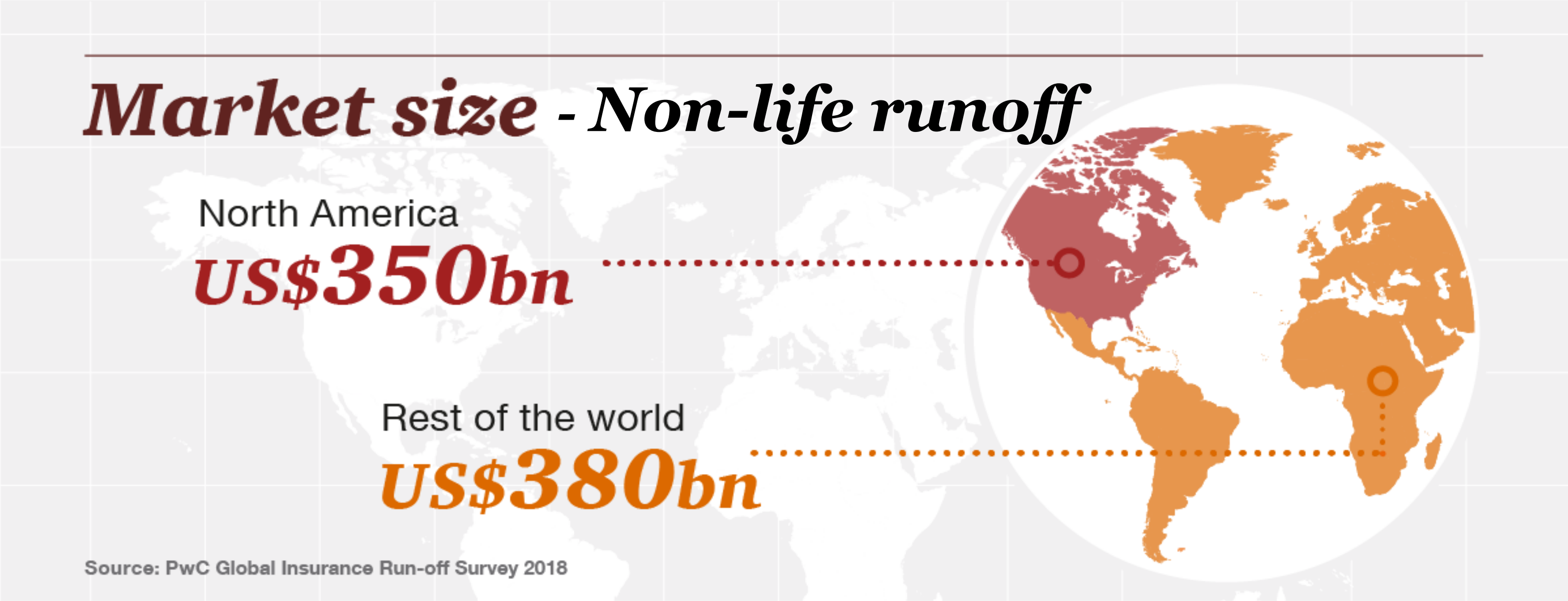
Insurance Business Transfer Model Law

Presented to NCOIL

by

Richard Newton and Luann Petrellis

July 11, 2019



pwc

www.pwc.com/globalinsurancerunoffsurvey

© 2018 PricewaterhouseCoopers LLP. All rights reserved.

- Almost all companies hold runoff or legacy liabilities that are no longer core to their business.
- In a recent survey conducted by PwC of the global insurance runoff market, U.S. P&C runoff liabilities were estimated to be $335 billion.*

The life runoff market is estimated to be even larger

*Moody's Investors Service May 23, 2018**

In their May 2018 analysis, Moody's estimated that insurers have **over $420 billion** of annuity, life insurance, long term care and other liabilities publicly designated as "legacy" or "run-off" that are targeted for an exit transaction.*

Close to **$270 million** in life, annuity and group benefits changed hands in 2017. Many of these transactions were sales fueled by plentiful alternative capital and reinsurance capacity.*

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

Current options to address legacy business
Limited in scope and effect

- Companies holding liabilities for discontinued business are looking for effective restructuring options to facilitate operational and capital efficiencies and gain legal finality.
- Existing options, such as sale, reinsurance/LPT, division legislation or policy novation/assumption reinsurance, are limited in their scope and effect and may not provide finality.
  - LPT/reinsurance – some economic relief but not legal finality
  - Sale – only works when business is in stand-alone legal entity
  - Division – solely intra-state and no legal finality
  - Novation/Assumption reinsurance – cumbersome, expensive, time-consuming process that in most instances will not result in positive consent from all policyholders.

The need for effective restructuring tools

- Companies need effective restructuring tools for non-core business that reduce or eliminate counter-party risk, optimize capital utilization and provide economic and legal finality while ensuring that policyholders are protected.
- Legacy business ties up significant amounts of capital, staff time, and management attention and is costly to administer to expiry.
- Over time credit risk problems can arise, loss development can emerge, staff attrition increases, and management is distracted from its core lines of business.
- Increased oversight, ongoing expansion of state regulation and limited restructuring options create operating issues, increase compliance costs and raise additional concerns that consume management time and attention.
- The complex and inconsistent 50 state US regulatory system makes it difficult to rationalize the risk management and administration of scattered legacy portfolios and optimize capital.

The insurance business transfer (IBT) is an effective restructuring tool

- In many jurisdictions worldwide, organizations increasingly utilize business transfer mechanisms as a strategic tool to restructure their business operations, to exit certain lines or to transfer portfolios of business to unleash excess capital, focus on emerging opportunities, and to free management attention and oversight to core activities
- If legacy business can be transferred or acquired by runoff acquirers or consolidators these buyers can create centers of excellence for specialist claim expertise and administration.
- This specialized knowledge can generate savings in administration and reserve management and provide a better claim experience for the claimant.
- The finality that is achieved through a transfer means the seller can move on and focus on new strategic priorities and the buyer can take full control of the runoff portfolio resulting in a more efficient approach.
- There is a large amount of capital available in the US market led by experienced PE firms and specialty run-off companies that can acquire legacy blocks and more efficiently run them off to expiry.
- It is important for the US insurance market to have similar restructuring options that are available in almost all advanced countries to remain competitive and thrive in the global economy.

IBT legislation is modeled on the UK Part VII Transfer

A proven business model with a successful track record

- *The UK Part VII Transfer allows for the transfer of a block of business by way of a statutory novation requiring the support of an independent expert report as well as court approval.*
- *Since it came into effect in 2001, the Part VII transfer has acted as a key driver for companies looking to restructure their operations and utilize capital more effectively.*
- *As of April 2019, there have been 285 successful transfers completed none of which have subsequently encountered financial difficulty.*
- *The Part VII Transfer applies to all lines of insurance, live and runoff.*
- *Approximately 30% of Part VII transfers were for life business.*

YEAR	No. of PART VII TRANSFERS
2002	3
2003	10
2004	18
2005	26
2006	29
2007	24
2008	18
2009	8
2010	12
2011	24
2012	15
2013	13
2014	11
2015	22
2016	6
2017	17
2018	16
2019 (at 4/17/19)	13
TOTAL	285

Current developments

- IBT legislation closely follows the format and processes of the UK's Part VII transfer. Governed by state legislation and regulatory approval, and supervised by the courts, it enables insurance policies to be novated from one insurer to another insurer through a judicial approval process, without the need for individual policyholder consent. Through a transparent and closely monitored approval process, the IBT brings the transferor complete finality for the transferred policies while ensuring that policyholders are adequately protected.
- 2015 - Rhode Island IBT legislation for commercial P&C run-off liabilities.
- 2018 - Oklahoma Senate Bill 1101 "The Oklahoma Insurance Business Transfer Law" that applies to all lines of insurance.
- The first OK IBT is expected to be finalized by year end 2019.
- NCOIL proposed IBT Model Law based on OK legislation.
- NAIC Restructuring Mechanisms Working Group and Subgroup.
- ACLI Best practices and guidelines for restructuring mechanisms.

Why is the IBT important to your state?

Business/economic development

- Attracts new companies to state to enhance insurance industry as companies will re-domesticate or form assuming companies in your state.
- Encourages economic growth and increased investment in the state's financial services sector.
- Generates jobs and other economic activity.
- Certain states will become centers of competence and dominate marketplace - advantage to being first to market.
- Similar to expansion of captive industry – VT was first in and dominates captive market.
- Domestic companies will have advantages in marketplace.

How the IBT works

A multi-layered, transparent process with multiple safeguards to protect policyholders

The IBT approval process is expected to take nine months (from date of submitting application to the regulator).

Because of the non-consensual nature of the process there are checks and balances that are designed to protect the interests of policyholders. These include:

Notice to all stakeholders, including policyholders;
Extensive financial disclosure;
Review and approval or non-objection of the chief regulators in the transferring and assuming company's state of domicile;
An independent expert report that evaluates the impact of the transfer on affected policyholders;
A hearing and opportunity to be heard; and
Judicial review and approval

Application of the IBT

A flexible restructuring tool

Combine similar business from one or more subsidiaries, putting all into a single company	• Allows a corporate group to reduce the number of its regulated companies. • Release excess capital for use elsewhere. • Save ongoing management, regulatory and administrative costs.
Transfer business between third parties	• To obtain business. • To exit business. • More flexible than a sale as it only involves the run-off liabilities apart from the whole company.
Separate out different books of business, putting them into separate companies	• Separate old liabilities from new business. • More efficient capital deployment. • Separate out liabilities that can be held to expiry or can be commuted. • Separate out books of business to be sold from those to be retained.

What are the benefits of IBTs?

Claim expertise

- Buyers can create centers of excellence for specialist claim expertise
- Sellers may lose business knowledge for business in run-off
- Industry requires fair treatment of claimants

Buyer’s specialist knowledge and pro-active approach can generate savings in reserves and a better experience for the claimant.

Finality

- Finality means the seller can move on and focus on new strategic priorities and the buyer can take full control of the run-off portfolio
- Leads to a quicker and more efficient approach

Finality benefits both buyer and seller and makes the process more efficient for policyholders.

Capital efficiency

- Diversifying balance sheet can reduce capital requirement (jurisdiction dependent)
- Steady deal flow means capital is continuously deployed

Transfers allow different portfolios to be combined and diversification benefits realized, allowing buyers to operate lower cost models.

Investment strategy

- Optimizing return on investments
- Transfers allow buyers full control over asset investment allowing risk adjusted returns to be maximized

An area that can be improved by the acquirers; some new entrants consider this to be a way to innovate and stand-out in a crowded market.

Thank you!

Luann Petrellis

lpetrellis@verizon.net

(610) 304-4524

Rick Newton

rn8652@aol.com

(727) 510-1177

Biographies

Luann Petrellis

Luann is an insurance professional with over 26 years of experience developing run-off and restructuring strategies for companies with discontinued insurance and reinsurance business. Luann has served as a chief operating officer for global insurance carriers managing the run-off operations of P&C and worker's compensation portfolios that included ceded and assumed reinsurance business.

Luann worked with the Rhode Island Division of Insurance and the Oklahoma Department of Insurance to draft and pass new legislation that provides for insurance business transfers, the first restructuring tool of its kind in the U.S. that enables companies to achieve finality for the transfer of legacy liabilities. From 2017 to 2019 Luann was employed by PwC as a managing director to focus on insurance restructuring and run-off and from 2015 to 2017 Luann worked with EY to expand their insurance run-off practice. Currently Ms. Petrellis is very involved in working with companies and regulators to develop solutions for long term care legacy liabilities – a serious challenge facing the industry.

Luann has made numerous presentations to trade organizations, regulatory bodies, and insurance companies regarding insurance restructuring and new developments in insurance restructuring legislation and she has written and published many articles on restructuring and run-off. In 2018 Luann was named "Person of the Year" by the Association of Insurance and Reinsurance Run-off Companies.

Luann is a member of the PA Bar Association. She received her J.D. from the James Beasley School of Law at Temple University.

Rick Newton

Rick has extensive experience in run-off and insurance restructuring and is recognized as a leader in the industry. Since 1982, Rick has been involved in the management of run-off portfolios. He has executed run-off transactions that includes ownership of several successful run-off insurance companies. Rick was part of the group that executed the 1st MBO of a troubled reinsurance company in 1987 that was successfully run-off.

In 1995, Rick formed International Solutions, LLC, a TPA / consultancy company focused on run-off and serves as its CEO. He works in both the domestic and international insurance industry, primarily providing advisory and management services to troubled run-off and turn around insurance situations. His experience includes the development of run-off business strategies and execution of operational plans.

Rick has led many successful run-off projects and has been involved in a wide range of transactional situations involving M&A, governmental privatizations, and capital raising in support of restructured run-off companies in the life, health and P&C industries.

Rick spearheaded the introduction of restructuring legislation in the US market and was significantly involved with the drafting and approval of the Amendments to RI Insurance Regulation 68 and the recently passed Oklahoma legislation providing for insurance business transfers. Rick continues to be recognized as a leader in promoting restructuring legislation for application in run-off and restructuring transactions.

Appendix

- Regulatory focus
- IBT application
- How can IBTs be used?
- Independent expert – critical focus areas

Regulatory focus in considering an IBT application

- State insurance regulators currently have well-developed statutes, practices, and procedures to handle transfer transactions such as those that will be executed pursuant to IBT legislation.
- The RBC framework has served regulators well for many years and the RBC Model Act specifically authorizes regulators to make necessary adjustments for runoff business.
- In 1997 the NAIC published a White Paper to identify and discuss regulatory, legal and public policy issues surrounding transactions that isolate existing insurance obligations from on-going insurance operations. The White Paper sets forth a pre-approval checklist and an appendix listing conditions and requirements for ongoing regulatory oversight for transactions like IBTs.
- Since the publication of the NAIC 1997 White Paper, there have been significant developments in the application of Principle Based Reserving and the use of economic modeling to determine both capital and reserve levels for transactions.
- New actuarial pronouncements, such as VM 20, have been put forth by the actuarial profession. The actuarial profession is well versed and well positioned in the use of applications that will be used to establish capital and reserve levels for transfer transactions.
- A one size fits all approach would unnecessarily restrict the regulator’s ability to make required adjustments and could result in adverse impacts to policyholders.
- Ultimately each transfer transaction must stand on its own, and regulators must have the flexibility required to respond to the requirements of each transaction.

IBT application

Primary factors to be considered when reviewing an IBT application

Risks - *Have all material internal and external risks been considered?*

Policyholder groups - *Have these been identified correctly and at an appropriate level of granularity?*

Capital metrics - *Have the appropriate capital metrics and sensitivity tests been considered for the business?*

Modelling - *Has the IE used the company's model, their own model, a regulatory model and is it fit for purpose?*

Special features - *Have these been fully understood and reflected in the impact assessment?*

Conduct - *What is the impact on policyholder experience? Have all requirements been fully considered?*

Independent Expert - *Is the independent expert sufficiently independent and experienced?*

Impact - *Will any individual group of policyholders be materially adversely affected by the transfer?*

How can IBTs be used?

A group reorganization

A large insurer wanted to rationalize its general insurance business. Over time it had accumulated 12 insurance entities each requiring separate governance, reporting, accounts, and capital. The group can use an insurance business transfer to consolidate into a much simpler structure with three entities, including one primary entity for general insurance underwriting, an entity for legacy liabilities and a white-label carrier. This corporate simplification also makes it much easier for the regulator – he or she can look at three balance sheets instead of 12!

A consolidation of legacy liabilities to position entity for sale

A large insurer wishes to dispose of its legacy operations, but these operations are split across 4 different entities, one of which was not even part of the group. Using an insurance business transfer, the insurer can package all the liabilities for sale into a single entity creating a simpler proposition for a share sale and thereby maximizing value.

A sale of legacy liabilities

A large insurer wants to improve its capital position by disposing of a subset of liabilities written prior to 2005. Having found a suitable purchaser, an insurance business transfer can be used to transfer the liabilities directly to the acquiring insurer.

Independent Expert

Critical focus areas

An important element of the IBT approval process is the review and report of the independent expert (IE) that evaluates the impact of the transfer on the affected policyholders.

An Independent Expert ("IE") is appointed for all insurance business transfers to assist the regulator and court in the decision whether to approve the transfer. The IE must be approved by the regulator whose primary considerations will include:

Appropriate skills and experience

Independence from the transfer

The IE's primary concern is security provided to policyholders and whether this is affected by the transfer. Focus is on comparative analysis of current vs. future state and risks to policyholders.

The IE will consider many factors including capital strength, risk of insolvency, policyholder service level, nature and amount of assets to be transferred, relative size of liabilities, security of groups of policyholders and reserve adequacy.