DRAFT 9/29/20

*WebEx Conference Call*

# RECEIVERSHIP LAW (E) WORKING GROUP
**Friday, October 23, 2020**
**2:00 p.m. Eastern / 1:00 p.m. Central / 12:00 p.m. Mountain / 11:00 a.m. Pacific**

## ROLL CALL

| | | | |
|---|---|---|---|
| Kevin Baldwin, Co-Chair | Illinois | Robert Wake | Maine |
| Laura Lyon Slaymaker, Co-Chair | Pennsylvania | Christopher Joyce | Massachusetts |
| Steve Uhrynowycz | Arkansas | James Gerber | Michigan |
| John Battle / Jack Hom | California | John Rehagen/Shelly Forrest | Missouri |
| Rolf Kaumann | Colorado | Justin Schrader | Nebraska |
| Jared Kosky | Connecticut | James Kennedy | Texas |
| Toma Wilkerson | Florida | Melanie Anderson | Washington |
| Kim Cross | Iowa | | |

NAIC Support Staff: Jane Koenigsman

## AGENDA

1. Discuss Comments Received on:
   a. Addressing Continuation of Essential Services in Receivership
   b. Updates to the *Receiver's Handbook for Insurance Company Insolvencies* for Qualified Financial Contracts —*Kevin Baldwin (IL)* and *Laura Lyon Slaymaker (PA)*

   - Original Exposure Requests — Attachment A
   - Combined Comments Received — Attachment B

2. Any Other Matters Brought Before the Working Group—*Laura Lyon Slaymaker (PA)*

3. Adjourn

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# ATTACHMENT A

Receivership Law (E) Working Group, Request for Comment:

Comments Due Thursday, Sept. 24, 2020

Send to Jane Koenigsman, NAIC Staff at jkoenigsman@naic.org

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On Aug. 25, 2020, the Receivership Law (E) Working Group requested comment from members, interested regulators and interested parties to gather ideas for recommendations to address the issue of continuation of essential services through affiliated intercompany agreements that arise during the receivership of an insurance company. Refer to the attached adopted Model Law Development Request for background information. Please provide comments in the following areas:

a. Recommendations for specific revisions to the Models 440 & 450 provisions to address this issue?
    - Models are available in the posted Aug. 25th call materials at https://content.naic.org/cmte_e_mlwg.htm, or at https://www.naic.org/prod_serv_model_laws.htm
b. Recommendations for other options outside of Models 440& 450 to resolve this issue?
c. What issues/challenges have you faced in this area that the Working Group should consider when working on recommendations?
    - If resolved, how did you resolve?
    - What would have been needed to resolve more efficiently or effectively?
d. Any hurdles or unintended consequences to be aware of?

# REQUEST FOR NAIC MODEL LAW DEVELOPMENT

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

**Please check whether this is:** ☐ **New Model Law** **or** ☒ **Amendment to Existing Model**

**1. Name of group to be responsible for drafting the model:**

Receivership Law (E) Working Group

**2. NAIC staff support contact information:**

Jane Koenigsman
jkoenigsman@naic.org
816-783-8145

**3. Please provide a brief description of the proposed new model or the amendment(s) to the existing model. If you are proposing a new model, please also provide a proposed title. If an existing model law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.**

- ***Insurance Holding Company System Regulatory Act (#440)***
- ***Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)***

In 2018 the Financial Stability (EX) Task Force made a referral to the Receivership and Insolvency (E) Task Force as part of the Macro Prudential Initiative (MPI). At the 2019 Summer National Meeting, the Receivership and Insolvency (E) Task Force adopted a report including recommendations to address receivership powers that are implicit in state laws, rather than explicit. One such area is the power to ensure the continuity of essential services and functions within a holding company group once an insurer is placed into receivership.

The Financial Stability Board's (FSB) Key Attributes (KAs) of Effective Resolution Regimes for Financial Institutions KA 3.2 states that a resolution authority should have the power to ensure the continuity of essential services and functions by requiring companies in the group to continue providing services. Under Common Framework for the supervision of Internationally Active Insurance Groups (ComFrame) (CF 12.7a), a resolution authority may take steps to provide continuity of essential services by requiring other entities within the IAIG (including non-regulated entities) to continue services. The Task Force identified the following authority and remedies available within the US regime related to these international standards:

- The *Insurance Holding Company System Model Act* (#440) requires approval of affiliated transactions, allowing a regulator to identify agreements that could create obstacles in a receivership. The *Insurance Holding Company System Model Regulation* (#450), Section 19, provides that cost sharing and management agreements specify if the insurer is placed in receivership that an affiliate has no automatic right to terminate the agreement.
- The Receiver can take action against a provider that refuses to continue services under a contract, or seek an order requiring it to turn over records. If an affiliate providing services is inextricably intertwined with the insurer, the Receiver could also seek to place the affiliate into receivership.

However, it was noted that some of these authorities and remedies may not address the immediate need to continue services in some receiverships. Despite these available remedies, receivers continue to be challenged by this issue in receivership, often resulting in significant additional legal and administrative expenses to the receivership estate.

One potential solution is to revise the definition of "insurer" under state insurance holding company laws to encompass affiliated entities whose sole purpose is to provide services to the insurer.

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The NAIC adopted 2020 charges for the Receivership Law (E) Working Group to: "Review and provide recommendations for remedies to ensure continuity of essential services and functions to an insurer in receivership by affiliated entities, including non-regulated entities. Consult with the Group Solvency Issues (E) Working Group as the topic relates to affiliated intercompany agreements."

Scope of the Proposed Revisions to Models 440 and 450

The scope of the request is limited to addressing the issue of continuation of essential services through affiliated intercompany agreements that arise during the receivership of an insurance company. The Receivership Law (E) Working Group under the Receivership and Insolvency (E) Task Force would complete the review and recommend proposed revisions. Revisions may be necessary to the following sections of Models 440 and 450 including, but not limited to:

- Model 440 Section 1. Definitions
- Model 440 Section 5. Standards and Management of an Insurer Within an Insurance Holding Company System
- Model 440 Section 12. Receivership

Model 450. Consistency with any revisions to Model 440

**4. Does the model law meet the Model Law Criteria?** ☒ **Yes** **or** ☐ **No** **(Check one)**

**(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).**

**a. Does the subject of the model law necessitate a national standard and require uniformity amongst all states?** ☒ **Yes** **or** ☐ **No** **(Check one)**

**If yes, please explain why:**

While this change is being made in connection with the NAICs Macro Prudential Initiative, most important is that such changes are needed to address the challenges receivers continue to encounter in the area of continuation services which often result in significant additional legal and administrative expenses to the receivership estate and all members of the Task Force supported this request.

**b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law?**

☒ **Yes** **or** ☐ **No** **(Check one)**

**5. What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?**

☒ **1** ☐ **2** ☐ **3** ☐ **4** ☐ **5** **(Check one)**

**High Likelihood** **Low Likelihood**

**Explanation, if necessary:**

**6. What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?**

☒ **1** ☐ **2** ☐ **3** ☐ **4** ☐ **5** **(Check one)**

**High Likelihood** **Low Likelihood**

**Explanation, if necessary:** See previous discussion.

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**7. What is the likelihood that state legislatures will adopt the model law in a uniform manner within three years of adoption by the NAIC?**

☒ **1** ☐ **2** ☐ **3** ☐ **4** ☐ **5** **(Check one)**

**High Likelihood** **Low Likelihood**

**Explanation, if necessary:**

At this juncture, the changes in concepts being considered are simple and because they have the potential to reduce expenses incurred by receivership estates, we believe such changes will be widely supported by all parties.

**8. Is this model law referenced in the NAIC Accreditation Standards? If so, does the standard require the model law to be adopted in a substantially similar manner?**

The *Insurance Holding Company System Model Act* (#440) is an Accreditation Standard but the task force has not yet considered whether this should become part of the required elements of that specific standard. However, given the potential the changes have in reducing the cost of regulation under receiverships, a national standard is likely appropriate.

**9. Is this model law in response to or impacted by federal laws or regulations? If yes, please explain.**

No.

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## Receivership Law (E) Working Group

## Request for Comment: *Receivers Handbook for Insurance Company Insolvencies*

## Comments Due Thursday, Sept. 24, 2020

## Send to Jane Koenigsman, NAIC Staff at jkoenigsman@naic.org

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On Aug. 25, 2020, the Receivership Law (E) Working Group requested comment from members, interested regulators and interested parties on qualified financial contract (QFC) guidance in the *Receivers Handbook for Insurance Company Insolvencies,* and the use of bridge financial institutions for handling QFCs in an advance planning or pre-receivership process. Refer to the attached Chapters 4 and 11. Please provide comments in the following areas:

Chapter 4 - QFCs

a. Comments on proposed edits to Chapter 4
b. Additional recommended edits to Chapter 4.
c. Recommendations for additional edits for:
   - Guidance where insurers do not directly hold the QFC but rather are in contracts with a market facing third party that holds the QFC.
   - Guidance for pre-receivership advance planning for QFCs.

Chapter 11 – Bridge Financial Institutions

d. Consider the use of bridge financial institutions outside of the Dodd Frank Receivership of a systemically important financial institution (SIFI) in addressing QFCs in receivership. Do you feel there would be a use for bridge financial institution outside of a Dodd Frank Receivership? If so, is the guidance in Chapter 11 applicable and useful for receivers in that context?
e. Comments and any recommended edits on this topic within Chapter 11.

## CHAPTER 4 – INVESTIGATION AND ASSET RECOVERY

*************************TEXT NOT SHOWN TO CONSERVE SPACE******************************

### VII. RECEIVERSHIP INVOLIVNG QUALIFIED FINANCIAL CONTRACTS

Insurer receivership Model Act (#555, commonly known as IRMA) Section 711 – Qualified Financial Contracts (or Similar Provision)

When financial markets are uncertain, it causes heightened scrutiny in the capital markets and among financial institutions about identifying, managing and limiting risk, as well as the need for adequate capitalization and for understanding the interdependency of the different financial sectors. One source of risk to financial market participants that rises due to the lack of certainty in the financial markets is the treatment of qualified financial contracts (QFC) and netting agreements in the event of the insolvency of state regulated insurers.

#### A. Definition of Qualified Financial Contract

IRMA defines a QFC as "any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement and any similar agreement that the commissioner determines by regulation, resolution or order, to be a qualified financial contract for purposes of this Act."

- Commodity contract is defined by reference to the Commodity Exchange Act (7 U.S.C. § 1) (Commodity Act) and is a contract for the purchase or sale of a commodity for future delivery on or subject to the rules of a board of trade or contract market subject to the Commodity Act; an agreement that is subject to regulation under Section 19 of the Commodity Act commonly known as a margin account, margin contract, leverage account or leverage contract; an agreement or transaction subject to regulation under Section 4(b) of the Commodity Act that is commonly known as a commodity option; any combination of these agreements or transactions and any option to enter into these agreements or transactions.

- Forward Contract, Repurchase Agreement, Securities Contract and Swap Agreement shall have the meanings set forth in the Federal Deposit Insurance Act, 12 U.S.C. § 1281(e)(8)(D), as amended from time to time.

It should be noted that an insurance contract is not a derivative or a qualified financial contract because an insurance contract includes the indemnification against loss. Therefore, reinsurance agreements would not be considered a swap agreement.

#### B. Insolvency Treatment of QFCs under the IRMA Section 711 Provision

IRMA Section 711 provides a safe harbor for QFC counterparties of a domestic insurer. The provision largely tracks similar provisions in the Federal Bankruptcy Code and the Federal Deposit Insurance Act (FDIA), as well as laws of other foreign jurisdictions. These safe harbor provisions for QFCs were adopted to avoid disruptions resulting from judicial intervention that can cause unintended chain reactions and significant systemic impact. Section 711 applies in both Rehabilitation and Liquidation proceedings.

Section 711 states that a right to terminate or liquidate or accelerate a closeout under a netting agreement or a QFC with an insurer either due to the insolvency, financial condition or default of the insurer or the commencement of a formal delinquency proceeding is not prevented by any other

provision of IRMA. Section 711 allows a counterparty to net different contracts and realize on collateral without a stay[1].

Section 711 addresses transfer of a netting agreement or QFC of an insurer to another party. In a transfer, the receiver has to transfer all of the netting agreement or QFC and all of the property and credit enhancements securing claims under the agreement or QFC. This prevents "cherry picking" and requires the transfer of everything, i.e., all of both the "in-the-money" and "out-of-the-money" positions.

### C. Considerations of QFCs held by an Insurer Receivership:

- Although the Investments of Insurers Model Act (either Defined Limits or Defined Standards) (#280) does not include limits on the amount of collateral an insurer is allowed to post, some states have restrictions on derivatives use, including quantitative limits, and limits on the pledging of collateral, based on type and credit quality. The receiver may also need to determine if a derivative use plan, if required, is in effect and if it dictates any collateral requirements.

- If the ability to net exists and there is no stay requirement, it is important that the regulator understand the QFC portfolio before the insurer's failure, either through a recent or ongoing financial examination or through an assessment made during regulatory supervision that precedes a receivership order, while recognizing that the market value of the derivatives positions can vary substantially over relatively short periods of time. The receiver also needs to have a good understanding of the relationship of the QFC contracts to the rest of the insurer's balance sheet.

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[1] Except where the state has adopted *Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts (*#1556).

**Guideline #1556 Drafting Note:** State receivership and insolvency laws may permit a contractual right to cause the termination, liquidation, acceleration or close-out obligations with respect to any netting agreement or qualified financial contract (QFC) with an insurer because of the insolvency, financial condition or default of the insurer, or the commencement of a formal delinquency proceeding. These laws are based upon similar provisions contained in the federal bankruptcy code and the Federal Deposit Insurance Act (FDIA). The FDIA also provides for a twenty-four-hour stay to allow for the transfer of QFCs by the receiver to another entity rather than permitting the immediate termination and netting of the QFC. 12 U.S.C. § 1821(e)(9)-(12). States that permit the termination and netting of QFCs may want to consider adopting a similar stay provision following the appointment of a receiver.

States that consider the enactment of a stay should take into account the relevant federal rules. In 2017 the Board of Governors of the Federal Reserve System (the Federal Reserve), the Federal Deposit Insurance Corporation (the FDIC) and the Office of the Comptroller of the Currency (the OCC) each adopted final rules and accompanying interpretive guidance (Final Rules) setting forth limitations to be placed on parties to certain financial contracts exercising insolvency-related default rights against their counterparties that have been designated as a global systemically important banking organization (GSIB). The Final Rules include the definition of master netting agreement that allows netting even though termination of the transaction in the event of an insolvency may be subject to a "stay" under several defined resolution regimes including Title II of Dodd Frank, the FDIA, as well as comparable foreign resolution regimes. Notwithstanding NAIC's request for inclusion, stays under the state insurance receivership regime (State Receivership Stays) were not included as an exemption within the definition. Therefore, unless the Final Rules are amended to recognize State Receivership Stays, if a state implements a stay as contemplated by the Guideline, insurers would find themselves disadvantaged, potentially resulting in additional costs and/or collateral requirements given the regulatory treatment for contracts that do not meet requirements for QFCs. Therefore, if a state is considering implementation of this Guideline, consideration should be given to whether the rules of the Federal Reserve, FDIC and OCC have been amended to recognize State Receivership Stays. For example, a state could adopt a stay that would be effective if and when the Final Rules recognize State Receivership Stays.

**References:** *Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 FR 42882 (13 November 2017), available at https://www.federalregister.gov/d/2017-19053; *Restrictions on Qualified Financial Contracts of Certain FDIC Supervised Institutions*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 FR 50228 (30 October 2017), available at https://www.federalregister.gov/d/2017-21951; *Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definition, 82 FR 61443 (28 December 2017), available at https://www.federalregister.gov/d/2017-27971; *Mandatory Contractual Stay Requirements for Qualified Financial Contracts*, 82 FR 56630 (29 November 2017), available at https://www.federalregister.gov/d/2017-25529.

Because most derivatives transactions are used for hedging purposes, if those contracts are terminated as a result of netting, the assets and liabilities will no longer be hedged.

- The receiver should be aware that there may be areas of contention and disagreement by parties in the netting, termination and closeout of QFC agreements—for example, disagreement over the valuation or in the resolution of transactions where the parties wait too long to terminate the contract.

- Some counterparties may have been accepting less liquid assets such as private placements based on the relative financial strength of the insurance company; typically, collateral for a QFC will be cash and U.S. Treasury bonds. The moving of over-the-counter (OTC) derivatives to centralized clearinghouses will gradually eliminate less liquid assets as well as assets with more volatile market values being used as collateral. It is also worth noting that it is possible to have non-admitted assets eligible as collateral. Where assets exceed concentration limits, the excess can be collateral without being an admitted asset.

- The impact of central clearinghouses (CCH) will be to standardize documentation and collateral requirements. The standard rules for collateral will be more restrictive and be applicable to all parties. These rules will generally allow for only high-quality assets that are more liquid and are expected to have less market value volatility. In addition, all parties will be subject to the same rules for both Initial Margin and Variation Margin. In the past, it was not uncommon for counterparties to not require Initial Margin from their higher quality clients. This will not be the case going forward. Even for derivatives transactions that do not go through central clearing, bank counterparties are facing more stringent capital requirements themselves if their exposures are not properly collateralized.

**D. Recommended Procedures for State Insurance Regulators/Receivers:**

To the extent possible, in a pre-receivership situation:

- To the extent a company has a small number of large QFC contracts that are important to the overall investment portfolio and operations of the insurer, in pre-receivership and in rehabilitation, the state regulator or receiver should reach out to the counterparty to determine if the counterparty is agreeable to continuing the contract and performing on the contract when the insurer enters receivership.

- Consider practical strategies for successfully managing the netting agreements and QFCs, not only at the inception of the receivership but ongoing during the receivership process.

- The receiver should evaluate the netting agreements and QFCs to gaining an understanding of the triggers for an event of default within the contract (e.g., filing of action, judicial finding, rehabilitation vs. liquidation, or fact of insolvency, etc.).

- Consider the applicability of any federal master netting agreement rules and regulations to the insurer's netting agreements and QFCs. (see the references to applicable federal rules in the preceding footnote in this Chapter [2]).

- Evaluate the need to consider the use of a bridge financial institution to transfer and manage the netting agreements and QFCs in a pre-receivership proceeding (i.e. administrative supervision). See Chapter 11–State Implementation of Dodd-Frank Receivership of this Handbook for guidance on the use of bridge financial institutions for a Dodd-Frank receivership.

[2] See footnote 1 of this Chapter.

- Carefully review the most recent financial statement filings and interim company records to identify the netting agreements and QFCs active at the time of receivership; understand the terms of the agreements and the valuation of the QFCs; and identify the securities held as collateral and counterparties to the contract. See Appendix for a Summary of Statutory Annual Statement Reporting of QFCs or the most current Statutory Annual Financial Statement and Instructions.

Once a rehabilitation or liquidation order has been entered:

- Provide notice of the receivership to counterparties, as appropriate under state law.

- Consider implementing a 24-hour stay on termination of netting agreements and QFCs, if allowed under state law. (See *Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts* [#1556] and accompanying drafting note in the preceding footnote in this Chapter[3].

- It is important for the receiver to keep track of which transactions have been terminated validly and which have not so that appropriate action can be taken when the validity of the termination is contested.

- Once the set off has occurred, if the receiver disagrees with the counterparties' valuation of either the collateral or the QFC transaction, the receiver would take the next steps to try to negotiate the correct amount and if unsuccessful pursue legal action.

- Consider engaging an investment expert to assist in the auditing, investigating and management of the netting agreements and QFCs within the investment portfolio. Refer to Chapter 3.VI of this Handbook for more guidance on auditing and investigating the investments of the receivership estate

## E. Exhibit – Qualified Financial Contract Annual Statement Reporting (As of 2020~~13~~)

The subsequent information provides a general description of how and where qualified financial contracts (QFCs) are reported within the *Accounting Practices and Procedures Manual* and the statutory financial statements.

Derivative Instruments—AP&P Disclosure

- Statement of Statutory Accounting Principles (SSAP) No. 27—*Off Balance Sheet and Credit Risk Disclosures~~ of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk~~*
- SSAP No. 86—~~*Accounting for*~~ *Derivatives~~ Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions~~*
- SSAP No. 108—*Derivatives Hedging Variable Annuity Guarantees*

Derivative Instruments—Annual Statement Disclosure

- Schedule DB – Part A, Section 1 – *Open Options, Caps, Floors, Collars, Swaps, ~~Swaptions~~ and Forwards*
- Schedule DB – Part B, Section 1 – *Open Future Contracts*
    - Within Part A and Part B, section 1 identifies the contracts open as of the accounting date, and section 2 identifies contracts terminated during the year.

Schedule DB – Part C – *Replication (Synthetic Asset) Transactions ~~(RSAT)~~*

Section 1 contains the underlying detail of replicated assets open~~wned~~ at the end of the year. Section 2 is reconciliation between years of replicated assets.

- Schedule DB – Part D, Section 1 – *Counterparty Exposure for Derivative Instruments Open*
- Schedule DB – Part D, Section 2 – *Collateral for Derivative Instruments Open*
- Schedule DB – Part E – *Derivative Hedging Variable Annuity Guarantees*

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[3] See footnote 1 of this Chapter.

- Specific to derivatives and hedging programs under SSAP No. 108)
- Schedule DL – Part 1 & 2 – *Securities Lending Collateral Assets*
- Notes to Financial Statement – *Investments*
- Notes to Financial Statement – *Derivative Instruments*
- Notes to Financial Statement – *Debt (FHLB Funding Agreements)*
- Notes to Financial Statement – *Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk*
- Notes to Financial Statement – *Debt – FHLB Funding Agreements*
- Notes to Financial Statement – *Fair Value Measurements*
- Notes to Financial Statement – *Analysis of Annuity Actuarial Reserve and Deposit Liabilities by Withdrawal Characteristics – FHLB Funding Agreements*

On a quarterly basis, the insurer only reports derivative instruments that are open as of the current statement date. Schedule DB – Part A – Section 1 lists the insurer's open options, caps, floors, collars, swaps and forwards. Open futures are reported in Schedule DB – Part B – Section 1, replications are reported in Schedule DB – Part C – Section 1, and counterparty exposure for derivatives instruments are reported in Schedule DB – Part D.

Repurchase Agreements—AP&P Disclosure

- SSAP No. 103R—*Accounting for* *Transfers and Servicing of Financial Assets and ExtinguishmentsExtinguishing of Liabilities*

Repurchase Agreements—Annual Statement Disclosure

- Notes to Financial Statement– *Investments*
- Notes to Financial Statement – *Debt*
- Repurchase agreements are disclosed in various investment schedules within the Annual Financial Statement depending on the type of investment. (Schedule D, DA, E, Supplemental Investment Risk Interrogatories) The Investment Schedule General Instructions provides the following list of codes to use in the appropriate investment schedule code column regarding investments that are not under the exclusive control of the reporting entity, and also including assets loaned to others. For example, a bond subject to a repurchase agreement would be detailed in Schedule D Part 1 – *Long-Term Bonds Owned* and use a code of RA in Code Column.

Codes

LS – Loaned or leased to others
RA – Subject to repurchase agreement
RR – Subject to reverse repurchase agreement
DR – Subject to dollar repurchase agreement
DRR – Subject to dollar reverse repurchase agreement
C – Pledged as collateral – excluding collateral pledged to FHLB
CF – Pledged as collateral to FHLB (including assets backing funding agreements)
DB – Pledged under an option agreement
DBP – Pledged under an option agreement involving "asset transfers with put options"
R – Letter stock or otherwise restricted as to sale – excluding FHLB capital stock (Note: Private placements are not to be included unless specific restrictions as to sale are included as part of the security agreement.)
RF – FHLB capital stock
SD – Pledged on deposit with state or other regulatory body
M – Not under the exclusive control of the reporting entity for multiple reasons
SS – Short sale of a security
O – Other
LS – loaned or leased to others
RA – subject to repurchase agreement
RR – subject to reverse repurchase agreement
DR – subject to a dollar repurchase agreement
DRR – subject to a dollar reverse repurchase agreement

Repurchase Agreements—Annual Statement Disclosure

- Notes to Financial Statement – *Investments – Repurchase Agreements, Restricted Assets*

- ~~Notes to Financial Statement – *Sales, Transfer and Servicing of Financial Assets and Extinguishment of Liabilities*~~
  ~~General Interrogatory – *Investment*~~

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# I. INTRODUCTION

As extraordinarily remote a set of circumstances necessitating it may be, under § 203(e) of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act, 18 USC § 5383(e) (Dodd-Frank Act), state insurance Commissioners, their designated deputy receivers and Guaranty Funds are charged with the enormous responsibility of resolving a systemically important insurance company. Those circumstances by definition would be unique and extraordinary. The circumstances also by definition would bring enormous time pressure with high stakes for the U.S. economy and the policyholders and creditors of the particular insurance company in receivership. Responding to those unique challenges would require advanced planning and analysis, which this Chapter addresses, by describing four baseline implementation areas for Commissioners, deputy receivers and guaranty funds to consider.

After a general introduction to the Dodd-Frank insurance receivership framework, the analysis in this chapter focuses on the following considerations:

1) Establishing processes at the state level to ensure the state receivership mechanism will respond effectively to a Dodd-Frank receivership.

2) Analyzing and preparing for the situation in which an insurance company is a subsidiary or affiliate of a covered financial company.

3) Describing national coordination initiatives to ensure the national state-based systems provide further support to administering a Dodd-Frank receivership.

4) Developing state laws that will ensure that state mechanisms can effectively initiate and administer a Dodd-Frank receivership.

# II. OVERVIEW OF DODD-FRANK INSURANCE RECEIVERSHIP FRAMEWORK

The Dodd-Frank Act was enacted on July 21, 2010. [1] Title II of the Dodd-Frank Act[2] creates a new orderly liquidation authority (OLA) for the dissolution of failing systemically important financial companies and certain of their subsidiaries when certain conditions are found to exist. In addition to the overview below, the federal and state processes are summarized in flowcharts attached as Exhibits 11-A and 11-B.

The Dodd-Frank Act defines the term "financial company"[3] as any company incorporated or organized under federal or state law that is a bank holding company as defined in the federal Bank Holding Company Act of 1956 (BHCA)[4]; a nonbank financial company supervised by the Federal Reserve Board of Governors (Board); any company (other than an insured depository institution or a nonbank financial company supervised by the Board) that is predominantly engaged in activities that the Board has determined are financial in nature or incidental thereto for purposes of Section 4 (k) of the BHCA (which includes an insurance company)[5]; or any subsidiary of

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[1] Public Law 111-203, 12 U.S.C. 5301 *et seq.*

[2] §§ 201 to 217, 12 U.S.C. 5381 *et seq.*

[3] § 201(a)(11); 12 U.S.C. 5381(a)(11).

[4] 12 U.S.C. 1841(a).

[5] 12 U.S.C. 1843(k). Section 4(k)(4) of the BHCA (12 U.S.C. 1843(k)(4)) provides: "For purposes of this subsection, the following activities shall be considered to be financial in nature: …(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State…."

the foregoing that is "predominantly engaged" in activities that are financial in nature or incidental thereto for purposes of the BHCA, other than a subsidiary that is an insured depository institution or an insurance company.[6]

Under the OLA, the Federal Deposit Insurance Corporation (FDIC) may be appointed as receiver of a "covered financial company" for purposes of liquidating the company.[7] The Dodd-Frank Act defines the term "covered financial company"[8] as a financial company for which the Secretary of the Treasury (Secretary) in consultation with the President has made a determination under § 203(b).[9] However, if the financial company is an insurance

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[6] § 201(b) provides that no company may be deemed to be predominantly engaged in activities that are financial in nature or incidental to a financial activity unless the consolidated revenues of such company from such activities constitute at least 80% of the total consolidated revenues of such company, including any revenues attributable to a depository institution investment or subsidiary.

[7] Subject to certain exceptions (notably for insurance companies), the Dodd-Frank Act does not contemplate a receivership for the purpose of rehabilitation or reorganization. § 204(a) provides:

It is the purpose of this title to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard. The authority provided in this title shall be exercised in the manner that best fulfills such purpose, so that—

> (1) creditors and shareholders will bear the losses of the financial company;
>
> (2) management responsible for the condition of the financial company will not be retained; and
>
> (3) the Corporation and other appropriate agencies will take all steps necessary and appropriate to assure that all parties, including management, directors, and third parties, having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility.

[8] § 201(a)(9).

[9] § 203(b) (12 U.S.C. 5383(b)) provides:

> (b) DETERMINATION BY THE SECRETARY.—Notwithstanding any other provision of Federal or State law, the Secretary shall take action in accordance with section 202(a)(1)(A), if, upon the written recommendation under subsection (a), the Secretary (in consultation with the President) determines that—
>
> (1) the financial company is in default or in danger of default [see footnote 10];
>
> (2) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States;
>
> (3) no viable private sector alternative is available to prevent the default of the financial company;
>
> (4) any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants as a result of actions to be taken under this title is appropriate, given the impact that any action taken under this title would have on financial stability in the United States;
>
> (5) any action under section 204 would avoid or mitigate such adverse effects, taking into consideration the effectiveness of the action in mitigating potential adverse effects on the financial system, the cost to the general fund of the Treasury, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;
>
> (6) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and
>
> (7) the company satisfies the definition of a financial company under section 201.

§ 203(c)(4) (12 U.S.C. 5383(c)(4)) provides:

> (4) DEFAULT OR IN DANGER OF DEFAULT.—For purposes of this title, a financial company shall be considered to be in default or in danger of default if, as determined in accordance with subsection (b)—
>
> (A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;
>
> (B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
>
> (C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or
>
> (D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

company[10] or its largest U.S. subsidiary (measured by total assets) is an insurance company, the director of the Federal Insurance Office (FIO) and the Board, at the request of the Secretary or on their own initiative, will make a written recommendation, by two-thirds vote of the Board and the affirmative approval of the Director of the FIO in consultation with the FDIC, to the Secretary on whether the Secretary should make a determination to invoke the OLA with respect to the financial company.[11]

The Secretary is required to notify the FDIC and the covered financial company subsequent to any determination under § 203. If the company's board of directors acquiesces or consents to the appointment of the FDIC, the Secretary must then appoint the FDIC as receiver. If the board of directors of the financial company does not acquiesce or consent to the appointment of the FDIC as receiver, then the Treasury Secretary must petition the U.S. District Court for the District of Columbia for an order before appointing the FDIC as receiver of any covered financial company.[12] The Court's review is limited to determining whether the Secretary's determination that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under the Dodd-Frank Act is arbitrary and capricious.

This review is made on a confidential basis and without any public disclosure, but with notice by the court to the company and a hearing in which the company may oppose the petition. If the court determines that the Secretary's determination is not arbitrary and capricious, the U.S. District Court is required to issue an order immediately authorizing the Secretary to appoint the FDIC as receiver of the covered financial company. The court is required to make its ruling within 24 hours of receiving the petition of the Secretary; otherwise, the petition will be deemed granted by operation of law. Either party may appeal the decision to the U.S. Court of Appeals for the D.C. Circuit and then to the U.S. Supreme Court (which is given discretionary jurisdiction to review the Court of Appeals decision on an expedited basis), but the decision may not be stayed or enjoined pending appeal.

Notwithstanding Section 203(b) of the Dodd-Frank Act, if an insurance company is a covered financial company or a subsidiary or affiliate of a covered financial company, then the liquidation or rehabilitation of such insurer and any insurance company subsidiary or insurance company affiliate of the covered financial company would be conducted as provided under applicable state law (by the appropriate state insurance regulator).[13]

However, with respect to such state-based receiverships, if within 60 days after a determination has been made to subject such entity to the OLA the appropriate state insurance regulator has not filed the appropriate judicial action in the appropriate state court to place such insurance company into "orderly liquidation" under the laws and requirements of the state, the FDIC is given the authority "to stand in the place of appropriate regulatory agency and file the appropriate judicial action in the appropriate State court to place such company into orderly liquidation under the laws and requirements of the State."[14]

If the covered financial company in receivership is an insurance company (or its largest U.S. subsidiary is an insurance company), the Dodd-Frank Act authorizes the FDIC to be appointed as receiver of an insurance company subsidiary which itself is not an insurance company (such as third-party administrators, brokerages, managing general agents and any entities that are not "subject to regulation"), even though the FDIC is not the receiver of the insurance company and the insurance company may not be insolvent or in receivership proceedings in state court.[15] Upon the appointment of the FDIC as receiver over such subsidiary, the subsidiary

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[10] Defined as "…any entity that is (A) engaged in the business of insurance; (B) subject to regulation by a State insurance regulator; and (C) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation or insolvency of an insurance company." § 201(a)(13); 12 U.S.C. 5381(a)(13).

[11] § 203(a)(1)(C); 12 U.S.C. 5383(a)(1)(C).

[12] § 202(a)(1); 12 U.S.C. 53823(a)(1).

[13] § 203(e); 12 U.S.C. 5383(e).

[14] § 203(e)(3); 12 U.S.C. 5383(e)(3).

[15] § 210(a)(1)(E)(i); 12 U.S.C. 5390(a)(1)(E)(i) provides:

itself will be considered a financial company subject to the OLA, and the FDIC will have all of the powers and rights with respect to that covered subsidiary as it has with respect to a covered financial company.[16]

The Dodd-Frank Act requires the FDIC as receiver to consult with the primary financial regulatory agency or agencies of any subsidiaries of the covered financial company that are not covered subsidiaries (such as state insurance regulatory officials), and coordinate with such regulators regarding the treatment of such solvent subsidiaries and the separate resolution of any such insolvent subsidiaries under other governmental authority.[17] The statute does not provide precise guidance as to how the FDIC would coordinate with the state insurance receiver of the insurance company if the subsidiaries or affiliates' operations are integral to the operation of the insurance company. Examples are management or service companies (when the insurer has no employees of its own), or third-party administrators (if the subsidiary has contracts with the insurance company), or if the insurance company and the subsidiary are jointly obligated to third parties (such as under a lease). In such instances, it is unclear how the state insurance receiver would protect the interests of the insurer. The appointment of the FDIC as receiver of an insurance company subsidiary may leave the insurance company parent in a weaker financial condition. To protect these operations, the states, through NAIC, must implement procedures for immediate initiation and administration of state insurance receiverships with a high degree of coordination with the FDIC, applicable guaranty funds and others.

## III. STATE LEVEL PROCESS FOR IMMEDIATE INITIATION OF STATE INSURANCE RECEIVERSHIP

### A. Rapid Response Protocol

Most states have enacted statutes governing the conservation, rehabilitation and liquidation of insurance companies that are patterned after one of three model acts that have been adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) or by the NAIC over the years: the Uniform Insurers Liquidation Act (Uniform Act); the Insurers Rehabilitation and Liquidation Model Act; and the Insurer Receivership Model Act (#245) (IRMA). NAIC Model Acts uniformly require that the chief insurance regulator of the insurer's domiciliary state (Regulator) be appointed receiver of the insurer to administer the receivership under court supervision.

Title II of the Dodd-Frank Act does not change state liquidation statutes. Nevertheless, the state Dodd-Frank responsibilities require state statutes that assure immediate execution of state receiverships necessary to effectively respond to a national crisis. If there is a federal determination that an insurance company meets the § 203(b) standards codified in 12 U.S.C. § 5383(b), then the Dodd-Frank Act anticipates that the insurance company would be placed immediately into receivership pursuant to state law, 12 U.S.C. § 5383(e). Subject to certain exceptions (notably for insurance companies), the Dodd-Frank Act does not contemplate a receivership for the purpose of rehabilitation or reorganization. See footnote 7, supra. Under state law, the form of receivership is not limited to liquidation. And Section 203(e)(1) of the Dodd-Frank Act, 12 U.S.C. § 5383(e)(1), explicitly refers to both rehabilitation and liquidation of insurance companies in the insurance company context.

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(i) IN GENERAL.—In any case in which a receiver is appointed for a covered financial company under section 202, the Corporation may appoint itself as receiver of any covered subsidiary of the covered financial company that is organized under Federal law or the laws of any State, if the Corporation and the Secretary jointly determine that—

(I) the covered subsidiary is in default or in danger of default;

(II) such action would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the United States; and

(III) such action would facilitate the orderly liquidation of the covered financial company.

[16] § 210(a)(1)(E)(ii); 12 U.S.C. 5390(a)(1)(E)(ii).

[17] § 204(c); 12 U.S.C. 5384(c).

If state regulators do not file the appropriate action within 60 days of the federal determination, then the FDIC has the authority to stand in the place of the state regulator for purposes of initiating the appropriate action under and pursuant to state law, § 203(e)(3), 12 U.S.C. § 5383(e)(3). Regulators, receivers, the courts and other interested persons should not plan to rely on the 60-day window. Immediate state action will be required in most Dodd-Frank insurance company receivership scenarios. Even in the unlikely event that the FDIC filed the state court action due to the passage of 60 days, state laws continue to require that the Regulator be appointed as receiver of an insurance company and that the receivership be conducted under state law.

This section outlines the steps individual states should take to create a rapid response protocol, organizational structure and coordinated interagency effort to immediately initiate a Dodd-Frank receivership and, in any event, meet the 60-day requirement under Title II of Dodd-Frank. The steps include:

- Advanced planning
- Coordination with the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and National Conference of Insurance Guaranty Funds (NCIGF)
- State-federal coordination with proper deference to state insurance regulators and receivers in the orderly liquidation of any insurance company
- Creation of a contact list and executive committee to coordinate receivership implementation
- Formal communication protocols
- Procedures for immediate initiation of receivership and contacting attorneys general
- Procedures or rules for expedited judicial review

## B. Advanced Planning

State regulators have long recognized that state receivers who expect to successfully administer a receivership must become familiar with the insurer's operations, business and structure as soon as possible. Ch. 1, § V (A), NAIC *Receivers Handbook for Insurance Company Insolvencies* (2009) (Receivers Handbook). The FDIC recognizes that advanced communication and planning is critical to a resolution that mitigates significant risk and minimizes moral hazard in a Dodd-Frank scenario. If there are multiple proceedings, coordination of those proceedings is essential to resolution of a Dodd-Frank scenario as much or more than in a traditional dual liquidation/bankruptcy scenario.

There are both existing and developing mechanisms in place for both state and federal regulators to consider the impact of the Dodd-Frank Act in the course of regulation. These mechanisms also assist regulators, the NAIC and, at the appropriate time, receivers to have advance (even if separate) direction and warning of the potential for a Dodd-Frank receivership affecting an insurance company. Beginning with the designation of companies as Federal Reserve Board-supervised nonbank financial companies under § 113(a) and spanning all the way to determinations of the Secretary under 12 U.S.C. § 5383(b), and encompassing all regulation in between, both state and federal regulators ideally will be provided with information sufficient to take some pre-receivership regulatory protective action, when necessary, and also engage in some level of advance receivership planning.

Indeed, state regulators may know in advance of federal regulators that significant financial problems exist in an insurance company. State regulators, therefore, may have opportunity for advance receivership planning and/or independent grounds prior to a 12 U.S.C. § 5383(b) determination to trigger state regulatory action, including:

- A confidential order of supervision by the state insurance regulator.
- Other heightened regulation/prudential standards by the state regulator, including but not limited to, examination, watch list or other restrictions limiting the insurer's issuance of new business.

Thus, there may be a platform in the current state regulatory structure for advance notice and planning by state regulators and receivers in advance of the notice of a federal determination under 12 U.S.C. § 5383(b).

Ideally, the Regulator's advance planning for a Dodd-Frank scenario involving a state-regulated insurer should be highly coordinated with the NAIC and the Receivership Financial Analysis (E) Working Group; other affected state regulators; NOLGHA and NCIGF; and federal regulators and receivers, including the FDIC and the affected insurance company. The insurance company or its parent/affiliate may be required to submit a confidential federal resolution plan providing for rapid and orderly resolution in the event of a future material financial distress or failure, Section 165(d), 12 U.S.C. § 5365(d). That plan should be provided to and reviewed by the Regulator as part of the Regulator's work to broadly pre-identify theoretical scenarios and responses, and certainly as part of the planning to implement an actual Dodd-Frank referral under 12 U.S.C. § 5383(b). The confidentiality provisions under the Dodd-Frank Act, as well as the federal and state confidentially restrictions, must be respected and addressed up front in memorandum of understanding (MoU) or other protections in formulating all pre-planning and communication plans. Alternatively, confidential state-based plans, such as Contagion Reports[18] (where applicable) or confidential Corrective Action Plans, can be used confidentially by state regulators as early planning tools.

Although the Dodd-Frank Act does not expressly require that a determination made under § 203(b) with regard to an insurance company be communicated to the Regulator (the determination is expressly required to be communicated to the FIO, FDIC, Federal Reserve and the covered financial company, and that information is confidential), that basic communication is implied as part of the FDIC's consultation obligations under § 204(c), 12 U.S.C. § 5384(c), and is obviously necessary to the orderly initiation of a Dodd-Frank receivership. Procedures should establish, at a minimum, that the recommendation and determination is immediately communicated in all cases to the NAIC as a central coordination point for state regulators and receiver, and also directly to the domestic Regulator when the company is itself an insurance company and the insurance regulators when there is an insurance company subsidiary or affiliate of a covered financial company. Discussions with the relevant federal actors should focus on state receivership planning and advance warning under the confidentiality constraints of the Dodd-Frank Act.

### C. Internal Procedure for Presenting Federal Determination to Commissioner and for Immediately Initiating Receivership

Whether a receivership is expected, preplanned or arises unexpectedly, state insurance regulators and receivers must be prepared internally for the immediate initiation of a receivership well before the expiration of 60 days where there is a federal systemic risk determination as to an insurance company.

In general, as discussed above, under 12 U.S.C. § 5383(a), the FDIC and the Board of Governors of the Federal Reserve System (Federal Reserve), on their own initiative or at the request of the Secretary, recommend that the Secretary appoint the FDIC as receiver for a covered financial company. The recommendation to place an insurance company or a financial company of which the largest domestic subsidiary is an insurance company into receivership is made by the Federal Reserve and the director of the FIO in consultation with the FDIC, 12 U.S.C. § 5383(a)(1)(C). The Secretary, in consultation with the President, determines whether the covered financial company satisfies the criteria in 12 U.S.C. § 5383(b).

[18] The NAIC Model Insurance Holding Company Act requires that annual reports to regulator identify material risk within the holding company systems that could pose a financial or reputational contagion to the insurer.

If such a determination is made, the Secretary notifies the covered financial company of the determination pursuant to 12 U.S.C. § 5383(c) and 12 U.S.C. § 5382(a)(1)(A)(i). There is no exact time limit for the notice, but the expectation is that the notice will be immediate.

Once the determination is made, if the company consents to the determination, the FDIC's appointment as receiver is immediate., 12 U.S.C. § 5382(a)(1)(A)(i). If there is no consent, then the Secretary, upon notice to the covered financial company, shall petition the U.S. District Court for the District of Columbia under seal for an order authorizing the Secretary to appoint the FDIC as Receiver, 12 U.S.C. §§ 5382(a)(1)(A)(i), (ii). The Court has 24 hours to determine whether the Secretary's determination that the covered financial company is in danger of default and satisfies the definition of a financial company is arbitrary and capricious, 12 U.S.C. § 5382(1)(A)(iv). If the Court determines the Secretary's findings are not arbitrary and capricious and that the company is a covered financial company, then the Court shall enter an order immediately authorizing the Secretary to appoint the FDIC as Receiver, Id. If the Court fails to make a determination within 24 hours, the petition is granted by operation of law, and the Secretary shall appoint the FDIC as receiver, 12 U.S.C. §§ 5382(a)(1)(A)(v)(I), (II). The Court's determination is subject to a limited scope and expedited appeal process, but not to stay or injunction, 12 U.S.C. §§ 5382(a)(1)(B), (a)(2). See Flowcharts, (Exhibit 11-A and 11-B).

One exception is that if the covered financial company is an insurance company or an insurance company subsidiary or affiliate of a covered financial company, the rehabilitation or liquidation of such company, and any insurance company subsidiary or affiliate of such company, shall be conducted as provided under state law, 12 U.S.C. §§ 5383(e)(1), (2). In that case, the Regulator has 60 days from the date on which the 12 U.S.C. § 5383(a) determination is made—not communicated—to file the appropriate judicial action in state court to place the insurance company into orderly liquidation under state law, or else the FDIC shall have the authority to make the filing. 12 U.S.C. § 5383(e)(3). The Dodd-Frank Act does not expressly require entry of a liquidation order in 60 days (or ever for that matter), but entry of a receivership order well in advance of the 60-day expiration must be the Regulator's goal in order to be consistent with the federal framework seeking to swiftly resolve company failure that threatens the national economy.

1. Internal Discussions

As referenced above, the first discussion that must occur is, minimally, notice of the federal determination from the Secretary or other federal representative to the state Regulator. That notice should be immediate.

However best interlocking with federal processes, discussions must occur as to how the federal government prefers to coordinate and plan for notice. For example, regulators may pre-identify themselves and other persons to be notified. NAIC mechanisms may also be useful to effect fast multi-state notice. Once the state regulator receives notice of the federal determination, the Internal Procedures in the domiciliary state, discussed more specifically below, are triggered if those procedures have not already been triggered as the result of advanced planning. There will be a critical need to respect statutes requiring confidentiality of non-public information in the hands of regulators in this and other preplanning processes. The notice will also likely trigger formal discussions and procedures with stakeholders outside the domiciliary state, but those procedures are not discussed at length in this section.

2. Key Elements of Initial Due Diligence

As in all receiverships, the Regulator who expects to successfully prosecute a receivership action must become familiar as soon as possible with the insurer's overall operations and business, as must any potential special deputy receivers and staff. Ch. 1, § V(A), Receivers Handbook. This cooperation and advance planning among the Regulator, the receiver and ideally also the company itself is especially imperative in a systemically important Dodd-Frank scenario. Indeed, the FDIC cites Lehman Brothers' lack of such a plan as a factor that contributed to the chaos of its bankruptcy. See

FDIC Report, *The Orderly Liquidation of Lehman Brothers Holdings Under the Dodd-Frank Act*, April 18, 2011.[19]

The circumstances of a Dodd-Frank receivership will dictate the priorities in the initial response once the significant risk to the financial stability of the U.S. is identified. Coordination and information sharing with the federal government, needless to say, will drive much of the early activity and due diligence. Beyond those initial priorities, a number of items will inevitably be a part of any initial due diligence process. Among priority due diligence items in a Dodd-Frank receivership will be for the receiver to meet with the Regulator's staff and possibly also key company personnel as soon as possible to discuss Resolution Plans to the extent they are available, as well as the perceived causes of the insurer's difficulties, the insurer's "place" in the overall corporate structure and its relationship to the systemically important company, and receivership options best suited to accomplish an orderly resolution and liquidation. See Ch.1, § V(A) Receivers Handbook.

In the Dodd-Frank scenarios, as in all receiverships, the Receiver must be able to readily assess which assets are the insurer's assets. There must be a prompt review and analysis of the interaction and agreements between the insurer and its affiliates and vendors—service agreements, management agreements, key employment agreements, pooling agreements and other similar arrangements. See Ch. 8, 9 Receivers Handbook. In particular, identification and analysis of qualified financial contracts and the impact of any termination and netting rights must be conducted. There must be a prompt assessment by the Receiver of the potential for a successful rehabilitation of the insurance company prior to or in connection with liquidation. Information from state and federal regulators can greatly assist the Receiver. It is also important for the Receiver to meet with the insurer's officers and/or directors, when possible. While these are elements of nearly all insurance receiverships, the receiver should plan for a faster and more focused analysis under the urgent circumstances a Dodd-Frank receivership of an insurance entity presents.

3. Attempt to Broadly Pre-Identify Theoretical Scenarios and Responses

As referenced above, Resolution Plans, Contagion Reports or other regulatory mechanisms exist by which companies confidentially file with the Regulator their plans in the event of a § 203(b) determination as to the failure of an insurer or related entity. Using these or other regulatory mechanisms, such as financial examination, the Regulator can broadly pre-identify theoretical scenarios and responses for actual or potential systemically important companies in the state.

4. Internal Procedure for Initiating State Receivership, Including Procedure for Early Consultation with the State Attorney General or Other Stakeholders

   a. Assuming there is an external procedure for communicating the federal determinations and/or prior proceedings to the domestic Regulator, the Regulator must, in turn, trigger internal procedures for filing the appropriate judicial action seeking liquidation or rehabilitation within 60 days of the determination.

   b. Most Regulators and Receivers have established internal procedures for contacting the chief liquidation officer, consulting with the attorney general or others needed to file a state receivership action and for notifying the Court once the action is filed. These internal procedures should be adapted, strengthened and memorialized for Dodd-Frank scenarios to provide for heightened and expedited notice and court action. In some states, statutory or rule change will be required to adapt to a Dodd-Frank scenario. For example, if the state requires a public or non-public bidding process for the appointment of a Receiver, that process must

[19] *www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf.*

be expedited or eliminated in the unique Dodd-Frank scenarios in order to assure federal statutory compliance and expedited appointment of a state receiver.

c. Each Regulator should, as an initial matter, establish an inter-agency Dodd-Frank Executive Committee (Committee) in advance of a Dodd-Frank insurance receivership. The Committee is a working group for preplanning functions and a resource for confidential coordination of a complex and urgent Dodd-Frank receivership. The Committee does not have independent powers, nor can the Commissioner delegate his or her authority to the Committee. The Committee would initially be charged with pre-identifying expedited procedures and pre-identifying contact points (Contact List) unique to each state in the event of a Dodd-Frank insurance company receivership. This would include the development of state-specific, formal communication protocols based on NAIC models and similar to state disaster and recovery plans. This would also include the adaptation of NAIC-based, or development of state-specific, pre-screened and/or outlined court or administrative documents for receiverships prompted by systemic risk determinations.

   In an actual Dodd-Frank scenario, the Committee could act as a group of multidisciplinary experts who are particularly tasked with assisting the Commissioner in the planning for and executing of the orderly resolution and liquidation of particular systemically risky insurance companies.

d. The mission of the Committee is to:

   - Plan in advance (pre-identify contact points and pre-identify expedited procedures that are annually reviewed) for a Dodd-Frank insurance receivership.
   - Assist the Commissioner in the assessment of alternatives for cost-effective resolution or receivership while maximizing protection of policyholders, creditors and the public. Accurate and timely information is critical to perform these functions.
   - Assist the Commissioner in assessing and rapidly responding to federal determinations in a manner that complies with Dodd-Frank and meets the goals of Dodd-Frank Title II.
   - Assure through preplanning or otherwise that adequate assets of any designated systemically important insurance company exist, or that other lending/funding exists, to pay for the receivership of an insurance company receivership arising under Dodd-Frank.
   - Assess early on the severity of potential obligations of guaranty funds resulting from liquidation of a systemically important insurer.
   - Work with the state Receiver to coordinate, implement and resolve the receivership.

e. Depending on the state, the Committee and the Contact List may be comprised of the same or different people. The Contact List is a list of key stakeholders who must be notified by the Regulator immediately in the event of a § 203(b) determination, certainly as to a domestic company, and also possibly in relation to a foreign company with business in that Regulator's state. A communication protocol similar to that in place under most states' disaster plans in general must be implemented.

   The Committee and/or the Contact List should include:

   - Regulator (Chair of Committee) and/or Chief Financial Regulator/Key Department of Insurance Personnel (Committee and Contact List). The Regulator is charged with immediately notifying the members of the Committee and the Contact List upon

notification of the federal determination. This notification may occur outside of normal business hours. Therefore, the communication procedures and protocols must anticipate a need to contact key stakeholders at any time of any day.

- Governor or appointed representative (Contact List)
- Chief Liquidation Officer, or Special Deputy Receiver (Committee and Contact List)
- Chief Legal Counsels of Regulator/Receiver (Committee and Contact List)
- Other agencies. It should be noted that some entities (for example. health maintenance organizations and other managed care organizations) may be regulated primarily or jointly by other state agencies, such as the department of health or specialized agencies.
- Attorney General or designated Assistant Attorney General (Committee and Contact List) and/or contracted outside counsel
- If state law and process allow, Chief or Administrative Judge of the receivership court (Contact List)
- Depending on state structure, Contracted Receivers (may need pre-approved short list for magnitude of a Dodd-Frank receivership; consider training core group of current state receivers who can be loaned to other states in the systemically significant circumstances) (Committee and Contact List). Commissioners may in their discretion consider sources of previously identified receivership expertise in assembling resources for the administration of a Dodd-Frank receivership. The NAIC Directory of Receivership and Run-Off Resources to Assist State Insurance Regulators provides commissioners, in their capacity as receiver, a list of professional resources. Examples of other sources of expertise may include the ABA Tort & Insurance Practice Section; the Association of Insurance & Reinsurance Run-Off Companies (AIRROC); the International Association of Insurance Receivers, which also accredits insurance receivers; and the International Association of Restructuring, Insolvency & Bankruptcy Professionals.
- NOLHGA and NCIGF, and specialized guaranty funds, such as title and managed care, where appropriate. (Committee and Contact List)
    - Additional Potential Parties for Active Receivership:
        - NAIC, including the Receivership Financial Analysis (E) Working Group. The NAIC can particularly assist with the notification to all affected state Regulators in the event that ancillary receiverships must be rapidly initiated.
        - FIO.
        - Ancillary receivers, if any.
        - FDIC to coordinate treatment of solvent and insolvent insurance company subsidiaries and affiliates and other issues.
        - Other state agencies that also regulate the insurance company.

### D. Procedure for Rapid Consultation with the State Attorney General or Other Counsel Required to Prepare and Make the Initial Filing

1. In all states, the State Attorney General represents the Regulator. In many states, the State Attorney General also represents the Receiver. Therefore, early consultation and coordination with the State Attorney General is required to swiftly transition a systemically risky insurance company to receivership under state law.

2. In some cases, national coordination with Attorneys General will be required to promptly and cost-effectively domesticate the receivership order in all or the majority of states.

3. States should plan for expedited and/or flexible procedures for the appointment of outside counsel, if required by the Regulator or Receiver. There will be a need for rapid conflicts checking and immediate retention.

4. Depending on state structure, states should consider development of a pre-approved short list of Attorneys General and/or qualified outside counsel who can respond to the magnitude of a Dodd-Frank receivership. This could ensure immediate consultation with attorneys needed to prepare and make the required filing in state court and execute the receivership under the urgent circumstances presented by a Dodd-Frank receivership.

5. Special attention should be devoted to those special cases in which the federal courts may also be involved, such as the insolvency of a risk retention group or the resort to Chapter 11 of the bankruptcy code by the parent or an affiliate of the troubled insurer that could result in the Section 362 automatic stay impeding accelerated proceedings.

### E. Other Considerations

1. States and the NAIC should develop pre-screened/outlined court documents.

2. In some states, statutory amendments may be required or favored to assure that a federal determination under § 203(b) or consent at the federal level is grounds for liquidation. Potential changes are discussed below in section VI. Notwithstanding that, there are provisions in the NAIC models and Model #245 that can be incorporated into pre-screened court administrative documents for receiverships prompted by systemic risk determinations, such as:

   a. Rehabilitation may be the best first step for all or part of an insurance company subject to a Dodd-Frank receivership, especially if there is a filed resolution plan providing for the orderly transfer, reinsurability or runoff of policyholder liabilities. Liquidation may be required if there is a critical need to trigger guaranty funds and an order of liquidation. Plus, a finding of insolvency is required by state law for that trigger. All receivership mechanisms should be considered in consultation with any applicable guaranty funds. In any case, rapid but sophisticated analysis of how a state receiver is going to close or resolve the insurance company must occur. This includes what liquid assets exist to run the receivership; what assets are (un)encumbered, including what liens have been taken by the FDIC; how assets can be sold or liquidated; how claims are going to be filed, determined and paid; and what is the effect of qualified financial contracts..

   b. The following grounds for receivership or liquidation in most current state codes could provide grounds for an insurance company receivership order in the event of a federal determination and can be incorporated into a consent, model complaint and order along with other grounds that may exist (i.e., insolvency):

- The insurer is in such hazardous condition that the further transaction of its business would be hazardous financially to its policyholders, creditors and the public. Compare § 203(b)(4).

- The board of directors or the holders of the majority of voting shares request or consent to state receivership.

**F. Timeline for Prompt Consideration by State Trial Court**

Once a petition for receivership is filed, the company will have an opportunity to defend itself, which can result in a trial or an evidentiary hearing. Some states may require or favor a statutory rule change to assure that a Dodd-Frank insurance company receivership complaint (where there is no consent) is fully litigated through appeal on an emergency track analogous to that set forth in § 202(b). All states will, at a minimum, require procedures for emergency intake and consideration of the complaint and any pro hac vice motions by the trial court. Regulators and Receivers should meet in advance with the Chief Administrative Judge or other appropriate official in the Receivership Court to discuss (i) the new requirements under Dodd-Frank; (ii) how the Court prefers to manage such complaints and cases, in particular if all or part of the initial complaint must be filed in person or heard outside of normal business hours; and (iii) what likely questions the Court would have in the event of a Dodd-Frank filing. Reference can be made to the U.S. District Court for the District of D.C. rules promulgated to implement the federal determination process.

While these court processes will not be entirely in the control of the Regulator and may potentially require legal changes, ideally the procedures would provide for:

1. Intake and administration protocol that results in automatic assignment to a particular judge (such as the chief administrative judge or duty judge) and that avoids jurisdictional disputes (e.g., whether the complaint and case is or is not assigned or transferred to a specialized court or docket).

2. Filing the complaint under seal where appropriate.

3. Intake and administration protocols that provide for expedited processes and orders, ideally hearing and determination of the complaint within 24 hours of filing. This may be accomplished pursuant to a court scheduling order or other order, or existing rules in some states.

   Separately, many, if not all, states have adopted special statutes or rules for expedited litigation and appeal of particular classes of cases. Although those classes of cases are more frequent than insurance receiverships in general, and Dodd-Frank receiverships in particular, state courts should give consideration now to the issue whether new rules or statutes are warranted to provide for immediate and expedited litigation of a Dodd-Frank insurance receivership on an analogous track as is set forth in § 203(b).

4. Limited or no intervention by third parties. To the extent existing state law in a particular state permits third parties (other than the company) to intervene as parties at the outset of an insurance company receivership, consider limiting the right to seek intervention in a Dodd-Frank receivership to ancillary proceeding that occur after entry and appeal of the receivership order. This will assure that states can meet the Dodd-Frank Act's need for immediate entry of a rehabilitation or liquidation order in response to a federal determination and that interventions do not interfere with the emergency activities of the court and the regulator. In states where statutes or case law do not presently grant third parties intervention and appeal rights in receivership cases, that law should be preserved in a Dodd-Frank receivership.

5. Domestication of the receivership order and/or initiation of ancillary receivership proceedings.

6. Limited appeal, both in terms of standing and scope of review, analogous to that set forth in Dodd-Frank, Title II, Section § 202. Conversely, only the insurance company, as represented by its board, should have standing to defend against a complaint for receivership as provided for in existing statutes. Affiliates, subsidiaries and creditors should not be permitted to participated in the litigation of the discreet issue whether a liquidation order should be entered because of the existence of a federal determination under § 203(b).

## IV. SUBSIDIARY AND AFFILIATE ISSUES

### A. Overview

Subsidiary and affiliate issues require that Commissioners and deputy receivers expand their scenario analysis and planning beyond situations in which an insurance company would be the covered financial company. As described below, several scenarios can emerge whereby the insurance company is affected by a Dodd-Frank receivership, although not as the covered financial company. In particular, issues emerge where the insurance company is an asset, direct or indirect, of a covered financial company, or where the FDIC's lien authority is brought to bear.

Section 2(1) of the Dodd-Frank Act defines "affiliate" as having the meaning set forth in 12 U.S.C. 1813[20], which defines the term as having the meaning set forth in 12 U.S.C. 1841(k), as follows: " ... any company that controls, is controlled by, or is under common control with another company."

Section (2)(18)(A) of the Dodd-Frank Act—Other Incorporated Definitions—provides that "subsidiary" has the meaning set forth in 12 U.S.C. 1813, where is it defined as follows:

(w) Definitions relating to affiliates of depositary institutions

(4) Subsidiary. The term 'subsidiary'

(A) means any company which is owned or controlled directly or indirectly by another company; and

(B) includes any service corporation owned in whole or in part by an insured depository institution or any subsidiary of such a service corporation.

Section 2(18)(A) of the Dodd-Frank Act also provides that the term "control" has the meaning set forth in 12 U.S.C. 1813,[21] where the term is defined as having the meaning set forth in 12 U.S.C. 1841, as follows:

(a)(2) Any company has control over a bank or any company if -

(A) the company directly or indirectly or acting through one or more other persons owns, controls, or has the power to vote 25 per centum or more of any class of voting securities of the bank or company;

(B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or

[20] 12 U.S.C. 1813(w)(6).

[21] 12 U.S.C. 1813(w)(5).

(C) the Board determines, after notice and an opportunity for hearing, that the company directly or indirectly exercises controlling influence over the management or policies of the bank or company.

Determination of an entity's status as an affiliate or subsidiary may vary under the Dodd-Frank Act from that under holding company or state law.

**B. Advanced Planning**

Section 210(a)(1)(G) of the Dodd-Frank Act provides broad power to the FDIC, as the receiver of a covered financial company, to transfer the company's assets without obtaining approval from any other entity.[22] If an insurance company is owned by a covered financial company, it is, therefore, an asset of the covered financial company, and the FDIC can transfer its ownership. The Dodd-Frank Act does not specify any conditions or limitations on the FDIC's power to transfer ownership, such as obtaining the approval of the domiciliary regulator. Thus, it appears that compliance with Insurance Holding Company System Regulatory acts is not contemplated, nor is compliance with other state laws governing ownership (for example, limitations on foreign ownership). It is possible that § 210(a)(1)(G) preserves state authority because comparable authority allowing the FDIC to transfer assets to a "bridge financial company" specifically excludes state approval. Whereas § 210(a)(1)(G) provides that the FDIC can make a transfer "without obtaining any approval, assignment or consent. …," § 210(h)(5)(D), governing transfers by the FDIC to a bridge financial company, provides that a transfer is effective " ... *without any further approval under Federal or State law*, assignment, or consent with respect thereto."[23] The express exemption from obtaining "Federal or State law" approval is not contained in § 210(a)(1)(G), which, therefore, might be interpreted as simply exempting the FDIC from obtaining approval from shareholders, lien holders or other private parties.[24]

An insurance company's assets would not appear to be subject to transfer by the FDIC because § 210(a)(1)(G) only authorizes the transfer of assets of the "covered financial company" for which the FDIC is the receiver. The section does not appear to authorize the FDIC to "transfer" the insurer's business through reinsurance or other arrangements. It also, therefore, does not appear to give the FDIC

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[22] § 210(a) - Powers and Authorities.

(1) General Powers

(G) Merger; Transfer of Assets and Liabilities. –

(i) In General. Subject to clauses (ii) and (iii), the Corporation [FDIC], as receiver for a covered financial company, may –

(I) ...

(II) transfer any asset or liability of the covered financial company (including any assets and liabilities held by the covered financial company for security entitlement holders, any customer property, or any assets and liabilities associated with any trust or custody business) without obtaining any approval, assignment, or consent with respect to such transfer.

[23] § 210(h) - Bridge Financial Companies

(5) Transfer of Assets and Liabilities.

(A) Authority of Corporation. The Corporation [FDIC], as receiver for a covered financial company, may transfer any assets and liabilities of a covered financial company (including assets or liabilities associated with any trust or custody business) to one or more bridge financial companies, in accordance with and subject to the restrictions of paragraph (1).

(D) Effective Without Approval. The transfer of any assets and liabilities, including

those associated with any trust or custody business of a covered financial company, to a bridge financial company shall be effective without any further approval under Federal or State law, assignment, or consent with respect thereto.

[24] § 210(h)(5) is ambiguous in its reference to exemption from "further" approval under Federal or State law. § 210 does not specify *any* State approval requirements, hence exemption from "further" approval is without an antecedent reference.

authority to transfer a wholly owned subsidiary of an insurer. The subsidiary is an asset of the insurer, not the covered financial company. But authority granted to the FDIC to impose liens (discussed below) is analogous, and that authority is interpreted as extending to an insurer's subsidiaries.

Under its authority to transfer assets of a covered financial company, the FDIC could transfer ownership of an insurer's affiliates. Transferring an affiliate (or a subsidiary) could be highly problematic for an insurer in numerous situations, such as transfer of an affiliated management company that runs the insurer's operations (the insurer itself may have no employees), transfer of an affiliate or subsidiary that generates profits recirculated by the parent company (or dividended by the subsidiary) to provide capital to the insurer, or transfer of an affiliate or subsidiary whose operations are essential to or interwoven with the operation of the insurer.

The Dodd-Frank Act also provides that the FDIC may transfer the assets of a covered financial company for which it has been appointed as receiver to a "bridge financial company." As noted above, the transfer may be made without approval under "State Law." Again, the FDIC does not appear to be bound by any provisions of Insurance Holding Company System Regulatory acts or other state laws. Transfer of an insurer or its affiliates to a bridge financial company raises the same issues regarding ownership and operation as are raised by the FDIC's power to otherwise transfer ownership. Transfer to a bridge financial company contemplates a further transfer or other disposition of assets when the status of the bridge financial company terminates.[25] Hence, a further transfer of ownership of an insurer could occur.

### C. Lien and Funding Issues

Section 204(d) of the Dodd-Frank Act provides that when the FDIC is appointed as receiver of a covered financial company, it can "make available ... funds" to the receivership. and it can use those funds for a number of purposes[26]. The contemplated purposes include: making loans to the covered financial

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[25] Section 210(h)(13) - Termination of Bridge Financial Company Status. -- The status of any bridge financial company as such shall terminate upon the earliest of --

(A) the date of the merger or consolidation of the bridge financial company with a company that is not a bridge financial company;

(B) at the election of the Corporation, the sale of a majority of the capital stock of the bridge financial company to a company other than the Corporation and other than another bridge financial company;

(C) the sale of 80 percent , or more, of the capital stock of the bridge financial company to a person other than the Corporation and other than another bridge financial company;

(D) at the election of the Corporation, either the assumption of all or substantially all of the liabilities of the bridge financial company by a company that is not a bridge financial company, or the acquisition of all or substantially all of the assets of the bridge financial company by a company that is not a bridge financial company, or other entity as permitted under applicable law; and

(D) the expiration of the period provided in paragraph (12), or the earlier dissolution of the bridge financial company, as provided in paragraph (15).

[26] § 204 - Orderly Liquidation of Covered Financial Companies.

(d) Funding for Orderly Liquidation. - Upon its appointment as receiver for a covered financial company, and thereafter as the Corporation [FDIC] may, in its discretion, determine to be necessary or appropriate, the Corporation may make available to the receivership, subject to the conditions set forth in section 206 and subject to the plan described in section 210(n)(9), funds for the orderly liquidation of the covered financial company. All funds provided by the Corporation under this subsection shall have a priority of claim under subparagraph (A) or (B) of section 210(b)(a), as applicable [administrative expenses or amounts owed to the United States, respectively], including funds used for --

(1) making loans to, or purchasing any debt obligation of, the covered financial company or any covered subsidiary;

(2) purchasing or guaranteeing against loss the assets of the covered financial company or any covered subsidiary, directly or through an entity established by the Corporation for such purpose;

(3) assuming or guaranteeing the obligations of the covered financial company or any covered subsidiary to 1 or more third parties;

company or any "covered subsidiary[27]"; purchasing assets of a covered financial company or covered subsidiary[28]; selling or transferring all or any part of "such acquired assets, liabilities or obligations" of a covered financial company or covered subsidiary[29]; and making payments to certain creditors[30]. Section (d) also provides that the FDIC may take a lien on property of a covered financial company or a covered subsidiary, as follows:

[I]ncluding funds used for --

(4) taking a lien on any or all assets of the covered financial company or any covered subsidiary, including a first priority lien on all unencumbered assets of the covered financial company or any covered subsidiary to secure repayment of any transactions conducted under this subsection.

Unlike the term "covered financial company," which is defined in relation to systemic risk[31], a "covered subsidiary" is defined as *any* "subsidiary" of a covered financial company, other than an insured depository institution, an insurance company, or a covered broker or dealer.[32] Further, the term has been interpreted as meaning a subsidiary at any level in the corporate organization; thus, the term appears to include the subsidiary of an insurance company.

For example, in the hypothetical illustration below, a covered financial company owns an insurance company, a federally insured depository, and several other direct and indirect subsidiaries. Under the Dodd-Frank Act, each of the subsidiaries will also be deemed to be a "covered subsidiary," except for the insurance company and the federally insured depository.

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(4) taking a lien on any or all assets of the covered financial company or any covered subsidiary, including a first priority lien on all unencumbered assets of the covered financial company or any covered subsidiary to secure repayment of any transactions conducted under this subsection;

(5) selling or transferring all, or any part, of such acquired assets, liabilities or obligations of the covered financial company or any covered subsidiary; and

(6) making payments pursuant to subsections (b)(4), (d)(4), and (h)(5)(E) of section 210.

[27] Subsection (d)(1), *supra*.

[28] Subsection (d)(2), *supra*.

[29] Subsection (d)(5), *supra*.

[30] Sections 210(b)(4), 210(d)(4) and 210(H)(5)(E).

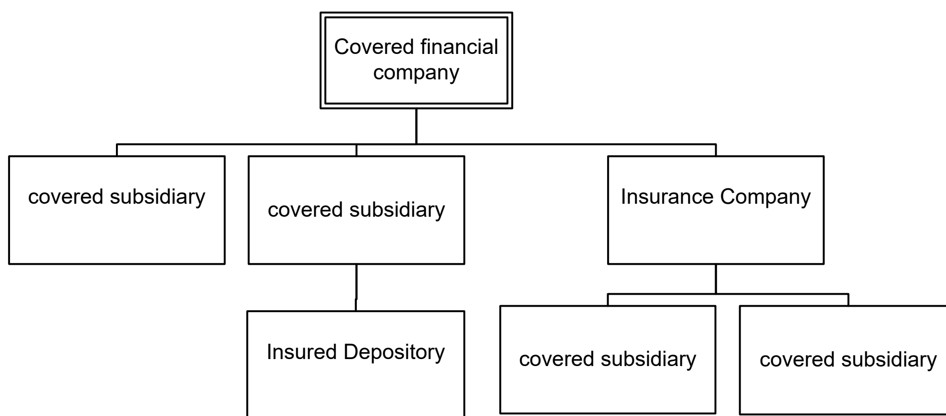
[31] *See* § 203(b).

[32] § 201(a)(9) - Covered Subsidiary. -- The term "covered subsidiary" means a subsidiary of a covered financial company, other than ---

(A) an insured depository institution;

(B) an insurance company; or

(C) a covered broker or dealer.




The FDIC adopted Regulation § 380.6[33] regarding its lien authority under § 204(d) as applied to insurance companies and their subsidiaries. The Regulation was amended from its original proposed form, in response to comments by the NAIC, NOLHGA/NCIGF and others, to provide that liens would only be imposed, generally, on the assets of the entity that actually received funds pursuant to § 204(d). The Regulation provides as follows:

Limitation on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies.

a) In the event that the Corporation [FDIC] makes funds available to a covered financial company that is an insurance company or to any covered subsidiary of an insurance company or enters into any other transaction with respect to such covered entity under 12 U.S.C. 5384(d), the Corporation will exercise its right to take liens on any or all assets of the covered entities receiving such funds to secure repayment of any such transactions only when the Corporation, in its sole discretion, determines that:

    1. Taking such lien is necessary for the orderly liquidation of the entity; and

    2. Taking such lien will not either unduly impede or delay the liquidation or rehabilitation of such insurance company, or the recovery by its policyholders.

b) This section shall not be construed to restrict or impair the ability of the Corporation to take a lien on any or all of the assets of any covered financial company or covered subsidiary in order to secure financing provided by the Corporation or the receiver in connection with the sale or transfer of the covered financial company or covered subsidiary or any or all of the assets of such covered entity.

Regulation 380.6, subsection (a) limits the FDIC to obtaining liens only on the entity that receives a loan from the FDIC and only if the lien will not unduly interfere with the liquidation or rehabilitation of the parent or affiliate insurer. Generally, this limitation would prevent liens on the assets of an insurance company that is a subsidiary of a covered financial company that received FDIC funding. Subsection (b), however, is a reservation of rights as to subsection (a) that may apply when the FDIC intends to place a lien on an insurer's assets in connection with obtaining financing or in connection with the sale or transfer of the covered financial company, a subsidiary or an affiliate.

The FDIC's lien authority could conflict with the authority of the receiver or the receivership court as to imposition of liens on an insurer's assets. Imposing liens on subsidiaries' assets could negatively affect the

[33] 12 C.F.R. § 380.6

operations of an insurer when a subsidiary's operations are interwoven with or integral to the operation of the insurer.

## V. NATIONAL COORDINATION

In the event of a Dodd-Frank receivership, national coordination between state insurance departments may require use of multiple resources, distribution lists and tools currently in place and available to state insurance departments/receivers. These include, though are not limited to, relying on the expertise of NAIC committees, such as the Receivership Financial Analysis (E) Working Group and the Financial Analysis (E) Working Group. The Receivership Financial Analysis (E) Working Group was established to monitor nationally significant insurers/groups within receivership to support, encourage, promote and coordinate multi-state efforts in addressing problems. This will include interacting with the Financial Analysis (E) Working Group, domiciliary regulators and lead states to assist and advise as to what might be the most appropriate regulatory strategies, methods and action(s) with regard to the receiverships. The Financial Analysis (E) Working Group was established to analyze nationally significant insurers and groups that exhibit characteristics of trending toward or being financially troubled and determine if appropriate action is being taken, as well as to interact with domiciliary regulators and lead states to assist and advise as to what might be the most appropriate regulatory strategies, methods and action(s).

It is likely that coordination between state insurance departments and federal bodies may include providing and receiving contact information with various parties (e.g., FDIC, FIO, and the U.S. Department of the Treasury [Treasury]). Thus, it is important to remember that the NAIC maintains distribution lists for various state insurance department parties, including primary receivership contacts, general counsel, chief financial regulator, etc. The NAIC also maintains contact information for federal bodies.

National coordination efforts may also need to involve the expertise of the state guaranty fund system and its existing national framework, if applicable. Thus, please refer to the NAIC's white paper *Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: An Approach to a National State Based System*. Prepared by the Receivership and Insolvency (E) Task Force, the white paper describes these communication and coordination considerations. Highlights from the publication include the following:

> Guaranty association involvement should be early enough that the guaranty associations can immediately undertake their statutory duties upon liquidation. As a practical matter, this calls for involvement as soon as it appears that there is a significant possibility of liquidation. This point may be reached even before the insurer is under administrative supervision or in conservation or rehabilitation. Assuming that the size, complexity and type of business of any given company has a direct bearing on how much lead-time is needed by the guaranty associations, there is a minimum amount of time, prior to being triggered, in which guaranty associations need to receive information, including quantification of covered liabilities by state, claims system information, lines of business and product specifics, third party agreements, as well as any other arrangements. If adequate information is not gathered pre-liquidation, delays in payments to claimants will result. Guaranty associations can often assist a regulator with formulating a plan for liquidation. Associations are frequently able to devote valuable resources, including legal, financial, actuarial, and other consulting services, in the design of a plan in circumstances in which budgetary or staffing constraints may pose challenges for regulators.

## VI. POTENTIAL CHANGES TO STATE LAW

Receivership and the call for orderly liquidation under Title II of Dodd-Frank may be triggered well before the existence of insolvency, impairment or other hazardous conditions have traditionally been established with respect to domestic companies. A Dodd-Frank orderly liquidation will also require a rapid response, as discussed fully in section III above. Accordingly, states should review and consider whether their existing state laws, including the grounds for rehabilitation or liquidation of a domestic company and related procedural rules for obtaining receivership orders, are sufficient to respond to federal determinations that domestic insurers meet the

standards codified in Title II of Dodd-Frank, 12 U.S.C. § 5383(b), and the receivership processes established under 12 U.S.C. § 5382(a) and § 5383(e).

In order to assist the states in this review, the Dodd-Frank Receivership Implementation (E) Working Group prepared the *Guideline for Implementation of State Orderly Liquidation Authority* ("Guideline"). See (Exhibit 11-C.) The Guideline is intended to provide guidance and serve as a template for potential state law drafting revisions. The Guideline provides that any of the triggers for a Dodd-Frank receivership under 12 U.S.C. § 5382(a), either consent by the company, entry of an order by U.S. District Court for the District of Columbia, or by operation of law under 12 U.S.C. § 5382(a)(1)(A)(v), see flowchart (Exhibit 11-A), constitute automatic grounds for rehabilitation or liquidation under state law. The Guideline also mirrors the Dodd-Frank Act by establishing timing and procedural rules for the expeditious entry and implementation of receivership orders that support both the policy goals of the Dodd-Frank Act and federal regulators, as well as the extraordinary responsibilities of state regulators for ensuring policyholder protection while resolving a systemically important insurance receivership.

## VII. EXHIBITS

*Exhibit 11-A: Initiation of Orderly Liquidation of Insurance Company Under Dodd-Frank*

*Exhibit 11-B: State Receivership Initiation Process*

*Exhibit 11-C: Guideline for Implementation of State Orderly Liquidation Authority*

***Exhibit 11-A: Initiation of Orderly Liquidation of Insurance Company Under Dodd-Frank***

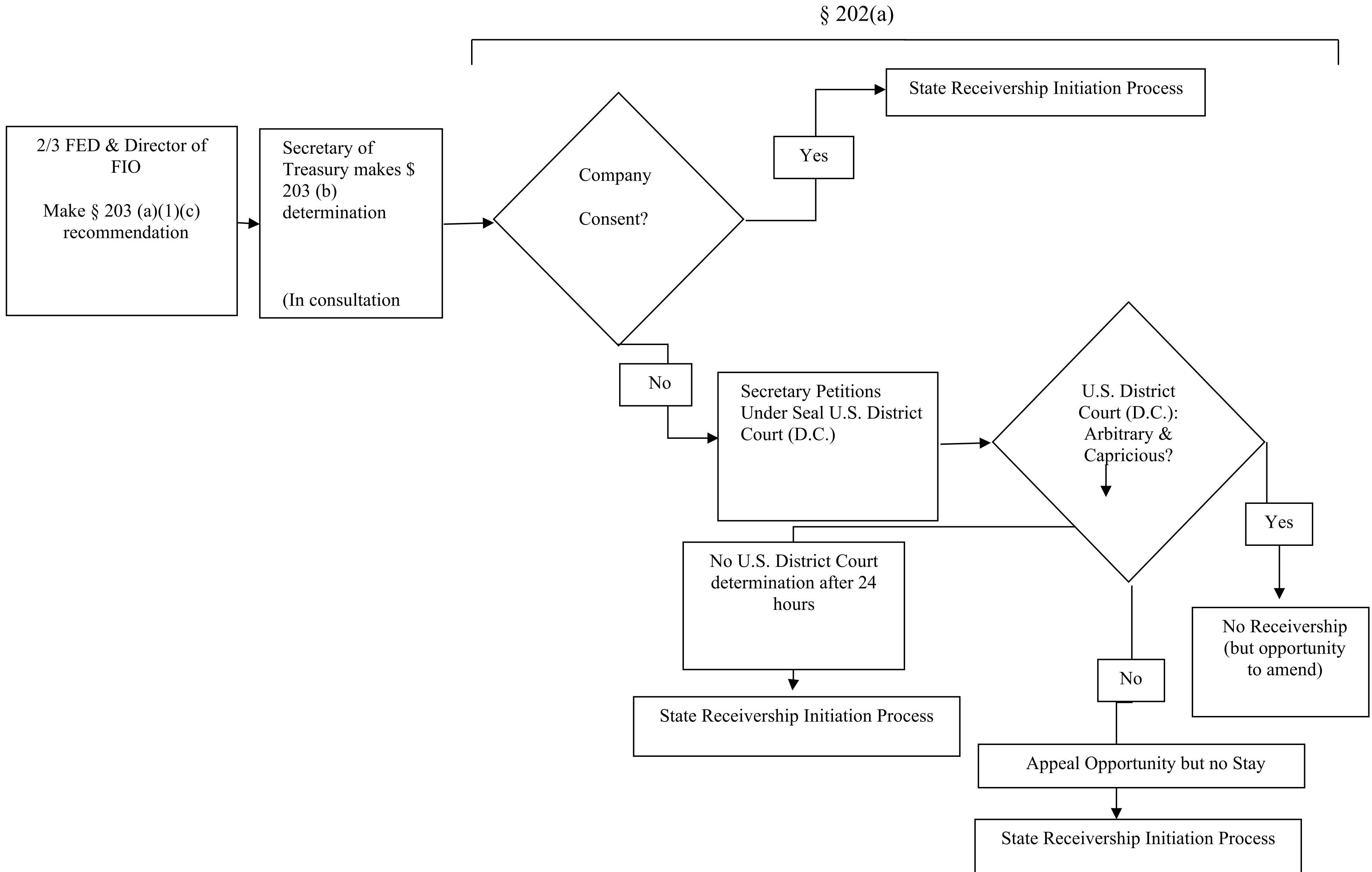
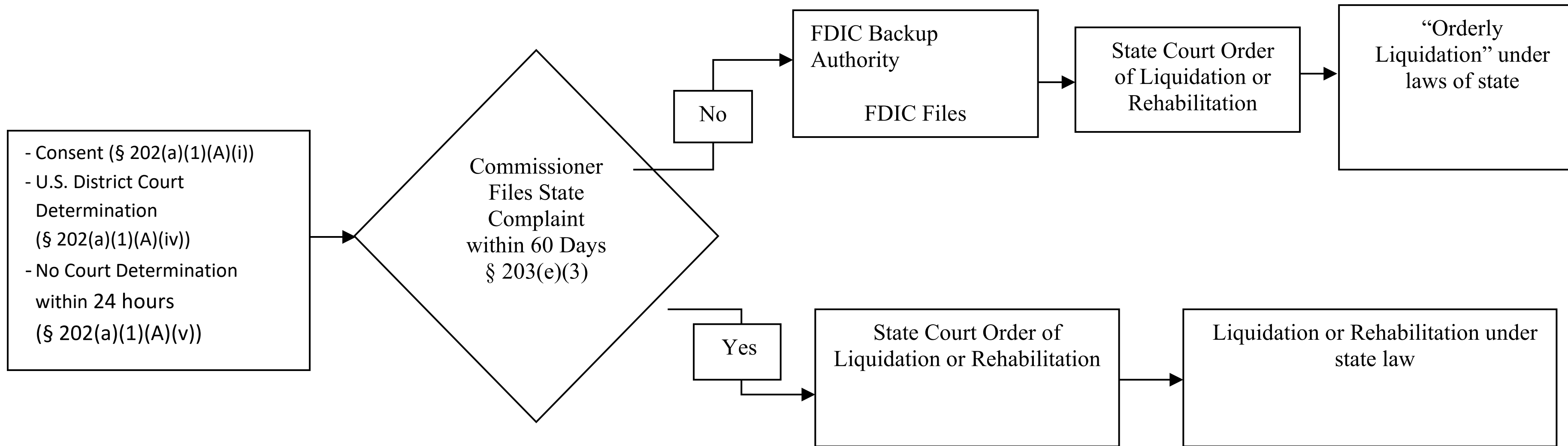


***Exhibit 11-B: State Receivership Initiation Process***

STATE RECEIVERSHIP INITIATION PROCESS



GUIDELINE FOR IMPLEMENTATION
OF STATE ORDERLY LIQUIDATION AUTHORITY

**Drafting Note:** Title II of Dodd-Frank, Pub. L. No. 111-203, provides for the orderly liquidation of certain financial companies, including qualifying insurance companies, with the FDIC generally seeking the appointment as receiver. However, in the case of qualifying insurance companies, the liquidation or rehabilitation of such a financial company will be conducted as provided under state law pursuant to 12 U.S.C. § 5383(e). If, at the end of the 60-day period provided for under 12 U.S.C. § 5383(e)(3), the commissioner (or other appropriate regulatory agency) has not filed the appropriate state judicial action to place the insurer into orderly liquidation, the FDIC shall have the authority to stand in the place of the commissioner and file the appropriate judicial action in the appropriate state court to place the insurer into orderly liquidation under the laws and requirements of the state. The following statutory language is not an amendment to the NAIC receivership models, but is intended as a Guideline for use by those states seeking to review their authority under existing state law for purposes of initiating rehabilitation or liquidation proceedings in accordance with the federal statute:

**[ ] Orderly Liquidation Authority**

In accordance with Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 with respect to an insurance company that is a covered financial company, as that term is defined under 12 U.S.C. § 5381:

A. The commissioner may file in the [insert proper court] court of this state a petition for an order of rehabilitation or liquidation on any of the following grounds:

   1) Upon a determination and notification given by the Secretary of Treasury (in consultation with the President) that the insurance company is a financial company satisfying the requirements of 12 U.S.C. § 5383(b), and the board of directors (or body performing similar functions) of the insurance company acquiesces or consents to the appointment of a receiver pursuant to 12 U.S.C. § 5382(a)(1)(A)(i), with such consent to be considered as consent to an order of rehabilitation or liquidation; or

   2) Upon an order of the United States District Court for the District of Columbia under 12 U.S.C. § 5382(a)(1)(A)(iv)(I) granting the petition of the Secretary of the Treasury concerning the insurance company under 12 U.S.C. § 5382(a)(1)(A)(i); or

   3) A petition by the Secretary of the Treasury concerning the insurance company is granted by operation of law under 12 U.S.C. § 5382(a)(1)(A)(v).

B. Notwithstanding any other provision in this Act or other law, after notice to the insurance company, the receivership court may grant a petition for rehabilitation or liquidation within 24 hours of the filing of a petition pursuant to this section.

C. If the court does not make a determination on the petition for rehabilitation or liquidation filed pursuant to this section within 24 hours after the filing of the petition, it shall be deemed granted by operation of law upon the expiration of the 24-hour period. At the time that an order is deemed granted under this section, the provisions of [cite to applicable state law addressing rehabilitation or liquidation] shall be deemed to be in effect, and the receiver shall be deemed to be appointed [optional: affirmed] and have all of the applicable powers provided by [refer to applicable state law addressing rehabilitation or liquidation], regardless of whether an order has been entered. The receivership court shall expeditiously enter an order of rehabilitation or liquidation that:

1) Is effective as of the date that it is deemed granted by operation of law; and

2) Conforms to [cite to applicable state law addressing rehabilitation or liquidation], as applicable.

D. Any order of rehabilitation or liquidation made pursuant to this section shall not be subject to any stay or injunction pending appeal.

E. Nothing in this section shall be construed to supersede or impair any other power or authority of the commissioner or state courts under this Act.

# ATTACHMENT B

To: RECEIVERSHIP WORKING GROUP

Re: REQUEST FOR COMMENTS: RECEIVERSHIP HANDBOOK FOR INSURANCE COMPANY INSOLVENCIES

From: Roy Eft, Chief Financial Examiner
Indiana Department of Insurance

September 24, 2020

Indiana has kept pace in adopting the provisions of the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions developed by the National Association of Insurance Commissioners ("NAIC"). We find Indiana's Supervision, Rehabilitation, and Liquidation Laws to be more than adequate to handle financially troubled insurance companies, to protect its policyholders, shareholders, employees and Indiana citizens. Our Insurance Department enjoys a good relationship with Indiana's insurance and business communities but we feel that relationship might be jeopardized by federal actions like Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

As pointed out in "State Implementation of Dodd-Frank Receivership" Dodd-Frank was adopted to deal with "an extraordinarily remote set of circumstances" stemming from the worst financial crisis since the Great Depression.[1] Certainly Dodd-Frank exposed a disturbing number of weaknesses in the national and global financial markets and systems and, given the dire circumstances, the adoption of Dodd-Frank answered the emergency conditions faced by the global financial systems, such as banks, finance companies, insurance companies, multi-national companies and small town businesses. The shocking number of banks closed by the FDIC (465 between 2009 and 2012) evidenced the severity of the crisis in the US and the rest of the world.

No segment of the financial system was spared during the crisis, however, the tendency to lump the insurance industry in with banks, brokerage firms and other financial organizations is misplaced. A report issued by the Government Accountability Office ("GAO") summarized the financial impact the crisis had on the insurance industry: "While some insurers experienced capital and liquidity pressures in 2008, their capital levels had recovered by the end of 2009. Net income also dropped but recovered somewhat in 2009. Effects on insurers' investments, underwriting performance, and premium revenues were also limited," says the GAO report titled, "Insurance Markets- Impact of and Regulatory Response to the 2007-2009 Financial Crisis."

Through it all the Insurance laws and regulations in Indiana along with the expertise and professionalism of staff of the Department of Insurance were able to see our insurance industry through the 2008 financial crisis and enable it to attain the strength and stability of current times. Many of us feel that the independence and local expertise of the insurance regulators in the US contributed substantially to the insurance industry's quick recovery from the financial crises. Given these thoughts, Indiana agrees that Dodd-Frank's insurance receivership provisions were hastily drafted and left many questions unanswered. Unfortunately, Dodd-Frank has set the

[1] It remains to be seen whether the 2008 Financial Crisis will be surpassed by the 2020 Covid 19 Pandemic.

stage for the insurance industry to follow the banking industry into the regulatory mess national and state banking institutions confront.

We support strengthening state based insurance regulation and allowing each state regulator the independence successfully enjoyed for many years. To the extent that Dodd-Frank has placed state regulators in uncertain regulatory waters we agree it may be appropriate to shore up our regulatory independence. However, Indiana is not willing to surrender its regulatory independence to either the federal government or in multi-state regulatory groups that result in state regulators governing insurance institution in other states. We endorse cooperation among the states but are unwilling to sign on regulation by state groups of regulators with authority to dictate decisions on insurance regulation in Indiana.

MAINE COMMENTS

**From:** Wake, Robert A
**Sent:** Tuesday, September 22, 2020 4:26 PM
**To:** Koenigsman, Jane M.
**Subject:** RE: Reminder: RLWG Request for Comments due Sept. 24, 2020

Although I agree that it is appropriate to develop amendments to Models 440 and 450, I do not believe they should take the form of deeming non-insurance affiliates to be "insurers." Depending on how such an expansion of the definition of "insurer" is structured, this could give rise to a wide range of potential unintended and undesirable consequences. We can recognize their role as regulated entities within the business of insurance without changing what it means to be an insurer.

It seems likely that changes to the receivership laws might also be desirable, but not in a manner that might upset the current balance between state and federal jurisdiction by purporting to take these non-insurer service providers outside the reach of federal bankruptcy laws.

MICHIGAN COMMENTS

**From:** Gerber, Jim (DIFS)
**Sent:** Wednesday, August 26, 2020 12:08 PM
**To:** Koenigsman, Jane M.
**Subject:** QFCs/Bridge

Chapter 4 - QFCs
a.Comments on proposed edits to Chapter 4-**None**
b.Additional recommended edits to Chapter 4-**None**
c.Recommendations for additional edits for:○Guidance where insurers do not directly hold the QFC but rather are in contracts with a marketfacing third party that holds the QFC.
○Guidance for pre-receivership advance planning for QFCs.

**Under guidance if not already required by the NAIC each insurer having QFCs should be required to file an annual report with its state of domicile providing a written description of its hedging strategy including which risks are being hedged and why and how its current QFCs holdings fit with the strategy. There should be separate descriptions for those with counterparties and those with over the counter QFCs. Said annual report would remain confidential. Such annual report would be useful for receivers, examiners and internal analysts.**

Chapter 11 – Bridge Financial Institutions
d.Consider the use of bridge financial institutions outside of the Dodd Frank Receivership of asystemically important financial institution (SIFI) in addressing QFCs in receivership. Do you feel there would be a use for bridge financial institution outside of a Dodd Frank Receivership? **Yes, there are many large companies with QFCS that are do not meet the criteria of Dodd-Frank but are important based on number of policyholders**. **In Michigan alone these would include Jackson National Life, the largest writer of variable annuities**. If so, is the guidance in Chapter 11 applicable and useful for receivers in that context? **Yes**.
e.Comments and any recommended edits on this topic within Chapter 11. **No**.

James Gerber, CFE
Director of Receiverships
Department of Insurance and Financial Services -State of Michigan

**From:** Gerber, Jim (DIFS)
**Sent:** Wednesday, August 26, 2020 11:12 AM
**To:** Koenigsman, Jane M.
**Subject:** Essential Services

Jane:

a. Recommendations for specific revisions to the Models 440 & 450 provisions to address this issue?
o Models are available in the posted Aug. 25th call materials at
https://content.naic.org/cmte_e_mlwg.htm, or at https://www.naic.org/prod_serv_model_laws.htm
No comment. Please see b.

b. Recommendations for other options outside of Models 440& 450 to resolve this issue? I continue to be interested in the party providing the essential services having a surety bond in case of non-performance of the contract. I think we should require the parties providing the service to provide services for a minimum time after termination (90 days?) as a contract requirement. I think the books and records belonging to the insurer and providing them should be a contract requirement since many of these entities are not regulated through the insurance code. Rather than changing the definition of insurer to include these companies, maybe require these companies to be licensed as third party administrators which in most states put them under the rules and regulations and examination of the insurance department.

c. What issues/challenges have you faced in this area that the Working Group should consider when working on recommendations? If resolved, how did you resolve? What would have been needed to resolve more efficiently or effectively?

None.

d. Any hurdles or unintended consequences to be aware of?

None.

James Gerber, CFE
Director of Receiverships
Department of Insurance and Financial Services -State of Michigan

# Oklahoma Receivership Office, Inc.

September 24, 2020

Kevin Baldwin, Co-Chair
Laura Lyon Slaymaker, Co-Chair
Receivership Law Working Group
National Association of Insurance Commissioners
230 McGee Street, Suite 800
Kansas City, MO 64108

RE: Request for Comment: Essential Services

Dear Co-Chairs Baldwin and Slaymaker:

Thank you for the opportunity to comment on the continuation of essential services provided through affiliated intercompany agreements during receivership of an insurance company.

The insurance holding company system can be a very effective structure by which to operate insurer(s) with the proviso of honest management practicing full disclosure under prudent corporate governance. In this environment, Models 440 and 450 provide ample oversight and the holding company system is beneficial.

Unfortunately, this is often not the case with troubled insurance companies. Instead, affiliate transactions are constructed to appear to be arms-length and to appear to be entered in good faith and compliant with the *Insurance Holding Company System Regulatory Act*. In reality, the agreements can be self-dealing, favoring the affiate and siphon assets away from the insurer. Often these related parties have no business purpose other than to provide services to the insurer.

The result is a self-inflicted, often fatal, wound necessitating regulatory action to protect policyholders and other creditors.

During a rehabilitation, the affiliate may continue to be engaged and committed as they have an incentive for the rehabilitation plan to succeed. However, once a liquidation order is entered, the collaborative effort evaporates. Affiliates can become unwilling to continue support services and may withhold data essential to the receiver; whether to try to extort a payment from the receiver or avoid litigation for their negligence, malpractice, or fraud. The cessation of services requires the receiver to take immediate and sometimes drastic action.

Oklahoma has frequently encountered issues with affiliates. The insurer may not have direct staff. Their data may be housed and maintained by an affiliate. The facility, furniture and equipment may be owned by yet another affiliate. In such cases, the receiver has had to find an alternative including evaluating the affiliate staff and make offers of employment to essential employees, move operations to another location that can be secured or incur costs to retain other service providers.

3613 NW 56th Suite 330
Oklahoma City, OK 73112

Phone (405) 947-0022
Fax (405) 947-0046

E-Mail mail@okaro.org
Web Site https://www.okaro.org

This frustrates the receiver's efforts for the timely notification to policyholders and transmission of claims data to the guaranty association and burdens the estate with additional expenses.

The potential solution identified in the Request for NAIC Model Law Development adopted by Executive Committee on August 13, 2020 to revise the definition of "insurer" to encompass affiliated entities whose sole purpose is to provide services to the insurer would be useful.

Other potential solutions could include:

- *Insurance Holding Company System Model Regulation* (#450):
    - provide in Section 19(B)(11), that if the insurer is placed in receivership, services will continue to be provided without regard to pre-receivership unpaid fees;
    - provide in Section 19(B)(12), that upon entry of a Receivership Order, those employees essential to operations and the services associated therewith become the exclusive right of the insurer directly at the Receiver's sole discretion and direction, subject to the supervising court's approval.
- The ability of the regulator to assess a substantial fine upon a related party that hinders the Receiver's efforts may be another useful tool to incentivize collaborative efforts by related parties.

If you have any questions, please feel free to contact me at dwilson@okaro.org or (405)947-0022.

Sincerely,

Donna L. Wilson, CIR-ML
Assistant Receiver/Estate Manager

PENNSYLVANIA COMMENTS

**From:** McDonald, Crystal
**Sent:** Wednesday, September 23, 2020 1:48 PM
**To:** Koenigsman, Jane M.
**Subject:** RLWG Request for Comments

Jane,

Below are Pennsylvania's answers to the Receivership Law Working Group's request for comment.

Model Act 440 &450

(a) While looking into the recommendations for specific revisions to Models 440 & 450 provisions, Pennsylvania focused on Section 6 – Examination. Section 6 makes the insurer responsible for supplying the commissioner with all books and records reasonably necessary to comply with this section. The examination is conducted at no cost to the commissioner and if the commissioner requires the use of a consultant, the company bears the cost of that consultant. Section 6 B(2) even allows for the possibility of penalties or suspension or revocation of the insurers license.

    In pre-receivership, the Commissioner has "teeth" to obtain what is needed and at no cost. Post- liquidation requires most of the same information with a shift in who pays for that information. The liquidator would like to see the "affiliate" that is holding the books and records held to the same standard as the company is pre-receivership. The liquidator would be able to demand the records and require receipt without depleting company assets.

    In addition, Section 12- Receivership states that the commissioner may proceed as provided to take possessions of the property of the domestic insurer and to conduct its business. This provision provides for the receiver to take possession but lacks the "teeth" referenced above.

(b) The only recommendation we have for options outside of the Models is to continue to work closely with the solvency side of the Pennsylvania Insurance Department, namely the financial analysts and examiners. They have the background information necessary for the receiver to gain knowledge about the inner workings of the company. In addition, we lean heavily on our liquidation statute and our liquidation orders to show what authority we have with respect to records and data. These resources lack penalties or punishment options for failure of the "affiliate" to comply. Any ability to force compliance by statute with penalties for failure to comply would save the liquidator time and money as our only recourse now is payment from estate assets for the necessary data or litigation to enforce the order, which is usually more costly and very time consuming.

(c) The issues and challenges faced in various liquidations involve data. In many instances when there are holding companies involved, the data is commingled data and/or unusable. Attempts to retrieve the data are usually rebuffed. The liquidator is provided with a fee schedule, not always open to negotiation, of costs associated with the retrieval of the data and conversion to a useable format. The data is usually housed on servers with other entities and those servers

are owned by the holding company, or an "affiliate" not the liquidated company. Payment of the fees is usually more cost effective than litigation, which is often our only other option.

What would have been needed to resolve more efficiently or effectively? A statutory requirement to segregate data and files held by different entities under the same holding company. The requirement to provide that data in a usable format would alleviate time delays and costs to the estates . Many of these companies use old, outdated or obscure systems that require a third party to convert. Any fees paid to separate or convert data come from the estate assets to the detriment of the claimants.

(d) One hurdle we need address is when the holding company has two, or more insurance companies under it and one is found to be insolvent while the others are not. Since all companies are housed under one roof and the solvent company(s) are still actively conducting business, the liquidator does not have freedom to collect the data and records required. As guests of the company we are housed in conference rooms with company guides. The liquidator has no control over which documents are being destroyed by personnel. The amount of time that goes by while attempting to figure out if all the data needed has been provided allows for corruption or destruction. In some estates the liquidator pays rent for a space to be allowed to remain on premises because the premises is wholly owned or leased by the holding company and not the insolvent entity.

Lastly, while most companies are moving away from paper records, we have encountered instances where an "affiliate" handled the business of two or more entities and the paper records pertaining to those entities have been co-mingled to the extent records could not be segregated. In order to properly obtain all books and records, every box would have to be reviewed in order to segregate those records properly. Review of every box because of the co-mingled records must done by holding company employees. This task must be paid for and there is not guarantee the liquidator receives every applicable file.

We do not feel as though we have the depth of knowledge necessary to answer any questions regarding QFCs and Bridge Financial Institutions at this time. We look forward to any educational opportunities provided to us that will help bolster our understanding.

If there is anything else you need please let me know.

Best,

Crystal McDonald

Crystal D.B. McDonald, Esquire| Project Director
Pennsylvania Insurance Department | Office of Liquidations, Rehabilitations and Special Funds
Capitol Associates Building | 901 N. 7th Street Harrisburg PA 17102
Phone: 717.886.2045 | Fax: 717.772.4543
www.insurance.pa.gov

*Twitter: @PAInsuranceDept*
*Facebook: Facebook.com/PAInsuranceDepartment*
*Virtual Meetings Available Upon Request*

***Wayne Mehlman***
*Senior Counsel*

September 24, 2020

Kevin Baldwin, Co-Chair
Laura Lyon Slaymaker, Co-Chair
Receivership Law (E) Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108

**RE: Guidance on Qualified Financial Contracts (QFCs) in the Receivers' Handbook**

Dear Co-Chairs Baldwin and Slaymaker:

The American Council of Life Insurers ("ACLI")[1] appreciates this opportunity to provide comments to the Receivership Law Working Group on guidance on qualified financial contracts (QFCs) that is in Chapter 4 of the *Receivers' Handbook for Insurance Company Insolvencies*.

General comment:

We suggest that Chapter 4 (*Investigation and Asset Recovery*) be patterned after Chapter 11 (*State Implementation of Dodd-Frank Receivership*) which we believe is better organized and well-footnoted.

Specific comments:

Page 1 – Header: The word "involving" is misspelled.

Page 1 - Second sentence in the first paragraph: The word "arises" is misspelled.

Page 2 – First paragraph in the Footnote: We suggest that the following language (in red) be added to the last sentence:

*States that permit the termination and netting of QFCs may want to consider adopting a similar stay provision following the appointment of a receiver for certain insurers – generally larger entities that may be significant in size but outside of being subject to a potential Dodd-Frank receivership."*

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[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States. Learn more at www.acli.com.

***American Council of Life Insurers***
*101 Constitution Avenue, NW, Washington, DC 20001-2133*
*(202) 624-2135 waynemehlman@acli.com*

Page 3 - Last sentence of the last bullet in Section C: We do not believe this sentence is necessary since initial margin requirements for all derivatives transactions not subject to clearing are being phased in to effectively require that all counterparties facing swap dealers post initial margins by September 2021

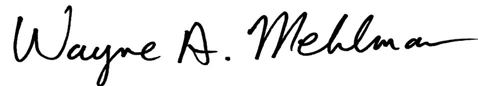
Page 3 - Third bullet in Section D: We do not believe that this bullet is necessary since entering into a receivership constitutes an "event of default" by its terms.

Page 4 - After the last bullet in Section D: We suggest that another bullet be added (in red) as follows:

*Consider how ongoing hedging of obligations and assets can be accomplished during and following a receivership.*

Thanks again for this opportunity to comment. If you have any questions, feel free to contact me at waynemehlman@acli.com or 202-624-2135.

Sincerely,



Wayne Mehlman
Senior Counsel, Insurance Regulation

September 24, 2020

Kevin Baldwin, Co-Chair
Laura Lyon Slaymaker, Co-Chair
Receivership Law (E) Working Group
National Association of Insurance Commissioners

Via e-mail to Jane Koenigsman: jkoenigsman@naic.org

**Re: Request for Comment: Essential Services**

Dear Ms. Slaymaker and Mr. Baldwin;

America's Health Insurance Plans (AHIP) appreciates the opportunity to comment on the Receivership Law (EE) Working Group's questions pertaining to Essential Services.

**a. Recommendations for specific revisions to the Models 440 & 450 provisions to address this issue?**

We note with concern the potential solution expressed in the Request For Model Law Development, i.e., to revise the definition of "insurer" in state holding company laws to encompass affiliated entities whose sole purpose is to provide services to the insurer. This would not set a good precedent, and may instead result in a slippery slope for others who might want to further expand the definition of "insurer" in the future. As seen in other issues, actions which expand insurance regulators' authority beyond their licensees are problematic and often impinge on the authority of other state officials, such as attorneys general. This alone can prove fatal to state legislation.

A preferable alternative would be to clarify Section 19.B(10) of the *Insurance Holding Company System Model Regulation, #450,* to provide for indemnification of the insurer not only for gross negligence or willful misconduct, but also for actions by the affiliate which violate subsections (11), (12) or (13), addressing access to the books and records, termination of the agreement, and continuation of essential services respectively.

Another option would be to include clear language in Model #450 so that in instances in which the receiver or commissioner has limited or no authority over the licensure of an entity, the receiver or commissioner has a statutorily authorized method by which to refer the issue to the

state authority which does, e.g., attorney general, health department, or secretary of state. If it is believed that those authorities might be unable or unwilling to act on such referrals, other targeted statutory language outside of insurance code provisions could be considered to clarify that such other officials not only have the authority to act on such referrals, but should do so.

**b. Recommendations for other options outside of Models 440 & 450 to resolve this issue?**

When feasible and appropriate under the complex circumstances of a particular case, receivers should be encouraged to take aggressive actions to seek indemnification under the revisions to Section 19.B(10) from uncooperative affiliates, not only to secure the conduct needed, but also to set strong precedents to serve as examples for other affiliates in other receiverships.

We would also suggest the Working Group do a careful review of the *Insurer Receivership Model Act, #555*, which is the foundational model and source of most of a receiver's statutory authority to act. Some of the suggestions in this letter might be better placed or duplicated and reinforced there, for example in Section 108.J and Section 601.

Also, see last recommendation under a., above.

**c. What issues/challenges have you faced in this area that the Working Group should consider when working on recommendations?**

N/A.

**d. Any hurdles or unintended consequences to be aware of?**

Caution should be exercised in any actions taken to modify the Holding Company Act, the Regulation, or other state legislation. Just as our insurance regulatory system is designed to carefully protect insurance entities' assets and solvency for policyholders' protection, it is reasonable to anticipate some level of resistance to actions proposed to compel better cooperation from affiliates. This resistance might come not only from other state government authorities, but also from within a holding company itself stemming from concern that the insurer's insolvency can become a contagion impacting other entities within the holding company structure.

Again, AHIP appreciates this opportunity to offer comments and responses to your questions, and we look forward to working with you to find the most productive way forward.

Sincerely,

Bob Ridgeway
Senior Government Relations Counsel
Bridgeway@AHIP.org
501-333-2621

# Arbor Strategies, LLC

**Chris Petersen**
703-847-3610
cpetersen@arborstrategies.com

September 24, 2020

Mr. Kevin Baldwin
Illinois Department of Insurance
State of Illinois
320 W. Washington St., 4th Floor
Springfield, Illinois 62767-0001

Ms. Slaymaker
Pennsylvania Insurance Department
1326 Strawberry Square
Harrisburg, Pennsylvania 17120

Via email to Jane Koenigsman, NAIC

Dear Mr. Baldwin and Ms. Slaymaker:

I am writing of behalf of Anthem, Cigna, CVS Health/Aetna, and UnitedHealthcare. These companies thank you for the opportunity to provide comments regarding the continuation of essential services through affiliated intercompany agreements in the context of a receivership.

These companies have a track record of working to strengthen protections for consumers who find themselves in the position of being insured by an insolvent company. Most recently, when the NAIC amended the Guaranty Association Model Act in 2018, we worked with states to develop and implement a resolution system that provides consumers with far more protections that it previously had – in many cases, at a significant financial cost to these companies. Unfortunately, the solutions under consideration by this Working Group are overly broad and do not put consumers in a better position than they are today. We hope to work with this Working Group to explore other options to protect consumers and reduce costs to the insolvency system.

Their main concern with the current proposal is the significant change to the definition of "insurer" in Model #440, the *Insurance Holding Company System Regulatory Act* (the Holding Company Model) to include affiliates "whose sole purpose is to provide services to the insurer." It appears that the Working Group supports the notion that these changes are needed to assist receivers in minimizing administrative costs.

We appreciate the Working Group's desire to minimize administrative costs in receiverships – and we agree there are efficiencies to be realized. In addition, we agree that receivership law should allow receivers to hold non-insurers within the holding company system to the terms of their contracts, similarly to how contracts outside the holding company system are handled. However, we do not agree that changing the definition of "insurer" is the best way to meet the Working Group's regulatory objectives. There are many other efficiencies that can be realized through the receivership process that do not fundamentally redefine what it means to be an "insurer."

Existing NAIC receivership laws and the Holding Company Model currently contemplate that receivers, who are appointed by the Insurance Commissioner, can stand in the shoes of the insolvent company and enforce its contractual rights. If the contracting parties refuse, the receiver has the statutory ability to secure a court order.

In addition, the Insurance Holding Company System Model Act gives regulators the authority to approve affiliate transactions.[1] Therefore, the domestic regulator of an insolvent company already has the opportunity to ensure that transactions between the insolvent insurer and the non-regulated affiliate will not adversely impact insurance consumers, and is fair and reasonable. Further, the Insurance Holding Company System Model Regulation includes additional protections by providing that affiliates of insolvent insurers may not automatically terminate[2] their services under a contract; thereby, eliminating the concern that the insurers will no longer be able to perform the essential services promised in the policy.

Finally, changing the definition of insurer to include affiliates will lead to significant unintended consequences. While Insurance Commissioners have broad regulatory authority over "insurers," they generally do not have regulatory authority over the operations of non-insurers within an insurance holding company system. By changing the definition of "insurer" in the context of receiverships, insurance regulators will have broad authority over the finances of entities not otherwise within their jurisdiction or expertise, while providing no additional benefit to consumers. This is a significant expansion of regulatory reach into companies that have no nexus to insurance other than to provide services to an insurer.

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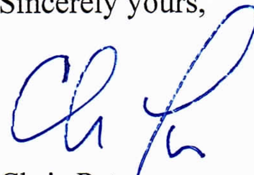
[1] Insurance Holding Company System Regulatory Act §5A (2)(d).
[2] Insurance Holding Company System Model Regulation §19B.(12).

Existing NAIC model laws and regulations already contain the authority this Working Group seeks to give to receivers. While the process to access this authority might not be as easy as the receiver would like it to be, i.e. in cases with a recalcitrant insurer or service provider, ease of administration is not the only principle the Working Group should consider. Before the Working Group fundamentally changes what it means to be an "insurer," regulated entities should have a better understanding of the nature of the problem we are trying to fix and we hope that the Working Group is open to alternatives to ease some of the administrative burdens often found in the receivership process.

Sincerely yours,



Chris Petersen
Arbor Strategies, LLC

Cc: Jane Koenigsman

National Organization of Life & Health Insurance Guaranty Associations

NCIGF National Conference of Insurance Guaranty Funds

**JOINT RESPONSE TO RECEIVERSHIP LAW (E) WORKING GROUP REQUEST FOR COMMENT REGARDING ESSENTIAL SERVICES**

**September 24, 2020**

The insurance promise is backed not only by capital; it also is backed up by the operational ability to deliver on that promise to consumers. The guaranty system partners with receivers after an insurer's failure to make good on that promise to the greatest extent possible, and therefore shares the goal of the Receivership Law (E) Working Group ("RLWG" or "Working Group"), expressed in its charge to "[r]eview and provide recommendations for remedies to ensure continuity of essential services and functions to an insurer in receivership by affiliated entities, including non-regulated entities."

We believe this is important to ensure insurance benefits to policyholders in the event the insurer's domestic regulator/receiver were to conclude it was necessary to assert jurisdiction over the service affiliates in the insurer's receivership proceedings. Without the service affiliates being answerable to the receivership proceeding, the receiver and the receivership court will have no meaningful opportunity to address administration of the insurance policies, employees, insurance policy files and records, office space from which to administer the insurance policies, insurance coverage, and management of investments supporting insurance policies, among other things.

In contributing to those recommendations, we start with a few principles:

- Continuity of essential services through affiliated intercompany agreements has a direct impact on consumers and on the ability of the guaranty system to help protect them when an insurer fails.
- The operational delivery of those essential services is an integral part of the business of insurance, and a group's structure should not affect either the insurer's obligation to deliver on that obligation, or the receiver and overseeing court's authority to enforce it.
- The "essential services and functions" under that authority are operational; we do not read the charge to purport to affect capital across a group.
- Any effective remedy must support a receiver's authority, rather than merely provide additional contractual assurances.

### Issues and Challenges

The collective experience of resolution professionals confirms that continuity of services from affiliates is an integral part of the insurance contract relationship between the insurer and policyholder and is a necessary component to providing insurance coverage to policyholders in receivership.

To illustrate the importance of the continuity of essential services, we offer the following scenario drawn from our collective experience (further details and a hypothetical organizational chart are set forth on Exhibit A):

- A large holding company controls an insurer writing nationally across multiple lines.
- The insurance group under common control of the holding company includes non-insurer affiliates providing administrative/management services, investment management, and personnel to the insurer affiliates pursuant to services and employee sharing agreements (the "service affiliates"). The holding company and the service affiliates are incorporated in a different state than the insurer's domicile (and different than any state issuing a certificate of authority). The insurer has no employees of its own and owns no real estate – instead, leasing personnel, space, and infrastructure from the service affiliates.
- The service affiliates also provide services to non-affiliated companies – for example, third party administrative services to hospitals or for closed blocks of policies to non-affiliated insurers that are domestic insurers in different states, and investment management services for non-affiliated financial entities.
- Claims data files managed by a third party administrator may be co-mingled with claims data of other insurers not in receivership and the administering entity may be reluctant to segregate the data in order to provide it to the receiver.
- The domestic regulator discovers significant financial irregularities and shortfalls at the insurance company and commences rehabilitation. The insurer faces liquidity challenges, with all liquid assets held by its investment management affiliate.
- The insurers and hospitals serviced by the service affiliates are concerned, and they are considering working with the holding company's officers to explore bankruptcy proceedings for the holding company and the service affiliates.
- The service affiliates honor their contractual obligations to the insurer but make no other concessions to the receiver.
- The data handling entity is financially troubled as well – perhaps as a result of the insurance company liquidation - and is laying off staff at the same time as the transition.

**Recommendations for Revisions to Model Holding Company Act**

There are legal theories that support including non-insurer affiliate entities in a receivership, including substantive consolidation, alter ego, abstention, and others. The legal bar for using such theories is high, and they may not be applicable in many cases, though receivers have used those theories successfully in appropriate cases and could seek to pursue those theories without any statutory change. The proposed language below is not intended to replace or impede use of those theories, which would continue to be available to receivers depending on the applicable circumstances and legal standards.

Instead, the proposed changes are intended to ensure that the receivership court has jurisdiction over an affiliate so that critical services necessary to the insurance relationship can be addressed in a receivership. Confirming jurisdiction of the receivership court would help ensure that the receiver can provide insurance coverage and benefits under the circumstances while avoiding significant delays and expenses that could harm policyholders. It also would help avoid judicial inefficiencies and inconsistent rulings arising from multiple courts being presented with similar or identical issues.

The Model Insurance Holding Company System Regulatory Act ("MHCA") already regulates affiliate transactions. The Model Insurance Holding Company System Regulation ("MHCR") requires that, as regards affiliate "[a]greements for cost sharing services and management services" the agreement shall provide that (1) a receiver steps into the contractual rights of the failed insurer, (2) a receiver has access to the affiliate's books and records, (3) the affiliate has no automatic right to terminate based on receivership, and (4) the affiliate must maintain operational programs and infrastructure. MHCR Section 19(B). These contractual obligations are helpful in receivership administration and could be enhanced, but enforcement is the challenge, and that enforcement requires the jurisdictional reach of the receiver and receivership court. Likewise, those obligations are of limited value as the larger group fails, with the prospect of individual bankruptcy proceedings for the non-insurer affiliates.

The Illinois receivership code provides a valuable model for statutory language contributing to a receivership court's ability to protect the effective administration of estates where affiliates are providing essential services. Under provisions regarding the scope of the receivership article, the Code provides that covered entities include insurers, affiliates, and persons specified in the article, as well as:

> … agents, managing general agents, brokers, premium finance companies, insurance holding companies, and all other non-risk bearing entities or persons engaged in any aspect of the business of insurance on behalf of an insurer against which a receivership proceeding has been or is being filed under this Article, *including, but not limited to, entities or persons that provide management, administrative, accounting, data processing, marketing, underwriting, claims handling, or any other similar services to that insurer, whether or not those entities are licensed to engage in the business of insurance in Illinois, if the entity or person is an affiliate of that insurer.*

215 ILCS 5/187(2) (emphasis added).

Similarly defining the scope of certain authority under the MHCA (or other appropriate statutory provision) would facilitate the regulation of insurance policies and directly benefit insurance policyholders and support the coverage provided under insurance policies in the event of an insurer's receivership. Such a provision also would help demonstrate a legislative intent to regulate those entities within the scope of state insurance regulation.

As a starting point, we suggest considering the addition of a new Section 5(A)(6) to the MHCA. The goal would be to establish that if an affiliate enters into a service agreement with an insurer, and a receiver is appointed for the insurer, the affiliate would be subject to the receivership proceedings and the authority of the receiver. Section 5 of the MHCA covers material affiliate transactions, requiring notice and regulatory non-disapproval for those transactions through the Form D process. A new Section 5(A)(6) could state:

> Any affiliate that is party to an agreement required to be filed pursuant to Section 5(A)(2)(d) providing essential services to an insurer that are an integral part of the insurer's insurance operations, the insurance contract relationship, or the insurer's ability to provide the related insurance coverage (including but not limited to management, administrative, accounting, data processing, marketing, underwriting, claims handling, investment, or any other similar services) shall be subject to the receivership proceedings and authority of any supervisor, rehabilitator, or liquidator for the insurer appointed pursuant to [receivership act] for the purpose of interpreting, enforcing, and overseeing the affiliate's agreements, relationship, and dealings with the insurer. An

affiliate's act of entering into an agreement subject to Section 5(A) is considered intentional conduct creating the necessary minimum contacts, and the receivership court shall have personal jurisdiction and exclusive subject matter jurisdiction related thereto. After notice and a hearing, the receivership court may limit application of the receivership proceedings to the affiliate upon finding that the services are not integral to the insurance contract relationship and the related insurance coverage.

Once the Working Group develops its recommendations, we also suggest drafting guidance through the Receiver's Handbook for Insurance Company Insolvencies. Resolution stakeholders would benefit from advanced thinking on the strategies and tactics, lessons learned, and potential challenges around authority over affiliates.

****

We expect that additional constructive solutions will emerge from the Working Group's deliberations, and we look forward to contributing to those discussions as the Working Group addresses the issue of continuity of essential services.

**Contact Information**

**National Organization of Life and Health Insurance Guaranty Associations**
13873 Park Center Road, Suite 505
Herndon, VA 20171
Phone: 703.481.5206
Fax: 703.481.5209

Peter G. Gallanis
President
E-Mail: pgallanis@nolhga.com

**National Conference of Insurance Guaranty Funds**
300 North Meridian, Suite 1020
Indianapolis, IN 46204
Phone: 317.464.8176
Fax: 317.464.8180

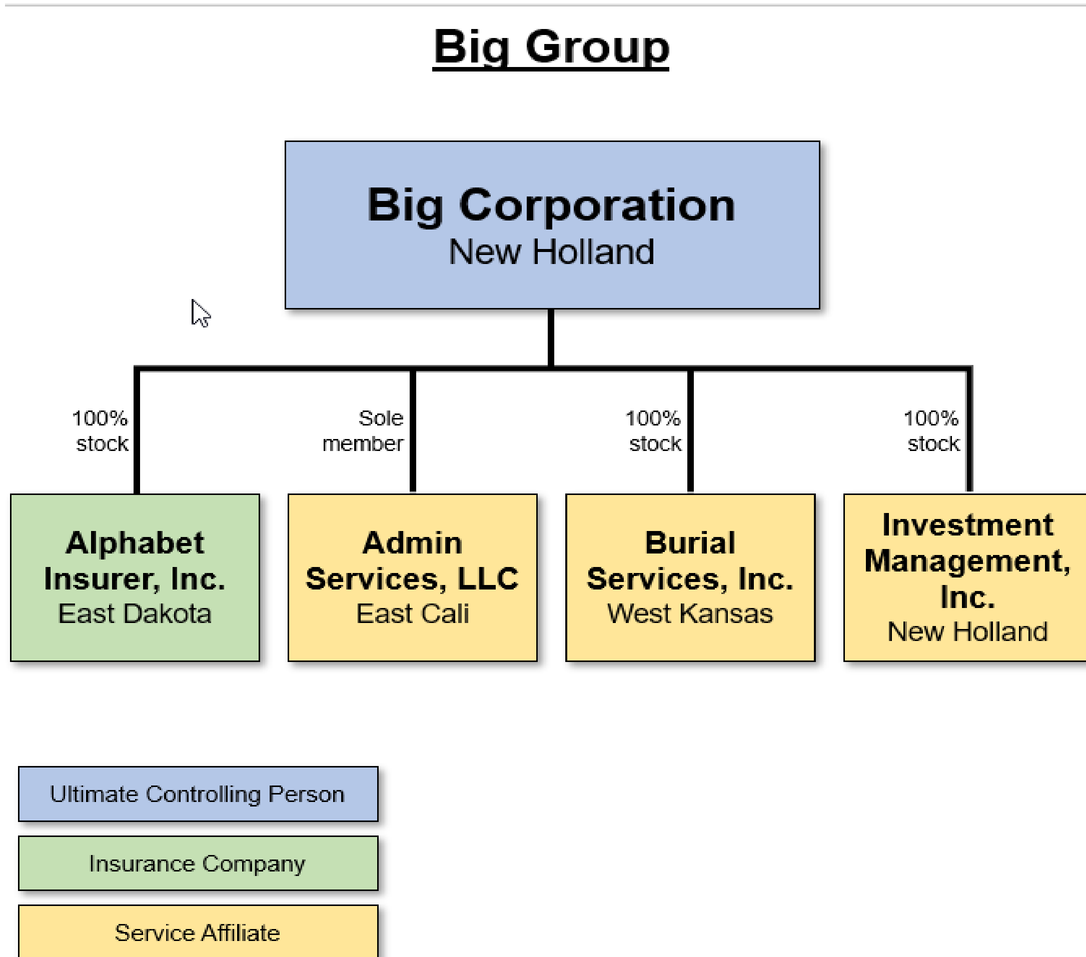
Roger H. Schmelzer
President
E-Mail: rschmelzer@ncigf.org

**Exhibit A**

**Four States; Five Companies; Multiple Lines**

Assume the following facts occurring in the following fictional states: East Dakota; New Holland; East Cali; and West Kansas.

Insurer Alphabet Insurer, Inc. ("Alpha") is an insurance company domiciled in East Dakota licensed in 27 states, but not licensed in New Holland. Alpha's insurance products include whole life, annuities, small value life products related to burial contracts, and long term care. Alpha is owned by Big Corporation ("Big"). Big is a privately held stock company organized in New Holland, and also owns the following: Admin Services, LLC ("Admin, LLC"), an LLC organized in East Cali; Burial Services, Inc. ("Burial, Inc.), a West Kansas company that sells preneed and cemetery contracts; and Investment Management, Inc. ("Investments, Inc."), also a stock company organized in New Holland.[1] A corporate organization chart reflects this hypothetical group:




[1] An affiliated Netherlands reinsurer could be added and/or an affiliated captive insurer domiciled in yet another state could be added. Those additions would increase the complexity by several factors and could be more realistic but for these purposes, those additional complexities are not included.

All the Big subsidiaries have a majority of the same officers and directors. Admin, LLC provides all the employment and administrative services for all the Big companies pursuant to a management services agreement. Alpha has no employees.

Investments, Inc. owns the home office and owns and/or manages all the investments for Alpha and the other Big companies. Alpha owns no real estate and pays rent for office space under the administrative services agreement.

Burial, Inc. arranges for trusts in order to protect the assets for the preneed contracts. All of the trust investments are in Alpha insurance products.

Some of the affiliates provide services to other non-affiliated companies. Admin, LLC has contracts to provide third party administrative services to two hospitals in East Cali and for three closed blocks of life policies to three non-affiliated insurers that are not domiciled in East Dakota. Investments, Inc. manages investments for other financial entities. All the data, processes, systems, hardware and software associated with the administration of insurance contracts is owned and in the possession of Admin, LLC. All the data, processes, systems, hardware and software associated with the administration of insurance contracts is owned and in the possession of Admin, LLC.

During the course of operations, all regulatory approvals have been secured, in particular regarding the management services agreement, all affiliated transactions, the state licensing requirements for TPAs, and the regulatory requirements applicable to preneed companies.

The East Dakota regulators discover significant financial irregularities and shortfalls and commence rehabilitation. Alpha's liquidity is bad and most of the liquid assets are held by Investment, Inc.

The hospitals and insurers serviced by Admin, LLC are concerned and are working with Big's officers to explore bankruptcy proceedings for Big, Admin, LLC and Investments, Inc. Several funeral homes in West Kansas are also concerned and are exploring state receivership options against Burial, Inc.

The affiliates honor their contractual obligations but make no other concessions with the Receiver.

In order to provide insurance benefits to policyholders, the East Dakota regulators are convinced they need the three affiliates, Admin, LLC, Investments, Inc., and Burial, Inc., to be subject to the jurisdiction and answerable to orders in Alpha's receivership proceedings. Without that, the concern is that the Receiver and the Receivership Court will have no meaningful opportunity to address administration of the insurance policies, employees, insurance policy files and records, office space from which to administer the insurance policies, insurance coverage, and management of investments supporting insurance policies, among others.