sale is desired, buyer can be the Assuming Company under the IBT process
- If approved, allows for legal novation of risks from each of the affected company entities
- Provides additional path to finality through Rhode Island Commutation Plan
  - Commutation Plan results in finality with potential return of capital
- Judicial review: Reviews for IBT and Commutation Plan allow for court sanctioned process

### Considerations:

- Due to separate judicial reviews for IBT and Commutation Plan:
  - Provides any objecting ceding companies with two challenges on process
  - Potential for higher frictional cost and increased execution risk

# Overview of Regulatory Alternatives

## *Oklahoma's Business Transfer Act*



- Oklahoma Senate Bill 1101
  - Modeled after UK Financial Services Act Part VII Transfer
  - <https://legiscan.com/OK/text/SB1101/2018>
- Provides the “basis and procedures for the transfer and statutory novation of policies from a transferring insurer to an assuming insurer by way of an Insurance Business Transfer without the affirmative consent of policyholders or reinsureds”
- Defines very broadly the policies of insurance that are subject to its provisions
  - “[A] policy, contract or certificate of insurance or a contract of reinsurance...and shall include property, casualty, life, health, long term care, accident, surety, title and annuity business”

# Overview of Regulatory Alternatives

## *Oklahoma's Business Transfer Act*



- Requires that the novation is subject to regulatory and court approval.
  - Allows for a “statutory novation with respect to all policyholders or reinsureds and their respective policies and reinsurance agreements...providing that the transferring insurers shall have no further rights, obligations or liabilities with respect to such policies...[releasing] the transferring insurers from any and all obligations or liabilities under the policies...”
- Allows transfer to an Oklahoma–domiciled insurer, which “may be a protected cell company established pursuant to the Oklahoma Captive Insurance Company Act”
- Makes no delineation between the types of eligible insurance coverage
  - Includes both live or active contracts as well as discontinued or ‘run off’ insurance

# Overview of Regulatory Alternatives

## *Oklahoma's Business Transfer Act*



- Introduces an Application Procedure by which the Insurance Business Transfer Plan is filed with the Oklahoma regulator for review.
  - The application may contain, among other items, “evidence of approval or non-objection of the transfer from the chief insurance regulator of the state of the transferring insurer’s domicile”
- Does not require, but may allow for, the application to be supplemented by an independent expert’s opinion.
  - However, the department’s review of the applications shall include “a review of the independent expert report”
- Requires that the department “shall authorize the submission of the Plan to the Court unless it finds that the Insurance Business Transfer would have a material adverse impact on the interests of policyholders or claimants...”

# Overview of Regulatory Alternatives

## *Division Statutes*



- Connecticut
  - Public Act No. 17-2 (HB 7025) An Act Authorizing Domestic Insurers to Divide
- Illinois
  - Public Act 100-1118
- Michigan
  - Senate Bill 1029
- Georgia
  - Senate Bill 156
- Iowa
  - House Bill 264
- Allow a domestic insurer (subject to a regulatory approved plan of division) to divide into two or more insurers, resulting in the Dividing Insurer and a new, divided entity (the “Resulting Insurer”) and allocate assets and obligations, including insurance policies (the “Divided Business”), to the Resulting Insurer
  - CT, IL, IO and MI apply to stock companies only
  - GA applies to stock and mutual insurers
- Also allows for creation of NewCo to accomplish Division and for merger of (presumably) divided companies
- While the PA and AZ Entity Transaction and Restructuring Acts apply to domiciled corporations broadly, the CT, IL, MI, GA and IA statutes apply only to insurers

# Overview of Regulatory Alternatives

## *Division Statutes*



### Advantages and Considerations:

- No required approval to affected ceding companies
- Regulatory review only though MI, IA and GA allow for public hearing
  - CT and IL provide for notice and regulatory review if deemed appropriate by the regulator
- Allows for range of future options:
  - Stand-alone management to expiration
  - Third party reinsurance
  - Sale
  - Merger
  - Re-domestication of newly divided entities to Rhode Island for closure
- **No judicial review** unless affected cedent files objection to regulatory review
- **No mechanism for accelerated closure**
- Resulting insurer remains jointly and severally liable for policies and liabilities of the dividing insurer not allocated in the plan of division
  - If a division breaches obligations of the dividing insurer, all of the resulting insurers are liable for the breach (although the breach will not affect the validity and effectiveness of the division)

# Overview of Regulatory Alternatives

## *Vermont Legacy Insurance Management Act*



- Vermont's Legacy Insurance Management Act, 8 V.S.A. Chapter 147 § 7111 et seq., ("LIMA") enables a **non-admitted** insurer from any jurisdiction to transfer closed blocks of business to a **special-purpose corporate entity** domiciled in Vermont, which assumes the obligations to policyholders
- Solely a novation process; **no regulatory mechanism to extinguish legacy liabilities**
- **Policyholders can opt out of the plan**

# Overview of Regulatory Alternatives

## *Assumption Reinsurance Model Act*



- Adopted by NAIC in 1993. Amended in 1999
- Adopted in nine states (including RI)
- Assumption Reinsurance Agreements
  - Contracts that transfer insurance risks or in force contracts
  - Effect a novation of the transferred contract
- Regulatory approval required from domiciliary regulators of the Transferor and Transferee
- Notice must go to all policyholders/cedents
- **Policyholders may accept or reject the transfer**
- No judicial review



# Overview of Regulatory Alternatives

## *Insurance Receivership Model Act*



- IRMA allows an insolvent company to establish values of contingent or unliquidated claims and close the estate
  - Only adopted in two states: Texas and Utah
  - Portions enacted in Maine, Missouri, Oklahoma, and Tennessee
  - Process utilized by Pennsylvania Insurance Department (as Liquidator) in 2016 and 2017 to agree the determined values of Class A and B Claims with the Guaranty Associations relevant to Westmoreland Casualty and Rockwood Insurance

# The Rhode Island Statute

## *Commutation Plan Benefits*



- Preserve industry reputation by honoring all presented and agreed policy claims in full
- Avoid prospective adverse reserve development on posted reserves
- Avoid prospective rehabilitation or insolvency of financially impaired entities
- Realize value from reserve redundancy and ceded reinsurance collections
- Eliminate management distraction and expense from legacy liabilities
- Release trapped capital for productive purposes

# The Rhode Island Statute

## *Initial Legislation*



- “Voluntary Restructuring of Solvent Insurers” – Chapter 27–14.5, applies only to commercial carriers domiciled in Rhode Island
  - Direct workers compensation and personal risks are excluded
  - Crystallizes, accelerates and terminates liabilities, eliminates ongoing expense and allows for extraction of trapped capital
- Applicable only to entire company not a separate portfolio unless that eligible portfolio is transferred to an existing or newly capitalized Rhode Island carrier
- Requires prior regulatory review by the Department of Business Regulation (“DBR”)
- Court monitored process
- Must receive assent of 50% or more of creditors by number, representing 75% or more by value of those voting in person or by proxy

# The Rhode Island Statute

## *2007 Amendment to the Statute*



- Chapter 27–14.5–1 was amended in 2007 to define a “commercial run-off insurer”, in part, as:
- “A Rhode Island domestic insurance company meeting the requirements of subsection (i) hereof and formed or re-activated for the sole purpose of entering into a voluntary restructuring under this chapter and whose liabilities consist of commercial liabilities transferred to said company with the approval of the commissioners and pursuant to the regulations issued by the department under this chapter. The amount of the commercial liabilities transferred must be less than or equal to the amount of assets transferred to the newly formed or re-activated company.”

# The Rhode Island Statute

## *2015 Regulatory Amendments*



- The amendments to the former Regulation 68 follow from the 2007 amendment to the Statute
- The amendments set forth the process by which a solvent insurer, domiciled within or outside of Rhode Island (the “Transferring Company”), can novate commercial run off liabilities to an assuming solvent Rhode Island insurer (the “Assuming Company”)
- The liabilities transfer process (the “Insurance Business Transfer Plan”) is subject to regulatory review and approval by both the current domiciliary regulator and the DBR
- Following review and, if appropriate, approval of the Insurance Business Transfer Plan by the DBR, the Assuming Company will seek an order from the Providence County Superior Court (the “Court”) approving the Insurance Business Transfer Plan

# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



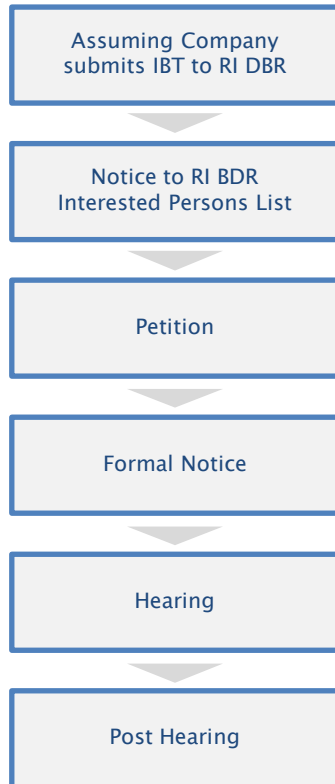
- Transferring Company receives approval from domiciliary regulator to move eligible business
- Assuming Company submits IBT to RI DBR
- Notice to RI DBR Interested Persons List
- Petition for Implementation of IBT
- Formal Notice to all policyholders
- Hearing
- Post Hearing Approval/Denial

# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



Transferring Company receives approval from domiciliary regulator to move eligible business



- Commercial insurance/reinsurance
- No direct WC or personal lines
- **In run off for at least 5 years**
- Domiciled in RI or another state

# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



Transferring Company  
domiciliary regulator approval

**Assuming Company submits IBT to RI DBR**

Notice to RI BDR  
Interested Persons List

Petition

Formal Notice

Hearing

Post Hearing

- IBT must be supported by expert opinion
- RI DBR distributes notice of IBT application to those on DBR interested parties list
- Interested parties (policyholders) have 15 days to submit comments
- DBR retains independent industry experts to review plan



# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



Transferring Company  
domiciliary regulator approval

Assuming Company  
submits IBT to RI DBR

Notice to RI BDR  
Interested Persons List

**Petition for Implementation of IBT**

Formal Notice

Hearing

Post Hearing

- Filed by the Assuming Company in the Rhode Island Superior Court once DBR approves IBT
- Assuming Company notifies all policyholders within 15 days of court issued scheduling order
- Policyholders have 60 days to submit comments on IBT

# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



Transferring Company  
domiciliary regulator approval

Assuming Company  
submits IBT to RI DBR

Notice to RI BDR  
Interested Persons List

Petition

Formal Notice

**Hearing**

Post Hearing

- Court considers petition and any policyholder comments submitted
- Court will approve IBT unless the court finds IBT will have a **materially adverse effect** on the rights of the policyholders

# The Rhode Island Statute

## *Insurance Business Transfer Plan Process*



Transferring Company  
domiciliary regulator approval

Assuming Company  
submits IBT to RI DBR

Notice to RI BDR  
Interested Persons List

Petition

Formal Notice

Hearing

**Post Hearing**

- Court approval of the IBT results in a complete novation of insurance obligations from the Transferring Company to the Assuming Company
- If the Court does not approve the IBT, the Assuming Company may amend the IBT and refile its Petition

# The Rhode Island Statute

## *IBT Issues for Consideration: Who Benefits*



- **Foreign and domestic owners of active insurers and reinsurers** that have legacy liabilities, eligible for closure under the commutation plan process within the active underwriting entity
- **Domestic owners of insurers or reinsurers in run off** with discreet lines of business that are eligible for closure under a commutation plan
- **Regulators** who are looking to improve the financial condition of active and discontinued business
- **Shareholders, reinsurers, counterparties** to insurers with discontinued liabilities

# The Rhode Island Statute

## *IBT Issues for Consideration: Arguments in Opposition*



- Diminishes the market perception of the insurance product
- Violates anti-assignment provisions of reinsurance agreements
- Does not comply with Dodd Frank §531(b) – Credit for Reinsurance
- Rhode Island lacks the authority to amend the regulation
- Novation to a single state licensed carrier impacts upon Guaranty Fund protection
- Does not require specific policyholder consent or approval
- Forces counterparties to accept a commutation plan
  - Mooted by House Bill 8163

# The Rhode Island Statute

## *House Bill 8163*



- Amendments introduced in 2018 to the Voluntary Restructuring Statute (House Bill 8163)
  - <https://www.legiscan.com/RI/bill/H8163/2018>
- Passed by state House and Senate and signed by the governor on July 2, 2018
- Expands utility of the IBT process:
  - Removes language from the 2007 statutory amendment
  - Defines voluntary restructuring broadly
  - Expands the use of protected cell entities

# The Rhode Island Statute

## *House Bill 8163*



- Increases the scope of the IBT process by removing the stipulation that the entity into which eligible commercial liabilities are transferred has been “formed or reactivated for the sole purpose of entering into a voluntary restructuring”
- Expands the definition of ‘voluntary restructuring’ making it possible to use the Rhode Island process for “enhancing organization and maximizing efficiencies”, while allowing “the transfer of assets and liabilities to or from an insurer”
- Allows for the use of protected cell entities in voluntary restructuring activities to avoid the intermingling of assets and liabilities from distinct parties.

# Application to Insolvents

## *Westmoreland Casualty Company*



- In an April 11, 2018 Memorandum and Order, Pennsylvania’s Commonwealth Court Confirmed an arbitration award in favor of the Pennsylvania Insurance Commissioner, as Liquidator of Westmoreland Casualty Company (the “Liquidator”), and against General Reinsurance Corporation (“reinsurer” or “Gen Re”).
- The Award compelled the reinsurer to reimburse the Liquidator for the reinsurer’s proportionate share of determined amounts agreed between the Liquidator and its creditors, several state guaranty associations; and
- Denied General Re’s Motion to Seal the Award, notwithstanding the confidentiality order in the underlying arbitration.



# Westmoreland Casualty Company

*Why the rulings break new ground*



The Court's Memorandum and Order demonstrates:

- The Liquidator's latitude to accelerate payment to the creditors, the state guaranty associations, in order to manage insolvent insurance companies efficiently;
- Reinsurers' obligations to indemnify liquidators for the sanctioned accelerated payments; and
- The public's right of access to decisions from private arbitrations, which directly affect the public's interests.

# Westmoreland Casualty Company

## *The Application*



- In 2016, the Liquidator for Westmoreland Casualty, an insolvent Pennsylvania-domiciled insurance company, sought approval of the final determined amounts of Westmoreland's obligations to its remaining creditors (the relevant guaranty associations), as "Westmoreland's full and final obligation to each relevant guaranty association" and in which the Liquidator detailed:
  - the history of the Westmoreland insolvency;
  - the steps taken to agree determined values with the Guaranty Associations for Class A (administrative expense) and Class B (loss and loss adjustment expense) amounts; and
  - the power and authority provided to the Liquidator by the Insurance Department Act of 1921 to manage the affairs of an insurer in liquidation.
- The Commonwealth Court granted the Application by Memorandum and Order dated May 13, 2016.

# Westmoreland Casualty Company

## *The Arbitration*



- Thereafter, the Liquidator sought recovery from Westmoreland's remaining reinsurers for their proportionate share of the determined Class B amounts. The Liquidator's arbitration proceeding against General Re followed.
- In its January 22, 2018 unanimous Panel Ruling on Summary Judgment and Final Award, the appointed Panel detailed the positions of the parties:
- Westmoreland contended that General Re is bound by the May 13, 2016 Order accepting the determined amounts as "Westmoreland's full and final obligation to each relevant guaranty association" and that settled losses of \$4,889,115.43 are due from Gen Re to Westmoreland under the terms of the reinsurance treaty.

# Westmoreland Casualty Company

## *The Arbitration*



- Gen Re opposed Westmoreland’s motion claiming that, under the treaty, the compromise of open claims with the guaranty associations was not a settlement of claims or losses paid by Westmoreland under the treaty.
- Gen Re contended that the treaty required that the guaranty associations actually had to pay the underlying workers’ compensation claims to the insureds before the payment amounts were properly due and owing from the reinsurer.
- The panel disagreed with Gen Re’s position ruling that “[p]ayment to the insured is not required to trigger the reinsurer’s obligation.”
- Citing the treaty’s insolvency clause, the panel ruled that the May 13, 2016 Order “fully and finally resolved the liability of the company (Westmoreland) for these claims” and that “there is no doubt that the approval of the settlement by the Commonwealth Court determined Westmoreland’s liability for these claims for all time.”

# Westmoreland Casualty Company

## *The Motion to Confirm*



- Following receipt of the panel’s award, and prior to satisfaction of that award by Gen Re, the Liquidator moved to confirm the award in the Commonwealth Court
- As reflected in the Commonwealth Court’s Memorandum, Gen Re did not oppose confirmation of the panel’s award
- Gen Re did move to seal the award claiming that disclosure would put Gen Re “at a competitive disadvantage when seeking to resolve similar disputes in the future.”
- Gen Re argued that “keeping the award under seal is consistent with the parties’ expectations under the Confidentiality Agreement” and that “this matter involves unusual facts and a legal dispute that is not an issue of public concern.”

# Westmoreland Casualty Company

## *The Ruling*



- In its April 11, 2018 Memorandum and Order, the Commonwealth Court disagreed with Gen Re, citing that
- **“the public has a common law right of access to judicial records”** and, moreover, reasoning and concluding that
- **“the arbitration award does not reveal secretive or confidential business information that could put Gen Re’s competitors or “counterparties” at a competitive advantage, the award sets forth the arbitration panel’s legal conclusion regarding Gen Re’s payment obligation following an Order of this Court [the May 13, 2016 Order].”**
- Citing the relevance of the Insolvency Act to the present dispute and the need for transparency for matters related to the administration of insolvent estates, the Court concluded that
- **“Gen Re’s interest in secrecy does not overcome the public’s right to access the award.”**



Thank you for your attention

Any further questions:

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