NAIC National Association of Insurance Commissioners

10/19/20

WebEx Conference Call

RECEIVERSHIP LAW (E) WORKING GROUP

Thursday, October 29, 2020
12:00 p.m. Eastern / 11:00 a.m. Central / 10:00 a.m. Mountain / 9:00 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 Addressing Continuation of Essential Services in Receivership—*Kevin Baldwin (IL)*
    - Summary of Recommendations for Continuation of Essential Services — Attachment A
    - Comment Letters Received (ME, MI, OK, PA, AHIP, Arbor Strategies LLC, NOLHGA & NCIGF) — Attachment B

2. Discuss Comments Received and Consider Adoption of the Revisions to *Receiver's Handbook for Insurance Company Insolvencies* for Chapter 4 for Qualified Financial Contracts —*Laura Lyon Slaymaker (PA)*
    - Comment Letters Received (IN, MI, ACLI) — Attachment C
    - Chapter 4 with Edits — Attachment D

3. Consider Adoption of the August 25 Conference Call Minutes—*Laura Lyon Slaymaker (PA)* — Attachment E

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

5. Adjourn

Attachment A

Commentor	Topic	Full comment letters on Continuation of Essential Services in Receivership are attached. The following contains only excerpts that identify recommendations, or in some cases where issues are described but no recommendation is identified.
Recommendations for Model #440 Section 5(A) - Standards and Management of an Insurer Within an Insurance Holding Company System		
NOLHGA & NCIGF	Include Non-insurer affiliates subject to receivership proceedings	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.**

Recommendations for Model #450 Section 19 - Transactions Subject to Prior Notice - Notice Filing (Form D)		
Oklahoma	Affiliated Contract Requirements – Unpaid fees	*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;**
Oklahoma	Affiliated Contract Requirements – Essential employees	*Insurance Holding Company System Model Regulation* (#450): 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.**
Oklahoma	Fines —Access to data and records and lack of cooperation	**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.
Pennsylvania	Affiliated Contract Requirements – Data and Records	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.
Pennsylvania	Affiliated Contract Requirements – Comingled Data and Records	**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. 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 comingled records must done by holding company employees. This task must be paid for and there is not guarantee the liquidator receives every applicable file.
Pennsylvania	Affiliated Contract Requirements – Access to data and record when holding company has multiple insurers	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.
Pennsylvania	#440, Section 6 Examinations —Access to data and records and lack of cooperation	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.
Pennsylvania-	#440, Section 12 - Receivership	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 (Section 6 – Examinations).

Michigan	Affiliated Contract Requirements – Limit on Termination of Services	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.**
Michigan	Affiliated Contract Requirements – Access to Data and Records	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.
AHIP	Affiliated Contract Requirements - #450, Section 19.B(10)	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.**
AHIP	Affiliated Contract Requirements - #450	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**.
AHIP	Affiliated Contract Requirements -	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,**

	#450, Section 19.B(10)	**but also to set strong precedents to serve as examples for other affiliates in other receiverships.**
Comments on Definition of "Insurer" in Holding Company Laws		
ME, AHIP, Arbor Strategies LLC	Opposes a Revised Definition of Insurer	**Opposes a revised definition** of "insurer" in state holding company laws to encompass affiliated entities whose sole purpose is to provide services to the insurer.
Oklahoma	Supports a Revised Definition of Insurer	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.**
Recommendations Other than Holding Company Acts		
Michigan	License service provider as a TPA	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.
Michigan	Surety Bond	I continue to be interested in the **party providing the essential services having a surety bond in case of nonperformance of the contract.**
AHIP	Update IRMA	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**.
NOLHGA & NCIGF	Receiver's Handbook	Once the Working Group develops its recommendations, we also **suggest drafting guidance through the Receiver's Handbook for Insurance Company Insolvencies**.
Pennsylvania	Pre-Receivership – Analysis and Exam	**Continue to work closely with the solvency side, …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.

Attachment B

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.

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.

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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

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
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Virtual Meetings Available Upon Request

AHIP
America's Health
Insurance Plans

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

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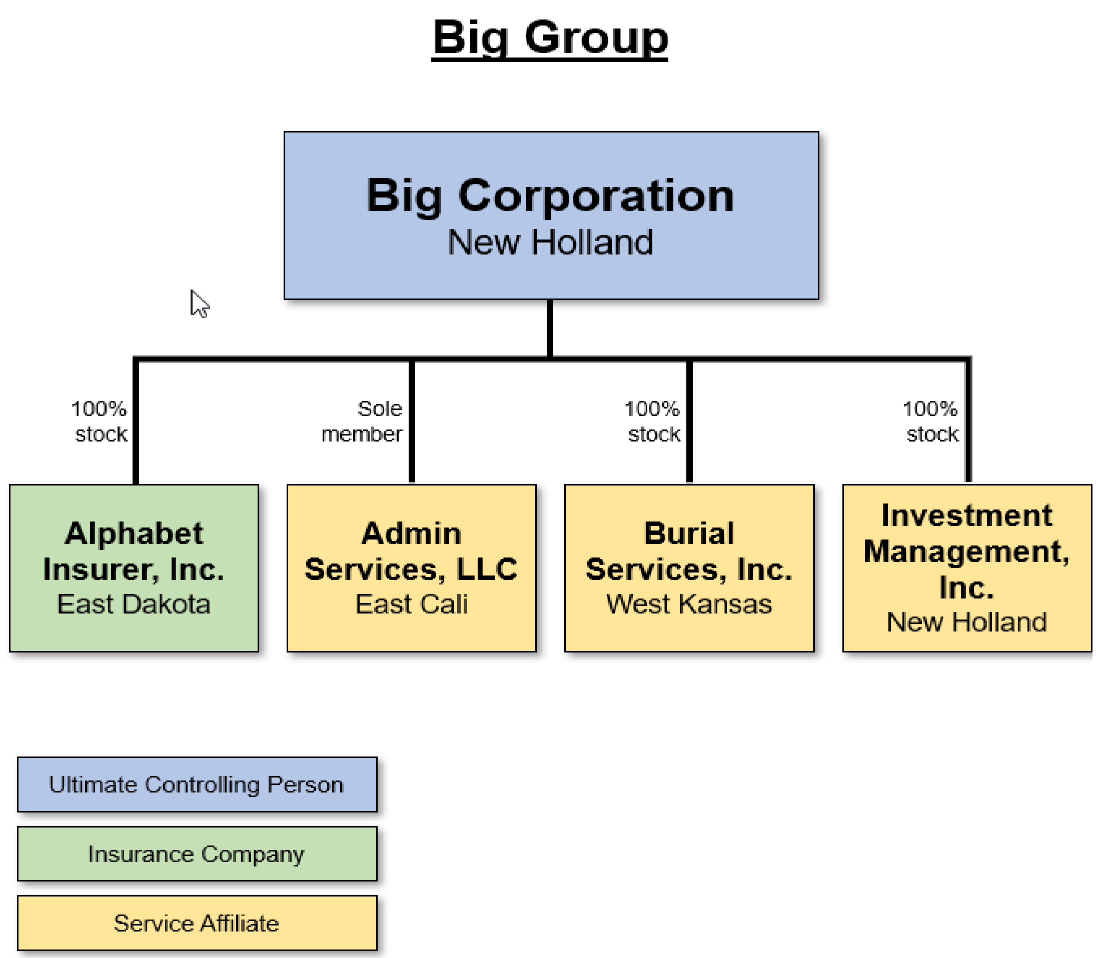
Exhibit A

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.

Attachment C

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.

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

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."

[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
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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 A. Mehlman

Wayne Mehlman
Senior Counsel, Insurance Regulation

Attachment D

CHAPTER 4 – INVESTIGATION AND ASSET RECOVERY

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

VII. RECEIVERSHIP INVOL~~IV~~VING QUALIFIED FINANCIAL CONTRACTS

Insurer R~~r~~eceivership Model Act (#555, commonly known as IRMA) Section 711 – Qualified Financial Contracts (or Similar Provision) addresses stays termination or transfers of netting agreements or qualified financial contracts (QFCs).

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 arises 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.

~~1~~ [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 for certain insurers – generally larger entities that may be significant in size but outside of being subject to a potential Dodd-Frank receivership.

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.).~~

- Evaluate if the insurer is engaged in netting agreements and QFCs through a market facing affiliate or non-affiliate, whereby the insurer's contract is with that market facing entity and the market facing entity has the contracts with the counterparties.

- 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

[2] See footnote 1 of this Chapter.

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.

- 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.

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

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*

[3] See footnote 1 of this Chapter.

- 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*
  - 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 Extinguishments*~~*Extinguishing*~~ *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*~~

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

Attachment E

Draft: 8/28/20

Receivership Law (E) Working Group
Conference Call
August 25, 2020

The Receivership Law (E) Working Group of the Receivership and Insolvency (E) Task Force met via conference call Aug. 25, 2020. The following Working Group members participated: Kevin Baldwin, Co-Chair (IL); Laura Lyon Slaymaker, Co-Chair (PA); Steve Uhrynowycz (AR); Jack Hom (CA); Rolf Kaumann (CO); Jared Kosky (CT); Toma Wilkerson (FL); Christopher Joyce (MA); Robert Wake (ME); James Gerber (MI); Shelley Forrest (MO); Justin Schrader (NE); and James Kennedy (TX).

1. Discussed its 2020 Charges

Mr. Baldwin summarized the Working Group's 2020 charges. He said any topics related to receivership and guaranty fund laws can be brought to this Working Group at any time.

2. Exposed a Request for Comment on the Continuity of Essential Services in Receivership

Mr. Baldwin said the Receivership and Insolvency (E) Task Force completed its Macroprudential Initiative (MPI) review in 2019, and earlier this year, it began discussions on the need to make the necessary model law changes to resolve the issue of the continuity of essential services through affiliated intercompany agreements that arise during the receivership of an insurance company. The Request for NAIC Model Law Development to consider amendments to the *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450) specific to this issue was adopted by the Executive (EX) Committee on Aug. 13. The Working Group should complete its work on this charge by the 2021 Fall National Meeting.

Mr. Baldwin said receivers have faced several challenges regarding the issue of the continuity of essential services, including:

- Ensuring that the services that the affiliate performs continue to be performed in receivership.
- In some cases, the affiliate may be operating the insurer(s) in the group.
- The affiliate is generally not subject to the receivership order.
- The affiliate may have physical custody of the books and records, which may create information technology (IT) issues.
- The affiliate that holds the records may charge fees to the estate to pay for the insurer's records beyond the cost to transfer the records.
- Data is comingled, and there are additional costs to separate the data.
- Insurers and affiliates in multi-state groups involve laws and authorities in multiple jurisdictions.
- Multiple insurers in the group may share the same affiliate's services.

Mr. Baldwin said some possible recommendations include the following, noting that some options may create issues that need to be considered further:

- Strengthening the language in the provisions within Model #440 and Model #450 regarding affiliated agreements to: 1) reinforce the requirements that the affiliate does not have an automatic right to terminate the agreement upon the insurer entering receivership; 2) require that intercompany agreements mandate that any records of the insurer held by the affiliate are property of the insurer; and 3) require that records be made immediately available and turned over immediately upon request.
- Consider how affiliated entities whose sole purpose is to operate and provide services to the insurer in the holding company group could be defined in Model #440, Model #450, and the *Insurer Receivership Model Act* (#555) to be considered an insurer for the purposes of a receivership.
- Include a provision that the affiliate providing services to insurers in the holding company group agree to be subject to the jurisdiction of the receivership court if the insurer goes into receivership.
- Issue injunctions preventing the affiliate from ceasing services to the insurer in receivership until the receiver or the receivership court terminates and releases it from the contract.
- Require a surety bond of the affiliate so that if it is unable to continue to provide services to the insurer in receivership, the receiver can collect on the bond to find another service provider.

Mr. Baldwin recommended gathering ideas from both state insurance regulators and interested parties based on experiences handling this issue in receivership. He requested that the responses to a request for comment be specific, including such things as: 1) specific proposed revisions to Model #440 and Model #450 provisions; 2) other options to resolve this issue outside of Model #440 and Model #450; 3) issues or challenges faced by receivers; 4) how those issues or challenges were resolved; and 5) what would have made the resolution more efficient or effective. He said the request for comment will be released for a 30-day public comment period ending Sept. 24.

Barbara F. Cox (National Conference of Insurance Guaranty Funds—NCIGF) said the topic of cyberinsurance in its white paper, *Insurance Resolution: Preparing for Cyber Claims*, which was presented at the Receivership and Insolvency (E) Task Force meeting on Aug. 7, is a topic to consider when drafting begins.

3. Exposed Revisions to the *Receiver's Handbook for Insurance Company Insolvencies*

Ms. Slaymaker said two of the Working Group's charges are to look at the current guidance for qualified financial contracts (QFCs) and develop any additional guidance for the *Receiver's Handbook for Insurance Company Insolvencies* (Handbook), if necessary. She said the current Handbook guidance includes QFCs in Chapter 4. She said NAIC staff have edited Chapter 4 to include the drafting note that was adopted by the NAIC in 2019 into the *Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts* (#1556), and they updated the statutory reporting references.

Ms. Slaymaker said the Working Group charges include consideration of how bridge financial institutions could be used in an advance planning or pre-receivership process. There is some guidance on the use of bridges in a federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) receivership of a systemically important financial institution (SIFI) in Chapter 11 of the Handbook.

Mr. Kennedy said the Handbook guidance may need to address that many insurers may not hold the QFCs directly but instead have contracts with third-party market-facing entities that hold the QFCs.

Ms. Slaymaker said both chapters would be exposed for review and comment. She requested that a review of the section on QFCs in Chapter 4 include a review of the revisions drafted by NAIC staff, a review of the current guidance, and comments on any recommendations for further revisions. For Chapter 11, while no recommended revisions are proposed, she requested consideration and comments on the use of bridge financial institutions outside of a SIFI receivership under the Dodd-Frank Act and whether the existing guidance in Chapter 11 would be applicable to a non-SIFI receivership and useful for receivers in that context. She said the exposure of the two chapters and the request for comment will be released for a 30-day public comment period ending Sept. 24.

4. Discussed Other Matters

Ms. Cox said the NCIGF submitted language that it developed regarding restructuring, such as insurance business transfers and company divisions, to the Restructuring Mechanisms (E) Working Group for consideration. She suggested flagging this topic as a possible future topic for discussion by this Working Group.

Having no further business, the Receivership Law (E) Working Group adjourned.

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