

Date: 4/19/22

*Virtual Meeting*

**RESTRUCTURING MECHANISMS (E) SUBGROUP**

Wednesday, May 4, 2022

2:00 – 3:30 p.m. ET / 1:00 – 2:30 p.m. CT / 12:00 – 1:30 p.m. MT / 11:00 a.m. – 12:30 p.m. PT

**ROLL CALL**

Doug Stolte/David Smith, Co-Chairs	Virginia	John Rehagen/ James Le	Missouri
Jack Broccoli, Vice Chair	Rhode Island	David Wolf	New Jersey
Mel Anderson	Arkansas	Dale Bruggeman	Ohio
Kathy Belfi	Connecticut	Andrew Schallhorn	Oklahoma
Judy Mottar	Illinois	Amy Garcia	Texas
Judy Weaver	Michigan	Amy Malm	Wisconsin
Fred Andersen	Minnesota		

NAIC Support Staff: Dan Daveline/Robin Marcotte

**AGENDA**

1. Review the Foundational Principles Draft Attachment 1  
*—Doug Stolte (VA), David Smith (VA), and Jack Broccoli (RI)*
2. Review the Best Practices Draft Attachment 2  
*—Doug Stolte (VA), David Smith (VA), and Jack Broccoli (RI)*
3. Review the Property/Casualty (P/C) Risk-Based Capital (RBC) Referral Response and Request for Input on How to Proceed Attachment 3  
*—Tom Botsko (OH)*
4. Adjournment

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# Foundational Principles

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## Background

An **insurance business transfer** (IBT) represents a transaction designed to transfer existing insurance obligations of one insurer (transferor) to a second insurer (transferee) without policyholder consent, subject to regulatory approval and, subject to court approval. While policyholder consent is not required, notice to policyholders and to the general public is required, and concerns regarding the transaction will be considered in the regulatory and/or court approval process. Pursuant to an IBT, the transferee becomes directly liable to policyholders and the transferring insurer's obligations under the contracts are extinguished thereby achieving legal finality for the transferring insurer.

A **corporate division** is a division of one insurer into two or more resulting insurers. The dividing insurer's assets and liabilities are allocated between or among the resulting insurers without requiring policyholder consent.

This document is foundational principles for state insurance regulators to use in reviewing IBT and corporate division transactions. While this guidance recommends minimum review standards, it does not rise to the level of a model law or regulation.

The exact laws under which both transactions are implemented can differ from one jurisdiction to the next and are not detailed herein. This guidance is not intended to address the legality of these transaction in various states but rather to provide a baseline of foundational principles to be used by all jurisdictions to address the primary risks associated with such transactions. Note that some jurisdictions have noted concerns that their laws do not permit nondomiciliary jurisdictions to sever policyholder rights without policyholder consent.

**Foundational Principles to Guide in Reviewing IBT and Corporate Divisions**

- 1. Policyholders and Other Key Stakeholders Should Never Be Left Worse Off** - Policyholders should be left in the same or a better position after completion of the transaction. The transaction should not be approved unless the effect on policyholders and other key stakeholders is neutral or there is some expected policyholder benefit(s). It is preferable that they are left in better position, but at a minimum the policyholders should be in a neutral position. Policyholders and other key stakeholders include those related to both the transferred policies and the remaining policies which are not transferred. Consideration should include the following: (Sources: 1, 3)
- a. How the security of policyholders' and claimants' (who include persons with certain rights and contingent rights under the policies) contractual rights are affected.
  - b. How policyholders' rights and reasonable expectations appear to be affected.
  - c. The compensation offered to policyholders for any loss of rights or expectations.
  - d. That policyholders will receive the same or better level of service regarding claims settlement, and access to support and capital as they received prior to the IBT or corporate division.
  - e. Continuity of guaranty fund coverage and other secondary market coverage.

**Drafting Note:**

Comments are requested on both the term no worse off and how it is measured. The terms of the insurance policy or reinsurance contract do not typically change. Does the term no worse off include more measures than financial strength / financial ability and operational measures such as service to policyholders?

Comments are requested on the definition of policyholders and key stakeholders: regulators noted that policyholders on both sides of the transaction (those transferred and those not transferred) should both be protected. However, in cases of secondary transfers of assumed reinsurance obligations, more input is requested.

- 2. Robust Regulatory Review Process** - Reviewing authorities should undertake efforts to establish, at a high level of confidence, that policyholders and other key stakeholders will experience no adverse effects. At a high level, the following key elements need to be embedded in law (along with existing *Insurance Holding Company System Regulatory Act* (#440) Form A requirements):
- a. The regulatory review must be robust, including evaluations of legal implications such as anti-innovation laws for policyholders in other states, financial projections, actuarial analysis and capital projections. The review should identify key risks to the transaction, and should, at a minimum, include the following: (Sources: 1)
    - i. A prospective solvency assessment. (Source: 4)
    - ii. A finding that the assets to be transferred to insurers (or surviving entities) involved in the transaction are adequate to cover the insurer's liabilities being transferred.

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- iii. A conclusion that the transaction does not have any adverse impact on policyholders and other key stakeholders, including services, benefits from reinsurers, guaranty associations or other secondary market mechanisms.
  - iv. A consideration of the plans of any insurer involved in the transaction to liquidate another involved insurer, sell or dividend assets, consolidate, merge, or make other changes, and the resulting impact on capital, policyholders, reinsurers, and guaranty associations.
  - v. An analysis of any relevant contracts, including claims management and reinsurance and recordkeeping. (Source: 4)
- b. Require Strong Financial Standards and Stress Testing
- i. Prescribed conservative assumptions should be included in capital calculations to avoid the manipulation of capital thresholds.
  - ii. Actuarial reserve and capital calculations should be performed by an expert that is independent of the insurance companies involved. (Source: 1, 7) Resulting projected RBC ratios and projected capital ratings should be reviewed. Policyholders and other key stakeholders should have the same economic protections which existed prior to the IBT or corporate division.
  - iii. The final decision should outline the purpose of the transaction and impacts to policyholders and other key stakeholders and the opinion of the independent expert(s), and reviewing regulators, including other impacted regulators, and the input from policyholders and other key stakeholders.
- c. Ultimate authority
- i. IBTs will require review by:
    - 1. Domestic regulators of both the assuming company and transferring company,
    - 2. Notice to other affected regulators,
    - 3. Report of Independent expert(s), and
    - 4. Court approval as the final authority
  - ii. Corporate Divisions will require review by
    - 1. Domestic regulator(s),
    - 2. Notice to other affected regulators,
    - 3. Report of Independent expert(s),etc. and
    - 4. Domestic regulators as the final authority.

**Drafting Note:**

Comments are requested on the use of an independent expert for corporate divisions. If commenters believe that an independent expert is not needed for a corporate division; should the department be required to show that they have adequate resources and expertise such as, actuarial experienced in the book of business being transferred, examiners with appropriate credentials and experience, etc. to review and approve a corporate division?

**3. Guaranty Fund Coverage - No impacted policyholder should lose guaranty fund protection as a result of a transaction. (Sources: 1, 2)**

- a. If there was guaranty fund coverage before the division or IBT, state regulators should ensure that there is coverage after the division or IBT. A division or IBT should not reduce, eliminate or in any way impact guaranty fund coverage. Guaranty fund representatives and the National Conference of Insurance Guaranty Funds (NCIGF) are a good resource for any guaranty fund coverage issues that arise in evaluating these transactions.

**Drafting Note:**

*National Conference of Insurance Guaranty Funds (NCIGF) commented that changes to existing Guaranty Fund models may be needed and will appoint a subcommittee to assist. The Restructuring Mechanisms (E) Working Group has made a referral to the Receivership and Insolvency (E) Task Force.*

**4. Secondary Market Mechanisms (Source: 6 )**

- a. If there were any secondary market or similar mechanisms which benefited the policyholders and other key stakeholders or otherwise accrued to the claims of policies, before the division or IBT, state regulators should ensure that the benefits remain after the division or IBT. A division or IBT should not reduce, eliminate or in any way impact coverage benefits.
- b. Other organizations such as the National Workers Compensation Reinsurance Association should be contacted, when relevant.

**5. Use Uniform NAIC Valuation and Accounting Standards (Source: 7)**

- a. When evaluating the solvency impact of a proposed transaction, the accounting utilized should be in conformance with the NAIC's uniform statutory accounting principles valuation and accounting rules in the Accounting Practices and Procedures Manual (AP&P Manual). Regulators are discouraged from allowing any permitted practices. If permitted practices are utilized, the impact of the deviations from the AP&P Manual at the time of the transaction, and in any subsequent projections, should be thoroughly analyzed and quantified and should be disclosed as part of the information shared with other affected regulators. In addition, statutory filings shall continue to provide disclosures of the impacts of prescribed and permitted practices in accordance with the Accounting Practices and Procedures Manual.

**6. Independent Expert (Sources: 1, 3, 7, 8)**

- b. The ability of a Commissioner to hire independent experts for specialized transaction review and financial testing, to be paid for by the applicant is essential;
- c. The regulatory review process for IBTs and corporate divisions will utilize an independent expert to advise and assist the ultimate reviewing authority (regulator and or the court) in reviewing proposed transactions (including advising on any adverse impact on policyholders, reinsurers, or guaranty associations) and to provide any other assistance or advice the regulator may require.

*Drafting Note: See request for comments on independent expert for corporate divisions.*

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- d. The independent expert evaluation should be undertaken by an expert to establish, at a high level of confidence, that policyholders and other key stakeholders will experience no adverse effects. The independent expert must provide a detailed report regarding the prospective solvency of the resulting entity.
- e. Other independent experts will also provide reports to be reviewed by the regulator and the ultimate approving authority. This will include an independent actuarial review of the reserves and capital (e.g. RBC and financial strength) before and after the transaction. The review is to ensure that all of the policyholders and other key stakeholders are a neutral or better condition after the proposed transaction. Note that the actuarial review is one of several experts that will likely be included and taken into consideration. While the independent expert can provide comments and evaluation of the reports of the other experts, the overall expert cannot change the reports of the other employed experts. For example, the reviewing expert cannot change the consulting actuarial opinion.
- f. The experts should be independent of any influence from the companies involved and subject to the approval of the domestic regulators.

### 7. Due Process (Sources: 1,3)

- a. Robust due process must be afforded to stakeholders (policyholders, claimants, reinsurers, guaranty associations including other regulators, etc.) impacted by a transaction in advance of any public hearing along with access to information concerning the transaction. This should include:
  - i. Notice to stakeholders in a form to be approved by the regulator;
  - ii. Public hearing;
  - iii. Adequate time to assess the impact as determined by the domestic regulator, but no less than 30 days; and
  - iv. Opportunity to submit written comments and or attend public hearings.

### Table of Sources

Reference	Source
1	American Property Casualty Insurance Association (APCIA) suggested concepts
2	National Conference of Insurance Guaranty Funds (NCIGF)
3	Prudential Regulation Authority (PRA)/Financial Conduct Authority (FCA) – UK part 7
4	Laws or procedures in Rhode Island
5	Corporate Division comment letter 7-24-29, (Athene, John Hancock TransAmerica Venerable) referencing Michigan Corporate Division law
6	Illinois Corporate Division example
7	Comment letter New York Life and Northwestern Mutual on restructuring charges
8	IBT Coalition comment letter

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Insurance Business Transfer (IBT) Transactions / Corporate Divisions Transactions

## Background

An **insurance business transfer** (IBT) represents a transaction designed to transfer existing insurance obligations of one insurer (transferor) to a second insurer (transferee) without policyholder consent, subject to regulatory approval and, subject to court approval. While policyholder consent is not required, notice to policyholders and to the general public is required, and concerns regarding the transaction will be considered in the regulatory and/or court approval process. Pursuant to an IBT, the transferee becomes directly liable to policyholders and the transferring insurer's obligations under the contracts are extinguished thereby achieving legal finality for the transferring insurer.

A **corporate division** is a division of one insurer into two or more resulting insurers. The dividing insurer's assets and liabilities are allocated between or among the resulting insurers without requiring policyholder consent.

The procedures in this section are best practices for state insurance regulators to use in reviewing IBT and corporate division transactions. While this guidance recommends minimum review standards, it does not rise to the level of a model law or regulation.

## Section I - Company information

**The filer requesting the transaction must provide the following minimum documentation for review by the regulatory authorities:**

### 1. Entity Contact Information

- a. Below information for 1) applicant: 2) Corporate Division Resulting Entities; 3) IBT – assuming entities (Source - IL law -10)
- b. Company Names Applicant (Source - Form A User Guide)
- c. DBA/AKA (If Applicable)
- d. NAIC Company Code
- e. NAIC Group Code Prior to Transaction (If Applicable )
- f. State of Domicile
- g. Lead States (If Applicable)
- h. Number and identity of Licensed States
- i. Comments (Regarding Surplus Lines, etc.)
- j. Contact Person (Required Information)

- k. Address (Required Information)
- l. Phone Number (Required Information)
- m. Email Address

**2. Affiliates of the Applicants**

- a. Organizational chart pre-transaction (Source - Form A User Guide)
- b. Ultimate controlling party pre-transaction
- c. Organizational chart post-transaction
- d. Ultimate controlling owner post-transaction
- e. Corporate Division - For each new company that will be created by the proposed division, a copy of its:
  - i. proposed articles of incorporation
  - ii. proposed bylaws and
  - iii. the kinds of insurance business that the new company would be authorized to conduct (Source - 10- IL CD Code)
- f. IBT - respective controlling parties of transferring and assuming companies

**3. Management of Applicants**

- a. Officer and director information for involved entities (Source - Form A User Guide)
- b. Individual's First and Last Name
- c. Position Title
- d. Known regulatory Actions

**Section II - Transactional Design**

The following procedure is intended to mitigate the risk of approving a proposed IBT/corporate division transaction that may not be well designed based upon the effects of the transaction.

**1. IBT Narrative of the proposed IBT, explaining:**

- a. Reasons for undertaking the IBT (Source-1997 R-WP, App. 2)
- b. All steps necessary to accomplish the IBT, including legal and regulatory requirements and the timetable for completing such requirements

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- c. The effect of the IBT on the insurer's financial condition
  - d. The effect of the IBT on the insurer's policyholders, claimants and other stakeholders
  - e. Summary of the IBT plan including any agreements (Source - 4- RI IBT Reg)
  - f. Identification and description of the business to be transferred
  - g. Most recent audited financial statements and annual reports of the Transferring Company filed with its domiciliary regulator
  - h. The most recent actuarial report and opinion that quantifies the liabilities in the business to be transferred to the Assuming Company under the policies or reinsurance agreements
  - i. Five years of pro-forma financial statements demonstrating the projected solvency of the Assuming Company and explanation of assumptions used and certification that all financial regulatory requirements will be met after the transaction
  - j. Officers' certificates of the Transferring Company and the Assuming Company attesting that each has obtained all required internal approvals and authorizations regarding the Insurance Business Transfer Plan and completed all necessary and appropriate actions relating thereto
  - k. Description of any guarantees or additional reinsurance that will cover the transferred business
  - l. A statement describing the Assuming Company's proposed investment policies and any contemplated third-party claims management and administration arrangements
2. **Corporate Division - Narrative - A general written summary of the proposed corporate division:**
- a. The manner of allocating between or among the resulting companies including: (Source -10-IL CD Code)
    - i. the assets of the domestic stock company that will not be owned by all of the resulting companies as tenants in common.
    - ii. The liabilities of the domestic stock company, including policy liabilities, to which not all of the resulting companies will become jointly and severally liable.
  - b. The manner of distributing shares in the new companies to the dividing company or its shareholders
  - c. A reasonable description of the liabilities, including policy liabilities, and items of capital, surplus, or other assets, in each case, that the domestic stock company proposes to allocate to each resulting company, including specifying the reinsurance contract, reinsurance coverage obligations, and related claims that are applicable to those policies.
  - d. All terms and conditions required by the laws of the jurisdiction or the articles of incorporation and bylaws of the domestic stock company

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- e. Evidence demonstrating that the interest of all classes of policyholders, claimants and other stakeholders of the dividing company will be properly protected; and all other terms and conditions of the division.
- f. Nothing in this shall expand or reduce the allocation and assignment of reinsurance as stated in the reinsurance contract.
- g. If the domestic stock company survives the division, the plan of division shall include:
  - i. All proposed amendments to the dividing company's articles of incorporation and bylaws if any
  - ii. If the dividing company desires to cancel some, but less than all, shares in the dividing company, the manner in which it will cancel such shares and
  - iii. If the dividing company desires to convert some, but less than all, shares in the dividing company into shares, securities, obligations, money, other property, rights to acquire shares or securities, or any combination thereof, a statement disclosing the manner in which it will convert the shares
- h. If the domestic stock company does not survive the proposed division, the plan of division shall contain the manner in which the dividing company will cancel or convert shares in the dividing company into shares, securities, obligations, money, other property, rights to acquire shares or securities, or any combination thereof.
- i. Terms of a plan of division may be made dependent on facts objectively ascertainable outside of the plan of division.
- j. Business Plan
- k. Ongoing Operations (Source - 1997 R-WP, App. 2)
  - i. A listing of the insurer's major markets/products
  - ii. A description of the insurer's strategy covering major markets/products and customers and the critical success factors for achieving these strategies
  - iii. A description of the insurer's competitive positioning for each of its major markets/products and a discussion of growth potential, profit potential and trends for each
  - iv. Identification and a discussion of the significant trends in the insurer's major markets/products, e.g., demographic changes, alternative markets, distribution methods, etc.
  - v. Identification of the largest risk exposures of the insurer, e.g., financial market volatility, environmental exposures, geographic distribution, etc.
  - vi. A description of the major business risks of the insurer, e.g., sales practices, data integrity, service delivery, technology, customer satisfaction, etc.

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### I. Run off Operations

- i. A description of all plans regarding any run-off operations.

### 3. Financial Information

- a. Historical financial statements, including the most recently filed annual and quarterly statutory statements. (Source - 1997 R-WP, App. 2)
- b. Financial statements (in a spreadsheet format) detailing the accounting of the proposed IBT including:
  - i. Schedules detailing assets and liabilities to be reallocated as part of the IBT
  - ii. An accounting of any special charges, reevaluations, or write downs to be made as part of the IBT
- c. Pro forma financial statements of the insurer(s) as if the IBT were approved including an explanation of the underlying assumptions
- d. Financial projections for five years (assuming the IBT is approved) for both the run-off and ongoing entities and an explanation of the assumptions upon which the projections are based
- e. A description of any tax consequences of the IBT

### 4. Financial Support

- a. If the plan provides for the provision of financial and managerial support by the parent company to all entities, such support needs to be legally enforceable before such support is given consideration in review of the transaction. (Source - 1997 R-WP, App. 2)
- b. The plan should provide for a commitment of parental and other legally enforceable plans for financial support to run off operations in the event of:
  - i. Inadequacy of reserves
  - ii. Asset deterioration
  - iii. Deterioration in the collectibility of reinsurance recoverables

### 5. Organizational Impact

- a. The plan should affirm that the restructured entity was either licensed or an approved surplus lines carrier in all jurisdictions in which it wrote business, and will be licensed in all jurisdictions where it takes on business as a result of the restructuring/ IBT. (Source - 1997 R-WP, App. 2)
- b. Analysis of the change in organizational structure resulting from the transaction. Areas to emphasize include:
  - i. Ownership of the resulting corporate structures

- ii. Relationship between management of the resulting entities
- iii. Substantial reinsurance arrangements between resulting entities
- iv. Other ongoing business ties between the resulting entities

### **Section III – Ultimate Reviewing Authority**

1. **IBTs will require review by:**
  - a. Domestic regulators of both the assuming company and transferring company
  - b. Notice to other affected regulators
  - c. Report of Independent expert(s) and
  - d. Court approval as the final authority
2. **Corporate Divisions will require review by:**
  - a. Domestic regulator(s)
  - b. Notice to other affected regulators
  - c. Report of Independent expert(s),etc. and
  - d. Domestic regulators as the final authority

***Drafting Note:***

Comments are requested on the use of an independent expert for corporate divisions. If commenters believe that an independent expert is not needed for a corporate division; should the department be required to show that they have adequate resources and expertise such as, actuarial experienced in the book of business being transferred, examiners with appropriate credentials and experience, etc. to review and approve a corporate division?

### **Section IV – Robust Regulatory Review**

#### **1. Initial Review of the Transaction**

The Domestic Regulator should conduct an initial review the proposal prepared by the insurer (transferor or transferee) to determine if all of the information required by Section I and II has been provided and the transaction has been properly designed. Some domestic regulators may choose to call a limited scope financial examination as part of conducting their review. The Domestic Regulator should ensure:

(Source - 1997 R-WP, App. 2)



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- a. The documented reasons for the proposed transaction are reasonable and appropriate based upon the Domestic Regulator's existing knowledge of the insurer/group.
- b. The steps necessary to accomplish the plan, including legal and regulatory expectations and a timeline, are reasonable and appropriate.
- c. The projected impact of the transaction (proforma financial statements and RBC before and after) on the financial condition of the transferor insurer and the transferee insurer will not render either company in a troubled company state.
- d. The proforma business plan for the transferor and the transferee including major business risks, products and etc. of the insurer (e.g. sales practices, data integrity, service delivery, technology, customer satisfaction, etc.) as described in Section II is reasonable and appropriate.

### 2. High Level of Confidence

Reviewing authorities should undertake efforts to establish, at a high level of confidence, that policyholders and other key stakeholders will experience no adverse effects. At a high level, several key elements need to be embedded in law (along with existing *Insurance Holding Company System Regulatory Act* (#440) Form A requirements).

- a. The regulatory review must be robust, including evaluations of financial projections, actuarial analysis and capital projections. In addition, the review should also include a confirmation that the insurer(s) have performed a due diligence of the legal implications in other jurisdictions, specifically those that have anti-novation laws. Correspondingly, all affected regulators should conduct a review of their own laws to ensure there is no potential legal conflict on the how policyholders are treated by the transaction compared to the requirements in their respective states.
- b. The review should be conducted by qualified independent experts and should identify key risks to the transaction. The expert should not be a department of insurance employee and should be able to assert independence from the reporting entities under discussion. The expert review should, at a minimum, include the following: (Sources: 1)
  - i. A prospective solvency assessment (Source: 4)
  - ii. A finding that the assets to be transferred to insurers (or surviving entities) involved in the transaction are adequate to cover the insurer's liabilities being transferred
  - iii. A conclusion that the transaction does not have any adverse impact on policyholders, including services, benefits from reinsurers, guaranty associations or other secondary market mechanisms
  - iv. A consideration of the plans of any insurer involved in the transaction to liquidate another involved insurer, sell or dividend assets, consolidate, merge, or make other changes, and the resulting impact on capital, policyholders, reinsurers, and guaranty associations
  - v. An analysis of any relevant contracts, including claims management and reinsurance and recordkeeping (Source: 4)

**3. Require Strong Financial Standards and Stress Testing**

- a. Prescribed conservative assumptions should be included in capital calculations to avoid the manipulation of capital thresholds. (See additional information in the section on assessment of capital risk.)
- b. Actuarial reserve and capital calculations should be performed by an expert that is independent of the insurance companies involved. (Source: 1, 7) Resulting projected RBC ratios and projected capital ratings should be reviewed. Policyholders and other key stakeholders should have the same economic protections which existed prior to the IBT or corporate division.
- c. The final decision should outline the purpose of the transaction and impacts to policyholders and other and other key stakeholders and the opinion of the independent expert(s), and reviewing regulators, including other impacted regulators, and the input from policyholders.
- d. Use Uniform NAIC Valuation and Accounting Standards (Source: 7)
  - i. When evaluating the solvency impact of a proposed transaction, the accounting utilized should be in conformance with the NAIC's uniform statutory accounting principles valuation and accounting rules in the Accounting Practices and Procedures Manual (AP&P Manual). Regulators are discouraged from allowing any permitted practices. If permitted practices are utilized, the impact of the deviations from the AP&P Manual at the time of the transaction, and in any subsequent projections, should be thoroughly analyzed and quantified and should be disclosed as part of the information shared with other affected regulators. In addition, statutory filings shall continue to provide disclosures of the impacts of prescribed and permitted practices in accordance with the Accounting Practices and Procedures Manual.

**4. Assessment of risk capital**

- a. One way that IBT laws can differ from corporate division laws is that some states' and jurisdictions' IBT laws, the liabilities of the transferee are segregated from the other liabilities not associated with such a transfer and under laws can be expected to be both self-sustaining (e.g. no more monies may be transferred to fund such liabilities under the terms of the transfer) and self-containing (e.g. cannot be used to cover liabilities not associated with the transfer).
- b. For IBTs or other transactions which will not have access to additional capital, an actuarial report of the adequacy of run-off reserves (gross and net) being transferred should include an analysis of:
  - i. A comparison of the existing reserves to a Value at Risk (Var) of 99.5% for a 1-year period (non-life business), 97.% for a 5-year period (non-life business) or conditional tail expectation (CTE) of 90 or some other higher level that are necessary to mitigate the risks
  - ii. A comparison to stressed reserves under reasonable deterministic criteria/scenarios provided by the state of domicile

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- iii. Comparison of the proposed claim staff expertise and levels compared to estimate of previous claims staff expertise and levels. (Source- State survey comments and 1997 Restructure White Paper)
  - iv. If the reviewing authority requires additional capital, which is higher than the required reserve, the additional amount should be reported in special surplus.
- c. Management assessment and corporate governance assessment
- d. Capital reviews of the transaction should consider the following (if relevant) to the transaction:
- i. Capital and/or reinsurance limits assessments should include quantitative analysis
  - ii. Risk exposure modeling
  - iii. Horizon and Confidence Levels to address: Short term (1 year); Mid-term (5 to 10 years); Long term (relatively consistent with liability horizon)
  - iv. Stress scenarios and their relationship to capital adequacy
  - v. Discuss impact on capital needs attributable to: Any diversification in liabilities (different types of exposures); Asset mix; Amount and quality of “outside” existing inuring reinsurance (applies to portfolio before any reinsurance acquired subsequent to the transaction ) and internal hedging
- e. Upon request, the State should provide access to information to other licensed states including the established amount of assets to be transferred to compensate for the uncertainty associated with the business and that the remaining assets need to be self-sustaining for the obligations transferred to it.
5. **State imposed restrictions**
- a. If necessary, consider issuing state-imposed restrictions to apply to the company after the transaction, such as:
    - i. Dividend restrictions
    - ii. Notice to state of major changes
    - iii. Planned targeted examinations
    - iv. Special surplus restricted capital

### **Section V – Review of the Transaction by an Expert**

1. **Use of an Independent Expert** (Source - Foundational concepts: 1, 3, 7, 8)
- a. The ability of a Commissioner to hire independent experts for specialized transaction review and financial testing, to be paid for by the applicant is essential.

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- b. The regulatory review process for insurance business transfers and corporate divisions will utilize an independent expert to advise and assist the ultimate reviewing authority (regulator and or the court) in reviewing proposed transactions (including advising on any material adverse impact on policyholders, reinsurers, or guaranty associations) and to provide any other assistance or advice the regulator may require.

**Drafting Note:** *See request for comments on independent expert for corporate divisions.*

- c. The independent expert evaluation should be undertaken by an expert to establish at a high level of confidence that policyholders and other key stakeholders experience no adverse effects. The independent expert must provide a detailed report regarding the prospective solvency of the resulting entity or entities or the assuming entity in the event of an IBT.
  - d. Other independent experts will also provide reports to be reviewed by the regulator and the ultimate approving authority. This will include an independent actuarial review of the reserves and capital (e.g. RBC and financial strength) before and after the transaction. The review is to ensure that all of the policyholders and other key stakeholders are a neutral or better condition after the proposed transaction. Note that the actuarial review is one of several experts that will likely be included and taken into consideration. While the independent expert can provide comments and evaluation of the reports of the other experts, the overall expert cannot change the reports of the other employed experts. For example, the reviewing expert cannot change the consulting actuarial opinion.
  - e. The experts should be independent of any influence from the companies involved and subject to the approval of the domestic regulators. (Source-UK Part VII PRA practices)
2. Determine scope of each of the expert(s) report(s) (Source - UK Part VII PRA practices)
    - a. How the expert report will be issued to the ultimate approving authority.
    - b. What parts of the report will be public?
    - c. Verifying that the expert is independent.
    - d. Who appointed the expert and how the requesting entity will pay the costs?
    - e. What are the expert's qualifications and experience?
    - f. Does the expert have any conflicts of interest?
    - g. Are the procedures to be performed by the expert documented in a manner that are understandable?
    - h. Opinion of the expert on the likely effects of the plan?
    - i. Opinion of the expert on whether there were alternatives.

- j. Opinion of the expert on whether different groups of policyholders, claimants and other stakeholders are likely to be impacted differently by the plan?
- k. Opinion of the expert on the likely effects of the transaction on any reinsurer of the transferor or dividing parties.

## **Section VI - Reserves and Capital**

Proposed corporate divisions and IBT transactions require by their nature that the independent experts and reviewing regulators must certify that the reserves and the capital position (e.g. RBC) that will apply to the insurer before and after the transaction will put the policyholders and other key stakeholders in the same or better position. The following procedures are intended to assist in evaluating this risk.

1. **Retain qualified independent actuarial experts** (Source - 1997 R-WP, App. 2)
  - a. The actuarial expert should perform a “ground up” actuarial review of case and incurred but not reported reserves with particular focus on any long tail claims. The actuarial expert should also opine on:
    - i. Methodologies used by the insurer to estimate reserves
    - ii. The adequacy of reserves on a gross and net of reinsurance basis
    - iii. The insurer’s economic approach to funding the run-off liabilities, including cash flow model stress tests
  - b. If reserve discounting is permitted, funding of the discount and the adequacy of reserves net of discount
    - i. The adequacy of the expertise of the insurer’s claims unit.
  - c. Ascertain that the initial plan allows sufficient capacity for material adverse reserve development.
2. **Determine impact based on an independent actuarial and capital review:**
  - a. Based on review of the reserves and capital (e.g. RBC) before and after the transaction, are all the policyholders, claimants and other stakeholders in the same or better condition after the proposed transaction? (Sources UK Part VII PRA practice concept and Foundational principles)
3. **Analysis of Reinsurance - independent reinsurance experts**
  - a. An analysis of reinsurance recoverables by a qualified expert including: (Source - 1997 R-WP, App. 2)
    - i. A review of the process used to monitor, collect and settle outstanding reinsurance recoverables

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- ii. An analysis of existing and projected reinsurance balances including the expected timing of cash flows
  - iii. An analysis of the quality and financial condition of the reinsurers and prospects for recovery
  - iv. A detailed description of write offs or required reserves based on the independent analysis taken as a whole
  - v. Disclosure of material disputes related to reinsurance balances and the potential impact of resolving those disputes
  - vi. A discussion of the impact of the IBT or Corporate Division on the collectibility of reinsurance balances
- b. A legal analysis of the effect that a rehabilitation or liquidation proceeding involving the restructured entity would have on the timing and amounts of reinsurance recoverables and on the legal rights of the reinsurers to claim setoffs against such recoveries.
- c. If reinsurance stop loss or excess of loss coverage is an integral part of the transaction, a copy of such agreement(s) and a written opinion from a qualified expert as to:
- i. The adequacy of coverage
  - ii. The ability of the treaty to perform as anticipated and be unaffected by delinquency proceedings
  - iii. The practical operation of the treaty
  - iv. The timing and method of payment of reinsurance premium
  - v. The financial condition of reinsurers
  - vi. The sufficiency of coverage and other resources.
- d. A discussion of existing or proposed reinsurance programs, whether with affiliates or other reinsurers, to assist the regulatory authority in determining that provisions are consistent with other information provided and that adequate coverage exists for both on going and run-off operations.
- e. Any proposed amended, cancelled, or new pooling agreements, including explanations of significant differences before and after the restructuring or transfer, flowcharts to demonstrate the proposed movement of business, and the anticipated financial impact upon the affected companies.
4. **Analysis of Liabilities other than Reserves** (Source - 1997 Restructure White Paper Appendix 2)

The regulator or its independent experts should conduct an analysis of material liabilities other than reserves, including a discussion about any reallocations or dispositions as part of the IBT or Corporate Division, especially as they relate to reinsurance agreements and inter-company cost and tax-sharing

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agreements. The analysis should include all non-reserve related accruals and outstanding debt line items found on the Statutory Annual Statement (page 3) for liabilities, including write-ins.

- a. Identification of any key concerns about potential legal decisions and/or pending verdicts that would substantially increase the expected aggregate liabilities (Source - RI Procedures)
  - i. Potential political or currency risks
  - ii. Potential “Black Swan” events (unusual and or infrequent)
  - iii. Potential sources of “hidden” or unknown liabilities – for example, unintended latent liability coverage, unintended extra-contractual obligations, unidentified or reinstated policies, quality of policy record keeping
  - iv. Risks related to the use of, or changes to the use of, outsourcing for claims management, asset management, or other administrative functions
  - v. Reliance on legal advice concerning claim liabilities

### 5. Analysis of Assets

The regulator or its independent experts should conduct an analysis of assets to determine if existing assets and future cash flows are sufficient to fund liabilities. This analysis should include:

(Source - 1997 R-WP, App. 2)

- a. Disclosure of assumptions regarding the assets of the insurer(s) involved in the IBT or corporate division, especially those assets with high volatility, liquidity uncertainties, material valuation issues, or representing a material percentage of the invested asset portfolio.
- b. Current appraisals of any material real estate or mortgage holdings, independent valuation of limited partnerships, certain privately traded investments, highly volatile collateralized mortgage obligations, structured securities, and any other assets of concern.
- c. A list of assumptions used by the insurer(s) as to investment yield, and disclosure of the effect that the reallocation of assets will have on historical investment yields.
- d. If the asset analysis performed of the insurer indicates a potential asset/liability matching problem, documentation that the insurer plans to act such as:
  - i. Reallocation of problem assets to other parts of the organizational structure that are financially capable of absorbing the additional risk
  - ii. Securing a parental guarantee of investment yield
  - iii. Securing a parental guarantee of asset valuation or a parental agreement to substitute the insurer’s assets
  - iv. Disposing of assets and replacement of better-quality assets or cash prior to approval of the IBT

## **Section VII – Analysis of Issues Affecting Policyholders, Claimants and other Stakeholders**

### **1. Legal clauses**

- a. Consider whether to require that “cut through” provisions be put in place for policyholders of the weaker entity. (Source - 1997 R-WP, App. 2)

### **2. Legal opinion**

- a. Obtain a legal opinion that policyholders and other key stakeholders of restructured entities will not lose guaranty fund coverage as a result of the IBT.

### **3. Consideration of rights of policyholders and other key stakeholders in other jurisdictions**

- a. Consider whether to require that a mechanism be put in place to obtain policyholder consent regarding any novations.
- b. Preserve rights of policyholders and other key stakeholders regarding secondary market mechanisms protections.

## **Section VIII – Due Process Communication of Transaction**

Robust due process must be afforded to stakeholders (policyholders, claimants, reinsurers, guaranty associations including other regulators, etc.) impacted by a transaction in advance of any public hearing along with access to information concerning the transaction. The following procedures are intended to address the risk of inadequate communication to various Stakeholders.

### **1. Review proposed communication plan**

The Regulator will review the proposed communication plan to ensure that the transaction is described in enough detail and provides enough time for a person to determine if they will be adversely impacted (Source - 1,3, UK Part VII PRA practices)

### **2. Communication to Policyholders, claimants and other stakeholders**

For the state of domicile of the transferor, or the entity requesting the corporate division, develop and document a plan and corresponding communication to various impacted stakeholders regarding a review of the proposed transaction by an independent external expert. Policyholders, claimants and other affected Stakeholders should always be given notice, access to all information needed to meaningfully review a proposed transaction, and an opportunity to be heard in court (IBT) or at the public hearing for a corporate division. (Source - UK Part VII PRA practices)

- a. Notice to stakeholders in a form to be approved by the regulator including:
  - i. Policyholders
  - ii. Claimants and their counsel of record
  - iii. Reinsurers



- iv. Other Stakeholders
- v. Adequate time to assess the impact as determined by the domestic regulator, but no less than 30 days and
- vi. Opportunity to submit written comments and or attend public hearings
- vii. Public hearing

### 3. **Notify/Coordinate with Affected Regulators**

The domiciliary regulator should communicate with other affected regulators regarding the transaction. Also, the process should require approval or non-objection of all affected states and the resulting entities should be licensed in all states needed so as not to impair policyholders' access to their state guaranty associations.

- a. Adequate time to assess the impact; and
- b. Opportunity to submit written comments and or attend public hearings.

## **Section IX - Guaranty Fund and Other secondary Market Considerations**

### 1. **Guaranty Fund Coverage**

No impacted policyholder should lose guaranty fund protection as a result of a transaction. (Sources: 1, 2)

- a. Where there was guaranty fund coverage before the division or IBT, state regulators should ensure that there is coverage after the division or IBT. A division or IBT should not reduce, eliminate or in any way impact guaranty fund coverage. Guaranty fund representatives and National Conference of Insurance Guaranty Funds (NCIGF) are a good resource for any guaranty fund coverage issues that arise in evaluating these transactions.

#### ***Drafting Note:***

*National Conference of Insurance Guaranty Funds (NCIGF) commented that changes to existing Guaranty Fund models maybe needed and will appoint a subcommittee to assist. The Restructuring Mechanisms (E) Working Group has made a referral to the Receivership and Insolvency (E) Task Force.*

### 2. **Secondary Market Mechanisms**

(Source: 6)

- a. Where there was secondary market or similar mechanisms which benefited the policyholders or otherwise accrued to the claims of policies, before the division or IBT, state regulators should ensure that the benefits remain after the division or IBT. A division or IBT should not reduce, eliminate or in any way impact coverage benefits.
- b. Other organizations such as the National Workers Compensation Reinsurance Association should be contacted, when relevant. (Source 11)

## Section X - Run-off Procedures

Most insurers have some amount of business that was written in prior years which is no longer being sold. To the extent the amount of such business is material for an insurer, it's not uncommon for the domestic state to perform separate procedures on such business. Such separate procedures are very common to the extent the insurer was performing so poorly that the company was put into supervisory control by the state of domicile, in which case it would be applied to the entire insurer. For other insurers, it may only apply to certain aspects of the company's operations. Run-off can also occur as a result of an IBT which transfers part of the business of one insurer (transferor) to a second another (transferee) or a corporate division transaction where one insurer divides into two or more resulting insurers. In all these situations the run-off is occurring on an involuntary basis and should be subject to the following regulatory guidance as a baseline of guidance to be used by all states. States can perform additional procedures beyond those listed, but these would be considered appropriate for all IBT, corporate division transactions, and other transactions where run-off is involuntary.

1. **Review the required documented run-off plan:** (Source - 1997 Restructure White Paper)
  - a. Review the monthly financial reporting of the run-off (claims development on a direct, ceded and net basis), actual vs projected results and the following related information:
    - i. Assumptions or material changes in assumptions regarding the assets included in the plan including specifically those that are subject to greater volatility, liquidity uncertainty, valuation issues, appraisals on material real estate and mortgage holdings
    - ii. Material disputes with reinsurers or other third parties
  - b. Reinsurance stop-loss plan and written opinion from qualified expert as to:
    - i. Adequacy of the coverages
    - ii. Ability of the plan to perform as anticipated
    - iii. Practical operation of the plan
    - iv. Timing and method of payment of the reinsurance premiums
    - v. Financial condition of the reinsurers
- b. **Require as part of the approval of the run-off plan the following:**
  - i. Pre-approval of any new reinsurance agreements or change in existing reinsurance agreements
  - ii. Pre-approval of any change in the daily operations of the company's existing practices including claims paying, investments practices and collections (e.g. reinsurance processes)
  - iii. Pre-approval of any affiliated transactions

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- iv. Pre-approval of any commutation of liabilities (inward or outward)
- b. For Run off plans Consider Subjecting to pre-approval all the following other items:
  - i. Dividends (including ordinary)
  - ii. Disposal or encumbrances of assets
  - iii. Withdrawal of bank accounts
  - iv. Lending of any funds
  - v. Transfer of property
  - vi. Incurring any debt, obligation or liability
  - vii. Terminate, surrender, forfeit, convert, or lapse any insurance policy, certificate or contract
  - viii. Reserves to be held lower than 99.5% for a 1-year period (non-life) or conditional tail expectation (CTE) of 90 (Source - 1997 Restructure White Paper)
- a. Reinsurance stop-loss plan and written opinion from qualified expert as to:
  - i. Adequacy of the coverages
  - ii. Ability of the plan to perform as anticipated
  - iii. Practical operation of the plan
  - iv. Timing and method of payment of the reinsurance premiums
  - v. Financial condition of the reinsurers (Source -1997 Restructure White Paper)

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### Table of Sources

Reference	Source
1	American Property Casualty Insurance Association (APCIA) suggested concepts
2	National Conference of Insurance Guaranty Funds (NCIGF)
3	Prudential Regulation Authority (PRA)/Financial Conduct Authority (FCA) – UK part 7
4	Laws or procedures in Rhode Island
5	Corporate Division comment letter 7-24-29, (Athene, John Hancock TransAmerica Venerable) referencing Michigan Corporate Division law
6	Illinois Corporate Division example
7	Comment letter New York Life and Northwestern Mutual on restructuring charges
8	IBT Coalition comment letter
9	NAIC Form A User's guide
10	IL Code (215 ILCS 5/Art. IIB heading) Article IIB. Domestic Stock Company Division
11	National Workers Compensation Reinsurance Association comment letter to SG

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**GLOSSARY OF TERMS**

(Related to the Form A System)

Term	Description
Affiliate	An “affiliate” of, or person “affiliated” with, a specific person is a person who directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.
Applicant (Information)	The applicant is the company or individual wishing to acquire a domestic insurer. When entering applicant information, one or the other may be entered but not both a company name and individual name.
Application Status	The application status may be any one of the following: Approved, Approved with Stipulation, Transaction Closed, Transaction Not Closed, Denied or Withdrawn. Submitted, Under Review, and Withdrawn.
CoCode	CoCode is the company code number assigned to the insurer by the NAIC.
Comments	Comments are a list of statements regarding the filing.
Company	A company is an applicant or entity that is other than an individual.
Contact Name	The contact name is the initial contact person at the state of domicile. The state contact person is the department staff, usually an analyst, serving as the primary liaison between the applicant, domestic insurer and other states.
Directors	Directors are the individuals who sit on the board of directors governing the applicant (company).
Domestic Insurer	The domestic insurer is the company being acquired or merged. The term insurer shall have the same meaning as set for within each state’s insurance code. Domestic insurer means an insurer domiciled in the respective state (e.g., a TX domestic insurer is licensed and domiciled in the state of Texas).
Domicile State Information	Domicile state information is information regarding the initial contact person at the state of domicile.
Entity	An entity is any person, company or organization related to the filing or having an interest in the filing. Entity types are as follows: applicant, affiliate, company, director, key party, officer and shareholder.
Filing Number	The filing number is a tracking number assigned a Form A filing only after the filing is saved by the Form A system.
Group Code	The group code is a unique three- to five-digit number assigned by the NAIC to identify those companies that are part of a larger group of insurance
“Independent Consultant” (Source: 4- RI Law IBT)	An impartial person who has no financial interest in either the Assuming Company or Transferring Company, has not been employed by or acted as a consultant or other independent contractor for either the Assuming Company or Transferring Company within the past twenty-four (24) months and is receiving no compensation in connection with the transaction governed by this regulation other than a fee premised on a fixed or hourly basis.

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Key Party	This category is included to allow a state to provide information on any “other parties” outside of those listed herein with a significant stake or involvement in the merger or acquisition. Such parties might include CPA firms, actuarial firms, law firms, other consultants, etc.
Lead State	The lead state is the state that may be coordinating a multi-state filing or consolidated hearing process. It may not necessarily be the lead state of a group, if that lead state is not party of the acquisition.
Officers	Officers are individuals who serve as an executive officer for the applicant (e.g., CEO, CFO, COO, etc.).
Shareholder	A shareholder is an individual who owns voting securities of the applicant. Generally speaking, the Form A requests information on only those owners/shareholders of 10% or more of the voting securities of the applicant.
State of Domicile	The state of domicile is the state where a company’s domiciliary regulator is. Typically the state of incorporation.
Transferring Company (Source: 4- RI Law IBT)	A company that transfers a part or all of its commercial insurance or reinsurance business to an Assuming Company pursuant to an Insurance Business Transfer Plan.

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## NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

### MEMORANDUM

TO: David Smith (VA) and Doug Stolte (VA), Co-Chairs of the Restructuring Mechanisms (E) Subgroup  
Judith L. French (OH), Chair of the Capital Adequacy (E) Task Force

FROM: Tom Botsko (OH), Chair of the Property and Casualty Risk-Based Capital (E) Working Group

DATE: Oct. 25, 2021

RE: Response to Request for Input Regarding Runoff Companies

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The Property and Casualty Risk-Based Capital (E) Working Group formed a small ad hoc group to discuss this topic and try to determine the best course of action. The Restructuring Mechanisms (E) Subgroup requested that the Working Group take the lead in addressing the charge to “consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff. “

After several discussions about what adjustments should be made to the risk-based capital (RBC) formula, the ad hoc group concluded that the best course of action is to monitor these companies through the state analysis and exam team functions. The characteristics and financial conditions of these runoff companies are very diverse, and it would be difficult to incorporate these varied characteristics into one adjusted formula. Many international countries monitor these companies through the analysis and exam processes and do not have a separate RBC formula.

Of the 2020 RBC filers, we identified 111 companies out of 2,477 that have the characteristics of a runoff company. Most of these companies have an RBC ratio greater than 300%. Five are below 200%.

During a series of discussions, the ad hoc group agreed that a runoff company, voluntary or involuntary, should include the following characteristics: 1) no renewing of policies for at least 12 months; 2) no new direct or new assumed business; and 3) no additional runoff blocks of business. In addition, the amount of renewal premium to reserves has also been identified as a characteristic of these types of companies when this ratio is de minimis.

The ad hoc group also recommends that a general and RBC interrogatory be added for the purpose of identifying a runoff company. The domiciliary state shall have the ability to verify the interrogatory response during the annual company financial analysis process.

As the ad hoc group considered various types and conditions of runoff companies, it became apparent that while many of these companies share the characteristic of very long tail liabilities, there are other characteristics of these companies that are so diverse that it made it difficult to summarize them into their own RBC formula.

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## NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

The ad hoc group reviewed several international perspectives of runoff companies. The international treatment of runoff companies is handled through the Analysis and Exam Teams. The ad hoc group agrees that a similar treatment of runoff companies is warranted.

The ad hoc group has some recommendations for the Working Group regarding the RBC instructions, specifically to the runoff companies. These include the following:

- Remove the Trend Test from the RBC calculation. These are runoff companies, and the possible retrospective premium should not complicate the already diverse situation.
- Remove the charge for premium growth if the company is no longer writing business.
- Remove  $R_{cat}$  from the formula. Because one of the characteristics of a runoff company is to not have written any new business for at least 12 months, we believe this short-term liability risk is not warranted.

As the ad hoc group shares its findings with the other two RBC working groups, we expect to hear other perspectives regarding the unique conditions of runoff companies from the Life Risk-Based Capital (E) Working Group and the Health Risk-Based Capital (E) Working Group.

Please contact Eva Yeung, NAIC staff support for the Property and Casualty Risk-Based Capital (E) Working Group, at [eyeung@naic.org](mailto:eyeung@naic.org) with any questions.

Cc: Robin Marcotte; Dan Daveline; Jane Barr; Eva Yeung

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