

ACQUISITIONS OF BLOCKS OF INSURANCE BUSINESS IN THE UNITED STATES

by

Jon Biasetti

Locke Lord Bissell & Liddell LLP

111 South Wacker Drive

Chicago, IL 60606

jbiasetti@lockelord.com

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This article will discuss the alternative structures principally used for buying and selling a block of insurance business in the United States and outline the key legal issues associated with these structures.¹

I. ALTERNATIVE TRANSACTION STRUCTURES

Insurance companies in the United States that decide to sell a block of insurance business have traditionally done so by entering into reinsurance transactions with another insurance company. In general, these reinsurance transactions may be structured as assumption reinsurance or indemnity reinsurance. There is a key difference between these two structures. In an assumption reinsurance transaction the policyholder must consent to the transaction, at least as it relates to the policyholder's individual policy, while in an indemnity reinsurance transaction the policyholder is not required to consent to the transaction and, in fact, the transaction is often "invisible" to the policyholder.

An insurance company that wishes to sell a block of insurance business must consider a variety of factors when choosing between an assumption reinsurance and indemnity reinsurance transaction including, without limitation, tax and regulatory issues, the business and strategic objectives of the company, whether speed to close the transaction is critical, etc. However, often the most important factor driving the insurance company's choice between the two structures is whether the insurance company wishes to only transfer its policy-related liabilities on its block of business to the reinsurance company through an indemnity arrangement or get out entirely from its block of business. If the insurance company wishes to get out of its block of business altogether, it will likely choose the assumption reinsurance structure because, as discussed below, through this structure the insurance company can be released by its policyholders from all

¹ The reader should refer to the two articles that I previously published in Assicurazioni: (a) La Disciplina dell'Assicurazione Privata Negli Stati Uniti, and (b) Acquisizione e Formazione di Società Assicuratrici Americane.

policy-related liabilities and make the reinsurance company directly and solely liable to the insurance company's policyholders for such liabilities.

There is another structure available to sell a block of insurance business which does not necessarily involve a reinsurance transaction. This structure is a policy replacement transaction and will be briefly discussed in greater detail below.

A. Assumption Reinsurance

The primary objective of assumption reinsurance is to allow the transferring insurance company (the "Cedant") to transfer its insurance risks, obligations and rights to an assuming insurance company (the "Reinsurer") by novation. Novation is a term of contract law. In a novation, the Reinsurer replaces the Cedant as the party contractually liable to pay benefits to the policyholders, and entitled to receive premiums therefrom, under the transferred insurance policies. Following the novation, the Cedant is released from any further legal obligation to pay benefits to the policyholders and all such policy-related liabilities are eliminated from the Cedant's financial statements. The end result in a successful assumption reinsurance transaction is that the Cedant's policies, upon novation, become policies of the Reinsurer. However, in order for the novation to be valid, the Cedant's policyholders must consent to the proposed replacement of the Cedant with the Reinsurer.

In the United States, the requirement of policyholder consent to an assumption reinsurance transaction is grounded in general contract principles. Therefore, policyholder consent must be obtained whether or not a state extensively regulates assumption reinsurance transactions (as noted in my earlier article, in the United States the business of insurance is primarily regulated by each of the individual states, their laws can vary significantly and an insurance company that transacts insurance outside of its state of domicile will be subject to the laws of each of these jurisdictions). The substitution of a new insurance company to discharge policy benefits is a material modification to the original contract purchased by the policyholder and may, depending on the facts and circumstances, significantly reduce the policyholder's security or alter the terms of coverage. For example, a policyholder may not want to be insured by a replacement insurance company that is not as financially strong or does not have as favorable a reputation as the original insurance company that issued the policy. Thus, to be valid and enforceable, each of the policyholder, Cedant and Reinsurer must consent to the novation and the release of the Cedant.

It should be noted, however, that although once the novation is effected the Reinsurer is contractually liable to pay benefits to the policyholders as if it originally issued the policies, as between the Reinsurer and the Cedant, they can, in the reinsurance agreement, provide that the Cedant will retain certain liabilities and agree to indemnify the Reinsurer therefor. For example, in the reinsurance agreement the liabilities assumed by the Reinsurer are often limited to the liabilities expressly covered under the terms of the policies, meaning that the Cedant will likely be asked to retain the risk of punitive or extra-contractual damages such as regulatory fines and penalties arising from its own errors and omissions in marketing or administering the block of business prior to closing the reinsurance transaction, pending or threatened litigation relating to the business transacted during the pre-closing period, and pre-closing premium tax and guaranty association assessment obligations.

A significant disadvantage to an assumption reinsurance transaction is that, in contrast to a 100% indemnity reinsurance transaction which is discussed below, in most cases numerous state insurance regulatory filings or approvals will be required before a Reinsurer can acquire a multi-state block of the Cedant's insurance business. In the United States, there has been increased regulatory scrutiny of assumption reinsurance transactions in recent years following the failure of a life insurance company that purported to assume a block of insurance business by assumption reinsurance without giving notice to the affected policyholders. This attention has been particularly fueled by controversy concerning the appropriate procedures for obtaining policyholder consent. The focus of the controversy relates to (a) the nature of the information that must be disclosed to policyholders in connection with a proposed novation; and (b) whether policyholder consent must be express or may be implied.

Reinsurers typically evidence their assumption of the Cedant's insurance policies by issuing an assumption certificate to the policyholders of the Cedant. This is often the first notice that policyholders receive of the assumption reinsurance transaction. The assumption certificate typically states that the Reinsurer has assumed the policyholder's insurance contract subject to its original terms and conditions and that the Cedant has been released from all obligations under the policy. It is at this point that industry practices have diverged. Some Reinsurers issue assumption certificates that have been worded in a way that suggests that policyholders are powerless to reject the novation. Other certificates provide that policyholders will be deemed to have consented to the novation, by implication, should they (a) fail to affirmatively reject the novation by a specified date; (b) pay premium or submit claims to the Reinsurer; or (c) engage in some other overt act. Except in rare cases (*i.e.*, large group programs in which only the group policyholder must give consent), Reinsurers generally have not obtained express written policyholder consent to assumption reinsurance transactions because of the enormous time delay and administrative burden that would be involved in getting such written consent. Obviously, the sooner the policyholders consent to the novation, the sooner the business objectives of the Cedant and the Reinsurer can be achieved. However, because of the concern that policyholders are not receiving proper notice in order to determine whether or not they should consent to the novation, the state insurance regulators have increased their scrutiny of assumption reinsurance transactions which has also increased the time and effort required to effect an assumption reinsurance transaction.

While a minority of states have historically regulated assumption reinsurance transactions, the National Association of Insurance Commissioner's ("NAIC") examination of the perceived abuses in completing these transactions led to the adoption of the Assumption Reinsurance Model Act in 1993 (the "Model Act"). As we discuss below, the Model Act (or variations thereof) has been adopted in nine (9) states.²

Even before the Model Act, however, a few United States courts invalidated novations on the theory that they had been effected without giving policyholders a meaningful opportunity to reject the transaction or sufficient facts on which to make an informed decision. *See, e.g.*,

² The NAIC is the organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories. State insurance regulators created the NAIC in 1871 to address the need to coordinate regulation of insurance companies that operate in more than one state.

Security Benefit Life Ins. Co. v. FDIC, 804 F. Supp. 217 (D. Kan. 1992); United Fire Ins. Co. v. McClelland, 780 P.2d 193 (Nev. 1989); and Baer v. Associate Life Ins. Co., 248 Cal. Rptr. 236 (Cal. App. 1988). I do not interpret these decisions to require express written policyholder consent or to otherwise prohibit assumption reinsurance transactions. It is my view that, under the general contract principles referred to above (and absent statutes that supersede these principles), implied policyholder consent should be sufficient to effect a novation provided that policyholders have a meaningful opportunity to reject the transaction and are given sufficient information on which to make an informed decision. More uncertain is the level of disclosure that must be provided regarding the facts and circumstances material to the assumption reinsurance transaction. In this connection, one of the Model Act's objectives was to legislate minimum disclosure standards to policyholders.

Because of the increase in regulatory interest in assumption reinsurance transactions and the virtual certainty that not all policyholders will consent to the transaction, it is almost always unlikely that all of the Cedant's insurance policies will be successfully novated. As a result, assumption reinsurance transactions typically provide that policies that are not novated for any reason (including the failure to obtain necessary regulatory consents) will be 100% reinsured on an indemnity basis and administered by the Reinsurer after the closing of the transaction. This means that with respect to the policies which have not been novated, the Cedant will continue to be contractually liable to pay benefits thereunder to its policyholders but will be reinsured for such liabilities by the Reinsurer.

As part of the assumption reinsurance transaction, the Cedant and the Reinsurer will negotiate the consideration to be paid by the Reinsurer to purchase the block of insurance business, and the amount and kinds of assets the Cedant will deliver to the Reinsurer to support the reserves transferred to the Reinsurer. The Reinsurer may also (a) request that the Cedant assign reinsurance, servicing, data processing, distribution and other material agreements relating to the business for the Reinsurer's benefit; and (b) consider hiring the Cedant's employees who are knowledgeable about the business or may be essential to facilitate a seamless transition of the administration function to the Reinsurer. Depending on the characteristics of the business being sold, the assets transferred by the Cedant to the Reinsurer are typically reduced to reflect (x) the present value of future profits on the transferred business; or (y) a present value discount to reflect the duration of the transferred liabilities or other asset-liability matching characteristics of the business. The difference between the amount of assets and liabilities transferred to the Reinsurer will represent income to the Cedant and is often referred to as the ceding commission or purchase price (the "Ceding Commission").

B. Indemnity Reinsurance

1. 100% Reinsurance

In recent years, several large reinsurance transactions in the United States have been structured as 100% indemnity reinsurance, probably because they can be closed more quickly than an assumption reinsurance transaction and do not require the consent of the Cedant's policyholders. In fact, as mentioned above, indemnity reinsurance transactions are often "invisible" to the Cedant's policyholders.

If a Cedant pursues an indemnity reinsurance transaction, the Cedant will continue to be contractually liable to pay benefits under its insurance policies but would reinsure 100% of the policy-related liabilities with the Reinsurer. Because the Reinsurer assumes 100% of the risk under the Cedant's policies, the Reinsurer typically requires that it be delegated the authority to administer the reinsured business in the Cedant's name. In some transactions, the Reinsurer assumes the administration obligation following a short-term transitional period which enables the administration function to be shifted gradually from the Cedant to the Reinsurer. The transfer of the administrative function results in cost reduction opportunities to the Cedant which, in some cases, may be a motivating factor in the Cedant's decision to sell a block of insurance business which is only marginally profitable or which no longer fits the Cedant's strategic objectives.

Like an assumption reinsurance transaction, the Cedant and the Reinsurer would negotiate the liabilities that will be transferred to the Reinsurer and those that will be retained by the Cedant. Thus, extracontractual or other obligations attributable to the Cedant's pre-closing operations may be retained by the Cedant. In addition to assets to support the transferred reserves, and like an assumption reinsurance transaction, the Reinsurer may request the Cedant to assign reinsurance, distribution, data processing, software and other material agreements for the Reinsurer's benefit and may desire to solicit the Cedant's employees for employment with the Reinsurer. At the closing of the reinsurance transaction, the Cedant would physically transfer the assets needed to support the reserves on the transferred business to the Reinsurer in exchange for the Reinsurer's payment of the Ceding Commission.

In an indemnity reinsurance transaction, and unlike assumption reinsurance, novations would not be obtained from the Cedant's policyholders.³ As a result, policyholders will not have a direct right of action against the Reinsurer for any of the reinsured policy-related liabilities. However, under United States statutory accounting principles, the net effect of the indemnity reinsurance transaction is to remove the reinsured policy-related liabilities from the Cedant's balance sheet.

The use of 100% indemnity reinsurance will result in a continuing credit risk to the Cedant that is tied to the Reinsurer's future financial condition and performance. For example, the Cedant will remain liable to discharge policy benefits to its policyholders even if the Reinsurer fails to discharge its obligations to the Cedant under the reinsurance agreement or becomes insolvent. To ameliorate this credit risk, Cedants often attempt to obtain security from the Reinsurer (in the form of letters of credit, trust accounts or other collateral) equal to the liabilities being reinsured by the Reinsurer. In addition, the Cedant must make sure that either the Reinsurer holds the necessary authorizations or licenses, or provides collateral security which complies with state insurance regulatory requirements, so as to allow the Cedant to obtain reserve credit in its financial statements for the reinsured business.

As discussed above, a potential advantage to a 100% indemnity reinsurance transaction is that the parties may avoid the extensive regulatory approvals and filings that would be required if

³ Depending on the facts and circumstances of the transaction, the parties may elect to give policyholders notice that the Reinsurer will be administering the reinsured policies as of a specified date.

the business were transferred by assumption reinsurance. This is primarily because indemnity reinsurance transactions do not require policyholder consent and consequently, state insurance regulators are generally less concerned with this structure. Thus, in most cases the indemnity reinsurance alternative will be less costly and may be more efficiently implemented than its assumption reinsurance counterpart. Nonetheless, notice or regulatory approval of a 100% indemnity reinsurance transaction may be required in the states of domicile of the Cedant and the Reinsurer and, depending on the size and characteristics of the business in comparison to the Cedant's other businesses, in states that apply bulk reinsurance statutes to insurance companies licensed in their state or that have enacted withdrawal statutes (discussed below).

II. REGULATORY APPROVALS OF REINSURANCE TRANSACTIONS UNDER STATE AND FEDERAL LAWS

Summarized below are the principal state and federal approval and filing requirements that may apply to reinsurance transactions specifying, where relevant, the requirements that apply to only some of the structures described above.

A. State Regulatory Approvals and Issues

1. Assumption Reinsurance Model Act

There are currently nine (9) states that have adopted the NAIC's Assumption Reinsurance Model Act (Colorado, Georgia, Maine, Missouri, Nebraska, North Carolina, Oregon, Rhode Island and Vermont). The Model Act requires an insurance company assuming or transferring insurance risks pursuant to an assumption reinsurance transaction to obtain the prior approval of the state commissioner of insurance. Although the Model Act allows an assumption reinsurance transaction to be completed with implied policyholder consent, the Model Act is a very difficult law to comply with as it requires significant disclosures to the Cedant's policyholders in order to effect a novation and allows them a very long time period during which they can reject the novation. The Model Act generally applies to insurance companies domiciled in the state but may, under certain circumstances, also apply to out-of-state insurance companies licensed in the state.

State laws based on the Model Act regulate (a) the information that must be provided in the assumption certificate sent to the Cedant's policyholders (including information on the Cedant's and the Reinsurer's balance sheets, operating results and commercial ratings); (b) when an assumption reinsurance transaction must be approved; (c) the factors that must be considered by the insurance commissioner in evaluating the transaction; and (d) the procedures for evidencing policyholder acceptance or rejection of the novation. The Model Act provides policyholders with what is essentially a twenty-five (25) month option to reject the assumption reinsurance and novation. As a result, substantial time will elapse before the Cedant can conclude that policyholders who reside in states that have adopted the Model Act have consented to the novation.

The Model Act would not apply to an indemnity reinsurance transaction in which the Cedant continues to remain directly liable to its policyholders. For this reason, Cedants that have issued a significant number of policies in states that have adopted the Model Act frequently do

not choose to structure the transaction as an assumption reinsurance transaction, at least in those Model Act states.

2. Other Assumption Reinsurance Laws

Other states have adopted laws that regulate assumption reinsurance transactions that, although not patterned after the NAIC Model Act, require prior approval or prior notice of assumption reinsurance transactions involving policyholders residing in their state. I am aware of at least nine (9) states that have adopted such requirements. These statutes would not apply to an indemnity reinsurance transaction. It is worth repeating that in order to effect valid novations, policyholders must give their informed consent to the assumption reinsurance transaction in these nine (9) states, the nine (9) states that have adopted the Model Act, and all other states where policyholders of the business reside pursuant to the United States general contract principles discussed above. Therefore, in large multi-state assumption reinsurance transactions, the Cedant and the Reinsurer often find themselves navigating through a labyrinth of varying state law requirements in order to effect a successful novation.

3. Approval of Assumption Certificates in Assumption Reinsurance

In order to evidence novations, the Reinsurer will issue assumption certificates to each of the Cedant's policyholders. The assumption certificates will state that the Reinsurer has assumed all obligations to pay benefits under the policies and that the Cedant has been released and discharged from these policy obligations. State insurance regulators treat assumption certificates as an insurance policy form subject to the state's customary form filing and approval requirements. This can potentially delay the effective date of the novation should a state object to the content of the assumption certificate. An issue that often arises in connection with these policy form filings is whether insurance regulators will approve an assumption certificate containing a deemer provision to evidence implied policyholder consent to the novation (rather than express written consent).⁴

4. Bulk Reinsurance Laws

Several states have enacted "bulk reinsurance statutes" which require prior approval of, or prior notice to, the state insurance department when a Cedant reinsures all or substantially all of its business (or a line or class thereof) in the state. For example, these bulk reinsurance statutes might apply if the Cedant were to reinsure all of its health insurance business in a particular state. Bulk reinsurance statutes are usually limited to insurance companies that are domiciled in their state, but some are drafted broadly enough to apply to all insurance companies that are authorized or licensed to do business in their state (*e.g.*, California Insurance Code § 1011(c)).

I am aware of approximately ten (10) states that apply their bulk reinsurance statutes to insurance companies licensed in their state. In general, the statutes do not expressly distinguish between assumption reinsurance and indemnity reinsurance transactions. As a result of my

⁴ A typical deemer provision states that, unless the policyholder affirmatively objects to the novation by a specified date, the policyholder will be deemed to have consented to the novation.

experience in dealing with insurance regulators in various reinsurance transactions, I have determined that some states only apply the statutes to assumption reinsurance, while other states (including California, New York and Wisconsin) apply the statutes to both assumption reinsurance and indemnity reinsurance transactions.

5. Withdrawal Statutes

Several states have withdrawal statutes or similar laws that are triggered when an insurance company seeks to: (a) withdraw from writing all or a line of business in the state; (b) nonrenew a block of business; or (c) cease marketing a type of business. The withdrawal statutes usually require that the state insurance department be given prior notice of the insurance company's plans for handling its residual insurance liability in the state and may result in the insurance company losing its certificate of authority or license to write one or more lines of business in the state. Because a Cedant's decision to sell a block of insurance business is sometimes made in concert with a broader strategic initiative to discontinue or exit from a line or type of business entirely, the Cedant must evaluate the potential application of these statutes.

6. Regulation of Administration Arrangements

In some states, insurance companies that delegate the responsibility to administer their insurance policies to third parties are subject to prior regulatory review and approval of their contractual arrangements. This is only an issue with respect to insurance business that is not novated by assumption reinsurance and, consequently, must be analyzed for any indemnity reinsurance transaction. As discussed above, because in a 100% indemnity reinsurance transaction the Reinsurer assumes 100% of the Cedant's policy-related liabilities, the Reinsurer often insists that it be given the authority to administer the reinsured business.

I am aware of at least two states (*i.e.*, Illinois and New York) which have objected to the transfer of administrative responsibility in a 100% indemnity reinsurance transaction because, according to the regulators, the Cedant did not retain sufficient oversight and control over certain aspects of the business. These issues are generally resolved through negotiations and contract drafting (and, in fact, may present the Cedant with an opportunity to retain a measure of control and involvement with respect to various aspects of the Reinsurer's post-closing administration of the reinsured business).

Cedants must be aware that the Reinsurer's post-closing administration of the reinsured business will result in ongoing legal risks to the Cedant, including (a) exposure to liability, extracontractual obligations and fines arising from the Reinsurer's administration of the reinsured business in the Cedant's name; and (b) reputational damage to the Cedant in the eyes of policyholders, insurance regulators and the general public based on the Reinsurer's acts or omissions after closing. Negotiations will attempt to mitigate these risks through indemnification remedies in the reinsurance agreement and the Cedant's right to participate in certain aspects of the post-closing administration of the reinsured business, including claims and litigation. In my seventeen years of experience negotiating reinsurance agreements, I can confidently state that this is one of the most negotiated and adversarial issues in large reinsurance transactions.

7. Financial Statement Credit

If the Cedant's block of business is not novated and, therefore, is reinsured on an indemnity reinsurance basis, the Cedant must obtain full financial statement reserve credit for the insurance liabilities it cedes to the Reinsurer. This will require an evaluation of (a) the laws of the Cedant's state of domicile; (b) the laws of states which apply their rules on credit for reinsurance to out-of-state insurance companies that are licensed in their state (including, without limitation, California, Kentucky and New York); (c) applicable statutory and generally accepted accounting principles; and (d) the Reinsurer's licensing status. Typically, under the laws of the various states full credit can be taken for business ceded to a Reinsurer which is authorized or licensed in the state of domicile of the Cedant. The credit for reinsurance rules also provide that the reinsurance agreement must contain a standard insolvency clause and comply with other statutory requirements. If the Reinsurer does not possess the necessary certificates of authority or licenses to enable the Cedant to obtain reserve credit in all states, the Cedant must have a contractual right in the reinsurance agreement to obtain collateral security which complies with state insurance regulatory requirements, such as a trust account or letter of credit, from the Reinsurer in order to obtain credit.

8. Unauthorized Insurers Laws/Fronting Statutes

In an indemnity reinsurance transaction, if the Reinsurer is not licensed in a state where the Cedant's policyholders reside there could be potential issues under the unauthorized insurers laws of the state. These laws generally prohibit the "transaction of insurance" in their state without an insurance license. In an indemnity reinsurance transaction in which the responsibility for administering the reinsured business (including the collection of premiums, processing claims and otherwise dealing with policyholders) is transferred to a Reinsurer that is not licensed in the state, state insurance regulators may claim that such activity constitutes the transaction of an insurance business in their state which requires the Reinsurer to be properly licensed.

In addition, the absence of the Reinsurer's licensing authority may give rise to issues under "anti-fronting" statutes in certain states. These states may be concerned over the transfer of 100% of the insurance risk and related administration obligations from the Cedant to a Reinsurer that is not licensed to do business in their state. States that have these anti-fronting prohibitions are concerned that Cedants, because they retain no risk and do not administer the reinsured business, are essentially "renting" their licenses to unlicensed Reinsurers that wish to escape regulation by the states. In states that aggressively apply their anti-fronting prohibitions to 100% indemnity reinsurance transactions, I have been able to avoid regulatory issues by structuring the reinsurance transaction in their state as a 90% quota share reinsurance transaction (i.e., the Cedant retains 10% of the policy-related liabilities on its block of business).

9. State Anti-Competition Statutes

Under various state insurance holding company acts, certain acquisitions which may have an anti-competitive effect in the state are subject to prior notice requirements to the insurance regulators. Approximately twenty-six (26) states have enacted these statutes. Historically, the statutes have been considered to apply only to transactions which result in a change in control of an insurance company domiciled in their state. However, in conjunction with certain indemnity

reinsurance transactions, some insurance companies have concluded that, while ambiguous, the statutes could also be applied to a 100% indemnity reinsurance transaction and they have made the pre-closing notifications the statute requires. In my view, and based on the express wording of the statutes, there are defensible legal arguments that these statutes would not apply to a 100% indemnity reinsurance transaction in which the Cedant does not undergo a change of control. To date, I am not aware of a case in which a state insurance department has concluded that the failure to make a pre-acquisition filing in an indemnity reinsurance transaction violates the anti-competition statutes.

B. Federal Regulatory Approvals and Issues

1. Hart-Scott-Rodino Act

The Hart-Scott-Rodino Anti-Trust Improvements Act of 1976 (the “H-S-R Act”) requires parties intending to acquire voting securities or assets to make a notification filing with the Federal Trade Commission and/or the Anti-Trust Division of the Department of Justice. Whether the H-S-R Act applies initially depends on the size of the parties and the size of the transaction. The H-S-R Act provides a 30-day waiting period during which the FTC and the Anti-Trust Division may determine whether the proposed acquisition will violate Federal anti-trust laws. The waiting period may be extended if the government requests additional information.

The FTC has determined that the notification requirements of the H-S-R Act apply to assumption reinsurance transactions that satisfy the H-S-R’s jurisdictional tests. In general, the FTC examines the Ceding Commission paid to the Cedant by the Reinsurer for the block of business to determine whether the transaction is of a size (*i.e.*, at least \$50 million) that requires prior notification and expiration of the waiting period. On the other hand, staff attorneys at the FTC have taken the position that 100% indemnity reinsurance transactions are not acquisitions under the H-S-R Act and therefore are not reportable.

III. POLICY REPLACEMENT TRANSACTIONS

Another structure for selling a block of insurance business which does not necessarily involve a reinsurance transaction is a “policy replacement” transaction.

In a policy replacement transaction the Cedant and the Reinsurer coordinate the cancellation or non-renewal of the Cedant’s block of business so that the Reinsurer, with the full support and endorsement of the Cedant, can offer the Reinsurer’s policy as a replacement upon the expiration or cancellation of the Cedant’s policy.

In policy replacement transactions the Cedant is often compensated based on the success rate at which the Cedant’s policyholders accept the Reinsurer’s replacement policy during a certain time frame, typically a two year period following the closing of the transaction. For example, the Cedant may be paid a commission on premiums received by the Reinsurer from the Cedant’s policyholders who accept the Reinsurer’s replacement policy. Contrary to an assumption reinsurance or indemnity reinsurance transaction, in a traditional policy replacement transaction the Cedant will retain 100% of the liabilities on its policies (unless the Reinsurer

agrees to 100% indemnity reinsure the Cedant's policies while they try to convince the Cedant's policyholders to accept the replacement policies offered by the Reinsurer).

Policy replacement transactions are becoming more common in the United States, particularly where the Cedant wishes to exit certain lines of business but is having difficulty finding a Reinsurer for its block of business. A Reinsurer may be unwilling to assume through a reinsurance transaction the policy-related liabilities of the Cedant but may be willing to pay for the right to solicit the Cedant's policyholders upon the expiration or cancellation of the Cedant's policies. If contemplating a policy replacement transaction, the parties must review many of the laws discussed above, including, without limitation, state withdrawal statutes, the H-S-R Act, and block non-renewal statutes.

IV. CONCLUSION

Reinsurance transactions involving large blocks of multi-state insurance business, whether structured as indemnity or assumption reinsurance, require Cedants and Reinsurers to carefully consider all of their options, make sure that they are adequately protected in the reinsurance agreement, and carefully navigate the insurance regulatory laws of the United States which can widely differ from state to state. That being said, the United States insurance industry and regulators are very familiar with these transactions and with proper guidance they can be effective tools for achieving company objectives.