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NAIC Restructuring Mechanisms Working Group Moves Forward With First Call on IBTs

By: Jonathan Bank, Robert A. Romano, John N. Emmanuel, Al W. Bottalico, Norris W. Clark and Stewart Keir

On March 11, 2019, the NAIC's Restructuring Mechanisms Working Group ("Restructuring Working Group") held its first call on insurance business transfers (IBTs), an issue gaining more and more traction from industry and state legislatures.

The Restructuring Working Group, as well as the Restructuring Mechanisms Subgroup ("Subgroup"), were established on February 19, 2019 by the Financial Condition (E) Committee. The Restructuring Working Group will primarily look at legal issues related to IBTs and the Subgroup will look at solvency and reporting requirements.

Why is this issue gaining importance? States have adopted or are in the process of adopting IBT laws or other restructuring mechanisms in the U.S. These include Rhode Island, Oklahoma, Arizona, Connecticut, Illinois, Michigan, Pennsylvania and Vermont with varying requirements and procedures to segregate insurer books of business, such as via a transfer between two insurers or a division of one company into two. 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. Experience with IBTs elsewhere, especially in the UK, which are permitted a under Part VII of the UK Financial Services and Markets Act 2000, provides support for the proposition that IBTs have been very successful over a substantial period of time. As a result, there has been an increased focus on the U.S. state restructuring laws.

The main charges for the Restructuring Working Group, whose co-chairs are Beth Dwyer, from Rhode Island, and Buddy Combs, from Oklahoma, include:

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 and considers alternatives that insurers are currently employing to achieve similar results; (b) summarizes the existing state restructuring statutes; and (c) addresses the legal issues posed by an Order of a Court (or approval by an Insurance Department) in one state that affects the policyholders of other states;
2. 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;
3. Review and propose changes to the Protected Cell Companies Model Act to allow for restructuring mechanisms; and
4. Develop financial solvency and reporting requirements for companies in runoff.

The charges for the Subgroup, whose co-chairs are Dave Smith and Doug Stolte, from Virginia, and Jack Broccoli, from Rhode Island, include:

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 or collecting premiums);
2. Consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff; and

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; and (e) proposed accreditation standards.

In addition to interested parties from insurers, trade groups (including NOLHGA, ACLI and AIRROC) and consultants, there were many regulators on the Restructuring Working Group's call who are not currently a part of the group but who may be added in the weeks to come as the group's charges take shape. One possible addition which was discussed was a review of consumer protection issues and how they may be impacted by IBTs.

The Restructuring Working Group and Subgroup have been given short time frames to complete their charges. As part of the group's process, other NAIC committees and groups will need to be consulted along the way. Possible amendments to the Protected Cell Company Model Act and amendments to Guaranty Association Model Act will need to be referred to other NAIC working groups before being adopted by the Restructuring Working Group. It may also be necessary for the Subgroup to develop additional financial surveillance tools to be used in the monitoring of insurers involved in restructurings. As a result, any new solvency standards developed by the Subgroup will need to be reviewed by the various NAIC committees that are responsible for those standards, *e.g.*, changes in RBC need to go to the Capital Adequacy working groups that update and amend the RBC formulas.

As for next steps, the Restructuring Working Group is scheduled to meet at the NAIC Spring National Meeting in Orlando on April 6, 2019 at 3:00 pm where it is expected that there will be presentations made to the group by interested parties. The Restructuring Working Group may also decide to issue a survey to industry as it seeks to gather as much information as it can on this topic.

Given the success of IBT type transactions in other highly regarded jurisdictions, this is likely to become an available option in the U.S. Locke Lord will continue to monitor and report on the progress of the Restructuring Working Group and Subgroup and any new developments with respect to the use of IBTs in the U.S.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors.

Jonathan Bank | 213-687-6700 | jbank@lockelord.com
Robert A. Romano | 212-812-8322 | rromano@lockelord.com
John N. Emmanuel | 212-912-2879 | john.emmanuel@lockelord.com
Al W. Bottalico | 213-687-6781 | al.bottalico@lockelord.com
Norris W. Clark | 213-687-6771 | nclark@lockelord.com
Stewart Keir | 212-812-8347 | skeir@lockelord.com