BY E-MAIL

August 14, 2019

Elizabeth Kelleher Dwyer
Buddy Combs
Co-Chairs, NAIC Restructuring Mechanisms (E) Working Group

Attention: Dan Daveline (ddaveline@naic.org)
Casey McGraw (cmcgraw@naic.org)

Re: The Restructuring Mechanism Working Group's Charges

Dear Superintendent Dwyer and Deputy Commissioner Combs:

The undersigned companies support the important work being done by the Restructuring Mechanisms (E) Working Group and are grateful for the opportunity to deliver these comments.

Division and Transfer Laws Have Serious Implications that Demand Procedural Protections

As life insurers, the financial security that we provide to our policyholders is often delivered gradually, over decades. Consumers have this long-term promise in mind when they enter into life insurance, annuity, and long-term care insurance contracts, and expect that the company that sold them a policy will stand behind it over the years to come. Life insurers, knowing that their obligations will last decades, manage their assets and liabilities conservatively to ensure they will maintain the financial strength needed to fulfil their promises. And the guard rails of our state insurance regulatory framework and backstop provided by our guaranty association system have developed over the years to be efficient and effective counterparts to a system where life insurers remain obligated for their promises.

Insurance business transfer and insurer corporate division statutes have the potential to turn this paradigm on its head. If consumers no longer can expect that the company that sells them their policy will stand behind it, will they trust life insurers to meet their financial security needs? If life insurers anticipate that they have an out for unsuccessful business, will they have less incentive to exercise their traditional conservatism in writing and managing long-term business? And, what strains and gaps might appear in our insurance regulatory system and guaranty backstop if life insurer liabilities become "fungible"?

Put another way, life insurers have options to transfer their policyholder contracts without transfer and division statutes. Those options protect policyholders by requiring a life insurer that wants to be relieved of its promises to give the policyholder the opportunity to say "no". Removing this protection not only disadvantages affected policyholders, it raises the broader threats to our life insurance marketplace and regulatory system described above.

For these reasons, we urge extreme caution when considering laws that permit insurers to divide or transfer life, annuity, or long-term care contracts without policyholder consent. A prior letter from New York Life and Northwestern Mutual to the Restructuring Mechanisms (E) Subgroup recommended principles for the regulatory review of proposed divisions or transfers. That letter (attached here for the Working Group's reference) focused on financial standards, consistent with the charges of the Subgroup. Given the Working Group's process-oriented charges, this letter elaborates on procedural safeguards we believe should be included in any such laws. We believe these procedural protections serve the principle that policyholders should never be left worse off by a division or transfer.

Our procedural recommendations follow four themes: (1) protecting policyholders in other states; (2) notice and transparency; (3) two-step approval process; and (4) ensuring uniform application of procedural protections. Robust financial standards can only succeed if they are accompanied by equally robust procedural safeguards. Procedural protections to reduce the potential for harm are particularly important because division and transfer laws do not include an effective proxy for policyholder consent, such as an "opt-out" right or a requirement for a supermajority vote by policyholders.

Protecting Policyholders in Other States

Although the dividing or transferring insurer may be licensed in multiple states, transfer and division laws have been silent regarding the process for bringing a division or transfer into force in states outside of the approving state. This omission creates significant uncertainty and magnifies the risk of adverse guaranty association impacts.

Any such law should require notice to the primary insurance regulator in each state with residents holding insurance contracts of a dividing or transferring insurer. Consultation with each foreign commissioner should be required, and each affected commissioner should have a right to object to the transaction, with a robust process to address objections. Policyholders should be able to participate and communicate regarding the transaction through their local insurance commissioner.

Lastly, the law should require that the resulting or transferee insurer be licensed in each state in which policyholders reside. This requirement is necessary to ensure that guaranty association coverage is provided directly in all states in which insureds reside rather than as orphan coverage provided by the domestic state guaranty association. The future of the state guaranty associations could be in jeopardy without this change.

Notice and Transparency

Policyholders and others affected by a proposed division or transfer must receive adequate information and the opportunity to make their voices heard. Some division and transfer laws provide even less public access to information than required in connection with a Form A filing. Public hearings should be required prior to commissioner or court action. Any division or transfer law should require delivery of a notice in sufficient detail to inform decision-making, well before any hearing or action, directly to all policyholders, agents, brokers, reinsurers, creditors, regulators and state guaranty associations of the dividing/transferring and resulting/assuming insurers.

Likewise, confidentiality provisions must balance the insurer's desire to safeguard competitively sensitive information with the public's interest in understanding the transaction and its potential impact. To inform decisions and allow for the opportunity to provide meaningful public comments, there must be public access to (1) relevant financial analysis, including an independent expert report, (2) a business plan for the dividing/transferring and resulting/transferee insurers, and (3) information on the background and qualifications of controlling persons and management.

Two-Step Approval Process

Unlike Part VII transfers in the United Kingdom and insurance business transfer legislation that has been enacted in the United States (e.g., in Oklahoma), insurer corporate division statutes enacted to date have not required court approval. Given the extraordinary nature of these transactions, and the potentially significant impact on the established contractual rights of policyholders, court approval should be required.

Approval should take place in two steps: (1) discretionary approval by the domiciliary insurance commissioner based on the insurer's application and the public hearing, and (2) a court process leading to judgment and a court order once statutory conditions are satisfied, giving all interested parties the benefit of an established legal process and the right to object.

Ensuring Uniform Application of Procedural Protections

We have two recommendations to ensure that these important procedural protections are applied uniformly to protect policyholders. First, we suggest they should be set forth directly in statute, rather than being left to implementing regulations or to a set of best practices or guidance. Second, as with the standards for review addressed in the attached letter to the Subgroup, we believe it is essential for the NAIC to establish strong, minimum procedural requirements as accreditation standards. The strength of the procedural safeguards applied to division and transfer transactions will contribute importantly to the solvency implications of those transactions and would eliminate the threat of forum-shopping. And maintaining uniform state laws that protect solvency is the essential purpose of the NAIC's accreditation system.

*   *   *

We appreciate the opportunity to comment on this important topic. Please let us know if you need any additional information or would like to discuss our comments.

Sincerely,

Eric DuPont
Vice President & Counsel, Government Affairs
The Guardian Life Insurance Company of America

Dominick M. Ianno
Head of State Government Relations
Massachusetts Mutual Life Insurance Company

Douglas A. Wheeler
Senior Vice President, Office of Governmental Affairs
New York Life Insurance Company

Andrew T. Vedder
Vice President – Solvency Policy & Risk Management
The Northwestern Mutual Life Insurance Company

BY E-MAIL

April 26, 2019

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

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

Re: The Restructuring Mechanism Subgroup's Charges

Dear Messrs. Stolte and Smith,

The undersigned companies are grateful for the opportunity to comment on the charges of the Restructuring Mechanisms (E) Subgroup.

In general, we strongly support the subgroup's charges. While we endorse all the charges, we ask that the subgroup give special emphasis to the development of uniform minimum standards for restructuring mechanisms.

The Importance of Strong, Uniform Standards for Divisions and Business Transfers

Several states have recently enacted new "division" and "insurance business transfer" laws that allow insurers to transfer and novate business without policyholder consent. While these laws offer new flexibility to companies and regulators, they also introduce new dangers for policyholders and the state-based system of insurance regulation. Because we believe there are existing alternatives that provide sufficient flexibility in nearly all circumstances and because we want to maintain policyholder protections, our strong preference is against the enactment or use of division and insurance business transfer statutes for life, annuity or health insurance. However, recognizing that regulators may wish to find a way to permit, in limited circumstances, transactions that are beneficial to all policyholders, our comments in this letter address the minimum standards required if life, annuity or health divisions or transfers are to be considered.

Unlike traditional indemnity reinsurance, where the original insurer remains liable, these new structures allow the original insurer to extinguish liability to policyholders. We have grave concerns about several aspects of these new laws:

- There is no nationally uniform financial standard or actuarial level of confidence for regulators to apply when reviewing the financial strength of a business included in a division or transfer. A strong, nationally uniform standard is necessary to ensure that policyholders are protected against the risk of insolvency. This standard should become an NAIC accreditation requirement. The development of this standard should be a critical area of focus for the subgroup.

- In some states, division and insurance business transfer laws are open to any line of business, even when it is difficult or impossible to arrive at a credible long-term valuation of the business involved. For example, a division could allocate distressed, hard-to-value long-term care liabilities to a newly created splinter company. In this scenario, healthier business and associated assets might remain with the original company, endangering policyholders relegated to the splinter company.

- Some laws also allow the creation of monoline insurers, potentially depriving policyholders of the benefits of diversification without their consent.

- Some laws also allow the division of a multi-state insurer into a splinter company licensed in a single state, potentially overwhelming the state's domestic guaranty association in the event of insolvency.

- Some laws sanction the use of non-admitted assets to support policy liabilities.

- Several laws lack other important procedural and substantive safeguards like public notice, requirements to consult with other interested states, independent expert review, a hearing or court process, and requirements to assess corporate governance and owner qualifications.

At their worst, these new laws could enable transactions that enrich shareholders at the expense of policyholders, guaranty associations and the reputations of both the industry and state-based system of insurance regulation. Effective, nationally uniform oversight of solvency has long been a hallmark of state-based insurance regulation. It is essential that the NAIC act to preserve this strength of the state-based system. These new transaction structures must not be allowed to undermine fundamental solvency regulation and policyholder protections. We expect that the subgroup's work will be a critical part of this effort.

In the discussion below, we suggest several principles that should govern regulatory review of proposed division and business transfer transactions.

Policyholders Should Never Be Left Worse Off

Regulators should never approve a division or insurance business transfer if it would leave any class of policyholders worse off. Instead, policyholders should be left in the same or a better position after completion of the transaction. Before the regulator signs off, a valuation should be undertaken by an expert to establish at a high level of confidence that policyholders will experience no adverse effects. The expert should be independent of any influence from the companies involved.

This approach would align the U.S. regulatory framework with well-established international precedents like the United Kingdom's "Part VII" business transfer regime. A focus on policyholder protection has been fundamental to the success of the U.K. regime. In a Part VII transaction, the regulator must provide a detailed report to the court and certify the solvency of the resulting entity. An independent expert must also provide a detailed report. When there are questions about the strength of the business involved, the U.K. regulators and the court will normally insist on ensuring that the business is transferred to a stronger insurer, not isolated in a weaker insurer.

Some state laws provide that a regulator should approve a division or business transfer if there is no "material adverse effect" on policyholders. This standard falls far short of what should be required. The standard endorses policyholder harm so long as the harm does not rise to a vaguely defined materiality threshold. For example, a transaction might accomplish nothing more than benefit shareholders at the expense of policyholders. Although the damage to policyholders may not rise to the level of a "material adverse effect," the law should not call on the regulator to approve unless the effect on policyholders is neutral or there is some expected policyholder benefit.

No Monolines

Regulators should never permit a transaction that transforms a diversified insurance company into one or more monoline insurers, especially when the transaction involves long-duration life, annuity or health insurance business. It makes little sense to deprive policyholders the benefits of diversification. The wisdom of this principle is borne out by the recent experience of carriers like Penn Treaty that concentrated their offerings in long-term care insurance.

Hard-to-Value Business Like LTC Should Be Ineligible for Division or Transfer

It is important that standards for approval acknowledge fundamental differences among lines of business. A standard that may be appropriate for short-duration commercial property and casualty risks is likely to need significant adjustments before it can be applied successfully to long-duration retail life, annuity and health businesses.

As a threshold matter, some lines of business are best excluded from division and business transfer transactions. Long-term care offers the best example. The history of reserve deficiencies, rate increases and, in some cases, insolvencies, associated with this product demonstrates the challenges of arriving at satisfactory valuations. Given this history and the long duration of the liabilities, it is clear to us that long-term care blocks should not be separated from other businesses that provide financial stability and diversification for the entity overall.

The experience of long-term care leads us to suggest the following possible approach to similar long-duration life and health businesses: for each such business, the regulator should be able to confirm the sufficiency of assets supporting the liabilities based on a reasonable valuation relative to an industry standard of experience. To make this determination, the Commissioner should first compare the valuation of liabilities to what the valuation would be using standardized valuation tables adopted by the NAIC for each line of business. If such standardized valuation tables are not available, the business should not be eligible for division or transfer.

Require Strong Financial Standards and Stress Testing for Long-Duration Business

Even if a long-duration life or health business is eligible for inclusion in a transaction, regulators will still need a robust framework to evaluate the long-term solvency of the business. Regulators should consider the following principles in the development of this framework:

- For long-duration life, annuity and health business, regulators should start with a focus on policy reserves, and should require stress testing of reserves at a "severely adverse" level. If reserves are not subjected to a high level of stress testing, a division or transfer may appear to leave a business adequately capitalized at the time of the transaction. However, the picture can change over time as long-term experience diverges from assumptions. Again, consider the recent experience of long-term care.

- Starting from a basis of reserves meeting a "severely adverse" standard, formulaic application of risk-based capital will, appropriately, result in a higher level of required capital for the business affected by the division or transfer. However, while risk-based capital may provide a useful starting point to establish capital requirements, it is not designed to measure relative financial strength and therefore would be insufficient on its own to determine the minimum required financial position of a transferred business.

- Instead, in addition to risk-based capital, regulators should explore capital standards for long-duration life and health business that are based on a defined ratio of asset adequacy standards. Capital standards based on this type of cash flow projection technique can help ensure that enough capital is held in a transferred business, supplementing the existing risk-based capital framework.

- Regulators should establish a confidence level based on the greatest present value of accumulated deficiencies over a long-term horizon across stochastic scenarios. The confidence level should be set at a standard that assures solvency over the life of the business so as to provide a robust backstop to the combination of reserves established to meet a "severely adverse" standard and risk-based capital.

- Prescribed assumptions should be included in capital calculations to avoid the manipulation of capital thresholds.

- Actuarial reserve and capital calculations should be performed by an expert that is independent of the insurance companies involved.

Use Uniform NAIC Valuation and Accounting Standards

When evaluating the solvency impact of a proposed transaction, regulators should not give credit for non-admitted assets. Decisions about these transactions should start from the NAIC's uniform statutory valuation and accounting rules.

The possibility that non-admitted assets might be used to back reserves and capital in these transactions is deeply troubling for the following reasons:

- Most non-admitted assets are classified that way because they are not readily available to satisfy policyholder claims.

- Put another way, many non-admitted assets are not readily marketable or do not produce future cash flows.

- Non-admitted assets can include anything a company owns, from illiquid and contingent letters of credit to office furniture, equipment, hardware and software.

- It makes sense to exclude these items from the pool of assets an insurance company can count toward the payment of future claims, as they are illiquid, unlikely to retain their value, and generally do not produce additional income.

- The distinction between admitted and non-admitted assets should not change in the context of a division or business transaction. In fact, given the risk that companies will use restructuring mechanisms to wall off distressed businesses, it is especially important that regulators scrutinize the quality of the assets involved.

Minimum Requirements Should Become NAIC Accreditation Standards

Ultimately, it will be essential that the NAIC establish strong minimum requirements for these transactions as accreditation standards. The strength of state-based system depends upon the integrity of solvency regulation across the country. Regulators will need to rely on their counterparts in other states to ensure that transferred businesses are uniformly supported by sufficient reserves and capital, and are run off in a solvent manner. Companies should not be allowed to arbitrage their way to diminished solvency oversight by choosing one domicile over another.

Other Procedural Safeguards Are Also Important

In this letter, we have focused primarily on the financial standards that should apply to divisions and insurance business transfers. We expect those standards will be a significant focus of the subgroup. However, there are other procedural safeguards that are equally important for these transactions. For example, since policyholders lose their normal right to consent, court oversight and approval should be required. Policyholders and other affected parties should always be given notice, access to all information needed to meaningfully review a proposed transaction, and an opportunity to be heard in court. Also, the process should require approval or non-objection of all affected states and the resulting entities should be licensed in all states needed so as not to impair policyholders' access to their state guaranty associations. We believe these protections should also be considered for accreditation requirements. We look forward to providing our views on this and other procedural safeguards to the Restructuring Mechanisms (E) Working Group.

* * *

We appreciate the opportunity to comment on this important topic. Please let us know if you need any additional information or would like to discuss.

Sincerely,

Douglas A. Wheeler
Senior Vice President, Office of Governmental Affairs
New York Life Insurance Company

Andrew T. Vedder
Vice President – Solvency Policy & Risk Management
The Northwestern Mutual Life Insurance Company