BY E-MAIL

July 22, 2019

Messrs. Doug Stolte and David Smith
Co-Chairs, NAIC Restructuring Mechanisms (E) Subgroup

Attention: Dan Daveline (ddaveline@naic.org)
Robin Marcotte (rmarcotte@naic.org)

Re: Suggestions Regarding Safeguards Related to Restructuring Mechanisms

Dear Messrs. Stolte and Smith:

The National Association of Insurance Commissioners (NAIC) has charged the Restructuring Mechanisms (E) Working Group (Working Group) with analyzing issues related to restructuring statutes, such as insurance business transfer (IBT) and corporate division (ICD) statutes. In connection with that effort, the Working Group has charged the Restructuring Mechanisms (E) Subgroup (Subgroup) with reviewing the various restructuring mechanisms and developing applicable safeguards for IBT and ICD transactions.

The undersigned companies write to express our support for the development of effective IBT and ICD models, as well as our belief that a framework can be developed that will strike the appropriate balance between industry's legitimate business needs and the financial, actuarial and due process standards that will achieve robust consumer protections. Like other restructuring mechanisms that have been managed and overseen by experienced regulators for decades, an orderly IBT and ICD process supervised by effective regulators will enable firms to operate more efficiently, better manage their capital, and improve solvency by encouraging and facilitating the flow of new capital to the industry, which ultimately will benefit consumers.

To that end, we offer the following suggestions to guide the development of safeguards related to such restructuring mechanisms:

*Procedural safeguards should be incorporated into all IBT and ICD statutes to ensure due process.*

IBT and ICD laws should include strong regulatory and judicial oversight and transparency. Because IBT and ICD laws would permit the transfer of insurance contracts without policyholder consent, any IBT or ICD transaction should require best practices from a due process standpoint allowing policyholders, non-domestic regulators and other interested parties an opportunity to be heard in a public hearing (in the context of an ICD transaction) or court proceeding (in the context of an IBT transaction). Independent expert analysis should be an important component of the approval process for any IBT or ICD transaction. Financial or valuation experts are regularly part of transactions requiring insurance regulatory approval (such as mutual company conversions and Form A change of control approvals), and requiring such an analysis from an independent expert in the context of restructuring mechanisms would be an important safeguard for policyholders and

the public. In the U.S., using Oklahoma as an example, the IBT process would require the approval of insurance regulators, court approval, expert review, and specific notices to policyholders of both the regulatory process and judicial process.

IBT is a concept that comes to the U.S. under foreign precedent and a proven track record. IBT transactions have been permitted in many countries outside the U.S., including the UK, the other states of the European Union (EU), Hong Kong and Australia, for many years. By way of example, nearly 300 IBT transactions have taken place under the UK Part VII (Part VII) transfer process since 2002, including life and non-life insurers, direct insurers, reinsurers, active writers and those in run-off, those insuring individuals and those insuring companies. Part VII replaced existing UK legislation[1] providing for IBTs that had been in place since 1982 and, as such, IBT transactions have taken place in the UK for nearly 40 years. The procedural safeguards under in-force IBT laws in the U.S., such as in Oklahoma, compare favorably with the procedural safeguards under Part VII, which similarly include regulator approval, court approval, expert review and notice to interested parties, including policyholders and reinsurers.

As the international precedents for IBTs demonstrate, IBTs conducted in accordance with appropriate procedural safeguards provide useful flexibility to regulators and the industry to the ultimate benefit of consumers.

*The standard of review of an IBT or ICD transaction should require consideration of fairness and the extent of any adverse impact on policyholders.*

A standard of review that requires consideration of fairness and the extent of any impact on policyholders, coupled with the procedural safeguards described above (i.e., approval of insurance regulators, court approval for IBT transactions and a contested administrative hearing for ICD transactions, expert review, and notices to policyholders) and the effective financial and actuarial standards described below, should ensure that policyholders' interests are protected in IBT and ICD transactions.

Applying an unnecessarily burdensome standard of review to IBT and ICD transactions, as suggested by some commentators, is inconsistent with the treatment of international precedents for IBTs, such as the Part VII transfer regime, as well as other transformative insurance transactions in the U.S.

For example, approval of a Part VII transfer requires a determination that, as a whole, the scheme is fair as between the interests of the classes of persons affected, and it is not the function of the court to produce what, in its view, is the best possible scheme.[2] In addition, it is likely that an unnecessarily burdensome standard would significantly reduce the number of IBT and ICD transactions and effectively eliminate the benefits that the proposed restructuring mechanisms are designed to provide to regulators, industry and consumers.

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[1] *See* Schedule 2C to the Insurance Companies Act 1982.

[2] *See* Re London Life Association Ltd (1989) (unreported); Re AXA Equity & Law Life Assurance Society plc [2001] 1 All ER (Comm) 1010; Aviva Life and Pensions UK Ltd, Re [2019] EWHC 312 (Ch); [2019] 2 WLUK 261; CHD.

In addition, Form A approval standards, which have been in place for decades and have a strong track record of success, cover the same bases that are the focus of the IBT deliberations—financial condition, suitability of new ownership and management, protecting policyholders, and avoiding public harm. The Form A process relies on the effective application of those standards by regulators. Likewise, restructuring mechanism approval would rely on a regulator's effectiveness, and would include additional procedural protections such as notice and opportunity to advocate for policyholders and a variety of interested parties, such as NOLHGA and NCIGF. In addition, the standard of review under in-force IBT laws in the U.S., such as the "not materially adversely effect" standard in Oklahoma, compare favorably with standards under Part VII, which, as discussed above, similarly focus on fairness to affected parties.[3]

*Each entity that results from an IBT or ICD transaction should be adequately capitalized and able to fulfill its obligations to policyholders.*

Evaluating the financial strength of the business included in an IBT or ICD transaction will be an important part of the regulatory review process. Time-tested financial and actuarial requirements, such as reserve requirements, risk-based capital, and the types of assets that can be used to support policyholder liabilities, should be applied as the safeguards to ensure that an entity that results from an IBT or ICD transaction is adequately capitalized and can fulfill its obligations to policyholders.[4] Moreover, following an IBT or ICD transaction, an involved insurer would need to comply fully with all applicable laws and regulations—including capital and solvency requirements—of its state of domicile. In any IBT or ICD transaction, actuarial reserve and capital calculations should be performed by an independent expert, and appropriate assumptions should be included in capital calculations. Regulators should have the discretion to require additional financial information if needed in connection with reviewing the financial strength of the subject business.

If review of the financial strength of a business included in IBT or ICD is properly evaluated by the applicable regulator, court, and independent experts and due process is followed, there should be no reason to subject the financial strength of a business included in such transactions to more rigorous financial and actuarial standards than would apply to an insurer in the ordinary course of its business. Similarly, if required capital calculations and standards adjust for the lack of diversification when an IBT or ICD results in a monoline insurer, there is no reason to prohibit a transaction that transforms a diversified insurance company into one or more monoline insurers,

[3] In a Part VII transfer, the appointed independent expert is required to consider and give his or her opinion of the likely effects of the transfer on policyholders, which generally consist of at least 3 groups: those that are retained in the transferor company; those that are proposed to be transferred from the transferor to the transferee; and the existing policyholders of the transferee company. In particular, the expert's opinion should compare the likely effects on policyholders if the transfer is or is not implemented; state whether alternative arrangements were considered (and if so, what); comment on any material differences between the effects of the scheme on different groups of policyholders; and consider the effects of the scheme on the security of policyholders' contractual rights, and on the levels of service provided to policyholders.

[4] Similarly, under the UK legislation, before the court will sanction a Part VII transfer, it must be satisfied that the transferee is sufficiently solvent.

as suggested by some commentators. Moreover, diversity of products does not guarantee that an insurer will never fail to meet its obligations, as there are many examples of troubled multi-line insurers. In fact, as compared to multi-line insurers, monoline insurers can offer increased depth of knowledge and expertise with respect to operating a particular line of business, which can improve administrative and financial performance for the benefit of policyholders.

*Regulators and courts should have the discretion to apply appropriate standards to all lines of business.*

All lines of business should be eligible for inclusion in IBT and ICD transactions. Rather than prescriptively excluding certain lines of business from eligibility under IBT and ICD statutes, as some commentators have suggested, the focus should be on ensuring there are adequate financial and procedural protections in place regardless of the line of business in question. For example, under existing insurance laws and regulations, financial and actuarial requirements vary by line of business. Such differences should also apply in determining the financial and actuarial requirements that should apply to specific lines of business involved in an IBT or ICD transaction. If long-term care or other hard-to-value liabilities can be properly evaluated by the applicable regulator, court, and independent experts and due process is followed, there should be no reason to exclude one or more lines of business from potentially being subject to an IBT or ICD transaction. Specific business transfer proposals may include reinsurance or similar risk transfer/spreading mechanisms addressing adequately the risks inherent in the underlying business. As a point of reference, Part VII transfers apply to both general insurance business and long-term insurance business. Moreover, applying appropriate financial and actuarial standards to hard-to-value blocks of business involved in an IBT or ICD transaction can strengthen the financial position of both the resulting company and the existing company, to the benefit of both the policyholders of the hard-to-value business and the remaining policyholders of the existing company. In addition, a reviewing regulator could in its discretion require structural safeguards as a condition to approval, allowing an IBT or ICD transaction to proceed only if the parties agree to structural protections that would further protect consumers.

*Any proposal must respect the multi-state licensing approach of the state-based system without disadvantaging the utility of the restructuring mechanisms.*

Consistent with fundamental principles of the U.S. state-based system of insurance regulation, each entity that results from an IBT or ICD transaction should be required to be licensed in all applicable jurisdictions.[5] Further consideration should be given to whether ICD statutes, in particular, should provide for an expedited process, post-transfer grace period or similar transition mechanism for the resulting entity to obtain new licenses in applicable jurisdictions.

[5] Similarly, under the UK legislation, before the court will sanction a Part VII transfer, it must be satisfied that the transferee has the authorization required to carry on the business being transferred.

We propose this approach for a few important reasons. First, insurance is a regulated activity that should be conducted in accordance with applicable licensing laws. Second, maintaining licenses in those jurisdictions where the transferring entity is licensed should help ensure appropriate guaranty association and fund coverage. And third, maintaining appropriate licenses supports the legal effectiveness of the transactions.

Relatedly, the states of domicile of the affected insurers should be vested with the authority (together with other procedural safeguards) to approve an IBT or ICD transaction, and other affected state insurance regulators should have an opportunity to be heard in a public hearing (in the context of an ICD transaction) or court proceeding (in the context of an IBT transaction) in the domiciliary jurisdictions.[6] However, we would encourage the Subgroup to reject outright any proposal that would require approval of or non-objection to an IBT or ICD transaction from all affected states, as suggested by some commentators. Requiring approval from all states where an involved insurer holds a certificate of authority would be inconsistent with current regulatory approval processes (e.g., transfer of ownership under the Form A process, oversight of holding company and affiliate transactions, granting credit for reinsurance and demutualization transactions), which place discretion principally in the hands of domestic regulators. This proposal would unnecessarily increase the time and monetary costs associated with the IBT and ICD process, which may not be in the best interest of the public or policyholders and would effectively strip the proposed restructuring mechanisms of any utility. Allowing for non-domestic state regulator participation in the public hearing (in the context of an ICD transaction) or court proceeding (in the context of an IBT transaction), at the discretion of the non-domestic state regulators, and requiring assuming insurers to be licensed in all states where the transferring insurer is licensed provides the appropriate level of recognition to the interests of non-domestic states.

We also wish to acknowledge what should be obvious: Concerns about guaranty system coverage post-transaction must be addressed squarely. Guaranty association and fund coverage cannot be compromised by restructuring mechanisms. That principle must be reflected in IBT and ICD statutes, and any individual proposal threatening guaranty system coverage would presumably fail regulatory review related to policyholder impact.

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[6] Similarly, from the EU perspective, IBT transactions under Part VII are currently (subject to Brexit), recognized by regulators across the EU without a separate requirement to follow the regimes in other EU states.

We appreciate the Subgroup's attention to the questions raised by restructuring mechanism proposals, respect the concerns raised by other interested parties, and commit ourselves as a resource while the NAIC and individual states work to shape a framework that continues to protect consumers while achieving the legitimate market needs met by restructuring tools.

Respectfully,

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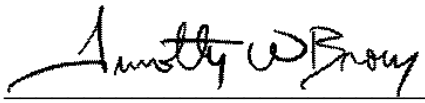

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cc: Mr. Buddy Combs and Ms. Elizabeth Kelleher Dwyer,
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