

BUSINESS TRANSFERS AND DIVISIONS, HERE AND ABROAD

International Association of Insurance Receivers

February 14, 2019
New Orleans, LA

Andrew Rothseid
RunOff Re.Solve LLC

Stephen Wayne Schwab
DLA Piper LLP (US)
Moderator

Daniel Schwartzer
Schwartzer Consulting

Nader Tavakoli
EagleRock Capital Management

What We Will Cover Today

- Introduction
 - Traditional Exit Strategy Alternatives
 - Historic and Recent Restructuring Mechanisms
- Legacy Transaction Alternatives
 - EU Part VII
 - US Business Transfer Statutes
 - Rhode Island's Voluntary Restructuring Statute
 - Vermont's Legacy Insurance Management Act
 - Oklahoma's Business Transfer Act
 - US Business Division Statutes
 - Connecticut and Illinois
 - Relative Merits of Statutory IBT/D
 - US Receivership Law
 - NAIC' Assumption Reinsurance, and Insurance Receivership Model Acts
 - Longstanding state receivership law: *Ambac, Public Service*

Introduction

Traditional Exit Strategy Alternatives

Alternative	Considerations
Run off to expiration	<ul style="list-style-type: none">• No legal (i.e., liability release) or financial finality• Tail exposure may > 25 years• Continued expense, distraction, potential reserve deterioration
Reinsurance	<ul style="list-style-type: none">• Costly premiums• Limited transfer of risk; continuing capital charge• Potential loss of claims control
Sale	<ul style="list-style-type: none">• Legal and financial finality if the subject business is novated or transitioned into a discrete legal entity• Potential discount to net asset value

Historic and Recent Restructuring Mechanisms

Historic Non-Insurance Specific Restructuring Mechanisms

- | | |
|--------------------------|--|
| Arizona and Pennsylvania | <ul style="list-style-type: none">• Entity Transactions Act allows companies to divide business into separate entities |
|--------------------------|--|

Historic Insurance Restructuring Mechanisms

- | | |
|-----------------------------|--|
| Ins. Receivership Model Act | <ul style="list-style-type: none">• Allows insolvent companies to establish values to close estate |
| Assumption Reins. Model Act | <ul style="list-style-type: none">• 9 states adopted; policyholders can accept or reject |

Recent and Emerging Restructuring Mechanisms

- | | |
|-------------------------------------|--|
| Rh. Island ('15), VT () Okla. ('18) | <ul style="list-style-type: none">• Insurance Business Transfer effects statutory novation |
| Connecticut ('17) & Illinois ('18) | <ul style="list-style-type: none">• Insurance Business Division effects division by operation of law |

Legacy Transaction Alternatives

EU Business Transfers: *UK Part VII Transfer*

- Process under Part VII of the UK's Financial Services and Markets Act 2000
- Statutory novation of a portfolio of general and/or life insurance policies from one insurer to another
- Basically, a court and regulator approved asset purchase agreement
- AKA insurance portfolio or business transfers throughout Europe
 - Ability to transfer associated assets and rights (outwards reinsurance, material service agreements and real estate) as part of court order and without the need for counterparty consent;
 - Ability to add ancillary orders related to the transfer, such as amending terms of policies (e.g. calculation of with-profits and references to sub-funds) and capital reductions
- UK process more onerous than other EEA processes – requires a scheme doc, court approval and independent actuary/expert.
- Policyholder safeguards: regulator fully participates, reports and appears in court; notice, and practical and proportional “communication strategy,” to policyholders, other regulators and reinsurers; all interested persons may appear and object; transfer must be “fair” to all

US Business Transfers: 1. *Rhode Island*

- “Voluntary Restructuring of Solvent Insurers” applies only to Rhode Island commercial P&C domiciliaries
 - Regulatory and court processes terminate liabilities (via statutory novation), eliminate ongoing expense, and extract capital
 - Flexible segmentation of defined portfolio into separate cells or legal entities which can be sold to 3d parties
 - Commutation Plan yields finality with potential capital return
- Notice to insureds, reinsurers, interested government officials, NCIGF, NOLHGA, state GAs
- Court hearing; implementation order **enjoins** all litigation in all jurisdictions
- 2007 statutory and 2015 regulatory amendments allow for portfolio transfers of eligible legacy exposures to newly created or existing shell entities
- 2018 clarifying statutory amendments; added protected cells and “voluntary restructuring”
- 2 court reviews (and possible appeal); **creditors meeting**

US Business Transfers: 2. *Vermont*

- Vermont's Legacy Insurance Management Act, 8 V.S.A. Chapter 147 § 7111 – 7121 enables a non-admitted insurer from any jurisdiction to transfer **closed blocks** of commercial P&C business (no workers comp, health, life or personal) to a Vermont domiciled entity
- Solely a **novation** process; no regulatory mechanism to extinguish legacy liabilities
- Policyholders can **opt out** of the plan or be deemed to accept; reinsurers can object per contract terms
- Consent to jurisdiction in each state of policyholder residence
- Fees: \$30K, transfer tax = 1% of 1st \$100m of gross liabilities, .5% above that; DOI expenses
- Assuming co. not subject to guaranty fund law
- Appeal to VT S. Ct.

US Business Transfers: 3. *Oklahoma*

- Okla. Stat. tit. 36, § 1681-8; modeled after Part VII
- 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 . . . effected by court order”
- Regulatory and court (broad power) approval effect release of transferor
- Business that may be transferred:
 - “[A] policy, contract or certificate of insurance or a contract of reinsurance . . . and shall include **property, casualty, life, health, and any other line the Commissioner finds suitable**”
 - Does not distinguish between live or active contracts from discontinued or ‘run off’ insurance
- Notice to insureds, NCIGF, NOLHGA, state GAs
- Allows transfer to an Oklahoma–domiciled insurer, which “may be a protected cell company”
- Appeal/Review available

US Business Division: 1. *Connecticut*

- Conn. Gen. Stat. § 38a-156r-z, **by operation of law, not transfer**; no court action
- Domestic insurer w/an approved plan may divide into 2 or more insurers, resulting in (or not) the Dividing insurer and a new (or surviving) divided entity (the “Resulting insurer”) with allocated assets and obligations, including secured and contingent
- Resulting insurer may be an LLP (156v(B)(10))
- Any line of business may be transferred
- Policyholder consent not required unless policy requires novation
- Transferor is released
- Notice and public hearing if Commissioner deems them to be “in the public interest”
- Interest holder approval may be required
- Commissioner must approve unless any Policyholder or interest holder not adequately protected, or fraudulent transfer
- If division breaches Dividing insurer obligation, **all Resulting insurers are liable jointly and severally**
- Contractual appraisal rights survive

US Business Division: 2. *Illinois*

- 215 Ill. Comp. Stat. 5/35B-1 – 50; purpose: stimulate economic development
- Division and allocation of assets and liability **by operation of law**, not a distribution or transfer
- Article/bylaw-required approvals apply
- All lines of business of a domestic stock company may be transferred, including direct and assumed
- Resulting company must be stock and may merge
- “Reasonable” notice required **if** Director deems to be in the public interest
- No policyholder opt out; reinsurers bound, but division cannot expand or reduce the allocation and assignment of reinsurance
- Transferor released via **“final order not subject to further appeal”**
- Notice and public administrative hearing if Director deems it to be in the public interest *or* the Dividing company requests
- Many grounds for Director to reject a division plan
- If division breaches Dividing insurer obligation, all Resulting insurers are liable jointly and severally
- Appraisal rights if Dividing company does not survive

Points for IBD/T

- Foreign and domestic owners of active re/insurers or those running off, under supervision or in receivership can offload entire portfolios or discrete lines of legacy liabilities w/finality
- Regulators can improve the financial condition of active and discontinued business
- Uncommitted/redundant capital can be reinvested
- Policyholders avoid receivership and receive their bargain benefit
- Guaranty funds are consulted but not triggered
- No estimation or acceleration issues
- Full transparency and fair disclosure of information
- Regulatory (and judicial) supervision
- Time limited challenges
- Responsive to new international equivalence and cooperation

Against

- Reputational risk
- Diminished consumer confidence in the industry
- Violates anti-assignment provisions of reinsurance agreements, which will change
- May not comply with Dodd Frank §531(b) – Credit for Reinsurance
- Novation to a single(?) state licensed carrier impacts Guaranty Fund protection
- Eliminates policyholder consent/approval
- Forces counterparties to accept a commutation plan (RI; NY)
- Potential due process challenge?
- Potential Contracts Clause challenge?

US Receivership Law: *NAIC Assumption Reinsurance Model Act*

- NAIC adopted 1993, amended 1999
- 9 states adopted
- Assumption Reinsurance Agreements
 - Contract transfers insurance risks or in-force contracts
 - Effects a **novation**
- Regulatory approval required from Transferor and Transferee domiciliary regulators
- **Notice** required to all policyholders/cedents
- Policyholders may **accept or reject** the transfer
- No judicial review

NAIC Insurance Receivership Model Act

§402 Rehab'r Powers & Duties

(A) May take **any action** deemed nec. to **reform & revitalize**

§403 Filing Rehab Plans

(A) Rehab'r shall file w/i a yr.; court may (dis)approve or modify; must comply w/applicable law, be **fair & equitable**; if life co., plan may incl. 1 yr. policy moratorium

(B) A plan must: . . . (1) provide **no less favorable treatment** of a claim or class of claims **than would occur in liquidation**, unless the holder . . . agrees to a less favorable treatment . . .; (2) provide **adequate means** for the plan's implementation; (3) contain information concerning the financial condition of the insurer and the operation and effect of the plan . . .

§404 Terminating Rehab

(A) If rehab accomplished or grounds no longer exist, then **return to independent operation**; co. directors may file motion

Insolvent insurer may **value contingent or unliquidated** claims and close the estate

TX, UT adopted; portions enacted in ME, MO, OK, TN

Longstanding State Receivership Law: *Ambac*

- Ambac – Rehab 2010; emerged 2018.
- WI “**segregated account**” statute
 - allowed for creation of separate entity, enabling reduction of \$47B NPO in 2010, to \$10B in 2018, \$6.7B of commutations and policy terminations, and R&W Litigation Maturity – JP Morgan Settlement of nearly \$1B, and better valuation of remaining cases, including CountryWide/BofA.
 - did not specifically allow for exit transaction
- Drive for all actions and transactions to be accretive and doing what was in the “best interest of policyholders” enabled court approval of the exit.
- Appellate Court* held:
 - We “afford great weight **deference** to the commissioner’s interpretation and application of [rehabilitation] statutes.” *Nickel*, 351 Wis. 2d 539, ¶¶ 20-21 ;
 - The rules of civil procedure do not apply in a rehabilitation case . . . [no] discovery. *Id.* ¶ 13;
 - “Wisconsin’s rehabilitation statutory scheme does not require that policyholders **fare as well . . .** as they would in liquidation” *Id.* ¶ 69;
 - “the commissioner, in the reasonable exercise of the state’s police power, may structure a rehabilitation plan that has the potential to adversely affect the interests of individual policyholders when the plan advances the **broader interests** of the policyholders, the creditors, and the public as a whole.” *Id.* ¶ 91.

* The WI Supreme Court denied petitions for review of this ruling (Mar. 19, 2014)

Public Service Ins. Co. (IL)

- After IL Dept. Form A and Receivership Court approval of Lynchpin Stock Purchase Agreement & Amended Rehab Plan, Premia acquired PSIC from parent mutual holding co.'s receiver for cash paid to the PSIC Estate (all company liabilities & assets, incl. co. shell) + % of future net reinsurance collections
- Court **channeled** from the Estate to **resumptive** PSIC *only* (i) all policyholder liabilities, (ii) assumed reinsurance liabilities from PSIC's wholly owned subsidiary Western Select, & (iii) associated assets, incl. WSIC common stock
- Premia re-capitalized PSIC to 300% RBC
- Estate retained:
 - liquid & contingent assets, income tax refunds & other deferred assets
 - legacy pension obligations to be discharged thru PBGC approved standard pension plan termination
 - obligation to pay all other claims and liabilities, incl. *pro rata* dividends to gen. creditors
- Court order released & precludes pre-Closing claims against, & Estate indemnifies, Premia

Thank You !

Andrew Rothseid
Principal
RunOff Re.Solve LLC
T: (610) 660-7738
E: andrew.rothseid@runoffresolve.com

Daniel Schwartzer
Principal
Schwartzer Consulting
T: (608) 206-3451
E: dan@schwartzconsulting.com

Stephen Wayne Schwab
Partner
DLA Piper LLP (US)
T: (312) 368-2150
E: stephen.schwab@dlapiper.com

Nader Tavakoli
Chairman and CEO
EagleRock Capital Management
T: (917) 450-2092
E: ntavakoli@eaglerockcapital.com