NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

**MEMORANDUM**

TO: Receivership and Insolvency (E) Task Force

FROM: Restructuring Mechanisms (E) Working Group

DATE: March 28, 2022

RE: Referral Regarding Potential Change to NAIC Model

The NAIC formed the Restructuring Mechanisms (E) Working Group because of recent changes to state laws in the areas of Insurance Business Transfer (IBT) and Corporate Divisions (CD). The Working Group is in the process of drafting a white paper that, among other things, documents the issues the statutes are designed to address and some of the legal issues. Specific to that point, during public discussions, the Working Group received input from both the National Conference of Insurance Guaranty Funds (NCIGF) and the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) on how policyholders can retain guaranty fund coverage after such a transaction. The following summarizes such input, which is further explained at the end of this memorandum.

> **NCIGF** – The NCIGF's position is that where there was guaranty fund coverage before the IBT or CD, state insurance regulators should ensure that there is coverage after the IBT or CD. An IBT or CD should not reduce, eliminate, or in any way affect guaranty fund coverage. A CD or IBT should not create, expand, or in any way affect coverage. The NCIGF suggested that possible technical gaps may exist in states that have adopted the *Property and Casualty Insurance Guaranty Association Model Act* (#540) and proposed specific changes to the model to address.

> **NOLHGA** – Described the three conditions that are needed for guaranty fund coverage after an IBT or CD. In general, restructuring statutes (or state insurance regulators reviewing proposed restructuring transactions) should clearly provide that assuming or resulting insurers must be licensed so policyholders maintain eligibility for guaranty association coverage from the same guaranty association that would have provided coverage immediately prior to a restructuring transaction. This means the resulting insurer must be licensed in all states where the transferring insurer was licensed or had ever been licensed with respect to the policies being transferred.

To that end, attached is a Request for NAIC Model Law Development form, which sets forth proposed changes to Model #540, as suggested by the NCIGF. The Working Group is not the technical expert in this area, but it does support the intent of retaining guaranty fund coverage; therefore, the Working Group asks the Receivership and Insolvency (E) Task Force to review the attached and determine where such changes could generally be supported. We are not trying to determine if this is the exact change to make to the model at this time, but rather whether the Task Force supports the project and would be willing to complete an update to the language if approved by the Financial Condition (E) Committee and the Executive (EX) Committee. To the extent possible, perhaps the Task Force could expose the attached Request for NAIC Model Law Development form, debate it, and return it to the Working Group prior to the Summer National Meeting, where the request could be made to the Financial Condition (E) Committee.

Please let the Working Group know if you have any questions.

The following is a more comprehensive summary of the positions of the NGIGF and the NOLHGA:

> The Working Group received input from the NOLHGA about the concerns for insurance consumers of personal lines life and health insurance business. The NOLHGA indicated that for there to be guaranty association coverage in the event of a life or health insurer insolvency, there are three conditions that must be present. Those conditions are:
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> 1. The consumer seeking protection must be an eligible person under the guaranty association statute; typically, this is achieved by being a resident of the guaranty association's state at the time of the insurer's liquidation.
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> 2. The product must be a covered policy.
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> 3. The failed insurer for which protection is being sought must be a member insurer of the guaranty association of the state where the policyholder resides. To be a member insurer, the insurer must be licensed in that state or have been licensed in the state to write the lines of business covered by the guaranty association.

In most states, coverage can also be provided for an "orphan" policyholder of the insurer by the guaranty association in the insolvent insurer's domestic state. Orphan policyholders are policyholders who are residents of states where the guaranty association cannot provide coverage because the insolvent insurer is not a member insurer due to not being licensed at the time required by the *Life and Health Insurance Guaranty Association Model Act* (#520). The orphan policyholder situation can arise when a policyholder purchases a policy in a state where the issuing company is licensed—i.e., is a member of the guaranty association—but subsequently moves to a state where the issuing insurance company was never licensed; i.e., is not a member of the guaranty association. The provision in Model #520, and the laws of most states, that provides that orphan policies are covered by the guaranty association in the insolvent insurer's domestic state is designed to plug the gap in these rare situations.

A key factor when considering a life or health IBT or CD transaction is whether the resulting insurer is or will be a member insurer in each state. If the resulting insurer is a member insurer of the same guaranty associations as the transferring insurer, guaranty association coverage will be preserved and not changed for all policyholders. Of course, specific guaranty association coverage will be determined if/when the resulting insurer is placed under an order of liquidation with a finding of insolvency. If the resulting insurer is not a member insurer of the same guaranty associations as the transferring insurer, policyholders may lose guaranty association coverage or be covered as orphans by the guaranty association in the insurer's domestic state. Orphan coverage was not designed to plug the gap in this situation. Shifting the coverage obligation to the domestic state guaranty association could result in guaranty association coverage being concentrated in that state.

To address these concerns with respect to IBT and CD transactions involving life or health insurance, restructuring statutes (or state insurance regulators reviewing proposed restructuring transactions) should clearly provide that assuming or resulting insurers must be licensed so policyholders maintain eligibility for guaranty association coverage from the same guaranty association that would have provided coverage immediately prior to a restructuring transaction. This means the resulting insurer must be licensed in all states where the transferring insurer was licensed or had ever been licensed with respect to the policies being transferred.

One interpretation of Model #540 is that based on the definitions of "Covered Claim," "Member Insurer," "Insolvent Insurer," and "Assumed Claim Transaction," an orphan policyholder could not be covered by the state guarantee association. Consequently, there is a concern that no guaranty association coverage would be provided if policies are transferred to a nonmember insurer. Many property/casualty (P/C) guaranty fund statutes require that the policy be issued by the now-insolvent insurer, and it must have been licensed either at the time of issue or when the insured event occurred. However, these limitations are designed to avoid coverage being provided when the policy at issue did not "contribute" to the association, which would not exist in the case of an assessable policy later transferred to an insurer that was not a member at the time the policy was issued. Moreover, the restrictions exist to prevent claims resulting from a company regulated as surplus lines, or a similar structure, to benefit from the protections afforded licensed business when a licensed company is liquidated.

The NCIGF's position is that where there was guaranty fund coverage before the IBT or CD, state insurance regulators should ensure there is coverage after the IBT or CD. An IBT or CD should not reduce, eliminate, or in any way affect guaranty fund coverage. A CD or IBT should not create, expand, or in any way affect coverage. The NCIGF suggested that possible technical gaps may exist in states that have adopted Model #540. These gaps could include the definitions of "Covered Claim," "Member Insurer," "Insolvent Insurer," and "Assumed Claims Transaction" found in Section 5 of the model.

Fulfilling this intent will likely require that P/C guaranty fund statutes be amended in each of the states where the original insurer was a member of a guaranty association before the transaction becomes final. The NCIGF indicated that it created a subcommittee to address this issue and oversee a coordinated national effort to enact the necessary changes in each state. It should be noted that the same membership and timing issues that are raised by IBTs could also be raised in the case of any other policy novation, including the assumption reinsurance transactions.