

# **NAIC RECEIVER'S HANDBOOK FOR INSURANCE COMPANY INSOLVENCIES**

## **CHAPTER 11: STATE IMPLEMENTATION OF A DODD-FRANK RECEIVERSHIP**

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## I. INTRODUCTION

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

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

- 1) Establishing processes at the state level to ensure the state receivership mechanism will respond effectively to a Dodd-Frank receivership;
- 2) Analyzing and preparing for the situation in which an insurance company is a subsidiary or affiliate of a covered financial company;
- 3) Describing national coordination initiatives to ensure the national state-based systems provide further support to administering a Dodd-Frank receivership;
- 4) Developing state laws that will ensure that state mechanisms can effectively initiate and administer a Dodd-Frank receivership.

## II. OVERVIEW OF DODD-FRANK RECEIVERSHIP FRAMEWORK

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

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

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<sup>1</sup> Public Law 111-203, 12 U.S.C. 5301 *et seq.*

<sup>2</sup> §§ 201 to 217, 12 U.S.C. 5381 *et seq.*

<sup>3</sup> § 201(a)(11); 12 U.S.C. 5381(a)(11).

<sup>4</sup> 12 U.S.C. 1841(a).

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

engaged” in activities that are financial in nature or incidental thereto for purposes of the BHCA, other than a subsidiary that is an insured depository institution or an insurance company.<sup>6</sup>

Under the OLA, the Federal Deposit Insurance Corporation (“FDIC”) may be appointed as receiver of a “covered financial company” for purposes of liquidating the company.<sup>7</sup> The Dodd-Frank Act defines the term “covered financial company”<sup>8</sup> as a financial company for which the Secretary of the Treasury (“Secretary”) in consultation with the President has made a determination under § 203(b).<sup>9</sup> However, if the financial company is an insurance company<sup>10</sup> or its largest U.S. subsidiary (measured by total

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

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

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

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

<sup>8</sup> § 201(a)(9).

<sup>9</sup> § 203(b) (12 U.S.C. 5383(b)) provides:

(b) DETERMINATION BY THE SECRETARY.—Notwithstanding any other provision of Federal or State law, the Secretary shall take action in accordance with section 202(a)(1)(A), if, upon the written recommendation under subsection (a), the Secretary (in consultation with the President) determines that—

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

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

(4) DEFAULT OR IN DANGER OF DEFAULT.—For purposes of this title, a financial company shall be considered to be in default or in danger of default if, as determined in accordance with subsection (b)—

- (A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;
  - (B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
  - (C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others;
- or
- (D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

<sup>10</sup> Defined as “...any entity that is (A) engaged in the business of insurance; (B) subject to regulation by a State insurance regulator; and (C) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation or insolvency of an insurance company.” § 201(a)(13); 12 U.S.C. 5383(a)(13).

assets) is an insurance company, the Director of the Federal Insurance Office (“FIO”) and the Board, at the request of the Secretary or on their own initiative, will make a written recommendation, by two-thirds vote of the Board and the affirmative approval of the Director of the FIO in consultation with the FDIC to the Secretary on whether the Secretary should make a determination to invoke the OLA with respect to the financial company.<sup>11</sup>

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

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

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

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

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

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<sup>11</sup> § 203(a)(1)(C); 12 U.S.C. 5383(a)(1)(C).

<sup>12</sup> § 202(a)(1); 12 U.S.C. 53823(a)(1).

<sup>13</sup> § 203(e); 12 U.S.C. 5383(e).

<sup>14</sup> § 203(e)(3); 12 U.S.C. 5383(e)(3).

<sup>15</sup> § 210(a)(1)(E)(i); 12 U.S.C. 5390(a)(1)(E)(i) provides:

the FDIC as receiver over such subsidiary, the subsidiary itself will be considered a financial company subject to the OLA and the FDIC will have all of the powers and rights with respect to that covered subsidiary as it has with respect to a covered financial company.<sup>16</sup>

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

### **III. STATE LEVEL PROCESSES AND PROCEDURES FOR IMMEDIATE INITIATION OF STATE INSURANCE RECEIVERSHIP**

#### **A. Rapid Response Protocol**

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

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

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

- (I) the covered subsidiary is in default or in danger of default;
- (II) such action would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the United States; and
- (III) such action would facilitate the orderly liquidation of the covered financial company.

<sup>16</sup> § 210(a)(1)(E)(ii); 12 U.S.C. 5390(a)(1)(E)(ii).

<sup>17</sup> § 204(c); 12 U.S.C. 5384(c).

Frank Act, 12 U.S.C. §5383(e)(1), explicitly refers to both rehabilitation and liquidation of insurance companies in the insurance company context.

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

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

- Advanced Planning
- Coordination with the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and National Conference of Insurance Guaranty Funds (NCIGF)
- State-Federal Coordination with Proper Deference to State Insurance Regulators and Receivers in the Orderly Liquidation of any Insurance Company
- Creation of a Contact List and Executive Committee to Coordinate Receivership Implementation
- Formal Communication Protocols
- Procedures for Immediate Initiation of Receivership and Contacting Attorneys General
- Procedures or Rules for Expedited Judicial Review

## **B. Advanced Planning**

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

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

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

- a confidential order of supervision by the state insurance regulator; or

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

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

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

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

### **C. Internal Procedure For Presenting Federal Determinations to Commissioner and for Immediately Initiating Receivership**

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

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

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<sup>18</sup> The NAIC Model Insurance Holding Company Act requires that annual reports to regulator identify material risks within the holding company system that could pose a financial or reputational contagion to the insurer.



pursuant to 12 U.S.C. § 5383(c) and 12 U.S.C. § 5382(a)(1)(A)(i) . There is no exact time limit for the notice, but the expectation is that the notice will be immediate.

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

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

## 1. Internal Discussions

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

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

## 2. Key Elements of Initial Due Diligence

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

bankruptcy. *See* FDIC Report, The Orderly Liquidation of Lehman Brothers Holdings Under the Dodd-Frank Act, April 18, 2011.<sup>19</sup>

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

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

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

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

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

- a. Assuming there is an external procedure for communicating the federal determinations and/or prior proceedings to the domestic Regulator, the Regulator must, in turn, trigger internal procedures for filing the appropriate judicial action seeking liquidation or rehabilitation within 60 days of the determination.
- b. Most Regulators and Receivers have established internal procedures for contacting the Chief Liquidation Officer, consulting with the Attorney General or others needed to file a state receivership action and for notifying the Court once the action is filed. These internal procedures should be adapted, strengthened and memorialized for Dodd-Frank scenarios to provide for heightened and expedited notice and court action. In some states, statutory or

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<sup>19</sup> [http://www.fdic.gov/bank/analytical/quarterly/2011\\_vol5\\_2/lehman.pdf](http://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf).

rule change will be required to adapt to a Dodd-Frank scenario. For example, if the state requires public or non-public bidding process for the appointment of a receiver, that process must be expedited or eliminated in the unique Dodd-Frank scenarios in order to assure federal statutory compliance and expedited appointment of a state receiver.

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

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

- d. The mission of the Committee is:
- Plan in advance (pre-identify contact points and pre-identify expedited procedures that are annually reviewed) for a Dodd-Frank insurance receivership.
  - Assist the Commissioner in the assessment of alternatives for cost effective resolution or receivership while maximizing protection of policyholders, creditors and the public. Accurate and timely information is critical to perform these functions.
  - Assist the Commissioner in assessing and rapidly responding to federal determinations in a manner that complies with Dodd-Frank and meets the goals of Dodd-Frank Title II.
  - Assure through pre-planning or otherwise that adequate assets of any designated systemically important insurance company exist, or that other lending/funding exists, to pay for the receivership of an insurance company receivership arising under Dodd-Frank.
  - Assess early on the severity of potential obligations of guaranty funds resulting from liquidation of a systemically important insurer.
  - Work with the state Receiver to coordinate, implement and resolve the receivership.
- e. Depending on the state, the Committee and the Contact List may be comprised of the same or different people. The Contact List is a list of key stakeholders who must be notified by the Regulator immediately in the event of a § 203(b) determination, certainly as to a domestic company, and also possibly in relation to a foreign company with business in that

Regulator's state. A communication protocol similar to that in place under most states' disaster plans in general must be implemented.

The Committee and/or the Contact List should include:

- Regulator (Chair of Committee) and/or Chief Financial Regulator/Key Department of Insurance Personnel (Committee and Contact List). The Regulator is charged with immediately notifying the members of the Committee and the Contact List upon notification of the federal determination. This notification may occur outside of normal business hours. Therefore, the communication procedures and protocols must anticipate a need to contact key stakeholders at any time of any day.
- Governor or appointed representative (Contact List)
- Chief Liquidation Officer, or Special Deputy Receiver (Committee and Contact List)
- Chief Legal Counsels of Regulator/Receiver (Committee and Contact List)
- Other agencies. It should be noted that some entities (for example health maintenance organizations and other managed care organizations) may be regulated primarily or jointly by other state agencies, such as the department of health or specialized agencies.
- Attorney General or designated Assistant Attorney General (Committee and Contact List) and/or contracted outside counsel
- If state law and process allow, Chief or Administrative Judge of the receivership court (Contact List)
- Depending on state structure, Contracted Receivers (may need pre-approved short list for magnitude of a Dodd-Frank receivership; consider training core group of current state receivers who can be loaned to other states in the systemically significant circumstances) (Committee and Contact List). Commissioners may in their discretion consider sources of previously identified receivership expertise in assembling resources for the administration of a Dodd-Frank receivership. The NAIC Directory of Receivership and Run-Off Resources to Assist State Insurance Regulators provides commissioners, in their capacity as receiver, a list of professional resources. Examples of other sources of expertise may include the ABA Tort & Insurance Practice Section; the Association of Insurance & Reinsurance Run-Off Companies (AIRROC); the International Association of Insurance Receivers, which also accredits insurance receivers; and the International Association of Restructuring, Insolvency & Bankruptcy Professionals.
- NOLHGA and NCIGF, and specialized guaranty funds, such as title and managed care, where appropriate. (Committee and Contact List)

*Additional Potential Parties for Active Receivership:*

- NAIC, including RFAWG . The NAIC can particularly assist with the notification to all affected state Regulators in the event that ancillary receiverships must be rapidly initiated.

- Federal Insurance Office
- Ancillary Receivers, if any
- FDIC to coordinate treatment of solvent and insolvent insurance company subsidiaries and affiliates and other issues
- Other state agencies that also regulate the insurance company

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

1. In all states, the State Attorney General represents the Regulator. In many states, the State Attorney General also represents the Receiver. Therefore, early consultation and coordination with the State Attorney General is required to swiftly transition a systemically risky insurance company to receivership under state law.
2. In some cases, national coordination with Attorneys General will be required to promptly and cost-effectively domesticate the receivership order in all or the majority of states.
3. States should plan for expedited and/or flexible procedures for the appointment of outside counsel, if required by the Regulator or Receiver. There will be a need for rapid conflicts checking and immediate retention.
4. Depending on state structure, States should consider development of a pre-approved short list of Attorneys General and/or qualified outside counsel who can respond to the magnitude of a Dodd-Frank receivership. This could ensure immediate consultation with attorneys needed to prepare and make the required filing in state court and execute the receivership under the urgent circumstances presented by a Dodd-Frank receivership.
5. Special attention should be devoted to those special cases in which the federal courts may also be involved, such as the insolvency of a risk retention group or the resort to Chapter 11 of the bankruptcy code by the parent or an affiliate of the troubled insurer that could result in the Section 362 automatic stay impeding accelerated proceedings.

**E. Other Considerations**

1. States and the NAIC should develop pre-screened/outlined court documents.
2. In some states, statutory amendments may be required or favored to assure that a federal determination under § 203(b) or consent at the federal level is grounds for liquidation. Potential changes are discussed below in section VI. Notwithstanding that, there are provisions in the NAIC models and IRMA that can be incorporated into pre-screened court administrative documents for receiverships prompted by systemic risk determinations, such as:
  - a. Rehabilitation may be the best first step for all or part of an insurance company subject to a Dodd-Frank receivership, especially if there is a filed resolution plan providing for the orderly transfer, reinsurability or runoff of policyholder liabilities. Liquidation may be required, if there is a critical need to trigger guaranty funds and an order of liquidation plus a finding of insolvency is required by state law for that trigger. All receivership mechanisms should be considered in consultation with any applicable guaranty funds. In any case, rapid but sophisticated analysis of how a state receiver is going to close or resolve the insurance company (what liquid assets exist to run the

receivership; what assets are (un)encumbered including what liens taken by FDIC; how can assets be sold or liquidated; how are claims going to be filed, determined and paid; what is the effect of qualified financial contracts) must occur.

- b. The following grounds for receivership or liquidation in most current state codes could provide grounds for an insurance company receivership order in the event of a federal determination and can be incorporated into a consent, model complaint and order along with other grounds that may exist (*i.e.*, insolvency):
- The insurer is in such hazardous condition that the further transaction of its business would be hazardous financially to its policyholders, creditors and the public. *Compare* § 203(b)(4).
  - The board of directors or the holders of the majority of voting shares request or consent to state receivership.

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

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

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

1. Intake and administration protocol that results in automatic assignment to a particular judge (such as the chief administrative judge or duty judge) and that avoids jurisdictional disputes (*e.g.*, whether or not the complaint and case is or is not assigned or transferred to a specialized court or docket).
2. Filing the complaint under seal where appropriate.
3. Intake and administration protocols that provide for expedited processes and orders, ideally hearing and determination of the complaint within twenty four (24) hours of filing. This may be accomplished pursuant to court scheduling order or other order, or existing rules in some states.

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

4. Limited or no intervention by third parties. To the extent existing state law in a particular state permits third parties (other than the company) to intervene as parties at the outset of an insurance company receivership, consider limiting the right to seek intervention in a Dodd-Frank receivership to ancillary proceedings that occur after entry and appeal of the receivership order. This will assure that states can meet the Dodd-Frank Act's need for immediate entry of a rehabilitation or liquidation order in response to a federal determination and that interventions do not interfere with the emergency activities of the court and the regulator. In states where statutes or case law do not presently grant third parties intervention and appeal rights in receivership cases, that law should be preserved in a Dodd-Frank receivership.
5. Domestication of the Receivership Order and/or initiation of ancillary receivership proceedings.
6. Limited appeal, both in terms of standing and scope of review, analogous to that set forth in Dodd-Frank, Title II, Section § 202. Conversely, only the insurance company, as represented by its board, should have standing to defend against a complaint for receivership as provided for in existing statutes. Affiliates, subsidiaries and creditors should not be permitted to participate in the litigation of the discreet issue whether a liquidation order should be entered because of the existence of a federal determination under § 203(b).

#### IV. SUBSIDIARY AND AFFILIATE ISSUES

##### A. Overview

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

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

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

(w) Definitions relating to affiliates of depository institutions

(4) Subsidiary. The term 'subsidiary'

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

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

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

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<sup>20</sup> 12 U.S.C. 1813(w)(6).

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

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

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

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

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

## B. Asset Transfer

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

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<sup>21</sup> 12 U.S.C. 1813(w)(5).

<sup>22</sup> §210(a) - Powers and Authorities.

(1) General Powers

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

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

(I) ...

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

<sup>23</sup> §210(h) - Bridge Financial Companies

(5) Transfer of Assets and Liabilities.

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

(D) Effective Without Approval. The transfer of any assets and liabilities, including those associated with any trust or custody business of a covered financial company, to a bridge financial company shall be effective without any further approval under Federal or State law, assignment, or consent with respect thereto.



§210(a)(1)(G), which therefore might be interpreted as simply exempting the FDIC from obtaining approval from shareholders, lien holders or other private parties.<sup>24</sup>

An insurance company's assets would not appear to be subject to transfer by the FDIC because §210(a)(1)(G) only authorizes the transfer of assets of the "covered financial company" for which the FDIC is the receiver. The Section does not appear to authorize the FDIC to "transfer" the insurer's business through reinsurance or other arrangements. It also, therefore, does not appear to give the FDIC authority to transfer a wholly owned subsidiary of an insurer. The subsidiary is an asset of the insurer, not the covered financial company. But authority granted to the FDIC to impose liens (discussed below) is analogous, and that authority is interpreted as extending to an insurer's subsidiaries.

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

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

### **C. Lien and Funding Issues**

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

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

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

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

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

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

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

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

<sup>26</sup> §204 - Orderly Liquidation of Covered Financial Companies.

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

[I]ncluding funds used for --

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

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

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

- (1) making loans to, or purchasing any debt obligation of, the covered financial company or any covered subsidiary;
- (2) purchasing or guaranteeing against loss the assets of the covered financial company or any covered subsidiary, directly or through an entity established by the Corporation for such purpose;
- (3) assuming or guaranteeing the obligations of the covered financial company or any covered subsidiary to 1 or more third parties;
- (4) taking a lien on any or all assets of the covered financial company or any covered subsidiary, including a first priority lien on all unencumbered assets of the covered financial company or any covered subsidiary to secure repayment of any transactions conducted under this subsection;
- (5) selling or transferring all, or any part, of such acquired assets, liabilities or obligations of the covered financial company or any covered subsidiary; and
- (6) making payments pursuant to subsections (b)(4), (d)(4), and (h)(5)(E) of section 210.

<sup>27</sup> Subsection (d)(1), *supra*.

<sup>28</sup> Subsection (d)(2), *supra*.

<sup>29</sup> Subsection (d)(5), *supra*.

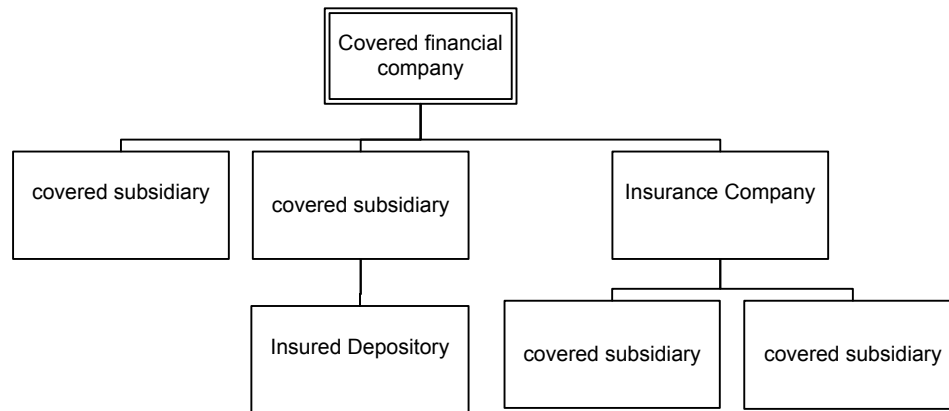
<sup>30</sup> Sections 210(b)(4), 210(d)(4) and 210(H)(5)(E).

<sup>31</sup> *See* § 203(b).

<sup>32</sup> §201(a)(9) - Covered Subsidiary. -- The term "covered subsidiary" means a subsidiary of a covered financial company, other than ---

- (A) an insured depository institution;
- (B) an insurance company; or
- (C) a covered broker or dealer.

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



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

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

- a) In the event that the Corporation [FDIC] makes funds available to a covered financial company that is an insurance company or to any covered subsidiary of an insurance company or enters into any other transaction with respect to such covered entity under 12 U.S.C. 5384(d), the Corporation will exercise its right to take liens on any or all assets of the covered entities receiving such funds to secure repayment of any such transactions only when the Corporation, in its sole discretion, determines that:
  1. Taking such lien is necessary for the orderly liquidation of the entity; and
  2. Taking such lien will not either unduly impede or delay the liquidation or rehabilitation of such insurance company, or the recovery by its policyholders.
- b) This section shall not be construed to restrict or impair the ability of the Corporation to take a lien on any or all of the assets of any covered financial company or covered subsidiary in order to secure financing provided by the Corporation or the receiver in connection with the sale or transfer of the covered financial company or covered subsidiary or any or all of the assets of such covered entity.

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

<sup>33</sup> 12 C.F.R. §380.6

intends to place a lien on an insurer's assets in connection with obtaining financing or in connection with the sale or transfer of the covered financial company, a subsidiary, or an affiliate.

The FDIC's lien authority could conflict with the authority of the receiver or the receivership court as to imposition of liens on an insurer's assets. Imposing liens on subsidiaries' assets could negatively affect the operations of an insurer when a subsidiary's operations are interwoven with or integral to the operation of the insurer.

## V. NATIONAL COORDINATION

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

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

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

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

## VI. POTENTIAL CHANGES TO STATE LAW

Receivership and the call for orderly liquidation under Title II of Dodd-Frank may be triggered well before the existence of insolvency, impairment or other hazardous conditions have traditionally been established with respect to domestic companies. A Dodd-Frank orderly liquidation will also require a rapid response, as discussed fully in section III above. Accordingly states should review and consider whether their existing state laws, including the grounds for rehabilitation or liquidation of a domestic company and related procedural rules for obtaining receivership orders, are sufficient to respond to federal determinations that domestic insurers meet the standards codified in Title II of Dodd-Frank, 12 U.S.C. §5383(b), and the receivership processes established under 12 U.S.C. §5382(a) and §5383(e).

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

**EXHIBIT 11-C: GUIDELINE FOR IMPLEMENTATION  
OF STATE ORDERLY LIQUIDATION AUTHORITY**

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

**[ ] Orderly Liquidation Authority**

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

- A. The commissioner may file in the [insert proper court] court of this state a petition for an order of rehabilitation or liquidation on any of the following grounds:
- 1) Upon a determination and notification given by the Secretary of Treasury (in consultation with the President) that the insurance company is a financial company satisfying the requirements of 12 U.S.C. § 5383(b), and the board of directors (or body performing similar functions) of the insurance company acquiesces or consents to the appointment of a receiver pursuant to 12 U.S.C. § 5382(a)(1)(A)(i), with such consent to be considered as consent to an order of rehabilitation or liquidation; or
  - 2) Upon an order of the United States District Court for the District of Columbia under 12 U.S.C. § 5382(a)(1)(A)(iv)(I) granting the petition of the Secretary of the Treasury concerning the insurance company under 12 U.S.C. § 5382(a)(1)(A)(i); or
  - 3) A petition by the Secretary of the Treasury concerning the insurance company is granted by operation of law under 12 U.S.C. § 5382(a)(1)(A)(v).
- B. Notwithstanding any other provision in this Act or other law, after notice to the insurance company, the receivership court may grant a petition for rehabilitation or liquidation within 24 hours of the filing of a petition pursuant to this section.
- C. If the court does not make a determination on the petition for rehabilitation or liquidation filed pursuant to this section within 24 hours after the filing of the petition, it shall be deemed granted by operation of law upon the expiration of the 24 hour period. At the time that an order is deemed granted under this section, the provisions of [cite to applicable state law addressing rehabilitation or liquidation] shall be deemed to be in effect, and the receiver shall be deemed to be appointed [optional: affirmed] and have all of the applicable powers provided by [refer to applicable state law addressing rehabilitation or liquidation], regardless of whether an order has been entered. The receivership court shall expeditiously enter an order of rehabilitation or liquidation that:

- 1) Is effective as of date that it is deemed granted by operation of law; and
  - 2) Conforms to [cite to applicable state law addressing rehabilitation or liquidation], as applicable.
- D. Any order of rehabilitation or liquidation made pursuant to this section shall not be subject to any stay or injunction pending appeal.
- E. Nothing in this section shall be construed to supersede or impair any other power or authority of the commissioner or state courts under this Act.