

Date: 11/16/20

*Virtual Meeting
(in lieu of meeting at 2020 Fall National Meeting)*

RECEIVERSHIP AND INSOLVENCY (E) TASK FORCE

Thursday, November 19, 2020

12:00 – 1:00 p.m. ET / 11:00 a.m. – 12:00 p.m. CT / 10:00 – 11:00 a.m. MT / 9:00 – 10:00 a.m. PT

ROLL CALL

Doug Slape, Chair	Texas	Gary Anderson	Massachusetts
Karima M. Woods, Vice Chair	District of Columbia	Anita G. Fox	Michigan
Lori K. Wing-Heier	Alaska	Chlora Lindley-Myers	Missouri
Elizabeth Perri	American Samoa	Matthew Rosendale	Montana
Alan McClain	Arkansas	Bruce R. Ramge	Nebraska
Ricardo Lara	California	Marlene Caride	New Jersey
Michael Conway	Colorado	Mike Causey	North Carolina
Andrew N. Mais	Connecticut	Glen Mulready	Oklahoma
David Altmaier	Florida	Jessica K. Altman	Pennsylvania
Robert H. Muriel	Illinois	Elizabeth Kelleher Dwyer	Rhode Island
Doug Ommen	Iowa	Raymond G. Farmer	South Carolina
Vicki Schmidt	Kansas	Carter Lawrence	Tennessee
Sharon P. Clark	Kentucky	Tanji J. Northrup	Utah
Eric A. Cioppa	Maine		

NAIC Support Staff: Jane Koenigsman

AGENDA

1. Consider Adoption of its Oct. 7 Minutes—*James Kennedy (TX)* Attachment One
2. Consider Adoption of the Report of the Receivership Financial Analysis (E) Working Group—*Toma Wilkerson (FL)*
3. Consider Adoption of the Report of the Receivership Large Deductible Workers' Compensation (E) Working Group—*Donna Wilson (OK) and Laura Lyon Slaymaker (PA)* Attachment Two
4. Consider Adoption of a Draft Model *Guideline for Administration of Large Deductible Policies in Receivership*—*Donna Wilson (OK) and Laura Lyon Slaymaker (PA)* Attachment Three
5. Consider Adoption of Revisions to the *Receiver's Handbook for Insurance Company Insolvencies* for Large Deductible Policies—*Donna Wilson (OK) and Laura Lyon Slaymaker (PA)* Attachment Four
6. Consider Adoption of the Report of the Receivership Law (E) Working Group—*Kevin Baldwin (IL)* Attachment Five
7. Consider Adoption of Revisions to the *Receiver's Handbook for Insurance Company Insolvencies* for Qualified Financial Contracts—*Kevin Baldwin (IL)* Attachment Six
8. Consider Exposure of a Draft Model Guideline for the Definition of a "Reciprocal State" in State Receivership Acts—*James Kennedy (TX)* Attachment Seven
9. Hear a Report of the Ad Hoc Group on Part A: Accreditation Standards for Receivership and Guaranty Fund Laws—*James Kennedy (TX)*

10. Discuss Comments Received and Consider Adoption of a Report on the
Macroprudential Initiative (MPI) to the Financial Stability (EX) Task Force
—*James Kennedy (TX)*

11. Hear an Update on International Resolution Activity—*James Kennedy (TX) and Robert Wake (ME)*

12. Discuss Any Other Matters Brought Before the Task Force—*James Kennedy (TX)*

13. Adjournment

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Draft: 11/18/20

Receivership and Insolvency (E) Task Force
Virtual Interim Meeting
October 7, 2020

The Receivership and Insolvency (E) Task Force met virtually Oct. 7, 2020. The following Task Force members participated: Kent Sullivan represented by James Kennedy, Chair (TX); Karima M. Woods, Vice Chair, represented by N. K. Brown (DC); Alan McClain represented by Steve Uhrynowycz (AR); Elizabeth Perri (AS); Ricardo Lara represented by Susan Bernard (CA); Michael Conway represented by Rolf Kaumann (CO); Andrew N. Mais represented by William Arfanis (CT); David Altmaier represented by Toma Wilkerson (FL); Doug Ommen represented by Kim Cross (IA); Vicki Schmidt represented by Tish Becker (KS); Sharon P. Clark represented by Jeff Gaither (KY); Gary Anderson represented by Christopher Joyce (MA); Eric A. Cioppa represented by Robert Wake (ME); Anita G. Fox represented by James Gerber (MI); Chlora Lindley-Myers and Shelley Forrest (MO); Matthew Rosendale represented by Steve Matthews (MT); Mike Causey represented by Jackie Obusek (NC); Bruce R. Ramage represented by Justin Schrader (NE); Marlene Caride represented by Diana Sherman (NJ); Glen Mulready represented by Donna Wilson (OK); Jessica K. Altman represented by Laura Lyon Slaymaker (PA); Elizabeth Kelleher Dwyer and Matt Gendron (RI); Raymond G. Farmer represented by Gwen Fuller McGriff (SC); Hodgen Mainda represented by Patrick Merkel (TN); and Tanji. J. Northrup represented by Jake Garn (UT).

1. Adopted its Summer National Meeting Minutes

Ms. Wilson made a motion, seconded by Ms. Lyon Slaymaker, to adopt the Task Force's Aug. 7 minutes (*see NAIC Proceedings – Summer 2020, Receivership and Insolvency (E) Task Force*). The motion passed unanimously.

2. Adopted its 2021 Proposed Charges

Mr. Kennedy said one comment was received jointly from the National Organization of Life and Health Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF) to insert the phrase "among other solutions" into the Receivership Law (E) Working Group's revised charge under C.2. Mr. Kaumann made a motion, seconded by Ms. Wilson, to adopt the Task Force's 2021 Proposed Charges with the proposed edit (Attachment One-A). The motion passed unanimously.

3. Received Comments on Key Provisions of Receivership and Guaranty Fund Laws

Mr. Kennedy said comments were received from 15 state insurance regulators and interested parties on each of the key provisions of receivership and guaranty fund laws that states should consider adopting into their laws, particularly with respect to receivership of insurers operating in multiple states (Attachment One-B).

a. Critical to a Multi-Jurisdiction Receivership

Mr. Kennedy said this project began with a referral from the Financial Stability (EX) Task Force to address an evaluation of receivership and guaranty fund laws and practices in the context of the Macroprudential Initiative (MPI). While a receivership of a multi-jurisdictional insurer would not likely have a material impact on financial stability or the broader financial markets, this project has highlighted areas of our receivership process that may need attention.

Mr. Kennedy said based on the comments received, eight of the 14 key topics have a majority of responses indicating that it is critical for states to a multi-jurisdictional receivership, including: 1) conflicts of law; 2) stays and injunctions; continuation of coverage; priority of distribution; ancillary conservation of foreign insurers; 6) domiciliary receivers in other states; treatment of large deductible workers' compensation policies; and 8) 2017 revisions to the *Life and Health Insurance Guaranty Association Model Act* (#520).

Mr. Kennedy said states are encouraged to ensure that their states' law addresses three of the topics, including conflicts of law, continuation of coverage, and priority of distribution. The Task Force will encourage states through help from the NAIC to provide outreach and updates to states' legislative liaison staff and education on future legal webinars.

Mr. Kennedy said the Louisiana comment letter involved the broader issue of a state receivership court affecting the policyholders in other states, especially in rehabilitation. The topic before the Task Force is regarding full faith and credit of

stays and injunctions. The Task Force is focused on the effect of whether a stay or injunction entered into a receivership court is honored in another state. This has been the subject of a lot of litigation, and receivers have expressed concern about this issue. Mr. Kennedy recommended that the three related topics be addressed, including stays and injunctions, ancillary conservation of foreign insurers, and domiciliary receivers in other states. He said the Task Force could draft a guideline as an alternative to address how states define reciprocity, as was adopted in Florida and suggested in written comments from Patrick Cantilo (Cantilo & Bennett LLP). Mr. Cantilo and Ms. Wilkerson agreed to help draft a guideline for future consideration by the Task Force.

Mr. Kennedy said the treatment of large deductible workers' compensation policies is being addressed by the Receivership Large Deductible Workers' Compensation (E) Working Group that is developing a draft Guideline for Administration of Large Deductible Policies in Receivership, which will be an alternative to Section 712 of the *Insurer Receivership Model Act* (#555). He said once adopted, states will be encouraged to adopt the guideline.

Mr. Kennedy said 32 states have adopted the 2017 revisions to Model #520, and three states have it under consideration. He said this is good progress, and he does not believe the Task Force should take any further action. Hearing no further comments, the Task Force took no further action on this topic.

Mr. Kennedy said based on the comments and discussion, a final report to the Financial Stability (EX) Task Force would be drafted and exposed in advance of the next Receivership and Insolvency (E) Task Force meeting to consider adoption at that meeting.

b. Consider as an Accreditation Standard or Other Methods to Encourage Adoption

Mr. Kennedy said for most of the 14 key provisions, commenters were not in favor of the development of revised Part A Accreditation standards for receivership and guaranty fund laws. Wayne Mehlman (American Council of Life Insurers—ACLI) said the ACLI's comment letter includes recommendations to improve accreditation standards without listing specific provisions. Barbara F. Cox (NCIGF) said it may be difficult and unrealistic in certain states to adopt the *Property and Casualty Insurance Guaranty Association Model Act* (#540) to meet an accreditation standard. Chris Petersen (Arbor Strategies LLC) said he represents a coalition of large health insurers that believe the 2017 revisions to Model #520 should be an accreditation standard. Peter G. Gallanis (NOLHGA) said he agrees with Ms. Cox that there are good faith policy differences state-to-state regarding property and casualty guaranty fund laws that create challenges in adopting Model #540 in all states. He said there are less state-to-state issues for life and health guaranty association laws. He said even though there has not been much broad opposition to the 2017 revisions to Model #520, there have been some disagreements in some states. He said if there is a move toward a new accreditation standard, there would need to be consideration given to transition timing and clarity on what requirement a state would need to meet now and in the future if models are amended. Mr. Kennedy recommended that an ad hoc group be formed to further discuss this topic and report back to the Task Force at its next meeting. The Task Force agreed.

c. Feedback on Other Topics

Mr. Kennedy said feedback was requested on various other topics that had been raised in previous comment letters that do not fit within the MPI referral. He said many of the topics are being pursued and addressed in other NAIC workstreams. Coordination between the Financial Analysis (E) Working Group and the Receivership Financial Analysis (E) Working Group is ongoing, and it recently included updates to pre-receivership guidance for state insurance regulators. The Task Force took no further action on this topic.

Mr. Kennedy said the topic of continuation of inter-affiliate services is being addressed by the Receivership Law (E) Working Group. He said the topic of orphan claims in large deductible workers' compensation is largely addressed in the draft Guideline for Administration of Large Deductible Policies in Receivership under development by the Receivership Large Deductible Workers' Compensation (E) Working Group. Ms. Cox said the NCIGF is working to address this topic in states' guaranty fund laws and practices, but situations occur outside of the guaranty fund authority, such as when policies are sold in states where the insurer is not licensed.

Mr. Kennedy said the topic of business risk transfers are being addressed by the Restructuring Mechanisms (E) Working Group. He said guidance for state insurance regulators on crisis management groups is being address through a project of the Group Solvency Issues (E) Working Group to develop regulatory guidance on the requirements for supervision of internationally active insurance groups (IAIGs) under the Common Framework for the Supervision of Internationally Active Insurance

Groups (ComFrame). As these two workstreams are in progress, the Task Force will provide input at an appropriate time in the future.

Mr. Kennedy said for the topic of promoting cost effective resolution, the feedback from commenters indicates that state insurance regulators already strive to achieve this result. He said the suggestion to provide standardized judicial education would be difficult to address due to differences between states' laws and practices. The feedback from commenters indicate that the concept of an NAIC receivership "SWAT Team" would be difficult to achieve due to costs and procurement requirements. Further, the Task Force and its working groups already consist of receivership experts. The Task Force took no further action on these three topics.

Mr. Kennedy said regarding the topic of addressing administrative costs of the guaranty funds not associated with insolvency activity, some states' guaranty fund laws do not allow for those types of assessments. Ms. Cox said the NCIGF is working on a project in NCIGF Model for an optional provision to allow states to assess for certain overhead expenses. It would be disastrous to have states' guaranty funds offices close due to lack of funding. Insolvencies occur with short notice, so maintenance of an office is necessary. Mr. Gallanis said this is not an issue for life and health guaranty associations. There may be certain situations that arise in states, but those states have found resolutions to those issues. Bill O'Sullivan (NOLHGA) said he agrees with Mr. Gallanis. He said this issue was addressed for life and health guaranty associations through the 2017 revisions to Model #520, where the dollar cap on class A assessments was eliminated. Mr. Kennedy agreed and encouraged states to adopt those amendments. The Task Force took no further action on this topic.

4. Discussed Other Matters

Mr. Kennedy reminded all parties that comments are due Oct. 30 on the exposure drafts of the Receivership Large Deductible Workers' Compensation (E) Working Group. He said the Task Force's next WebEx meeting will be held Nov. 19.

Having no further business, the Receivership and Insolvency (E) Task Force adjourned.

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Draft: 11/18/20

Receivership Large Deductible Workers' Compensation (E) Working Group
Webex Meeting
November 5, 2020

The Receivership Large Deductible Workers' Compensation (E) Working Group of the Receivership and Insolvency (E) Task Force met via Webex Meeting November 5, 2020. The following Working Group members participated: Donna Wilson, Co-Chair (OK); Laura Lyon Slaymaker, Co-Chair (PA); David Phifer (AL); Steve Uhrynowycz (AR); Toma Wilkerson (FL); Sarah Crittenden (GA); Robert Wake (ME); Shelly Forrest (MO); Tom Green (NE); John Rehagen (MO); and James Kennedy (TX).

1. Adopt a Model Guideline for Administration of Large Deductible Policies in Receivership

Ms. Wilson said the new Model Guideline for the Administration of Large Deductible Policies in Receivership was exposed for a 30-day comment period ending Oct. 30, 2020. Only a few non-substantive punctuation edits were received and are incorporated in the draft. The drafting group based the Guideline largely on the principles and structure of the National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model) with certain modifications. The Guideline is not the NCIGF Model but is based on the principles of the NCIGF Model because the NCIGF Model approach has been adopted by several states using varying language. The NCIGF Model has evolved over time based on additional experiences from insolvencies. The drafting group felt that the new Guideline would serve as a viable alternative to *Insurer Receivership Model Act* (#555) Section 712.

Mr. Wake made a motion to adopt the new draft Guideline for Administration of Large Deductible Policies in Receivership which was seconded by Mr. Green (Attachment Three). The motion passed unanimously.

2. Adopt Revisions to the *Receiver's Handbook for Insurance Company Insolvencies*

Ms. Slaymaker said the draft was exposed for a 30-day comment period ending Oct. 30, 2020. Only a few non-substantive punctuation edits were received and are incorporated in the draft. asked for a motion to adopt revisions to the *Receiver's Handbook for Insurance Company Insolvencies* (Handbook). These revisions incorporate the new Model Guideline for Administration of Large Deductible Policies in Receivership. Mr. Uhrynowycz made a motion to adopt the revisions to the Handbook which was seconded by Ms. Wilson (Attachment Four). The motion passed unanimously.

Having no further business, the Receivership Large Deductible Workers' Compensation (E) Working Group adjourned.

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Draft: 11/18/20

Receivership Large Deductible Workers' Compensation (E) Working Group
Webex Meeting
September 30, 2020

The Receivership Large Deductible Workers' Compensation (E) Working Group of the Receivership and Insolvency (E) Task Force met via Webex Meeting Sept. 30, 2020. The following Working Group members participated: Donna Wilson, Co-Chair (OK); Laura Lyon Slaymaker, Co-Chair (PA); Steve Uhrynysz (AR); John Rehagen and Shelly Forrest (MO); Tom Green (NE); Mark Jordan (NM); and James Kennedy (TX).

1. Exposed a Model Guideline for Administration of Large Deductible Policies in Receivership

Ms. Wilson introduced Guideline for Administration of Large Deductible Policies in Receivership as an alternative to Section 712 of the *Insurer Receivership Model Act* (#555). The Working Group directed NAIC staff to expose the model guideline for a 30-day public comment period ending Oct. 30, 2020.

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

Ms. Wilson introduced exposure of revisions to the *Receiver's Handbook for Insurance Company Insolvencies* (Handbook). These revisions are based on the guideline and have been made primarily to align the handbook to the draft guideline for Model #555. Therefore, the revisions to the Handbook are contingent upon adoption of the guideline. The Working Group directed NAIC staff to expose the revisions to the Handbook for 30-day public comment period ending Oct. 30, 2020.

Having no further business, the Receivership Large Deductible Workers' Compensation (E) Working Group adjourned.

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Adopted by the Executive (EX) Committee and Plenary, _____, 2020

Adopted by the Financial Condition (E) Committee, _____, 2020

Adopted by the Receivership and Insolvency (E) Task Force, _____, 2020

Adopted by the Receivership Large Deductible Workers' Compensation (E) Working Group, November 5, 2020

GUIDELINE FOR ADMINISTRATION OF LARGE DEDUCTIBLE POLICIES IN RECEIVERSHIP

Drafting Note: Having the necessary statutory authority specific to large deductible workers' compensation products in receiverships is key to the successful resolution of these insurers. There are currently two statutory authority options available, and there are differences across states as to which authority has been adopted: 1) Section 712 of the NAIC *Insurer Receivership Model Act* (#555—IRMA), Administration of Loss Reimbursement Policies; and 2) the National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Legislation, Administration of Large Deductible Policies and Insured Large Deductible Collateral. Both provide statutory guidance that articulates the respective rights and responsibilities of the various parties, which greatly enhance a state's ability to manage complex large deductible programs in liquidation. Generally, both approaches provide for the collection of reimbursements, resolve disputes over who gets the reimbursements and ensure that the claimants are paid. The provisions in each of the two options generally complement each other, except for conflicting provisions regarding the issue of the ultimate ownership of, and entitlement to, the deductible recoveries and large deductible collateral as between the estate and the guaranty association. The issue is whether the guaranty associations, on behalf of the claimants, are entitled to any deductible reimbursements or whether they are a general estate asset that is shared pro rata by the guaranty associations and the uncovered claimants.

As of the drafting of this Guideline, the NCIGF model approach has been adopted by several states using varying language. However, the NCIGF model has evolved over time based on additional experiences from insolvencies and the NCIGF continues to modify its model as warranted. The NAIC has developed the following Guideline based largely on the principles and structure of the NCIGF model with certain modifications made by the NAIC Large Deductible Workers' Compensation (E) Working Group of the Receivership and Insolvency (E) Task Force. The following statutory language is not an amendment to the NAIC receivership models but is intended as a Guideline for use by states as an alternative to IRMA Section 712, Administration of Loss Reimbursement Policies.

Administration of Large Deductible Policies in Receivership

This Guideline shall apply to workers' compensation large deductible policies issued by an insurer subject to delinquency proceedings under [insert cite to state's receivership statute]. Large deductible policies shall be administered in accordance with their terms, except to the extent such terms conflict with this Guideline. This Guideline does not apply to policies where the insurer has no liability for the portion of a claim that is within the deductible or self-insured retention.

A. Definitions.

For purposes of this Guideline:

- (1) "Large deductible policy" means any combination of one or more workers' compensation policies and endorsements and contracts or security agreements entered into between an insured and the insurer in which the insured has agreed with the insurer to:
 - (a) Pay directly the initial portion of any claim covered under the policy up to a specified dollar amount which the insurer would otherwise be obligated to pay, or the expenses related to any claim; or
 - (b) Reimburse the insurer for its payment of any claim or related expenses under the policy up to the specified dollar amount of the deductible.

The term "large deductible policy" includes policies which contain an aggregate limit on the insured's liability for all deductible claims, a per-claim deductible limit or both. The primary purpose and distinguishing characteristic of a large deductible policy is the shifting of a portion of the ultimate financial responsibility under the large deductible policy to pay claims from the insurer to the insured, even though the obligation to initially pay claims may remain with the insurer, and the insurer remains liable to claimants in the event the insured fails to fulfill its payment or reimbursement obligations.

Drafting Note: States may wish to establish a minimum dollar deductible threshold for application of this statute based on local conditions. Because the payment of the entire amount of the claim remains the unconditional obligation of the insurer, the insured's loss reimbursement obligation should not be treated as a "deductible" for the purpose of any applicable exclusion from guaranty association coverage, even though these policies are commonly referred to as "large deductible policies."

Large deductible policies do not include policies, endorsements or agreements which provide that the initial portion of any covered claim shall be self-insured and further that the insurer shall have no payment obligation within the self-insured retention. Large deductible policies also do not include policies that provide for retrospectively rated premium payments by the insured or reinsurance arrangements or agreements,

except to the extent such reinsurance arrangements or agreements are put in place as security for the policyholder's large deductible obligations.

- (2) "Deductible claim" means any allowed claim, including a claim for loss and defense and cost containment expense (unless such expenses are excluded), under a large deductible policy to the extent it is within the deductible.
- (3) "Large deductible collateral" means any cash, letters of credit, surety bond, or any other form of security posted by the insured, or by a captive insurer or reinsurer, to secure the insured's obligation under the large deductible policy to pay deductible claims or to reimburse the insurer for deductible claim payments. Large deductible collateral may also secure an insured's obligation to reimburse or pay to the insurer as may be required for other secured obligations.
- (4) "Commercially reasonable" means to act in good faith using prevailing industry practices and making all reasonable efforts considering the facts and circumstances of the matter.
- (5) "Other secured obligations" means obligations of an insured to an insurer other than those under a large deductible policy, such as those under a reinsurance agreement or other agreement involving retrospective premium obligations the performance of which is secured by large deductible collateral that also secures an insured's obligations under a large deductible policy.

B. Handling of Large Deductible Claims.

Unless otherwise agreed by the responsible guaranty association, all large deductible claims that are also "covered claims" as defined by the applicable guaranty association law, including those that may have been funded by an insured before liquidation, shall be turned over to the guaranty association for handling.

- (1) If a deductible claim is not covered by any guaranty association, the receiver shall draw on available large deductible collateral to pay the claim; or make other arrangements with the insured to ensure the timely payment of the claim. The receiver shall pay the claim promptly from the large deductible collateral unless the insured pays the claim directly or there is no available large deductible collateral.
- (2) Deductible claims paid by the insured or by the receiver in accordance with this Guideline shall not be treated as distributions of estate assets under [insert cite to state's liquidation priority distribution statute]. To the extent the insured, or a third-party administrator on behalf of the insured, pays the deductible claim, pursuant to an agreement by the guaranty association or otherwise, the insured's payment of a deductible claim in whole or in part will extinguish the obligations, if any, of the receiver and/or any guaranty association to pay that claim or that portion of the claim. No credit or charge for an imputed or constructive distribution of any kind shall be made against the receiver or a guaranty association on the basis of an insured's payment of a deductible claim.

Drafting Note: This provision addresses so called "orphan claims," which are situations where, because of variations in state law or for other reasons, claims generally covered by the guaranty fund system are not provided such protection. States should take steps, through statutory revision or otherwise, to avoid orphan claims, especially for workers' compensation insurance. However, if such claims do exist, this provision permits the receiver to utilize available large deductible collateral, or other funds provided by the employer, to ensure that they continue to be paid. Alternative language that states may consider is as follows: "In cases where a deductible claim is not a guaranty association covered claim and the claimant has no other remedy either from the employer or other resources available in a state, the receiver may pay the claim to the extent of the deductible with available Large deductible collateral as described in subsection E(2) below."

C. Deductible Claims Paid by a Guaranty Association.

To the extent a guaranty association pays any deductible claim for which the insurer would have been entitled to reimbursement from the insured, a guaranty association shall be entitled to the amount of the reimbursement, and available large deductible collateral as provided for under subsection E to the extent necessary to reimburse the guaranty association. Such amounts shall be paid to the guaranty association net of any of the receiver's collection costs as described in subsection F. Reimbursements paid to the guaranty association pursuant to this subsection shall not be treated as distributions under [insert cite to state's liquidation priority distribution statute] or as early access payments under [insert cite to state's early access statute].

To the extent that a guaranty association pays a deductible claim that is not reimbursed either from large deductible collateral or by an insured's payments, or incurs expenses in connection with large deductible policies that are not reimbursed under this subsection, the guaranty association shall be entitled to assert a claim for those amounts in the delinquency proceeding, except as provided in subsection D(5).

Nothing in this subsection limits any rights of the receiver or a guaranty association that may otherwise exist under applicable law to obtain reimbursement from insureds for claims payments made by the guaranty association under policies of the insurer or for the guaranty association's related expenses, such as those provided for pursuant to [insert cite to state's guaranty association net worth provision], or existing under similar laws of other states.

D. Collections

- (1) The receiver shall take all commercially reasonable action to ensure that the large deductible collateral remains adequate to secure the insured's obligations, and to collect reimbursements owed for deductible claims as provided for herein:
 - (a) Paid by the insurer prior to the commencement of delinquency proceedings;
 - (b) Paid by a guaranty association upon receipt by the receiver of notice from a guaranty association of reimbursable payments;
 - (c) Paid or allowed by the receiver; or
 - (d) Approved by the receiver for payment.
- (2) If the insured does not make payment within the time specified in the large deductible policy, or within sixty (60) days after the date of billing if no time is specified, the receiver shall take all commercially reasonable actions to collect any reimbursements owed.
- (3) Neither the insolvency of the insurer, nor the receiver's or insurer's inability to perform any of its obligations under the large deductible policy, shall be a defense to the insured's reimbursement obligation under the large deductible policy.
- (4) An allegation of improper handling or payment of a deductible claim by the insurer, the receiver and/or any guaranty association shall not be a defense to the insured's reimbursement obligations under the large deductible policy.
- (5) If the receiver declines to seek or is unsuccessful in obtaining reimbursement from the insured for a large deductible obligation and there is no available large deductible collateral, a guaranty association may, after notice to the receiver, seek to collect the reimbursement due from the insured on the same basis as the receiver, and with the same rights and remedies including without limitation the right to recover reasonable costs of collection from the insured. The guaranty association shall report any amounts so collected from each insured to the receiver. The receiver shall provide the guaranty association with available information needed to collect a reimbursement due from the insured. The receiver shall notify all other guaranty associations that have paid large deductible claims on behalf of the same insured. Amounts collected by a guaranty association pursuant to this paragraph shall be treated in accordance with subsection C. The expenses incurred by a guaranty association in pursuing reimbursement shall not be permitted as a claim in the delinquency proceeding at any priority, except as agreed by the receiver at or before the time the expenses are incurred; however, a guaranty association may net the expenses incurred in collecting any reimbursement against that reimbursement.

E. Large Deductible Collateral

- (1) Subject to the provisions of this subsection, the receiver shall utilize large deductible collateral, when available, to secure the insured's obligation to fund or reimburse deductible claims or other secured obligations or other payment obligations. A guaranty association shall be entitled to large deductible collateral as provided for in this subsection to the extent needed to reimburse a guaranty association for the payment of a deductible claim. Any payments made to a guaranty association pursuant to this subsection

shall not be treated as distributions of estate assets under [Insert cite to state's liquidation priority distribution statute] or as early access payments under [Insert cite to state's early access statute]. Such payments shall extinguish the receiver's obligations to the guaranty association with respect to any claim or portion of a claim that has been reimbursed from large deductible collateral.

- (2) All claims against the large deductible collateral shall be paid first to reimburse claim payments made by the insurer, the receiver, or the guaranty associations to reimburse their deductible claim payments on large deductible policies. After these obligations are satisfied, remaining claims shall be paid in the order received and no claim of the receiver, except in accordance with this subsection, shall supersede any other claim against the large deductible collateral.
- (3) Notwithstanding any agreement between the insured and the insurer, the receiver shall draw down large deductible collateral to the extent necessary in the event that the insured fails to:
 - (a) Perform its funding or payment obligations under any large deductible policy;
 - (b) Pay deductible claim reimbursements within the time specified in the large deductible policy or within sixty (60) days after the date of the billing if no time is specified;
 - (c) Pay amounts due the estate for pre-liquidation obligations;
 - (d) Timely fund any other secured obligation; or
 - (e) Timely pay expenses.
- (4) Excess large deductible collateral may be returned to the insured when deemed appropriate by the receiver after a periodic review of claims paid, outstanding case reserves, and allowance for adverse development and claims incurred but not reported as determined by the receiver."

F. Administrative Fees

- (1) The receiver is entitled to recover through billings to the insured or from large deductible collateral all reasonable expenses that the receiver incurred in fulfilling its collection obligations under this Guideline. All such deductions or charges shall be in addition to the insured's obligation to reimburse claims and related expenses and shall not diminish the rights of claimants or guaranty associations.
- (2) To the extent the receiver cannot collect such expenses pursuant to paragraph (1), the receiver is entitled to deduct from the large deductible collateral or from the deductible reimbursements reasonable and actual expenses incurred in connection with the collection of the large deductible collateral and deductible reimbursements.
- (3) To the extent such amounts are not available from reimbursements or large deductible collateral, the receiver, or guaranty associations if provided under an agreement with the receiver under subsection D(5), shall have a claim against the estate as provided pursuant to [insert cite to state's liquidation priority distribution statute].

Drafting Note: State policymakers should decide whether this provision, when enacted, should apply to existing liquidations.

Draft: 11/5/20

Revisions specific to the new NAIC Model Guideline discussed below subject to the NAIC's adoption of the Guideline

Chapter 5 – Claims

V. PAYMENT OF APPROVED CLAIMS [HANDBOOK PAGE 291]

A. Priority of Distribution in Receiverships

5. Class 3 and 4 – Claims for Policy Benefits

a. Deductible and Limits

The policyholder's claim is for the amount that the insurer should have paid. The insurer's liability attaches after the deductible has been paid by the insured ("Non-Advancement Policies"). However, for some policies (e.g., some workers' compensation policies), the insurer is required to pay the claim and seek the deductible from the insured (thereafter, known as "Large Deductible Policies"). It is common for insureds to post collateral with the insurer for deductible payments that may be made by the insurer, for which the insurer then seeks reimbursement from the insureds. ~~With other policies, the insurer's liability attaches after the deductible has been paid by the insured ("Non-Advancement Policies").~~ There are three available Model alternatives that provide for the disposition of large deductible policy recoveries between receivers and guaranty associations: IRMA Section 712, the Guideline for Administration of Large Deductible Policies in Receivership (Guideline XXXX) and, National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model) ~~provides for the disposition of Large Deductible Policy recoveries between receivers and guaranty associations.~~ Individual state statutes ~~(see, for example, 40 PA §221.43a) based on the NCIGF Model or Guideline XXXX~~ may differ from IRMA Section 712 in certain respects."

IX. BEST PRACTICES FOR SUCCESSFUL BILLING AND COLLECTION OF LARGE DEDUCTIBLE PROGRAMS IN LIQUIDATION [HANDBOOK PAGES 307-314]

A. Overview of Large Deductible Worker's Compensation

A large deductible worker's compensation policy or program is a method of insuring workers' compensation risk with the employer assuming some of that risk in a deductible of \$100,000, \$250,000, or even higher per claim ~~(varies by state)~~ and an insurer taking on the remaining risk. Large deductible programs for workers' compensation can be complex arrangements and depend on the employer's fulfillment of its obligation to reimburse all claims within the deductible. If the employer is unable to fulfill that obligation, the financial consequences to the employer could be catastrophic, and the employer's inability to pay could have a cascading impact on the financial health of the insurer. In order to manage this risk successfully, insurers and state insurance regulators must have a clear understanding of the nature and size of the insurer's exposure. Additionally, they must ensure that there are adequate measures in place to limit and mitigate the risk of the employer's failure to pay and ensure injured workers will receive benefits in compliance with state law.

~~In states that permit~~ Professional employer organizations (PEOs); ~~PEO's~~ often operate large deductible workers' compensation programs that are backed by large deductible policies. A PEO is an outsourcing firm which provides services to small and medium sized businesses. The PEO enters into under a contractual co-employment agreement with its clientele. Where permitted by state law, these services generally include workers' compensation coverage obtained by the PEO in its own name. If the PEO assumes

~~most of the risk of that program by purchasing a large deductible policy, it recovers the estimated cost through the fees it charges its clients. If those fees are inadequate to cover the actual costs of the claims, or if the employer or the PEO fails to pay for any other reason to reimburse its share of the claims, the insurer incurs an unexpected liability, and the failure of the claim reimbursement mechanism has been a significant factor in a number of insurer insolvencies. For further information and guidance on high-deductible workers' compensation insurance and PEOs, refer to the NAIC's 2016 Workers' Compensation Large Deductible Study.~~

B. Administration of Large Deductible Plans

The administration of large deductible plans is impacted by entry of an order of liquidation. In such cases, ~~there are two options available regarding statutory authority concerning Large Deductible Worker's Compensation, namely:~~ are three versions of applicable model legislation for states to consider. The most recent is Guideline XXXX. The three Model alternatives are as follows:

- (a) *Insurer Receivership Model Act* (Model #555—IRMA) Section 712 Administration of Loss Reimbursement Policies; ~~or;~~
- (b) *Guideline for Administration of Large Deductible Policies in Receivership* (Guideline XXXX); ~~or,~~
- (c) National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model).

~~Both—Each of these three alternatives provide statutory guidance that articulates the respective rights and responsibilities of the various parties, which would greatly enhance the ability to manage complex large deductible programs post-liquidation. Generally, both—all approaches provide for the collection of large deductible reimbursements from policyholders, clarify entitlement to reimbursement, and ensure that the claimants are paid. The provisions in each of the two options generally complement each other except for conflicting provisions regarding the issue of the ultimate ownership of and entitlement to the deductible recoveries and collateral as between the estate and the guaranty fund. The most significant difference is the approach taken to address the ultimate ownership of and entitlement to the deductible recoveries paid by the employer or drawn from collateral as between the estate and the guaranty fund, and collateral as between the estate and the guaranty fund. IRMA § 712 generally treats these funds as general assets of the estate, while Guideline XXXX and the NCIGF Model apply them directly to the payment of claims. It should be noted that the NCIGF Model has evolved over time based on additional experiences from insolvencies and the NCIGF continues to modify its Model as warranted; as a result, states that have based their laws on the NCIGF Model have done so with varying language.~~

C. Communication and Reporting Between the Liquidator, Policyholders and Guaranty Associations, Including Administration of Self-Funded Policyholder Programs

1. Claim payment, reserve, and reimbursement reporting-

The administration of large deductible programs requires strong communication and reporting programs between the Liquidator, guaranty associations, and policyholders. Under ~~the both—all three Model Acts~~ alternatives, the Liquidator is required to administer large deductible programs, and related collateral securing large deductible obligations, consistent with the policyholder's policy provisions and large deductible agreement ("LDA") ~~except where those provisions conflict with the statute, as amended by the provisions of the Model Act. Both—All three Model Acts~~ alternatives make provision for two types of LDAs, those that permit self-funding direct payment by the policyholder, and those that require initial payment by the insurer or guaranty association with reimbursement by the policyholder. Both arrangements necessitate the reporting of claim payments and outstanding claim reserves to the Liquidator for billing, guaranty association

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reimbursement, and establishing collateral need requirements. The Liquidator's uniform data standard or UDS should be deployed as the reporting protocol for guaranty association claim payments and outstanding claim reserves. Policyholders that continue self-payment/funding under their LDA will need to continue or establish a claim information reporting protocol with the Liquidator through the policyholder's third-party claim administrator or through a proprietary claim information aggregator. ~~Both~~All three Model Acts/alternatives require the Liquidator to form an independent opinion on outstanding claim reserves reported by policyholders and guaranty associations, including ~~a safety factor~~ an allowance for adverse development and incurred but not reported liability to ensure that collateral remains adequate throughout the administration of the program.

2. Agreements between Liquidator and guaranty associations:

~~An agreement between the Liquidator and the guaranty funds may be advisable. Forthough it is less important in~~ states that have enacted ~~the either of the two Model Acts~~one of the three Model alternatives or ~~other comprehensive similar~~ statutory framework for the Liquidator's administration of large deductible programs, ~~an agreement between the Liquidator and the guaranty associations is not necessary. The Models provide a comprehensive framework for administration of the program. For states that have not enacted either Model, an agreement between the Liquidator and guaranty associations may be advisable.~~The Model alternatives can serve as an outline for the issues that should be addressed in such an agreement in states that have not enacted pertinent legislation. Among other things, an agreement should address: whether large deductible recoveries are estate assets subject to the Liquidator's distribution regime or directly pass-through to the guaranty association on account of its prior claim payments; claim reporting protocols; frequency of collateral review and reimbursement activity; and administration of collateral for under collateralized non-performing policyholder accounts.

3. Converting policyholder accounts from an incurred to paid basis

~~Generally, LDAs are on a paid basis with collateral for the reserves. The NCIGF Model Act provides for the conversion of a policyholder's LDA at liquidation from an "incurred" to a "paid" basis. However, liquidators may encounter contractual arrangements where an LDA is constructed such that policyholders pay periodic large up-front payments that were accounted as premium based on losses incurred, as opposed to paid basis. After a certain number of years, the LDA provides policyholders with an opportunity to elect paid basis rather than incurred basis; which converts the incurred payments to collateral. The liquidator may wish to negotiate a conversion at the outset of liquidation.~~ Conversion of a policyholder's LDA at liquidation from an "incurred" to a "paid" basis is beneficial to policyholders in several ways. Most importantly, conversion at liquidation treats pre-liquidation incurred loss payments made by the policyholder to the insurer as collateral, and thus property of the policyholder pledged to the insurer and restricted to the satisfaction of that policyholder's claims, rather than as a general asset of the liquidation estate. Conversion also offers flexibility to a policyholder as to the type of security provided to an insurer in satisfaction of the collateral requirement. Conversion affords policyholders the ability to utilize a letter of credit to secure an insurer for the outstanding portion of their loss, rather than payment of cash, since the outstanding bill after conversion is reflected in the Liquidator's collateral need analysis, rather than an incurred loss billing.

~~The NCIGF Model Act recognizes these important policyholder rights and provides incentive to policyholders to cooperate with the Liquidator's administration of large deductible programs and guaranty association reimbursement.~~The Liquidator should consider notifying large deductible policyholders of these important policyholder rights at the inception of a liquidation proceeding and offer policyholders the opportunity to elect to convert their large deductible programs from an incurred to paid basis, in accordance with the NCIGF Model Act, memorializing any elections with an endorsement that otherwise follows and requires the policyholder to adhere to the provisions of the applicable law the NCIGF Model Act.

4. Large deductible billing by Liquidator-

The Liquidator should establish a large deductible billing and collection program that bills policyholders on a periodic basis, e.g., quarterly, ~~that meets Liquidator and policyholder expectations for claim payments made by the estate prior to liquidation and by guaranty associations after liquidation.~~ The Liquidator's invoice to policyholders should communicate a claim payment summary that includes detail such as the insurer or guaranty association's check number, date of payment, payee, account year, and remaining large deductible limits. Large deductible programs that are ~~self funded~~ paid directly by policyholders should also report their claim payments to the Liquidator on a similar periodic basis, so that the Liquidator can establish appropriate claim reserves, track the exhaustion of the policyholder's deductible limits, report to reinsurers and collect reinsurance. Consideration should be given to using one of many proprietary billing and collection software programs to automate the large deductible billing and collection process. Large deductible recoveries that are subject to guaranty association reimbursements should be aggregated and distributed on a quarterly or other periodic basis that balances the Liquidator's accounting requirements and the guaranty associations' reimbursement needs.

5. Annual collateral review by Liquidator-

~~The NCIGF Model Act Guideline XXXX and the NCIGF Model, consistent with the typical LDA,~~ requires the Liquidator to perform ~~an periodic-annual~~ collateral review for each policyholder account. Consistent with the typical LDA, this review should be performed annually, to ensure that the Liquidator holds adequate collateral to support a policyholder's large deductible obligations and to release any excess collateral held back to the policyholder. This review should include a report to the policyholder on total incurred claims, claims paid, outstanding reserves, including an appropriate allowance for adverse development and claims incurred but not reported, any additional safety factor and total collateral need. The Liquidator's collateral review should result in a report to the policyholder and an invoice for additional collateral need or a release and distribution of excess collateral. The Liquidator should consider whether any additional safety factor should be included for non-performing policyholder accounts. ~~The NCIGF Model Act Guideline XXXX~~ provides flexibility on the timing of the annual review, enabling the Liquidator to perform the annual review process throughout the calendar year so that all policyholder account reviews are not due at the same time.

D. Administration Fees

Section 712 (G) ~~OF~~ IRMA provides:

The receiver is entitled to recover through billings to the insured or from large deductible policy collateral all reasonable expenses that the receiver or guaranty associations incur in fulfilling their responsibilities under this Section. All such deductions or charges shall be in addition to the insured's obligation to reimburse claims and related expenses and shall not diminish the rights of claimants.

Further, Section 712(F) provides, in part:

The expenses incurred by a guaranty association in pursuing reimbursement shall not be permitted as a claim in the delinquency proceeding at any priority; however, a guaranty association may net the expenses incurred in collecting any reimbursement against that reimbursement.

Several states have adopted statutory provisions similar to the IRMA provisions regarding handling of large deductibles in an insolvency and provide for the Receiver to retain reasonable actual expenses incurred from the reimbursement to the guaranty association(s). Similarly, statutes may provide for the guaranty association to net expenses incurred in collecting a reimbursement.

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Guideline XXXX subsection (F) provides:

- (a) The receiver is entitled to recover through billings to the insured or from collateral all reasonable expenses that the receiver incurred in fulfilling its collection obligations under this section. All such deductions or charges shall be in addition to the insured's obligation to reimburse claims and related expenses and shall not diminish the rights of claimants or guaranty associations.
- (b) To the extent the receiver cannot collect such expenses pursuant to paragraph (1), the receiver is entitled to deduct from the collateral or from the deductible reimbursements reasonable and actual expenses incurred in connection with the collection of the collateral and deductible reimbursements.
- (c) To the extent such amounts are not available from reimbursements or collateral, the receiver, or guaranty associations if provided under an agreement with the receiver under subsection D(5), shall have a claim against the estate as provided pursuant to [insert state priority of claim statute].

When there is no statutory guidance, receivers should include a provision for reimbursement of reasonable actual expenses in an agreement with the guaranty associations regarding the collection and allocation of large deductibles.

E. Policy and Collateral Definitions

It is important that state laws define large deductible workers' compensation policies and large deductible collateral.—Defining the treatment of such policies and associated collateral is imperative for developing policies and processes for administering the collection of assets. The following definition is taken from Guideline XXXX. The definitions in the other Model Acts are similar; however, the term used in IRMA is "loss reimbursement policy".

~~For purposes of this handbook,~~—"Large deductible policy" means any combination of one or more workers' compensation policies and endorsements ~~issued to an insured~~, and contracts or security agreements entered into between an insured and the insurer in which the insured has agreed with the insurer to:

- (a) Pay directly the initial portion of any claim covered under the policy up to a specified dollar amount, which the insurer would otherwise be obligated to pay, or the expenses related to any claim; or
- (b) Reimburse the insurer for its payment of any claim or related expenses under the policy up to the specified dollar amount of the deductible.

The term "large deductible policy" also includes policies which contain an aggregate limit on the insured's liability for all deductible claims, ~~in addition to~~ a per claim deductible limit or both. The primary purpose and distinguishing characteristic of a large deductible policy is the shifting of a portion of the ultimate financial responsibility under the large deductible policy to pay claims from the insurer to the insured, even though the obligation to initially pay claims may remain with the insurer, and the insurer remains liable to claimants in the event the insured fails to fulfill its payment or reimbursement obligations.

The dollar amount of "large" will vary by state law. While many states might associate a minimum financial threshold, it is more important to consider the administration of the policy compared to a traditional policy. Deductible amounts can include claim-related payments by the insurer for medical and indemnity benefits, allocated loss adjustment expenses, such as medical case management expenses, legal defense fees, and independent medical exam expenses.—It is critical that the policy specify the claim-related payments that are the responsibility of the policyholder and not be inside agreements or other agreements outside of the policy.

Collateral held by the insurer should be defined as amounts held as security for the insured's obligations under the large deductible policy. The policy should ~~provide~~ specify acceptable financial instruments that can be held for the large deductible policy. Typical collateral requirements include: cash, letters of credit, surety bonds, or other liquid financial means held for the benefit of the insurer.

Guideline XXXX defines "large deductible collateral" to mean "any cash, letters of credit, surety bond, or any other form of security posted by the insured, or by a captive insurer or reinsurer, to secure the insured's obligation under the large deductible policy to pay deductible claims or to reimburse the insurer for deductible claim payments. Collateral may also secure an insured's obligation to reimburse or pay to the insurer as may be required for other secured obligations."

F. Responsible Party ~~F~~for Collection of Large Deductible Reimbursements

It is critical to immediately establish the party responsible for billing and collecting large deductible payments or reimbursements. While some states might have specific statutory language that specifies the entity responsible, some statutes might be silent. In the case where the statutes do not specify responsibility, it is recommended that the receivers and guaranty associations enter into an agreement that allows for the most efficient administration of the large deductible collections.

Specific consideration should be given to large deductible policies that provide coverage in multiple states and have claimants subject to the jurisdiction of multiple guaranty funds.—If feasible, the most efficient approach for such policies would likely be for the receiver to administer the deductible billing and collection process. Throughout the life of the estate, claimants continue to incur benefit payments and expenses and deductible collection efforts may last beyond the life of the estate. The party responsible for collections needs the ability to compromise and settle the future obligations.

The receiver should make provisions in its discharge motion and Court order, to the extent possible, regarding the transition of ongoing deductible collections to the guaranty association as well as the disposition of any collateral being held by the receiver.

G. Treatment of Collateral in Receivership

When collateral has been posted by or on behalf of a large deductible policyholder, what does the receivership estate actually own?—The answer is generally found in the documents pledging the collateral to the insurer.

~~The Insurance Receivership Model Act, NAIC Model Law # 555 ("IRMA")~~ defines "property of the estate" to include "all right, title and interest in property ... includ[ing] choses in action, contract rights, and any other interest recognized under the laws of this state."¹—In states without an explicit statutory definition, the common-law definition is substantially similar.

This means that the insurer's right to draw on the collateral automatically becomes an asset of the receivership estate, but the collateral itself is not an estate asset unless and until it is drawn.—In the first instance, the conditions and procedures for drawing the collateral should be spelled out in the relevant contract documents (which could include third-party instruments such as letters of credit or surety bonds), but state law could provide additional rights,² and will specify what the receiver may do when the documents are silent, incomplete, or missing.

¹ IRMA § 104(V)(1).

² For example, IRMA § 712(D) specifically provides that the relevant provisions of the policy are not controlling "where the loss reimbursement policy conflicts with this section."

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Possession and control over the collateral are distinct from ownership.—The insurer could already be in possession of the collateral before the receivership, or the receiver might act to take possession by enforcing applicable contract rights or by negotiating an agreement.—Nevertheless, this does not immediately give the receiver the right to use the collateral to pay claims.—The defining characteristic of collateral is that it is intended to serve as a backstop in case the policyholder does not meet its obligations to pay all reimbursements promptly and in full.—Commonly, the right to draw on collateral only attaches after the policyholder has defaulted or has consented to a draw, or, if the collateral is a letter of credit (LOC), after the issuer has given notice of nonrenewal (in which case the receiver must act promptly to call the LOC or obtain replacement collateral).—There could also be the opportunity to negotiate an agreement under which the policyholder turns over the collateral and makes a lump-sum payment to commute any further reimbursement obligations, or the collateral might have been structured from the outset as a “working” loss fund from which the insurer was expected to pay claims in the ordinary course of business.

In any case, while it is essential for the receiver to preserve and exercise the right to access the collateral as needed, it is also essential to ensure that collateral is not dissipated to pay claims that the policyholder should be funding.—Special consideration needs to be given in situations where the policyholder is at risk of being or becoming judgment-proof, or where rights to the collateral are shared with other creditors of the policyholder and prompt action is necessary to preserve the receiver’s priority.

When the guaranty association is paying the claims, it is generally entitled to receive the proceeds of any policyholder reimbursements, including draws on the collateral.—Under laws substantially similar to IRMA, these payments are considered early access distributions (but without the necessity for court approval) which may be subject to subsequent clawback, while Guideline XXXX and ~~laws substantially similar to~~ the NCIGF Model treat them as the ultimate source of funding for the underlying claims, so that they belong unconditionally to the guaranty association.³—Either way, however, it is the receiver rather than the guaranty association that has the right and obligation to draw on the collateral,⁴ unless there is a formal written agreement assigning that right to the guaranty association.

Finally, there is always the hope that the policyholder’s reimbursement obligations will be oversecured or will become oversecured as claims are run off.—In that case, any excess collateral will revert to the policyholder or the policyholder’s guarantor.—State law might expressly provide a process for determining when excess collateral is being held by or on behalf of the receiver,⁵ or the ability to return collateral before the estate is closed might be part of the general powers of the receiver.—However, because workers’ compensation is a long-tail exposure with significant risk of adverse reserve development, receivers must take great care not to make premature or excessive return distributions.

H. Issues Raised by Net Worth Exclusions and Deductible Exclusions

Unlike other lines of insurance, workers’ compensation insurance is generally exempt from the statutory caps on guaranty association coverage, so that the guaranty fund is usually obligated to pay workers’ compensation claims in full. However individual states may have adopted caps on guaranty association coverage.⁶—States have created this exception to honor their state’s promise that injured workers will be paid the full benefits to which they are

³ Compare IRMA § 712(C)(3) with Guideline XXXX § (C) and NCIGF Model A § 712(C).

⁴ See Guideline XXXX § (E)(3) and NCIGF Model A § 712(E)(3).

⁵ See, e.g., Guideline XXXX § (E)(4) and NCIGF Model A § 712(E)(5).

⁶ See *Property and Casualty Insurance Guaranty Association Model Act*, NAIC Model Law (#-540 (“PC GA Act”), § 8(A)(1)(a)(i).—Almost all states have some provision requiring payment in full of workers’ compensation claims, but some states might have caps or other limitations on coverage.

entitled.—The general purpose of these exclusions is to avoid any obligation for the guaranty association to pay losses that can and should be borne by the policyholder.—Net worth exclusions make guaranty association protection unavailable to policyholders with net worth above a specified threshold, while deductible exclusions expressly prohibit guaranty association coverage for amounts within a policy deductible.

Unless these exclusions are drafted and implemented carefully, there is a risk that they could result in delays in claims payments or even a complete loss of coverage.—In some states, claimants might be protected by an uninsured employer fund, but that is not the purpose of those funds, so even if such a fund exists in your state, it should be a priority to ensure that however it is done, the estate, employer, or guaranty association will provide for payment in full of all benefits due under the state’s workers’ compensation laws.—If this is not possible under current law, regulators should advocate for a change in the law.—A variety of successful approaches are available; there is not a single one-size-fits-all solution that is best for every state.

1. Net Worth Exclusions:

The ~~PC-GA-Aet~~ *Property and Casualty Insurance Guaranty Association Model Act (#540)* contains an optional section, with a variety of alternative provisions states can select, excluding coverage for high-net-worth insureds, whether they are individuals or business entities.⁷—The base version sets the threshold at \$50 million, while one of the alternatives sets the threshold at \$25 million.—Many states have enacted some version of this clause or some comparable net worth exclusion.

The impact on workers’ compensation coverage depends on how the exclusion is structured.—In states with provisions substantially similar to any of the three alternatives under the ~~PC-GA-Aet~~ *Model 540*, coverage is excluded completely for first-party claims by high-net-worth insureds, but workers’ compensation claims against high-net-worth policyholders are administered by the guaranty association on a “pay-and-recover” basis: that is, the guaranty association has the obligation to pay the claim in the first instance, and the right to be reimbursed by the policyholder.⁸—Thus, claimants are fully protected, and for large deductible policies, this mirrors the structure of the policy for claims within the deductible.—In states with guaranty association laws similar to *Guideline XXXX* or the NCIGF Model, this is the same reimbursement right the guaranty association would have ~~in the absence of the exclusion~~ as the insurer’s successor: in the absence of the exclusion.

If the policyholder is cooperative, the guaranty association has the option of negotiating an agreement where the policyholder advances funding for claims within the deductible.—However, if the policyholder is not cooperative, guaranty associations have expressed concern that the pay-and-recover framework is burdensome and gives the policyholder too much leverage to avoid or delay paying its obligations in full.—If ~~PC-GA-Aet~~ *Model 540*’s Alternative 2 is modified to treat workers’ compensation claims the same as other third-party claims, then the guaranty association has no obligation unless the formerly high-net-worth policyholder has become insolvent.⁹—Otherwise, the claimant’s only recourse is against the policyholder or the insured’s estate.—As stated above, the injured worker should be protected by some means in these cases.

When a guaranty association net worth exclusion and a large deductible both come in to play on the same claim, it is imperative that the receiver and guaranty association stay in close communication in order to avoid

⁷ ~~PC-GA-Aet~~ *Model 540*, § 13.

⁸ Alternative 1 applies the pay-and-recover obligation to all third-party claims.—Alternative 2 excludes most third-party claims as well as all first-party claims, but requires the guaranty association to pay workers’ compensation claims, statutory automobile insurance claims, and other claims for ongoing medical payments.—Alternative 3 excludes only first-party claims and claims by out-of-state claimants that are subject to a net worth exclusion in the claimant’s home state; this alternative does not create any statutory right of recovery when the guaranty association is obligated to pay a third-party claim.

⁹ ~~PC-GA-Aet~~ *Model 540*, § 13(B)(2) Alternative 2.

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any confusion regarding which entity is responsible for the collection.— In ~~both~~ IRMA §712, Guideline XXXX and the NCIGF Model large deductible model statute, the guaranty fund is entitled to collect net worth reimbursements.— Coordination of these collections with receiver efforts to collect on high deductible will do much to avoid duplication of billings and potential resulting collection delays.

2. Deductible Exclusions:

~~The PC-GA Act Model 540~~ does not contain any explicit deductible exclusion.— Instead, it simply provides that “In no event shall the association be obligated to pay a claimant an amount in excess of the obligation of the insolvent insurer under the policy or coverage from which the claim arises.”¹⁰— However, some states have enacted explicit language further clarifying that there is no guaranty association coverage for amounts within a policy’s deductible or self-insured retention.¹¹ For example, Minnesota law excludes “any claims under a policy written by an insolvent insurer with a deductible or self-insured retention of \$300,000 or more, nor that portion of a claim that is within an insured’s deductible or self-insured retention” from coverage by the property and casualty guaranty association.¹²— A Minnesota employer entered into an employee leasing arrangement with a PEO, which obtained a workers’ compensation policy with a \$1 million deductible.— Both the PEO and the insurer became insolvent, and the Minnesota Court of Appeals held that there was no guaranty association coverage for workers’ compensation claims against the client employer because of the statutory deductible exclusion.¹³— The court observed that the Legislature deliberately chose to protect the guaranty association from unlimited exposure, without mentioning that the Legislature also deliberately created an exception making the cap on coverage inapplicable to workers’ compensation claims (which strongly suggests that the statute in question, which is tied to the statutory \$300,000 cap on coverage, was not written with workers’ compensation in mind).¹⁴— Likewise, the court took for granted that the statute’s undefined term “deductible” included the contract provision at issue in the case, even though the insurer had assumed the unconditional liability to pay all claims in full.— The opinion did not consider the possibility that the Legislature’s intent was simply to clarify that the guaranty association has no obligation to drop down and pay claims from the first dollar if the insurer would have had no obligation to pay those claims.

Therefore, if states determine that there is a need to include express provisions addressing deductibles and self-insured retentions in their guaranty association laws, it is essential to avoid unintended consequences.— In particular, the key terms should not be left undefined.— For this reason, IRMA coined the term “loss reimbursement policy” in its section addressing these types of policies, to distinguish them from true deductibles, where the insurer has no obligation to pay anything except the portion of the loss that exceeds the deductible.¹⁵

¹⁰ ~~PC-GA Act Model 540~~, § 8(A)(1)(b).— Compare ~~LH-GA Act Life and Health Insurance Guaranty Association Model Act (#520)~~, § 3(B)(2)(a), expressly excluding from life and health guaranty association coverage “A portion of a policy or contract not guaranteed by the member insurer, or under which the risk is borne by the policy or contract owner.”

¹¹ Currently, the only states with language specifically excluding claims within policy “deductibles” are Iowa, Louisiana, Minnesota, Missouri, and Nevada.— Louisiana’s exclusion applies only to policies issued to group self-insurance funds, and Missouri’s does not apply to workers’ compensation claims.

¹² Minn. Stat. § 60C.09(2)(4).

¹³ *Terminal Transport v. Minnesota Ins. Guar. Ass’n*, 862 N.W.2d 487 (Minn. App. 2015), *review denied* June 30, 2015.

¹⁴ Minn. Stat. § 60C.09(3).

¹⁵ For example, if a consumer has an auto policy with a collision deductible of \$1,000, and the repair costs \$5,000, the insurer’s liability is limited to \$4,000.— “Self-insured retentions” (SIRs) in commercial excess policies are designed to function the same way on a larger scale.— If a business is found liable (or a third-party claim is settled) for \$500,000, and its liability policy has an SIR of \$300,000, the insurer is never responsible for more than the remaining \$200,000, even if the policyholder is bankrupt.

This is the crucial difference between a “large deductible” workers’ compensation policy and an excess policy.—Although “large deductible” policies transfer a significant amount of risk back to the policyholder, they do not extinguish the insurer’s liability.—That is why “large deductible” policies, in states that allow them, are accepted as a mechanism for satisfying the policyholder’s compulsory coverage obligations, while excess policies generally are not.—Usually, excess workers’ compensation policies may only be issued to self-insurers that have been approved by the state.—It is the approved self-insurance program, not the excess policy, that satisfies the employer’s compulsory coverage obligation, and the insurer has no liability for any portion of a claim that falls within the employer’s self-insured retention.¹⁶—Thus, despite the terminology that is commonly used, it is the excess policy, not the large deductible policy, that functions as a “deductible” in the traditional sense of the term.

It is worth noting, however, that commercial self-insured retention and large deductible policies can vary widely in policy terms and sometimes “side agreements” supplement the policies.—Arrangements can contain aggregate limits, can vary on the obligation for defense cost and expenses and, in some cases permit the insured to “self-fund” its claims with an account in the possession of the TPA which is handling the claims. Because of these complexities, policy terms and any related endorsements and side agreements should be carefully reviewed.—Whether such side agreements are legally enforceable requires a thorough case-by-case analysis in light of applicable state laws.

Chapter 6 – Guaranty Funds/Associations

II. PROPERTY AND CASUALTY GUARANTY FUNDS [HANDBOOK PAGES 332-333]

J. Large Deductible Policies

In ~~March of 2006~~2016, the NAIC adopted a white paper titled *Workers’ Compensation Large Deductible Study*. ~~The paper revisits and reconsiders issues raised in an earlier 2006 Workers’ Compensation Large Deductible Study.~~ —~~The 2016 study provides valuable information about how large deductible policies work and special issues that can arise with their use.~~

As used in workers’ compensation coverages, large deductible policies allow employers to retain a certain amount of claims risk, thereby reducing the cost of their workers’ compensation coverage. Typically, these policies are administered by the insurer or a third-party administrator paying claims within the deductible and obtaining reimbursement from the insured employer. In the receivership context, where guaranty funds pay claims within the deductible, there is an issue as to the handling of the insured employer’s reimbursement of payments within the deductible. That is, should the reimbursement be paid to the guaranty fund outside the receivership distribution scheme, or should the reimbursement be treated as an asset of the receivership estate subject to the claims of all creditors? ~~At the time the NAIC white paper was adopted, four states, Pennsylvania, Illinois, California and Texas had~~Several states have provisions in place in their respective receivership liquidation statutes which provided that large deductible reimbursements should be paid directly to the guaranty fund outside the receivership distribution scheme.¹⁷

~~Subsequently, Michigan and Utah have also amended their liquidation statutes to deal with the issue of large deductible reimbursements, both of which call for the assets to flow at 100% to the guaranty associations and not be treated as general assets of the estate.~~¹⁸

¹⁶ In many states, a separate self-insurance guaranty fund protects claimants if a self-insured employer becomes insolvent. Those funds typically operate entirely under the state’s workers’ compensation laws, not the state’s insurance receivership or insurance guaranty fund laws.

¹⁷ 40 P.S. § 221.23a (PA); 215 ILCS 5/205.1; Cal. Ins. Code §1033.5; Tex. Ins. CODE §21A.213.

¹⁸ MCL 500.8133a; UT 31A-27a-612(6)

Draft: 11/5/20

~~Legislation continues to be proposed on this issue and receivers should consult their state's laws. (The New Jersey Workers' Compensation Guaranty Fund act has also been amended to address this issue.)⁴⁹ Among the findings and recommendations contained in the NAIC white paper is: "Guaranty fund laws should be changed or clarified to assure that reimbursements by employers for claims paid by guaranty funds under deductible plans go to the guaranty fund instead of simply becoming assets of the estate." As mentioned above, this can also be accomplished by amending receivership/liquidation statutes and this has been the most typical approach in state legislatures thus far. For examples of state codes, see Exhibit 6-4.~~

Where the insolvent insurer wrote large deductible policies, the receiver should be mindful of this issue and should consult with the affected guaranty associations as soon as possible. The receiver should also review those states' guaranty fund statutes where the claims will be processed to determine whether claims within large deductibles are "covered claims" as defined in the appropriate guaranty fund act. Typically, claims under workers compensation policies will be covered. However, claims under policies for other lines of business may not be covered. The availability of guaranty fund coverage is to some extent dependent upon the specific language of the policy involved.

IRMA provides for a different treatment of large deductible collections. Under IRMA § 712, payments of such monies to the guaranty funds are treated as early access. ~~See IRMA § 712.~~

Under the Guideline for Administration of Large Deductible Policies in Receivership (Guideline XXXX) subsection B, "Unless otherwise agreed by the responsible guaranty association, all large deductible claims that are also "covered claims" as defined by the applicable guaranty association law, including those that may have been funded by an insured before liquidation, shall be turned over to the guaranty association for handling." Refer to the Guideline subsection B for further discussion of deductible claims paid.

Chapter 9 – Legal Considerations

III. CLAIMS [HANDBOOK PAGES 545-546]

I. Large Deductibles

The purpose of these large deductible amounts is to reduce premiums for the insured while permitting the insured to meet statutory or regulatory insurance requirements. Large deductible policies are most common in the workers compensation area but may be found in other types of liability insurance.

Typically, a large deductible policy provides that the insurer will pay claims in full and then collect the deductible amount from the insured. Conversely, first party claims against an auto policy with a deductible are paid minus the amount of the deductible. To ensure that the deductible will be paid, most insurers that write this type of policy will require the insured to post some form of security. This can be a letter of credit, securities placed in a trust or escrow account for the benefit of the insurer, or some other form of a third-party commitment to reimburse for claims within the large deductible, such as a bond or large deductible reimbursement insurance policy. When the insurer pays a claim, depending on the agreement with the insured, the insurer may either submit a bill to the insured for the amount of the claim paid within the deductible or collect directly from the collateral.

As long as the insurer and the insured remain solvent, there are seldom any difficulties with large deductible arrangements. If the insured becomes insolvent and stops paying the deductible billings and if

⁴⁹ ~~N.J.S.A. 34:15-111.~~

the collateral held is insufficient to pay current and future billings, the insurer's ability to collect the amounts due will be adversely affected.

If the insurer becomes insolvent and is placed into liquidation, the property and casualty and workers compensation guaranty associations will be triggered to begin paying claims. Just like the insurer, the guaranty association will be responsible for first dollar coverage of the claims. After the guaranty association pays the claim, the liquidator can then collect the amount of the claim within the deductible from the insured or the collateral. Historically, receivers and the guaranty associations disagreed on the disposition of these proceeds ~~has become a very contentious issue between the receivers and the guaranty associations.~~ Some Receivers believe that the proceeds are claims based assets, similar to reinsurance recoverables, which should go into the general assets of the estates and be distributed *pro rata* to all claimants. The guaranty associations believe that, to the extent that the claim payment is within the deductible, they are not paying a claim on behalf of the insolvent insurer but rather on behalf of the insured and therefore, they should receive the reimbursement directly.

The first significant incidence of large deductible policies in a receivership occurred in the administration of the Reliance Insurance Co. Estate. During the early years of this receivership, the guaranty associations paid several hundred million dollars of claims within large deductible limits. After extensive unsuccessful negotiations between the Pennsylvania liquidator and the guaranty associations, a suit was filed in the Commonwealth Court of Pennsylvania asking the Court to determine entitlement to the large deductible recoveries. The suit was rendered moot by passage of Act 46 of 2004 by the Pennsylvania General Assembly. Act 46 provided that the liquidator would collect the deductible reimbursements and deliver them to the guaranty associations that had paid the claims. The Act allows the liquidator to retain part of the reimbursements to offset the expense of collection.

Subsequently, several other states ~~including Texas, Illinois, Michigan, Utah and California~~ have enacted legislation addressing this issue modeled after the National Conference of Insurance Guaranty Funds (NCIGF) Model Large Deductible Act (NCIGF Model). On [date], the NAIC adopted Guideline for Administration of Large Deductible Policies in Receivership (Guideline XXXX) that also addresses this issue. ~~As this area is constantly evolving, a newly appointed Statutes vary by state, therefore, the receiver for a property and casualty large deductible insolvency should insurer must consult local counsel and review the applicable statutes of the domiciliary state and states where the claims will be processed.~~

- § 712 of IRMA requires the receiver to collect the deductible reimbursements as a general asset of the estate, but the amount collected is to be distributed to the guaranty associations that have paid claims within the deductible amount as early access subject to claw-back if the amount distributed ultimately exceeds the amount to which the receiving guaranty association would be entitled from the final estate distribution.
- Under Guideline XXXX subsection B, "Unless otherwise agreed by the responsible guaranty association, all large deductible claims that are also "covered claims" as defined by the applicable guaranty association law, including those that may have been funded by an insured before liquidation, shall be turned over to the guaranty association for handling." Refer to the Guideline subsection B for further discussion of deductible claims paid.

Draft: 11/09/20

Receivership Law (E) Working Group
Virtual Meeting
October 29, 2020

The Receivership Law (E) Working Group of the Receivership and Insolvency (E) Task Force met Oct. 29, 2020. The following Working Group members participated: Kevin Baldwin, Co-Chair (IL); Laura Lyon Slaymaker, Co-Chair (PA); Steve Uhrynowycz (AR); Jack Hom (CA); Jared Kosky (CT); Miriam Victorian (FL); Kim Cross (IA); Christopher Joyce (MA); Robert Wake (ME); James Gerber (MI); Shelley Forrest (MO); Justin Schrader (NE); James Kennedy (TX); and Melanie Anderson (WA). Also participating was: Donna Wilson (OK).

1. Discussed Comments Received on the Continuity of Essential Services in Receivership

Mr. Baldwin said the Working Group is charged with developing recommendations for remedies to ensure continuity of essential services and functions to an insurer in receivership that can create costly legal and operational challenges in receivership. These services are often provided by affiliated entities, including non-regulated entities, through intercompany agreements. As a result, one possible recommendation is to make necessary changes to the *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450). He said state insurance regulators and interested parties were asked to respond to several questions, including recommendations for specific revisions to Model #440 and Model #450 to address this issue, recommendations for any options other than Model #440 and Model #450, and any challenges or issues. Mr. Baldwin said seven comment letters were received from Maine; Michigan; Oklahoma; Pennsylvania; America's Health Insurance Plans (AHIP); Arbor Strategies LLC; and a joint letter from the National Organization of Life and Health Guaranty Association (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF). In addition, NAIC staff provided a document summarizing recommendations from the comment letters (Attachment Five-A).

a. Model #440, Section 5(A) Standards and Management of an Insurer Within an Insurance Holding Company

Peter Gallanis (NOLHGA) said he is sympathetic to the Working Group's goal to identify techniques and tools that allow for enhanced enforcement of service commitments made to insurers that go into receivership. There is concern in doing this by broadening the definition of "insurer." NOLHGA believes that there is an ability to increase enforcement through the proposed amendments and to clarify that to the extent there are material commitments on the part of the service providers that are not regulated entities, the receivership court be explicitly granted and be recognized as having jurisdiction over those entities for purposes of enforcing their obligation under those agreements. This would diminish procedural receivership court obstacles.

Roger Schmelzer (NCIGF) said the NCIGF also supports shoring state laws to assist receivers in a smooth transition to liquidation. A priority for the NCIGF is that the availability of claims data is extremely critical to a property/casualty (P/C) insolvency. He said the NCIGF supports modifications to Model #440 and possibly also the *Insurer Receivership Model Act* (#555).

Chris Petersen (Arbor Strategies LLC) said Arbor Strategies LLC has concerns about including non-insurers in the definition of "insurer." He said he supports the language proposed by the NOLHGA and the NCIGF as he believes it is a better approach and addresses the issue without the unintended consequences of a change in the definition of "insurer."

Mr. Kennedy said he has experienced receiverships where an affiliate that went into bankruptcy held all the insurer's data and information technology, and the affiliate had all of the employees that supported the insurer. He said agreements between insurers and the affiliates providing the services should include language that state that the records of the insurer held by the affiliate are the property of the insurer. If the affiliate files for bankruptcy, the bankruptcy court can point to the agreement to show the data and records are not property of the bankruptcy estate. He also suggested the agreement have a choice of law provision that states that in the event of a lawsuit over the agreement, the jurisdiction of the insurer is the jurisdiction where the lawsuit would be filed, which would be the same jurisdiction as the receivership.

Mr. Baldwin said the language proposed by the NOLHGA and the NCIGF will be included as part of the drafting process. Mr. Kennedy, Ms. Slaymaker and Mr. Wake agreed.

b. Model #450, Section 19 Transactions Subject to Prior Notice—Notice Filing (Form D)

Mr. Baldwin said several states and interested parties submitted recommendations to amend Model #450, Section 19 regarding transactions subject to prior notice.

Ms. Slaymaker said Pennsylvania has experienced situations where the data is comingled and must pay the affiliate to separate the data at the expense of the estate. She suggests the agreement specify the data is maintained in a segregated and usable format.

Robert Ridgeway (AHIP) said AHIP recommends an amendment to the Model #450 that would provide for indemnification of the insurer not only for gross negligence or willful misconduct, but also for actions by the affiliate that violate subsections (11), (12) or (13), addressing access to the books and records, termination of the agreement, and continuation of essential services respectively. AHIP also suggests making a referral to other authorities that have direct ability to affect the affiliate, which may require modifications to that official's statutory authority. He said since Model #555 gives the receiver authority to act, Section 108.J and Section 601 are related and may need amending.

Ms. Wilson said Oklahoma has similar recommendations but also included a recommendation for a fine to be assessed so that there is a cost to the affiliate for not cooperating with the receiver. A requirement without a fine or penalty means the affiliate may not cooperate. Mr. Wake said in Maine, the insurance code provides for penalty options for any violation of the insurance code, unless otherwise stated. Mr. Kennedy said a fine may work for a nonaffiliated third-party administrator (TPA) or managing general agent (MGA) but may not be helpful for an affiliated entity. He said typically when the insurer enters receivership, the affiliate does not survive either. Mr. Wake said the fine should be imposed for compliance in the ordinary course of business before an insurer fails. Mr. Kennedy said financial examiners should be looking for these issues in the examination of a holding company system.

Mr. Gerber said Michigan has similar recommendations regarding the books and records being property of the insurer. He also recommends, as part of the contract, the entity providing the services to the insurer should be required to have a surety bond to perform so that the insurer can collect on the surety bond to fund the operations. He said he thinks a surety bond may be a better option than a fine or penalty because the insurer has the surety bond to collect on.

Mr. Baldwin said the recommendations received and discussed on Model #450, Section 19 will be included as part of the drafting process. He said NAIC staff and several Working Group members will work together to create a draft for discussion during a future meeting.

c. Model #440, Definition of "Insurer"

Mr. Baldwin said only four comments were received on amending the definition of "insurer" in Model #440 to encompass affiliated entities whose sole purpose is to provide services to the insurer. Three of the commentors were opposed. Mr. Petersen said the changes proposed to Model #440, Section 5(A) and Model #450, Section 19 eliminate the need for a change in the definition of "insurer." Mr. Baldwin said amending the definition will not be part of the initial drafting process.

d. Other Recommendations

Mr. Baldwin said a few recommendations were suggested other than modifications to Model #440 and Model #450 that the Working Group can consider, including updates to *Receiver's Handbook for Insurance Company Insolvencies* (Receiver's Handbook) guidance once model revisions are adopted; communication and coordination with financial solvency units within the states' insurance department; and licensing affiliated service providers as TPAs. Mr. Gerber said Michigan recommended that affiliates that provide claims benefit administration could be licensed as third-party administrators.

2. Adopted Revisions to the Receiver's Handbook

Ms. Slaymaker said the Working Group received comment letters from Indiana, Michigan and the American Council of Life Insurers (ACLI) regarding proposed revisions to the Receiver's Handbook regarding qualified financial contracts (QFCs) in chapter four (Attachment Five-B). Ms. Slaymaker said NAIC staff also proposed minor amendments to Chapter 4. She said no changes were proposed to Chapter 11 for use of bridge financial institutions.

Mr. Gerber made a motion, seconded by Mr. Kennedy, to adopt the revisions to Chapter 4 of the Receiver's Handbook for QFCs, including proposed amendments from ACLI and NAIC staff (Attachment Six).

3. Adopted its Aug. 25 Minutes

The Working Group met Aug. 25 and took the following action: 1) exposed a request for comment on the continuity of essential services in receivership; and 2) exposed revisions to the Receiver's Handbook for QFCs and bridge financial institutions.

Mr. Schrader made a motion, seconded by Mr. Gerber, to adopt the Working Group's Aug. 25 minutes (Attachment Five-C). The motion passed unanimously.

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

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CHAPTER 4 – INVESTIGATION AND ASSET RECOVERY

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

VII. RECEIVERSHIP INVOLVING QUALIFIED FINANCIAL CONTRACTS

Insurer Receivership 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 stay¹.

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

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>.

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. 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 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 Chapter³).
- 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 20~~2013~~)

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

² See footnote 1 of this Chapter.

³ See footnote 1 of this Chapter.

- 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~~ 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*****

Model Laws, Regulations, Guidelines and Other Resources *[insert date if adopted]*

GUIDELINE FOR DEFINITION OF RECIPROCAL STATE IN RECEIVERSHIP LAWS

Drafting Note: The receivership laws of most states address the coordination of receiverships involving multiple states. Typically, these laws provide that a domiciliary receiver appointed in another state has certain rights and protections, such as the following:

- The domiciliary receiver is vested with the title to the insurer’s assets in the state;
- Attachments, garnishments, or levies against the insurer or its assets are prohibited; and
- Actions against the insurer and its insureds are stayed for a specified period of time.

In many states’ laws, these provisions may apply only if the domiciliary state is a “reciprocal state.” Frequently, the definition of a reciprocal state is based on NAIC model laws adopted more than twenty years ago. These definitions may be inconsistent with laws in other states, and more prescriptive than the Part A standards of the NAIC Financial Regulation Standards and Accreditation Program for state receivership laws. As a result, the assets of a receivership estate might not be protected outside of the domiciliary state, and the Receiver may be forced to defend litigation in multiple forums.

The provisions described above are intended to promote judicial economy, which benefits all participants in the receivership process. This Guideline provides a statutory definition that may be used by states with a reciprocity requirement to effectuate the purposes of these provisions. Under this definition, any state meeting the applicable NAIC Part A Accreditation standards for receivership laws will be treated as a reciprocal state. The definition recognizes the diversity of existing state receivership laws, and should avoid unnecessary litigation regarding the recognition of a state as a reciprocal state.

Definition of Reciprocal State for Receivership

“Reciprocal State” means a state that has enacted a law that sets forth a scheme for the administration of an insurer in receivership by the state’s insurance commissioner [or substitute the equivalent title used by the state, such as superintendent or director], or comparable insurance regulatory official.

Chronological Summary of Action (all references are to the Proceedings of the NAIC)
[insert reference if adopted]



To: Financial Stability (EX) Task Force
From: Receivership and Insolvency (E) Task Force
Re: Report on Macroprudential Initiative (MPI) Referral
Date: November 19, 2020

The following report summarizes the conclusions of the Receivership and Insolvency (E) Task Force (RITF) in response to the Macroprudential Initiative (MPI) referral on recovery and resolution. While the RITF has completed its recommendations, the RITF will conduct further work on the issues as described below.

1. Evaluate recovery and resolution laws, guidance, and tools, and determine whether they incorporate best practices with respect to financial stability

The Receiver's powers under laws based on the *Insurer Receivership Model Act* Model #555 (IRMA) and its predecessor, the *Insurer Rehabilitation and Liquidation Model Act* (IRLMA), in conjunction with the authority granted to the Receiver by court orders, generally provide the powers described in:

- International Association of Insurance Supervisors (IAIS) Insurance Core Principle (ICP) 12, *Exit from the Market and Resolution*;
- Common Framework for the supervision of Internationally Active Insurance Groups (ComFrame) material integrated into ICP 12; and
- Financial Stability Board (FSB) *Key Attributes of Effective Resolution Regimes for Financial Institutions* (KAs).

While powers under state laws comport with the ICPs, ComFrame, and the KAs, in some cases the powers are implicit rather than explicit. The RITF reviewed current laws with respect the following issues:

a. Bridge Institutions

State receivership laws do not expressly provide for the establishment of a bridge institution (Bridge), but the Receiver may establish a Bridge under those laws. While a Bridge is typically not needed in a receivership, it could have the benefit of addressing an early termination on qualified financial contracts (QFCs). However, implementing a Bridge for this purpose would require a temporary stay on termination rights. As noted in Item 3 below, the current misalignments with Federal rules on the termination of master netting agreements for QFCs effectively precludes temporary stays on termination of QFCs in a receivership, thereby preventing the use of a Bridge for this purpose.

Conclusion: The Receivership Law (E) Working Group reviewed guidance in the Receiver's Handbook for Insurance Company Insolvencies (Receivers Handbook) and developed revisions to guidance regarding the use of bridge institutions and administration of QFCs in receivership and pre-receivership planning.

b. Providing Continuity of Essential Services and Functions

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 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 following authority and tools were identified:

- 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. In some circumstances, such as a situation where an affiliate providing services is inextricably intertwined with the insurer, action can be taken to place the affiliate into receivership.

It was noted that some of these remedies might not address the immediate need to continue services in some cases. Therefore, the Task Force delegated further work on this topic to the Receivership Law (E) Working Group.

Conclusion: The Receivership Law (E) Working Group is developing, among other solutions, revisions to Models 440 and 450 to address remedies to ensure continuity of essential services and functions to an insurer in receivership by other affiliated entities in a holding company group, including non-regulated entities. The Model Law Request to develop revisions to Models 440 and 450 was adopted by Executive (EX) Committee in August 2020. The Working Group expects to finalize its work in this area in 2021.

c. Variations in States' Receivership Laws

The RITF recognized that few states have adopted IRMA, and most have laws based on IRLMA or prior models. In 2017, the Financial Condition (E) Committee issued a memorandum to states to consider adoption of certain provisions of IRMA.¹ The RITF further identified eight key areas within receivership and guaranty fund law that it encourages states to adopt. The key areas include: conflicts of law; continuation of coverage; priority of distribution; stays and injunctions; ancillary conservation of foreign insurers; domiciliary receivers in other states; treatment of large deductible workers compensation policies; and the 2017 revisions to the *Life and Health Insurance Guaranty Association Model Act* (#520). The RITF also determined that some states may require an alternative solution to revise their laws for stays, injunctions and “full faith and credit” provisions. Therefore, the RITF recommends redefining “reciprocal state” in states’ receivership law as an optional solution. The RITF concluded the following:

Conclusion:

- *The RITF developed a Model Guideline defining “reciprocal state” that was released for exposure at the ~~2020 Fall National~~ Nov. 19, 2020, virtual Meeting, and which will be considered for adoption in 2021.*
- *The RITF will work towards educating states on key areas of receivership and guaranty fund laws that enhance efficiencies and effectiveness of the receivership process, as identified through this workstream, including related new Model Guidelines adopted by the NAIC, outreach to states’ legal staff and other educational opportunities.*
- *The RITF formed an ad hoc group to discuss Financial Regulation Standards and Accreditation Program Part A standards for receivership and guaranty fund laws and will take any recommendations from the ad hoc group under consideration in the future.*

2. Evaluate recovery and resolution planning tools for systemically important cross-border U.S. groups

The RITF determined that many recovery and resolution planning topics in the KAs and ComFrame are generally covered in the guidance for pre-receivership planning in the Receiver’s Handbook. Additionally, some topics were identified that may be captured elsewhere within the US solvency monitoring frameworks (e.g., ORSA, Supervisory Colleges, Crisis Management Groups, Examinations, etc.). The RITF found that:

- The Dodd Frank Act’s provisions for resolution planning address the requirements of the KAs and ComFrame for an insurer designated as a Systemically Important Financial Institution (SIFI). Other jurisdictions may have similar planning requirements for international groups.

¹ https://naic-cms.org/sites/default/files/inline-files/cmt_e_receivership_related_170717_committee_recommendation.pdf

- The requirements in state laws for corrective action plans under risk-based capital (RBC) laws and hazardous financial condition laws may satisfy this requirement for insurers that fall short of the applicable RBC solvency benchmarks, or otherwise trigger a corrective action requirement meeting those solvency benchmarks.
- Regarding crisis management groups and crisis management planning, the NAIC *Insurance Holding Company System Model Act* (#440) Section 7 provides the commissioner with the authority to develop crisis management plans as part of supervisory colleges. Further, Model 440 Section 7.1, provides for authority for the commissioner to act as the group-wide supervisor of internationally active insurance groups (IAIG) and engage in group-wide supervision activities as outlined in the model, though not explicit to recovery and resolution plans. Additionally, the NAIC *Financial Analysis Handbook* contains guidance and a template for a crisis management plan. This authority and guidance provide states with the flexibility to discuss the necessity for crisis management plans within supervisory colleges and/or crisis management groups and to make the determination to develop such plans on a case-by-case basis.

Conclusion:

- *The RITF agreed that consideration of imposing recovery plan reporting requirements on insurers that are not in financial distress is outside the scope of the RITF and may require consideration by U.S. group-wide supervisors of IAIGs.*
- *The Group Solvency Issues (E) Working Group is undertaking a project to update insurance regulatory guidance as it pertains to supervision of IAIGs under ComFrame, including guidance on crisis management groups. The RITF will provide input at the appropriate time to this work stream. The Working Group's project is expected to be completed in 2021.*
- *The RITF will continue to review and provide input to the IAIS on recovery and resolution topics including the upcoming Application Paper on Resolution Powers and Planning.*

3. Evaluate whether there are misalignments between federal and state laws that could be an obstacle to effective and orderly recovery and resolutions for U.S. insurance groups

a. Temporarily Stay Early Termination Rights

The Task Force evaluated the impact of the federal rule recognizing temporary stays on terminating master netting agreements for qualified financial contracts (QFCs), which does not recognize stays in a state receivership proceeding. The regulators held discussions with federal banking authorities regarding the handling of QFCs and bridge institutions in banking resolutions. This information will be used to assess the utility of a stay on QFC terminations in an insurance receivership.

Conclusion:

- *In 2019, the NAIC adopted amendments to the Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts (#1556) to highlight the conflict with the federal rule to state insurance regulators who may be considering adoption of Guideline #1556.*
- *The Task Force adopted revisions to existing guidance for receiverships involving qualified financial contracts at the Nov. 19, 2020 virtual 2020 Fall National Meeting.*

b. Taxes in Receivership and Federal Releases

The Task Force identified topics where guidance for taxes in receivership and federal releases should be drafted in the Receiver's Handbook.

Conclusion: The RITF adopted revisions to the Receiver's Handbook for guidance on taxes in receivership and federal releases at the 2020 Summer National Meeting.