FEDERATION OF REGULATORY COUNSEL

Insurance Business Transfers and Divisions: Developments in Two Similar, but Different, Processes

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For decades, the insurance industry has dealt with issues of how to effectively and finally resolve run-off and discontinued books of insurance business.[1] In 2004, the Association of Insurance & Reinsurance Run-Off Companies ("AIRROC") was formed to allow insurers to address issues of legacy business.[2] Traditional existing options, such as commutations and loss portfolio transfers ("LPTs"), might not provide the finality that the insurer with legacy issues seeks. In a recent survey conducted by PwC of the global insurance runoff market, U.S. P&C run-off liabilities were estimated to be $348 billion, representing nearly half the size of the global legacy market.[3] United States insurance companies with such run-off business are looking for effective exit solutions to facilitate operational and capital efficiencies and gain legal finality. In their May 2018 analysis, Moody's estimated that life insurers have more than $420 billion of annuity, life insurance, long term care and other liabilities publicly designated as "legacy" or "run-off" that are targeted for exit transactions.[4]

In recent years, a growing number of states have enacted legislation to provide legacy or run-off options for the insurer holding the business. One concept is the insurance business transfer ("IBT") and the other is the division framework. This article addresses the two concepts including their differences, as well as some nuances among the states in terms of the process and what lines are covered.

Part VII Transfers

In the UK, IBTs are permitted under Part VII of the UK Financial Services and Markets Act 2000 ("Act").[5] There have been more than two hundred Part VII transfers under the Act since it became effective.[6] Part VII has been used as a model and justification for developments in the United States.

Rhode Island and IBTs

In 2002, shortly after the Act became effective in the UK, Rhode Island addressed transfer of legacy business when it enacted the Voluntary Restructuring of Solvent Insurers Act (the "RI Commutation Act"), which prescribes a process for a Rhode Island-domiciled "Commercial Run-Off Insurer"[7] to extinguish its outstanding liabilities pursuant to a court-ordered commutation plan, with the approval of 50% of policyholder creditors representing at least 75% of claim value.[8] In 2016, amending the RI Commutation Act, the Rhode Island Department of Business Regulation (the "Department") introduced Insurance Regulation 68, which provides a new IBT mechanism that allows for the transfer of blocks of U.S. property casualty business from any insurer (the "Transferring Company") into a Rhode Island-domiciled Commercial Run-Off Insurer as defined under the RI Commutation Act (the "Assuming Company"). Unlike the RI Commutation Act, which provides for a whole-company commutation, Regulation 68 enables a Transferring Company to novate books of business to the Assuming Company. In order to effectuate a Regulation 68 transfer, a number of steps must take place:

- Approval of the transfer by the domiciliary state of the cedant;
- An independent expert report on the impact of the transfer on policyholders;
- Independent actuarial evaluation of the adequacy of the reserves being transferred and the sufficiency of the assuming company's assets;
- Approval by the Rhode Island Department of Insurance;

- Notification of all affected policyholders; and,
- Review and approval by the Providence County Superior Court.[9]

To date, no insurer has completed the Regulation 68 IBT process.

Oklahoma Follows Suit

In May 2018, Oklahoma followed suit, enacting its own IBT law.[10] The Oklahoma law became effective November 2018, and is most closely aligned with UK's Part VII transfer regime. The law does not require affirmative consent from policyholders. Compared to Rhode Island's, the Oklahoma law is broader, as it includes property, casualty, life, health and any other line the Oklahoma commissioner finds acceptable. In addition, Oklahoma's law is not restricted to run-off.

NCOIL Adopts Model IBT Law

The National Council of Insurance Legislators ("NCOIL") is "a legislative organization comprised principally of legislators serving on state insurance and financial institutions committees around the nation,"[11] with a focus on drafting insurance model laws. At its spring meeting in March 2020, NCOIL adopted an IBT model law.[12] The model law was based on the Oklahoma IBT law. In November 2019, Commissioner Glen Mulready approved Provident Washington Insurance Co.'s IBT plan to be submitted to the court for review and potential approval.[13]

Vermont and Arizona

In 2014, Vermont passed a limited law that allows transfers in limited circumstances.[14] Under the Legacy Insurance Management Act ("LIMA") of 2014, non-admitted insurers can transfer closed books of commercial non-admitted insurance policies or reinsurance. A closed book is defined as one in run-off for more than five years. Vermont's LIMA requires notice to all policyholder and reinsurance counterparties, and policyholders and reinsurers can opt out. Those who object are excluded from the transfer.

LIMA requires only regulatory approval and an order and then, once approved, has the full force and effect of a statutory novation.

In 2015, Arizona passed a statute that broadly addresses IBTs and transfers.[15]

Division Laws

Unlike with IBTs, where the legacy business is transferred to another insurer, in a corporate division, an insurer divides into two or more insurance companies and, depending on the state, creates isolated blocks of business for potential sale to third parties. Because the business is not transferred, no court approval is necessitated by the division, distinguishing it from the IBT process. The reasoning behind that difference is that the division results in the same entity still owning the divided company. In the transfer, a new company steps in and so additional concerns of fairness and policyholder treatment are at stake.

The allocation of assets and liabilities for the blocks of business divided between the resulting insurers occurs without policyholder consent, and in the states that have enacted division laws, generally no court approval is required.

The division, like a merger, is effected by operation of law, and some have compared to the process akin to a reverse merger.[16] In 2017, Connecticut enacted its division law, requiring an insurer to submit a plan of division that must set forth certain elements prescribed by statute and must be approved by the insurance commissioner.[17] The other states' Division Laws are very similar to Connecticut's. To date, other states that have enacted division laws are:

- Illinois (2018)[18];
- Michigan (2018)[19];
- Iowa (2019)[20]; and,
- Georgia (2019)[21].

Each state has its own variation of the requirements for approving a division and the lines of business subject to the act.

Illinois is somewhat representative of the type of division law that states have passed. Per Illinois legislation, a company wishing to divide in accordance with the law must submit a plan that contains the following:

(1) the name of the domestic stock company seeking to divide;

(2) the name of each resulting company that will be created by the proposed division;

(3) the manner of allocating between or among the resulting companies;

(4) the manner of distributing shares in the new companies to the dividing company or its shareholders;

(5) a reasonable description of the liabilities, including policy liabilities, and items of capital, surplus, or other assets, in each case, that the domestic stock company proposes to allocate to each resulting company, including specifying the reinsurance contract, reinsurance coverage obligations, and related claims that are applicable to those policies;

(6) all terms and conditions required by the laws of this State or the articles of incorporation and bylaws of the domestic stock company;

(7) evidence demonstrating that the interest of all classes of policyholders of the dividing company will be properly protected; and

(8) all other terms and conditions of the division.[22]

The Illinois Division Act does not require that the Insurance Department Director hold a hearing to determine the appropriateness of the plan, but provides the discretion to hold a hearing; the dividing insurer may also request one.

Whether a hearing is conducted or not, the Director is directed to approve a plan consistent with the provisions in 215 ILCS 5/35B-25(b), which provides:

> (b) The Director shall approve a plan of division unless the Director finds that:
>
> (1) the interest of any class of policyholder or shareholder of the dividing company will not be properly protected;
>
> (2) each new company created by the proposed division, except a new company that is a nonsurviving party to a merger pursuant to subsection (b) of Section 156, would be ineligible to receive a license to do insurance business in this State pursuant to Section 5;
>
> (3) the proposed division violates a provision of the Uniform Fraudulent Transfer Act;
>
> (4) the division is being made for purposes of hindering, delaying, or defrauding any policyholders or other creditors of the dividing company;
>
> (5) one or more resulting companies will not be solvent upon the consummation of the division; or
>
> (6) the remaining assets of one or more resulting companies will be, upon consummation of a division, unreasonably small in relation to the business and transactions in which the resulting company was engaged or is about to engage.[23]

In a division, the same insurance group still retains the divided company or companies, and in Illinois, like most states, the division is limited to intra-state transactions.

Restructuring Mechanisms (E) Working Group

The NAIC formed the Restructuring Mechanisms (E) Working Group in 2018 to, among other objectives, take a look at the current legislation and review "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."[24] At the initial meeting of the Working Group, many states were learning about IBTs and divisions and other mechanisms for the first time and in many cases voicing opposition to those mechanisms. That opposition has softened to a large extent, but some groups and companies have expressed reservations and concerns. For example, the National Conference of Insurance Guaranty Funds ("NCIGF") adopted its "Position Statement on Restructuring"[25] on October 1, 2019. The NCIGF position stated in part:

> Again, where the original company was a member of one or more guaranty funds and potential claimants and policyholders had been covered by a guaranty fund prior to the transaction, care should be taken to make sure that those same claimants and policyholders are covered by a guaranty fund after the transaction. This may require guaranty fund laws and/or other insurance laws to be amended in each of the states where the original company was a member of a guaranty fund before the transaction becomes final.
>
> Although this is a developing issue, restructuring statutes as described above are part of the existing insurance landscape. Currently, the best course of action is for the guaranty fund system to work with industry, state and national trades, and regulators to resolve the guaranty fund coverage issues in a tailored fashion, taking account of variances in state laws and restructuring statutes that may come in to play.[26]

Conclusion

The insurance industry has long struggled with issues of run-off blocks or lines of business and how to administer those legacy policies while operating as a go-forward entity with active policyholders.

Both IBTs and divisions provide insurers with some additional tools to work toward such finality, with IBTs if approved providing true finality. Late 2020 or early 2021 might see some transactions getting to the finish line, with the amount of division amongst various constituencies still to be determined.[27] Several states have given the insurers such tools and frameworks for addressing their legacy books.

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[1] *See, e.g., "*AIRROC Webinar Series: Introduction to Run-Off Leveraging Legacy Liabilities," originally broadcast on February 6, 2019, available at https://www.naic.org/documents/cmte_e_res_mech_sg_190523_c_2.pdf. On that webinar, Jonathan Bank, an attorney at Locke Lord, spoke of his experience in 1974 at his employer, Teledyne, with run-off. In the world is incredibly small, I spent five years at Argonaut Group, which Banks refers to, and five years at Unitrin, another Teledyne spinoff. Bank is a great attorney and friend, and I also started my career at Lord Bissell & Brook, the predecessor to Locke Lord.

[2] https://www.airroc.org/about-Airroc#:~:text=The%20Association%20of%20Insurance%20%26%20Reinsurance,solutions%20to%20their%20common%20problems.

[3] https://www.pwc.com/gx/en/industries/financial-services/publications/global-insurance-run-off-survey.html.

[4] Available at https://www.investmentnews.com/article/20180523/FREE/180529954/insurers-are-selling-off-old-annuity-business-x2014-what-advisers#.XOqq_sdVQOY.email.

[5] https://www.legislation.gov.uk/ukpga/2000/8/part/VII.

[6] For an excellent summary of Part VII transactions that have occurred, *see* Sidley Austin LLP's "UNITED KINGDOM PROPOSED PART VII FSMA INSURANCE BUSINESS TRANSFER SCHEMES AS AT 4 SEPTEMBER, 2020," available at https://www.sidley.com/~/media/publications/part-vii-transfers.pdf.

[7] An insurer whose business includes only the reinsuring of non-life business and/or the insuring of any line of business other than life, workers' compensation and personal lines)

[8] R.I. Gen. Laws § 27-14.5.

[9] https://rules.sos.ri.gov/regulations/part/230-20-45-6.

[10] https://www.ncigf.org/wp-content/uploads/2019/10/OK-Adopted-law.pdf.

[11] http://ncoil.org/history-purpose/.

[12] http://ncoil.org/2020/03/31/ncoil-adopts-insurance-business-transfer-model-act/.

[13] https://www.insurancejournal.com/news/southcentral/2019/11/26/549694.htm.

[14] https://www.ncigf.org/wp-content/uploads/2019/10/VT-LIMA-law.pdf.

[15] https://law.justia.com/codes/arizona/2015/title-20/section-20-736/.

[16] Pennsylvania has long had a general corporation division law that applies to all businesses in Pennsylvania. Several years ago, Brandywine used the statute to effectuate a division.

[17] https://www.ncigf.org/wp-content/uploads/2018/10/CTDivisionStatute.pdf.

[18] https://www.ncigf.org/wp-content/uploads/2019/10/215-ILCS-5_-Illinois-Insurance-Code_Division.pdf.

[19] http://www.legislature.mi.gov/(S(2lmuag2un3tfuyxasqojh50q))/mileg.aspx?page=getObject&objectName=mcl-218-1956-55.

[20] https://www.legis.iowa.gov/publications/search/document?fq=id:1034963.

[21] https://www.ncigf.org/wp-content/uploads/2019/10/GA-adopted-legislation.pdf.

[22] 215 ILCS 5/35B-15(b), https://www.ncigf.org/wp-content/uploads/2019/10/215-ILCS-5_-Illinois-Insurance-Code_Division.pdf.

[23] *Id.*

[24] https://content.naic.org/cmte_e_res_mech_wg.htm#:~:text=2020%20Charges,employing%20to%20achieve%20similar%20results.

[25] https://www.ncigf.org/wp-content/uploads/2019/12/Adopted-Restructuring-Position-Statement.pdf.

[26] *Id.*

[27] For an excellent summary of some of the IBTs and division laws that have been enacted and advocating for them, the ProTucket "Paper on Issues Relating to Its Licensing and Accreditation" is worth a read, available at https://www.naic.org/documents/cmte_e_res_mech_sg_190523_c_3.pdf.