

# Alternative Mechanisms for Troubled Insurance Companies

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2009

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National Association of Insurance Commissioners

# **Alternative Mechanisms for Troubled Companies**

## **An NAIC White Paper**

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**February 2010**

**Created by the  
NAIC Restructuring Mechanisms for Troubled Companies Subgroup  
of the Financial Condition (E) Committee**

**Drafting Note: This white paper is limited to situations where the legal entity is in a financially troubled condition that could potentially lead to an insolvency in the foreseeable future. It will not consider situations where the insurer is merely inconvenienced by a particular book of business.**



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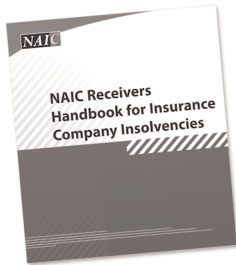
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# **I. INTRODUCTION**

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## **A. BACKGROUND/PURPOSE**

State insurance regulators have well-developed receivership statutes, practices, and procedures to handle impaired and insolvent insurers. These statutes, practices, and procedures serve, first and foremost, the goal of consumer protection. They are a critical and essential part of the Regulatory Solvency Framework. However, given improvements in regard to the early detection of financially troubled insurers and insureds' requirements for A-rated coverage, a new landscape has emerged with a growing number of troubled insurers seeking to engage in mechanisms of run-off or restructuring as an alternative to being placed in traditional receivership proceedings. For example, as of mid-year 2008 alone, there were approximately 129 active insurers in voluntary run-off domiciled in the United States with over \$36 billion in claims in progress. As a result of a changing landscape and the fact that the NAIC has little formal documentation available to regulators dealing with alternative mechanisms for winding-down troubled companies, the Receivership and Insolvency (E) Task Force during 2007 began drafting charges to undertake a study of alternative mechanisms and relative best practices. These charges were presented to the Financial Condition (E) Committee during the 2007 NAIC Winter National Meeting. The Committee members supported the charges, but felt the topic of active troubled insurers required the expertise and perspective of regulators involved in the active solvency monitoring process, as well as receivership process. Thus, a Restructuring Mechanisms for Troubled Insurers Subgroup was formed directly under the Committee with regulators representing both perspectives. The Subgroup's 2008 adopted charges were as follows:

Undertake a study of alternative mechanisms, such as solvent schemes of arrangement, solvent run-offs, and Part VII portfolio transfers (a transfer leaving no recourse to original contractual obligor/insurer) and any other similar mechanisms to gain an understanding of:

- (i) How these mechanisms are utilized and implemented.
- (ii) The potential effect on claims of domestic companies, including the consideration of preferential treatment within current laws.
- (iii) How alien insurers (including off-shore reinsurers) who have utilized these mechanisms might affect the solvency of domestic companies.
- (iv) Best practices for state insurance departments to consider if utilizing similar mechanisms in the United States and/or interacting with aliens who have implemented these mechanisms.

The study is documented in the form of this NAIC white paper. Additionally, the study was limited to situations where the legal entity was in a financially troubled condition that could have potentially led to an insolvency in the foreseeable future. The Subgroup did not consider situations where the insurer was merely inconvenienced by a particular book of business or wished to exit the insurance business for reasons unrelated to solvency.

## **B. AUTHORITY & APPLICABILITY**

The information in this white paper is meant to provide guidance to state insurance regulators and be an advisory resource. It discusses approaches and concepts that are available within and outside the United States in order to assist regulators with assessing possible alternatives for handling troubled insurers. Mechanisms discussed in this white paper may not be available or applicable in all jurisdictions due to differences in statutes, regulations, and implementing tools and resources, as well as changing market conditions. In fact, statutes and regulations that define the authority and duties of regulators may require,

or provide for, specific procedures to be implemented in certain circumstances. In addition, although this white paper was intended to generally apply to all risk-assuming entities that are subject to the authority of the insurance department, the majority of the Subgroup's discussion was focused on property/casualty insurance companies. Due to their unique characteristics, the mechanisms mentioned in this white paper, may not be appropriate in the context of life, health, or other personal lines of insurance for which guaranty association protections are available, or for certain types of specialized risk-assuming entities (e.g., health maintenance organizations, syndicates, risk retention groups, chartered purchasing groups, chartered self-insured groups or pools, captives, insurance exchanges, etc.). Lastly, an appropriate mechanism for a particular troubled insurer will also depend on the specific circumstances of the situation.

### **C. OTHER CONSIDERATIONS**

As state insurance regulators consider the relative advantages and disadvantages of these alternative mechanisms, they should do so in the context of the overall policy objectives behind each alternative. Different policy objectives will inevitably lead to very different results. The current system that utilizes liquidation and provides for guaranty fund protection for certain policyholder claims reflects a legislative policy that places the rights of policyholders and claimants above the interests of other creditors of the insolvent company. While these laws may vary somewhat from state to state, they share several key features. The interests of policyholders and claimants are granted priority over claims brought by other insurers, the government, and general creditors. The laws seek to preserve, to the greatest possible extent, the insurance protection that the policyholder believed he/she was getting when he/she purchased his/her policy from the now-insolvent insurer. The law treats all similarly situated claimants in the same manner, thereby prohibiting preferential treatment for certain favored individuals or entities. Finally, they preserve, in some meaningful form, the right of judicial review. These elements form the foundation of the existing system that exhibits a clear legislative choice to place the interests of consumers above the interests of investors and large institutions that are better equipped to withstand the losses resulting from insurer insolvency.

## **II. GENERAL ADVANTAGES AND DISADVANTAGES FOR UTILIZING ALTERNATIVE MECHANISMS FOR TROUBLED COMPANIES**

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### **A. ADVANTAGES**

- Alternative mechanisms can be useful tools for a troubled insurer's management and regulators, potentially leading to a quicker resolution than a traditional receivership.
- Alternative mechanisms typically allow for continuous claims payments, or at least orderly claims processing and partial claims payments without interruption.
- Alternative mechanisms can cost less than receiverships, thus resulting with maximum dollars paid out to policyholders/claimants.
- Alternative mechanisms may allow greater flexibility to achieve commercially acceptable results, such as freeing up capital.

### **B. DISADVANTAGES**

- The inherent risk for consumer and claimant issues increases, requiring stronger regulatory monitoring and controls for protection. For some alternative mechanisms, there is no guarantee that appropriate fairness will take place.
- Alternative mechanisms for troubled insurers might become a tool for solvent carriers to transfer value away from policyholders.
- As to reinsurance, restructuring might affect the value of the future reinsurance claim or offset rights, arbitration rights, and reinsurance collateral.
- The cost of efficiency or company enticements may come at the expense of policyholders or insureds.
- Difficult decisions arise with a troubled insurer that is not clearly solvent or insolvent, and significant ramifications could follow with certain choices.
- Companies may seek to continue run-off or restructuring activities even after it becomes clear that the company is hopelessly insolvent, resulting in preferential payments made at the expense of outstanding claims.
- Compensation incentives may restrict future claims-paying ability.
- Voluntary restructuring schemes may deny policyholders and consumers the substantive and procedural safeguards otherwise available for their protection in court-supervised receivership proceedings.
- Run-off and restructuring schemes may be used to circumvent state priority and preference rules in order to discount claims at the expense of policyholders and other claimants. They may also be used to circumvent other consumer protection laws, including state receivership and guaranty association laws as well as commutation and assumption transfer laws.
- May allow the company to terminate coverage and extinguish liabilities over the objections of policyholders and other creditors by majority cram-down vote.
- Run-offs and restructuring schemes may result in substantially reduced payments to policyholders. State receivership laws typically require a showing that a rehabilitation plan is fair and equitable, complies with priority rules, and provides no less favorable treatment of claims than would occur in liquidation. Run-offs and alternative mechanisms, such as those addressed herein, may have the ability to sidestep these equitable standards and permit broad discretion in discounting claim values. In fact, the success of a plan may be dependent on the ability to impose

deep discounts on claims, and there may be no rules or mandatory standards in place to protect policyholders or claimants.

- There is a risk that similarly situated creditors will be treated differently or that they will receive payments that are less than they would receive in an insolvency proceeding.
- Alternative mechanisms adopted in any given state may not be enforceable across state lines, leaving the company at risk of further exposure, litigation, and ongoing collection activity that may disrupt efforts to implement a restructuring plan.
- Alternative mechanisms are not appropriate for compromising the claims of consumer policyholders due to lack of sophistication and the existence of extensive consumer protections built into insolvency laws.
- In the absence of strong regulatory involvement, there is a risk that policyholders and creditors will not receive adequate or accurate information on which to base their decisions.
- The interests of management may not be the same as the interests of policyholders and creditors.

### **III. TYPES OF ALTERNATIVE MECHANISMS FOR TROUBLED COMPANIES**

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#### **MECHANISMS AVAILABLE TO INSURERS WITHIN THE UNITED STATES AND RELATED TERRITORIES**

##### **A. RUN-OFF OF TROUBLED INSURER**

###### **1. DESCRIPTION**

A troubled company run-off is usually a voluntary course of action where the insurer ceases writing new business on all lines of business, but continues collecting premiums and paying claims as they come due on existing business. Due to state cancellation laws, the insurer may be required to renew business, which can be particularly challenging for insurers running-off personal lines risks. The insurer may seek to run-off business in the traditional sense—paying claims in full in the ordinary course of business—or management of the insurer might seek to end or limit their exposure on insurance business before policy terms expire by utilizing reinsurance, assumption transfers, negotiated settlements, and/or voluntary policy commutations. These transactions should not have a negative impact on policyholders, as close regulatory monitoring is normally maintained throughout the process. The goal is to completely close operations while remaining solvent.

In order to succeed in run-off, assets and income must be maintained at sufficient levels to cover the remaining claims and administrative costs of handling those claims. However, solvent run-offs may have little revenue other than investment income, and run-offs may develop into insolvencies that could require receivership proceedings—for example, if the insurer is unable to collect reinsurance, makes errors in estimating recoverable assets, experiences a decline in asset values and investment income, and/or encounters other cash flow issues at any point in the process.

Although run-off mechanisms can generally be applied to property/casualty, life, health, title, or fraternal insurers, it is of general consensus that personal lines should not be included in any commutation plan incorporated as a component of any run-off plan.

###### **a. STATUTORY BASIS FOR SUPERVISED RUN-OFF PLANS**

Run-off of a troubled company may be subject to regulatory supervision under applicable state law. (See, e.g., NAIC Risk-Based Capital (RBC) For Insurers Model Act, Section 6.B(2).) Regulatory supervision of a troubled company run-off may be triggered in order to enhance the regulatory oversight and monitoring of the financial performance, consumer protections, and market conduct related to implementation of the run-off plan. Enhanced regulatory oversight may include increased financial and regulatory reporting requirements, regulatory approval of transactions and claim settlement practices, and on-site regulatory supervision. Supervision of the run-off plan is conducted in order to ensure that policyholders, consumers, and other creditors fare no worse under the run-off plan than in receivership.

For example, the Illinois Insurance Code, based on the NAIC Model Act, provides the Illinois Director of Insurance with a discretionary alternative mechanism for handling troubled property and casualty companies and health organizations whose RBC Reports indicate a mandatory control level event. Section 35A-30(c) of the Illinois Insurance Code, 215 ILCS 5/35A-30(c), provides:

In the case of a mandatory control level event with respect to a property and casualty insurer, the Director shall take the actions necessary to place the insurer in receivership under Article XIII or, **in the case of an insurer that is writing no business and that is running-off its existing business, may allow the insurer to continue its run-off under the supervision of the Director.** (Emphasis added)

A mandatory control level event is defined under the statute as an RBC Report that indicates that the insurer's total adjusted capital is less than its mandatory control level RBC. Under this statutory mechanism, if there is a mandatory control level event at a company that has ceased writing new business and the company is engaged in a voluntary run-off, the Director has the discretion to either seek a receivership order or to allow the company to continue its run-off under the Director's supervision.<sup>1</sup> In order to persuade the Director to exercise the supervised run-off option, the company must prepare and present a comprehensive run-off plan, including financial projections, that establishes that the plan is viable, that there is a high probability that the run-off can be conducted without putting policyholders at greater risk, and that all claim obligations will be satisfied.

The specific content of the run-off plan may vary depending upon the nature of the business being run-off and the financial circumstances of the troubled company. (See a sample outline for a run-off plan at *VII. Appendix C.*) However, the primary goals of the plan should include and achieve consumer protection, satisfaction of all policyholder obligations, and the maintenance of positive surplus and sufficient liquidity. Typically, the components of such a plan would include substantial cost-cutting measures, commutations of reinsurance agreements, collection of outstanding premium, recovery of statutory deposits, policy buy-backs, novations, and claim settlements.<sup>2</sup> A key element of such a plan would be a discussion of the benefits to the policyholders of a run-off rather than a receivership, including the impact of any state guaranty fund or guaranty association coverage.

The nature and scope of the Director's supervision may be delineated in a comprehensive corrective order, which would include and reference such things as the run-off plan, periodic reporting requirements, on-site monitoring, procedures relating to the approval of transactions, claim settlement practices, and other related matters. The corrective order, which may be amended from time to time, would likely be confidential under state law. Because the company is involved in a supervised run-off, it may be appropriate to negotiate certain adjustments (e.g., discount reserves, allow prepaid expenses, remove schedule F penalty) to its statutory financial statements, but, as adjusted, the financial statements should still comply with Generally Accepted Accounting Principles. Any such adjustments should be based upon credible forecasts and other available information.

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<sup>1</sup> Section 35A-30(d), 215 ILCS 5/35A-30(d), of the Illinois Insurance Code provides the Director with a similar supervised run-off option with respect to troubled health organizations.

<sup>2</sup> In 2005, the Illinois voidable preference statute was amended to provide that in the case of a company involved in a supervised run-off, a transaction involving transfer of cash or other assets by the company (buy-back, settlements, etc.) that was approved by the Director in writing cannot later be found to constitute a voidable transfer, 215 ILCS 5/204 (m)(C). This provision provides policyholders and other parties to buy-back, novation, commutation and other approved transactions with protection from the voidable preference statute in the event that the company ultimately goes into liquidation. In the absence of this protection, policyholders and others may be reluctant to enter into such transactions.

## **2. ADVANTAGES/DISADVANTAGES**

### **ADVANTAGES**

- Voluntary run-offs may enable commercial parties to achieve commercially acceptable results in arm's-length transactions that reflect customary market practice.
- Timely defense and payment of policyholder claims in full not otherwise always covered by guaranty funds or associations.
- Potentially more favorable environment for the negotiation of disengagement transactions and commutations with reinsurers.
- Continuity of management information systems.
- Some business entities may be willing to acquire insurance companies in run-off and inject additional capital or reduce overhead expense. This consolidation and management expertise could provide some efficiency for regulators in regard to their monitoring processes.
- Typically involve commutations and other solutions reflective of the consent of the contracting parties.
- There is evidence that it appears to be a robust method, given that there are accumulators of seasoned run-off companies.
- Strategic decisions can be made quickly and efficiently working with appropriate state regulators.

### **DISADVANTAGES**

- Preferential treatment issues might arise when dealing with business-to-business structures, if both large and small policyholders exist, as deals tend to focus on settling with large carriers first. In addition, more complicated commutations may be structured in the run-off plan to be handled last.
- Preferential payments may arise with respect to creditors whose priority of payment in the event of liquidation would be classified below that of policyholder and consumer claims.
- Policyholders and consumers may be compelled to accept less than the fair value of their claims.
- Potential negative impact of adverse claim development.
- Attempts to commute or settle with policyholders (complete policy buy-backs) can result in reinsurers resisting payment.
- To the extent the estate assets are reduced by paying claims earlier, the estate assets remaining to pay remaining policyholder and guaranty association claims will be reduced, costing the industry more.
- Larger insureds may have better leverage to negotiate better settlements.
- Absent regulatory oversight—there is no guarantee that settlements will be at consistent or even fair levels.
- The absence of court oversight and mandatory rules and standards (such as priority rules and rehabilitation plan standards) increases the likelihood that policyholder claims will be sharply discounted and that bargained-for benefits and protections will be lost.
- Guaranty funds may be disadvantaged in a subsequent receivership if non-guaranteed creditors were paid more than the ultimate distribution from the receivership.



## **B. NEW YORK REGULATION 141**

### **1. DESCRIPTION**

In 1989, at the request of the New York Superintendent of Insurance, the New York Legislature enacted New York Insurance Law § 1321. Section 1321 authorized the Superintendent to permit an impaired or insolvent New York domestic insurer (or an impaired or insolvent United States branch of an alien insurer entered through New York) to commute reinsurance agreements to eliminate the company's impairment or insolvency.

Until the Legislature enacted NYIL § 1321, commutation agreements with troubled New York domestic insurers were subject to challenge as potential preferences pursuant to the Insurance Law's voidable transfer provisions. When the Legislature enacted Section 1321, it extended the voidable transfer period from four to 12 months (NYIL § 7425(a)). The Legislature also amended the insurance law to provide that commutation agreements executed pursuant to NYIL § 1321 "shall not be voidable as a preference" (NYIL §7425(d)).

Section 1321 required that any commutation proposed under the new statute be approved by the Superintendent "in accordance with standards prescribed by regulation." In 1990, the acting New York Superintendent promulgated Regulation 141 (Regulation No. 141, Commutation of Reinsurance Agreements, N.Y. Compo Codes R. & Regs. tit. 11, Section 128 (1989) (11 NYCRR Section 128)). Regulation 141 sets out the "applicable standards that the superintendent will use in determining whether such commutations entered ... will be approved."

Regulation 141 applies to all New York-domiciled insurers (and U.S. branches) "other than a life insurance company" as defined in NYIL § 107(a)(2). However, the regulation excludes impaired or insolvent life insurers and solvent insurers. The Regulation sets out how a troubled insurer may propose and implement a Regulation 141 plan. Among other things, the Regulation's procedures add the requirement that any company seeking the benefits of Regulation 141 must stipulate that the troubled insurer will consent to an order of rehabilitation or liquidation if its proposed commutation plan does not restore policyholder surplus to the required minimum amounts (or such surplus as the Superintendent deems adequate).

The troubled insurer must provide the New York Department with a draft commutation agreement and a proposed commutation offer that will be extended to "each and every ceding insurer to which the impaired or insolvent insurer has obligations." The reinsurer must also provide a balance sheet showing both the insurer's impairment or insolvency as determined by the Superintendent and a pro forma balance sheet reflecting the troubled company's financial condition subsequent to the plan's implementations.

The proposed commutation offer must include an offer to pay a percentage of the cedent's losses. The impaired insurer must advise its cedents that the commutation offer remains subject to the Superintendent's determination that the total of all accepted commutation offers has restored policyholder surplus either to a statutory minimum or an amount that the Superintendent deems adequate.

Regulation 141 requires that offers to commute assumed reinsurance obligations be made to "each and every ceding insurer to which the impaired insurer or insolvent insurer has obligations." The Regulation broadly defines the term "obligations" to include paid losses, loss reserves, incurred but not reported

(IBNR), all loss adjusting expenses (paid, case, and IBNR), reserves for unearned premiums, and “any other balances due under the reinsurance agreements.” The terms of all proposed commutation agreements must be the same.

For example, the same discount must be offered to each cedent—e.g., 90% of paid losses, 60% of case reserves, and 30% of IBNR. No cedent may be favored with different discounts. Discounts for different lines of business may be proposed, but these discounts must be “reasonable, actuarially sound, and supported by documents justifying such a variance.” To date, none of the Regulation 141 plans approved by New York Superintendents of Insurance has incorporated different discounts by line of business.

Any proposed Regulation 141 plan submitted to the Superintendent must include an exhibit setting forth the obligations due each cedent to which the troubled company has obligations and the consideration (commutation offer) to be paid each cedent. Within 10 days of the plan’s approval, the troubled company must deliver its proposed commutation agreements to its cedents. No cedent may be compelled to commute its “obligations.” The terms of the proposed commutations and the amount offered “shall not be subject to negotiation.” Each cedent makes its own determination with respect to whether the cedent wishes to accept the proposed commutation or refuse to commute and run the risk that the Regulation 141 plan will not succeed.

The results of an approved plan must be returned to the Superintendent within a period specified by the Superintendent. The plan results must include: copies of all executed commutation agreements; copies of all rejected commutation agreements; “correspondence pertaining to all ... offers made to the ceding insurers”; a pro forma balance sheet showing the effect of the accepted/rejected offers; any other components of the plan to restore surplus to policyholders; and copies of any agreements that modify, commute, or assign any retrocession agreements.

If the Superintendent determines that the proposed commutation agreements and any other plan components sufficiently restore policyholder surplus, the commutation agreements take effect. The Superintendent may specify, when he or she approves the Regulation 141 plan, that cedents that agree to commute be paid within so many business days.

If the Superintendent determines that surplus has been restored, the Superintendent may proceed against the troubled company armed with the company’s stipulation consenting to entry of any order of rehabilitation or liquidation.

The primary procedural safeguards for an approved Regulation 141 plan include: the state regulator’s full discretion to accept, reject, or modify any proposed plan; explicit requirements that the same commutation terms be offered to every ceding company whose obligations appear on the troubled company’s books and records; the absence of any “cram down” provisions that would allow the Superintendent to approve the commutation of a cedent’s contracts over a cedent’s objections; time-frames for the submission of a plan and payment of agreed commutation amounts within days after the plan’s results have been approved; and provisions calling for the preservation and production of all communications between the troubled company and its cedents.

In addition, and as previously noted, the commutation agreements executed pursuant to an approved Regulation 141 plan will not take effect “unless ... the plan shall eliminate the insurer’s impairment or insolvency” and restore surplus to policyholders to levels required under the insurance law or an amount that the Superintendent deems “is adequate in relation to the insurer’s outstanding liabilities or financial needs.”

Although the troubled company's directors must consent to an order of rehabilitation or liquidation if the company's surplus has not been restored to the required minimum, the Superintendent need not consider any plan proposed pursuant to Regulation 141 "in lieu of taking any other action" against the company. This gives the Superintendent full discretion to decide whether to allow the troubled company to propose a plan or to take other action against the company, including supervision, rehabilitation, or liquidation.

Thus far, three professional reinsurers have successfully implemented New York Superintendent-approved commutation plans pursuant to Regulation 141: 1) Rochdale Insurance Company; 2) Paladin Reinsurance Company; and 3) Constellation Reinsurance Company. In addition, the Insurance Company of the State of New York (INSCORP) obtained the Superintendent's approval for a Regulation 141 plan and submitted its commutation plan results to the Superintendent. However, as a result of the continued adverse development, INSCORP's policyholder surplus could not be improved to an acceptable level, and INSCORP was placed in rehabilitation.

See *VII. Appendix D – Reference List of NAIC Model Laws and State Selected Related Statutes* for review of the Regulation.

## **2. ADVANTAGES/DISADVANTAGES**

### **ADVANTAGES**

- No cedent can be outvoted and compelled to accept a commutation offer.
- All communications to and from the ceding insurer must be preserved and provided to the regulator.
- Although the regulation was designed for professional reinsurers, the plan also works if the troubled insurer is engaged in assumed reinsurance and also wrote direct business.
- No court approval is required.
- The plan must show how the proposed commutations will affect its retrocessional program, thus reducing the risk that the commutation plan will bind or negatively affect retrocessionaires.
- The Superintendent has ultimate oversight, flexibility, and control, to the extent that the Superintendent may approve, disapprove, or modify a plan, and the Superintendent may also review all the communications exchanged relating to the offer to ensure that no unfair offsets were arranged or that offers to commute did not otherwise favor or disfavor particular cedents.
- Regulation 141 also allows for other components to be added to the plan to restore policyholder surplus, including surplus notes and capital contributions.

### **DISADVANTAGES**

- As an offer under this regulation is based on the assuming reinsurer's books at a given date, discrepancies between the ceding and assuming insurers' books are likely to occur.
- Timing could become problematic if the regulator does not enforce strict deadlines regarding the consideration and execution of offers.
- Regulation 141 does not require an audited balance sheet to confirm the extent of the troubled insurer's financial condition.
- Many subjective considerations must be used by the troubled insurer to determine in advance what percentage of approval is needed for the plan to work.

## **C. RHODE ISLAND STATUTE AND REGULATION FOR VOLUNTARY RESTRUCTURING OF SOLVENT INSURERS**

### **1. DESCRIPTION**

Rhode Island's Title 27, Chapter 14.5<sup>3</sup> provides for voluntary restructuring of solvent insurers. The statute was intended to provide an alternative to a traditional run-off by bringing "solvent schemes of arrangement" (which are discussed further in the next section) to the United States. It allows solvent companies that are in run-off to reach a court-ordered (and department of insurance supervised) agreement with all of its creditors in order to accelerate completion of the run-off, bringing certainty of payment to creditors and reducing administrative costs often associated with lengthy run-offs.

The statute sets forth a structure for court-ordered review, approval and implementation of what the statute refers to as a "commutation plan." The process may only be utilized by reinsurers and commercial property and casualty insurers domiciled in Rhode Island and in run-off (R.I. Gen. Laws § 27-14.5-1(6)). In addition, the insurer must be solvent and adequately reserved in accordance with all applicable Rhode Island statutes and regulations, as well as in compliance with all other department solvency standards.

A company considering the process must first prepare and submit their proposed commutation plan to the insurance department for review<sup>4</sup> (Insurance Regulation 68(4)(a)(i)). A commutation plan is very broadly defined as a plan for extinguishing the outstanding liabilities of a commercial run-off insurer. After the plan is reviewed by the department and all issues are resolved, the company may apply to the court for an order agreeing to classes of creditors and calling for a meeting of creditors (Insurance Regulation 68(4)(a)(iii)). At this point, the company is required to give notice of the application and proposed commutation plan to all parties pursuant to fairly broad requirements set forth in the statute (R.I. Gen. Laws §§ 27-14.5-3 and 27-14.5-4(b)(1)).

All creditors and interested parties (such as Guaranty Funds) are granted full access to the plan and all information related to the plan. Both creditors and interested parties are given an opportunity to file comments or objections to the plan with the court (R.I. Gen. Laws § 27-14.5-4(b)(3)). Ultimately, all creditors must be given an opportunity to vote on the commutation plan, and approval of the plan requires consent of at least i) 50% of each class of creditors, and ii) the holders of 75% in value of the liabilities owed to each class of creditors (R.I. Gen. Laws § 27-14.5-4(b)(4)). However, it is important to note that only the claims of creditors present or voting through proxy at the meeting of the creditors are counted toward determining whether the requisite majorities have been achieved. (See Insurance Regulation 684(e)(i).)

Upon approval of the commutation plan by the creditors, the company must petition the court to enter an order confirming the approval and allowing implementation of the plan (R.I. Gen. Laws § 27-14.5-4(c)(1)). The implementation order must enjoin all litigation in all jurisdictions between the applicant and creditors, as well as release the applicant of all obligations to its creditors upon payment of the amounts specified in the plan (R.I. Gen. Laws § 27-14.5-4(c)(2)). The court may only issue an

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<sup>3</sup> The Rhode Island statute was adopted in 2002 and amended in 2007. See R.I. Gen. Laws § 27-14.5-1 *et seq.*, "Voluntary Restructuring of Solvent Insurers," and R.I. Insurance Regulation 68 (Commutation Plan regulations).

<sup>4</sup> Plan approval is done by the court; however, the department has the statutory authority to intervene in any proceeding brought under this statute. According to the Rhode Island Division of Insurance Regulation, it is highly unlikely that the court would approve a plan over the Division's objection.

implementation order if it determines that implementation of the commutation plan would not materially adversely affect either the interests of objecting creditors or the interests of assumption policyholders (R.I. Gen. Laws § 27-14.5-(c)(1)(ii)). The court does have a responsibility to ensure that all policyholders and creditors have been treated fairly. Once the implementation order is entered, distribution to creditors may begin.

After implementation and upon completion of the commutation plan, the court can issue an order of discharge or dissolution. As a result of this order, the company is either i) dissolved or ii) discharged from the proceeding without any liabilities. At this point, any residual assets are distributed to the company owners (R.I. Gen. Laws § 27-14.5-4(d)).

One of the key aspects of the process is that the court's implementation order releases the insurer from all obligations to its creditors upon payment of the amounts specified in the commutation plan. This brings about a court-ordered finality to the run-off that would not be possible utilizing traditional run-off options. To this end, the order actually binds the insurer and all of its creditors and owners, whether or not a particular creditor or owner is affected by the plan or has accepted the plan, or whether or not the creditor or owner ultimately receives money under the plan. The order is also binding whether or not creditors had actual notice (R.I. Gen. Laws § 27-14.5-3(b)).

It is also important to note that because the restructuring mechanism provided for by the statute would not be appropriate or practical for companies with a large number of small creditors with very diverse interests, the statute is restricted to use by reinsurers and commercial property and casualty insurers. It includes express limitations on the lines of business that can be included in a commutation plan, and specifically excludes all life insurance, workers' compensation and personal lines (See R.I. Gen. Laws § 27-14.5-1(21)). However, in cases where a company does have excluded lines, the statute provides for a bifurcated process for disposing of all lines of business within the context of the run-off scheme. Commercial lines would be included in the commutation plan, and, if possible, excluded lines would be transferred to an eligible insurer through court-ordered and department-sanctioned assumption reinsurance (See R.I. Gen. Laws § 27-14.5-1(6) and R.I. Gen. Laws § 27-14.5-4(d)(2)(ii)). Again, the process is available only to solvent companies—the theory being that the restructuring would permit all liabilities to be paid in full.

The definition of "Commercial Run-off Insurer" under the statute was expanded by amendment in 2007 to include companies newly formed or re-activated under Rhode Island law solely for the purpose of accepting transferred business for restructuring pursuant to the statute (See R.I. Gen. Laws § 27-14.5-1(6)). The purpose of this amendment was to expand the population of insurers that might qualify for the process. The amendment permits an insurer to transfer some or all of its commercial liabilities (a very controversial process) to a newly formed run-off entity for the sole purpose of implementing a commutation plan pursuant to the statute. The original insurer would be allowed to continue writing business with no further obligations under the transferred policies. Any such transfer would require prior approval of the department.

Since the statute's enactment in 2002, no insurer has availed itself of the statute, and no other U.S. state has adopted a similar law.

## 2. ADVANTAGES/DISADVANTAGES

### ADVANTAGES

- Might provide a better solution for policyholders and investors than traditional run-off options (creditor democracy).
- Provides certainty of payment to creditors of present and future claims.
- Avoidance of a lengthy run-off with the associated ongoing administrative costs, adverse claim development and deteriorating reinsurance collections.
- Provides certainty of payment by reinsurers.
- Accelerated release of capital to shareholders at the conclusion of the process, allowing for more efficient deployment of capital to non-run-off operations.
- Such mechanisms might attract capital to the industry, as the availability of a reasonable exit mechanism for these companies will create an active market for investment in run-off companies.

### DISADVANTAGES

- Permits an insurer to terminate coverage and extinguish liabilities over the objections of policyholders and creditors who are in the minority.
- Creditors are bound by the plan whether they had notice or not, and only those present or voting through proxy are counted toward establishing the requisite majority, which may create incentives to manipulate notice (though the department and court could take steps to prevent such manipulation).
- Although the process is limited to solvent insurers and the intent therefore is that full value will be paid to all creditors, there are no guarantees that all policyholders will receive full value, or even present value for their claims (especially those with IBNR claims).
- There is no reference to segregating and preserving reserve assets for excluded lines, or any explanation as to how policies and claims would be administered and paid during the interim period prior to completion of the plan.
- Questions concerning the enforceability of any such plan across state lines may leave companies exposed to further risk, litigation and disruption or termination of a plan—i.e., even if the Rhode Island court did approve the plan, it is possible that policyholder or claimant actions could arise in other states' courts, (or perhaps federal courts), resulting in enforcement and implementation issues for the company attempting the restructuring.<sup>5</sup>
- Although the Rhode Island plan is available only to commercial insurers and reinsurers in run-off, the plan is not exclusively limited to “troubled” companies; thus, any commercial run-off insurer could conceivably use this mechanism to cease operations and eliminate ongoing claims payment liability.
- Despite the fact that there is significant statutorily delineated regulatory guidance included in the Rhode Island framework (unlike UK solvent schemes), parties may view Rhode Island’s “commutation plan” statute as simply a domestic version of the UK’s solvent schemes and attribute all of the disadvantages associated with UK-like solvent schemes of arrangements (listed below in D-2) to the Rhode Island system.
- Because the Rhode Island statute allows for the formation or reactivation of a domestic company and the transfer of assets and liabilities to that company, certain parties view this as allowing a “ring-fence” of assets, unfairly shielding assets from creditors.

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<sup>5</sup> For a detailed discussion on the issue of enforceability, see David Wright, “A Question of Enforceability,” Run Off Business, Issue 12, Spring 2005, pp. 20-22.

## **MECHANISMS AVAILABLE TO INSURERS OUTSIDE THE UNITED STATES AND RELATED TERRITORIES**

### **D. UK-LIKE SOLVENT SCHEMES OF ARRANGEMENTS**

#### **1. DESCRIPTION**

A scheme of arrangement is essentially a statutory compromise or arrangement between a company and its creditors. The process is allowed under Part 26 of the United Kingdom Companies Act 2006 that requires majority creditor approval representing at least 75% in value of obligations; confirmation by the UK Financial Service Authority (FSA) of no objections; and court sanction. If approved, the process will bind all creditors, but does not necessarily bind reinsurers. The process has evolved over the years and includes a process for insolvent and solvent insurers.

The FSA maintains a very active role in reviewing the schemes with a review document containing approximately 30 questions. In July 2007, the FSA issued a process guide related to decisions made with schemes that included the following:

- Stresses that the scheme must comply with principles for businesses (e.g., treating policyholders fairly and communicating in clear terms).
- Established an FSA schemes review committee.
- Stated that the run-off should be at least five years old.
- Distinguishes between individual retail and small commercial policyholders, large commercial policyholders and other risk carriers.
- Distinguishes between insolvent risk carrier, marginally solvent risk carrier and substantially solvent risk carrier.
- In case of substantially solvent risk carrier, the FSA is likely to object to a scheme unless the risk carrier offers benefits designed to ensure that policyholders are not in a worse position than in a solvent run-off.
- Provides for a role of policyholder advocate.
- The FSA may not object to a scheme, even if it fails to satisfy the criteria stipulated, if the risk carrier can demonstrate that the scheme treats policyholders fairly (e.g., through suitable additional benefits for policyholders and/or safeguards for dissenting procedures).

As of September 2008, there have been approximately 174 solvent schemes of UK non-life business. However, in every instance when policyholders have mounted serious opposition, the UK courts have ruled in the policyholders' favor. In particular, objecting policyholders have successfully challenged the British Aviation Insurance Co. Ltd. (BAIC), Willis Faber Underwriting Management (WFUM) and Scottish Lion solvent schemes in the UK courts. These are the only solvent schemes involving direct policyholder coverage that have been challenged to date, and all three have resulted in the court rulings favorable to the policyholders. To date, no UK court has agreed to sanction a solvent scheme involving direct coverage (as opposed to reinsurance) in the face of a policyholder legal challenge to the scheme.

Claims being paid can include IBNR, and most schemes have the ability to pay for IBNR based on estimation methodology. Additionally, schemes will allow a creditor's methodology to be used, if reasonable.



Chapter 15 of the U.S. Bankruptcy Code may be used to assist with a scheme of arrangement in the United States. The effect is to grant a U.S. bankruptcy court authority to enforce the scheme and protect the company's assets from creditors. However, although no UK solvent scheme has yet been challenged under Chapter 15 of the U.S. Bankruptcy Code, there is a possibility that such challenges may arise, and the U.S. bankruptcy courts could reject solvent schemes.

## **2. ADVANTAGES/DISADVANTAGES**

### **ADVANTAGES**

- Some advocates state that solvent scheme mechanisms, in particular, have proven to be very effective in the UK and other jurisdictions to permit closure of companies that have reduced their liabilities to fairly minimal levels and that can reasonably estimate their future liabilities.
- Such mechanisms might attract capital to the industry, as the availability of a reasonable exit mechanism from these companies will create an active market for investment in run-off companies.
- Companies using UK schemes of arrangements have statistically improved their net asset position by approximately 5%.
- Some insurers have made payments to creditors at or near 100%.
- Schemes may allow a creditor's claim estimation methodology to be used, if reasonable.

### **DISADVANTAGES**

- Schemes may undermine the value of insurance contracts by not honoring contractual obligations.
- Lost coverage may hurt policyholders at the expense of American citizens and the economy.
- Schemes could pose a formidable collective action problem.
- Schemes could undermine the reliability of insurance institutions.
- Schemes may allow for the reduction or cancellation of contractual obligations outside the scope of the current receivership system by not adhering to the statutory priority of distribution rules. Under such a scheme, a troubled company could force certain policyholders to commute (or buy-back) mutually agreed-upon insurance coverage despite their objections.
- The use of terms "debtor" and "creditor" used in the restructuring arena may tactically create a new environment for insurance where risk transfer is not necessarily part of the product purchased.
- Enforceability across state lines.
- Schemes could be used by companies to simply reorganize their corporate structure to move reinsurance operations unencumbered by old claims under a different name.
- In its latest proposal, the Reinsurance (E) Task Force had a provision where an insurer engaging in solvent schemes would not be allowed to take a reduction of collateral.
- Chapter 15 is a relatively new provision of the Bankruptcy Code with relatively little case law to support it, thus leaving the ability for judges' discretion and leeway in its application.
- Schemes can involve reinsurers, where the reinsurance contract with an insurance company is negatively affected.
- Schemes could provide an opportunity for solvent insurers to avoid insurance and reinsurance obligations and return the risk to insureds of ceding companies who purchased the coverage in good faith.
- Schemes force creditors to trade insurance coverage for payments based on estimations of future claims that are inexact and possibly unfair.

- The individuals chosen to adjudicate claims under a scheme may lack expertise in the necessary legal issues.
- There is no oversight of solicitation by the company of scheme acceptances. Thus, some accepting creditors may have already achieved favorable settlements, while dissenting creditors are left to litigate their claims in an unfavorable forum.
- Schemes do not allow dissenting policyholders to opt out of the scheme.
- Schemes do not ensure continuation of coverage.
- Schemes do not include a safety net of guaranty association protection.
- Schemes do not allow a policyholder to seek judicial review of its claims against the insurer.

## **E. PART VII PORTFOLIO TRANSFERS**

### **1. DESCRIPTION**

Part VII of the Financial Services and Markets Act 2000 (FSMA) allows for a transfer of insurance business under a statutory and court process. The transfer allows a reinsurer to move all or certain of its reinsurance business (assets and liabilities) to another reinsurer without the consent of each and every policyholder but with the sanction of the UK High Court. The main statutory requirements are: 1) policyholder notification; 2) a report by an independent expert; 3) UK High Court approval; and 4) no objection by the FSA or other regulators and interested parties, including policyholders.

The court is involved in the process with the directions hearing, which is when court will grant leave to proceed. The court is also involved in the hearing to sanction the transfer (or final hearing). The relevant legislation and requirements can be found in VII. Appendix D4.

The transferee must be an insurance company established in a European Economic Area (EEA) state. However, the transferor can be authorized in the UK, an EEA branch of a UK firm, a UK branch of an EEA firm, an EEA firm with no UK branch, or a non-EEA that is permitted to carry on business in the UK.

Per the FSA Web site, the following are reasons why reinsurance firms undertake Part VII transfers:

- Rationalization—combine similar business from two or more subsidiaries, putting all into a single regulated entity.
- Efficiency—transfer business between third parties, separating old liabilities in run-off from new business, putting each into separate firms.
- Capital reduction—transfer business to a new firm and extract any surplus shareholders' funds.
- Exit—transfer business such as employers' liability that cannot be schemed.

The legal effect of a Part VII transfer is a statutory unilateral novation of the affected contracts of insurance or reinsurance, including any rights attaching to those contracts.

The two primary aspects for the protection of affected parties are as follows: 1) the independent expert's report, which needs only to consider the effect on policyholders; and 2) the court is required to be satisfied that the transfer as a whole is fair as between the interests of different classes of persons affected by the transfer.

Per the FSA Web site, the FSA and the court are concerned whether a policyholder, employee, or other interested person or any group of them will be adversely affected by the scheme. This is primarily a

matter of actuarial and regulatory judgment involving a comparison of the security and reasonable expectations of policyholders without the scheme with what would be the result if the scheme were implemented. The court will pay close attention to any views expressed by the FSA regarding whether individual policyholders or groups of policyholders may be adversely affected, though this does not necessarily mean that the transfer is to be rejected by the court.

The key question is whether the transfer as a whole is fair as between the interests of the different classes of persons affected. However, it is not the function of the court to produce what, in its view, is the best possible scheme. With regard to different transfers, the court may deem all fair, but it is the company's directors' choice to select the transfer to pursue. Under the same principle, the details of the scheme are not a matter for the court, provided that the scheme as a whole is found to be fair. Thus, the court will not amend the scheme, because individual provisions could be improved upon.

Overall, a loss portfolio transfer is a means of transferring outstanding net or gross legal liability from one insurer to another insurer. It has been viewed as a form of retrospective reinsurance. The transfers must be sanctioned by the court, and are subject to review and opinion by an independent expert that is approved by the FSA. Notice of the proposed transfer is usually required to be sent to all policyholders of the parties unless the court decides otherwise. A detailed report must also be provided setting out all the details and the independent expert's opinion. The FSA and any party who feels adversely affected by the transfer can make representation to the court for consideration.

The FSA is also required to assess a number of aspects (e.g., whether policyholders will be worse off moving from one place to another, or if there is any potential risk posed by the transfer). Rating agency ratings or the effect on ratings could be a component as part of the FSA's considerations, as well as other regulatory bodies.

There have been over 100 Part 7 transfers, and the majority dealt with internal reorganization within holding groups. Over 50% were performed in the life industry. Very few Part 7 transfers have seen business go from a company to a third party; however, they are becoming increasingly popular. The receiving company's motives for entering into these arrangements may stem from tax advantages to potential profits based on one's claims handling experience.

COMPARISON OF PART 7 TRANSFERS WITH U.S. ALTERNATIVES (*BINGHAM TABLES*)

	<b>Part 7 Transfers</b>	<b>Assumption Reinsurance Solvent</b>	<b>Assumption Reinsurance Insolvent</b>	<b>Rehabilitation Proceedings</b>
<b>Creditor Voting</b>	No	Yes	No	No
<b>Regulatory Review</b>	Yes	Yes	Yes	Yes
<b>Creditor Input</b>	Low	High	Low	Medium
<b>Transparency</b>	Low	High	Low	Medium
<b>Court Review</b>	Yes	No	No	Yes
<b>Hold-ups &amp; Hold-outs</b>	No	Yes	No	No

	<b>Schemes of Arrangement</b>	<b>Run-off with Commutations</b>	<b>Rehabilitation Proceedings</b>
<b>Who Runs the Case</b>	Management	Management	Regulator
<b>Stay of Proceedings</b>	Yes	No	Yes
<b>Hold-ups and Hold-outs</b>	Yes	Yes	No
<b>Creditor Votes</b>	Yes	Yes	No
<b>Regulatory Involvement</b>	Review	Ongoing Monitoring	Control
<b>Claims Adjudication</b>	Management Appointee	Variety of Courts	Receivership Court

The foregoing tables compare schemes of arrangement and Part 7 transfers with analogous mechanisms available under U.S. law. While it appears that the mechanisms are similar in many respects, in practice they have proven to be quite different. Under UK schemes of arrangement, policyholders have been forced to accept payouts based on estimations of their claims so that equity holders can recapture the capital of the company. Under UK Part 7 transfers, policyholders have been forced to accept the credit of another insurer in order to permit the insurer from whom they bought the policy to exit business and recapture its capital. Current U.S. practice, with the possible exception of the Rhode Island statute, would not enable these results. Policyholders are only required to accept payment based on estimation in the U.S. where the company is insolvent and shareholders will not receive a return of their capital. Also, under current U.S. practice, policy transfers to a new insurer are not made involuntarily except where there is an insolvency of the transferor. While UK regimes certainly have safeguards in the form of voting (in the case of schemes) and court review (in the case of schemes and Part 7 transfers), the ultimate risk is left on the policyholder.

## 2. ADVANTAGES/DISADVANTAGES

### ADVANTAGES

- Permits more efficient management of transferred books of business, allows dedicated capital and focused solutions to be applied to run-off liabilities, and promotes efficient use of capital for ongoing business.
- Options can be explored to strengthen policyholder protections and reach regulator approval, such as altering deductibles, strengthening reserves, obtaining reinsurance, and other arrangements to share the risk.
- Might attract new capital to insurance businesses insofar as it can be invested directly in run-off liabilities, and strengthens ongoing companies by permitting the separation of those liabilities.
- Can reduce risk of exposure.

- A recent amended UK rule introduces a simpler alternative where no court sanction is required for pure reinsurance business transfers if all the policyholders affected by the transfer consent to the proposal.
- Substantial regulatory oversight is required.

#### **DISADVANTAGES**

- Could transfer obligations from the entity the creditor dealt with: to one that is completely unknown; to one with whom the creditor would have never willingly chosen to deal; from a differing country subject to different regulation; and to a less secure debtor.
- A Part VII-like transfer to an alien reinsurer from a U.S. domestic reinsurer may cause the primary insurer to lose its credit for reinsurance.
- Very difficult to quantify trapped capital in these scenarios.
- Problems could arise for a ceding company, if the Part VII transfer goes to a reinsurer with a lower rating, because the rating agency could lower the ceding company's rating.
- Could present unique accounting and reporting anomalies on both a statutory and GAAP basis.
- The regulator is not required to publicly explain its decision-making process.

## **IV. OBSERVATIONS AND CONSIDERATIONS BEFORE USING ALTERNATIVE MECHANISMS**

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### **A. EXISTING STATUTORY AUTHORITY AND REQUIREMENTS**

#### **1. STATE RECEIVERSHIP/GUARANTY FUND LAWS**

Delinquency proceedings (receiverships) are instituted against an insurance company by an insurance department for the purpose of conserving, rehabilitating, or liquidating an insurance company. All require a court order, and the domiciliary state court will take jurisdiction over matters involving the resulting receivership estate. The court's role is to ensure transparency and due process and to be an independent arbiter of any disputes that may arise. The nature, timing, and extent of regulatory action in any given troubled insurer situation depend on the circumstances of the particular situation.

The U.S. Constitution in Article I, Section 10 states that "No state shall ... pass any ... law impairing the obligation of contracts." However, during certain delinquency proceedings, states may, on rare exceptions, impair contracts, but only where there is a legitimate public purpose behind the law.

It should be noted that the language in the rehabilitation statutes for most states is very broad and provides that anything that will restructure, revitalize, or reform the insurer can be proposed in a plan.

#### **2. PRIORITY DISTRIBUTION STATUTES/PREFERENTIAL TREATMENT**

One of the key consumer protections in the existing state delinquency proceedings are the priority distribution statutes that require payment of policyholder-level claims before the payment of any other claimants, including non-policy claims of the United States government, claims of other insurers and reinsurers, and general creditors. These same priority distribution statutes also require members of the same class or group of creditors to be treated similarly. The priority distribution statutes ensure that the needs of consumers, who might not be sophisticated in insurance matters, are placed ahead of non-policyholder level claimants and that everyone with the same level or type of claim is treated the same.

If assets are not sufficient to cover the remaining claims and administrative costs of an insurer using one of the alternative mechanisms, then all claims paid prior to that point have been given a preference at the expense of the claims to be paid in the future. As a result, the receiver could be statutorily required to attempt to recover these preferential payments.

### **B. CONSUMER PROTECTIONS AND PUBLIC POLICY CONSIDERATIONS**

In order to ensure some baseline of protections for policyholders and consumers, there are certain core principles that regulators should strive to maintain with any alternative mechanism for troubled insurers. The first among these, a requirement that the company honor its contractual obligations to policyholders, is considered the primary and overriding principle. This first principle translates into no impairment of policy benefits and claims without the express, informed, voluntary consent of the policyholder. The others are corollary principles, all supporting that primary goal of honoring contractual obligations to policyholders. Any alternative mechanism for run-off or restructuring of a troubled insurance company's obligations should strive to establish parameters consistent with these principles.

## Core Principles:

1. Honor Contractual Obligations to Policyholders. Alternative mechanisms should not be a way for an insurance company to sidestep its contractual obligations to policyholders. There should be no involuntary restructuring of policies or impairment of policy benefits or claims permitted outside of receivership. This would preclude any changes to policies, or reductions to policy claims or benefits, without the express, informed, voluntary consent of individual policyholders. Accordingly, there should be no cram-down approval of a mechanism by majority vote over the objection of policyholders; no involuntary transfer of risk back to policyholders through forced commutation of claims or otherwise; and no cancellation, termination, or non-renewal of coverage, except as permitted under the express terms of the policy. In short, every policyholder should be entitled to continue coverage and to receive all policy benefits for the full term of their policy.
2. Meaningful Notice and Information Sharing. This contemplates accurate, consistent, and timely notice and disclosures to all policyholders, creditors, and guaranty associations of meaningful information (including financial information, status plans, and any proposed assumption reinsurance or other significant transactions) at inception and on an established schedule thereafter. Disclosures should also identify creditors (at least below the policy level) in order to permit some meaningful, organized discussion among creditors.
3. Adherence to Priority Scheme. Alternative mechanisms should require adherence to statutory liquidation priority schemes. They should not provide a mechanism for circumventing the distribution priority to benefit the company, its shareholders, employees, other stakeholders, or specific groups of policyholders at the expense of other classes of policyholders. Controls on preferences and the outflow of assets are needed, and will require regular ongoing review. The company and/or equity shareholders should not be permitted to retain assets unless all claims having priority, as measured under state liquidation laws, have been satisfied in full.
4. Coherent, Comprehensive Financial Planning. Any alternative mechanism should be based on a fully developed and comprehensive financial plan that includes complete and meaningful financial data, and projections based on reasonable and realistic financial assumptions. There should be full disclosure and transparency in financial planning, monitoring, and reporting as a condition to approval of any such plan and throughout implementation. In addition, any such mechanism should provide a global solution addressing all in-force policies and pending policy claims. There should be no ring-fencing or piecemeal disposition of assets and liabilities that may result in unequal treatment of policyholder claims, and give rise to preference and priority concerns. Moreover, the fairness and reasonableness of any mechanism cannot be reasonably assessed on a transaction-by-transaction basis without consideration of the overall impact on other policyholders and creditors.
5. Procedural Safeguards. Any alternative mechanism should provide substantive procedural safeguards, including clear standards for disclosure, reporting, and external review; appropriate and timely notice; access to information and the opportunity for informed participation for all stakeholders; court and/or regulatory approval for all significant actions to be taken; and meaningful compliance monitoring and reporting.



## **V. OBSERVATIONS AND CONSIDERATIONS WHEN USING ALTERNATIVE MECHANISMS**

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### **A. EXISTING STATUTORY AUTHORITY AND REQUIREMENTS**

#### **1. USE OF PERMITTED PRACTICES**

There have been situations where an insurer would be able to maintain operations for 20 years, but to date, since liabilities barely exceed assets based on NAIC accounting practices and procedures, the insurer is nearly or technically insolvent. A carefully thought-out permitted practice could allow a troubled insurer time to dramatically restructure in order to provide better results for consumers in terms of timely claims payments.

#### **2. MODIFICATIONS TO EXISTING STATUTORY AUTHORITY**

In some circumstances, state insurance regulators may want to consider modifying laws and regulations to provide for a more favorable environment for certain alternative mechanisms. For example, the Illinois Division of Insurance strongly supported the General Assembly's adoption of 215 ILCS 5/204 in the Illinois Insurance Code's provision on Prohibited and Voidable Transfers and Liens to protect transfers made during the Division's supervision of a solvent run-off. The language reads as follows:

m) The Director as rehabilitator, liquidator, or conservator may not avoid a transfer under this Section to the extent that the transfer was: \*\*\*

(C) In the case of a transfer by a company where the Director has determined that an event described in Section 35A-25 [215 ILCS 5/35A-25] or 35A-30 [215 ILCS 5/35A-30] has occurred, specifically approved by the Director in writing pursuant to this subsection, whether or not the company is in receivership under this Article. Upon approval by the Director, such a transfer cannot later be found to constitute a prohibited or voidable transfer based solely upon a deviation from the statutory payment priorities established by law for any subsequent receivership.

### **B. SURVEILLANCE MONITORING BY STATE INSURANCE REGULATOR**

State insurance regulators need to consider whether the state has appropriate expertise on staff or whether the state needs to hire outside consultants of particular functions, such as claims assessment, reserves, reinsurance, etc. Please refer to the *Troubled Insurance Company Handbook* for a description of competency and skills of personnel assigned to conduct surveillance on troubled insurers.

#### **1. SUPERVISION ORDERS/CONSENT AGREEMENTS/LETTER OF UNDERSTANDING**

Regulators may want to consider various methods to articulate the regulator's expectations with an alternative mechanism, as well as the possible recourse that may occur with the insurer as a result of certain actions or behaviors. Such communication methods can be informal, such as a letter of understanding with the insurer, or formal, such as voluntary consent agreement or a confidential supervision order.

If a supervision order is taken under the commissioner's administrative provisions, the insurer's management will generally remain in place subject to restrictions in the supervision order and the direction of the supervisor. The supervision can be voluntary or involuntary and confidential or public. Confidential supervisions are becoming more infrequent, as disclosures of such regulatory actions have become more necessary under federal law for insurers within publicly traded groups. Some states may require court approval, as well.

## **2. FINANCIAL REPORTING/ANALYSIS/EXAMINATION**

All active insurers that are not in liquidation proceedings should be filing quarterly financial statements to the NAIC Financial Data Repository to provide regulators, policyholders, creditors, and claimants meaningful information. Enhanced monitoring, such as monthly financial statements and claims/exposure reports, should also be considered.

All states should conduct analysis and examination practices in compliance with Part B of the Financial Regulation Standards and Accreditation Program.

## **3. COMMUNICATIONS**

As a result of utilizing various alternative mechanisms, regulators should attempt to coordinate the situation and supervisory plan with other affected insurance departments/jurisdictions, other regulatory agencies, and guaranty associations. Coordination may be useful to avoid actions that may be counterproductive. Interdepartmental and intradepartmental communication is also important to ensure that key departmental officials possess all relevant information to permit decisions to be made on a timely basis.

# **C. BENEFITS, RISKS AND CONTROLS: FOR U.S. CLAIMANTS/POLICYHOLDERS WHEN A NON-U.S. INSURER OR REINSURER RESTRUCTURES**

## **1. INTRODUCTION**

This section considers the impact upon U.S. policyholders and creditors of the restructuring of non-U.S. insurers and reinsurers. It will not consider the impact upon U.S. policyholders and creditors of the restructuring of the U.S. branch of a non-U.S. insurer, because that will be governed largely by familiar U.S. laws and procedures. However, it should be noted that the extent to which the U.S. branch may realize economic support from its non-U.S. parent and/or affiliates is likely to be governed primarily by the laws of the jurisdiction(s) in which the latter are domiciled.

What this section examines is the possible impact on U.S. policyholders and creditors of the restructuring of a non-U.S. insurer or reinsurer outside the U.S. The restructuring of a non-U.S. insurer or reinsurer may be governed simultaneously by the laws of several jurisdictions. For example, as Solvency II becomes the norm in the European Union, an insurer or reinsurer doing business in many member jurisdictions may be subject to their various laws to varying degrees. However, the jurisdiction in which the parent is domiciled (or the group supervisor, if different) may be particularly influential even over the fate of subsidiaries in other jurisdictions. The continued evolution of group supervision as an integral part of Solvency II is likely to enhance the influence of the parent's domicile. Less predictable will be the management of the restructuring of insurers doing business simultaneously in EU and non-EU jurisdictions. There remains a wide disparity in the core principles underlying insurance

regulatory systems throughout the world—some attributable to the pace of economic development, others to fundamental cultural differences, and still others to specific national public policies.

This section endeavors to identify the key considerations that should be evaluated from the perspective of U.S. policyholders and creditors when their non-U.S. insurer or reinsurer is restructured. It seeks also to provide a sampling of illustrations of how those considerations might evolve in specific circumstances. Pre-purchase evaluation of how these considerations are addressed in a particular jurisdiction may enable the astute policyholder to avoid purchasing coverage that is apparently reliable but for which there is little effective protection upon restructuring.

## **2. POTENTIAL ADVANTAGES AND RISKS OF RESTRUCTURING MECHANISMS**

In many non-U.S. jurisdictions, mechanisms are available for the restructuring of insurers and reinsurers short of formal rehabilitation or liquidation proceedings. A distinction should be drawn between restructuring in the face of potential insolvency (the focus of this paper) and restructuring as a business strategy not in response to immediate solvency concerns. In the latter case, there is little justification for compromising policyholder interests, and regulatory schemes typically do not permit that result. It is in the face of a potential insolvency that restructuring can present a meaningful dilemma.

On the one hand, restructuring mechanisms can be advantageous when compared to rehabilitation or liquidation proceedings in three key respects:

- a. Such mechanisms typically offer at least a realistic prospect of a faster resolution of the underlying financial challenge.
- b. Often, these mechanisms are cheaper and therefore consume fewer scarce resources in the implementation of the process itself.
- c. Often these mechanisms serve to preserve coverage that might otherwise have to be terminated in the context of formal proceedings.

On the other hand, there can be some serious draw-backs in these alternative schemes. The next subsection considers key factors in more detail. However, the principal concerns that may arise in the context of these alternatives include:

- a. Reduced regulatory and judicial oversight resulting in diminished policyholder protection.
- b. Greater likelihood that policyholder interests will be compromised for the sake of other constituencies, such as owners, managers, and other creditors.
- c. The probability that policyholders will have less influence in the process and a diminished ability to protect themselves from potentially adverse outcomes.

## **3. KEY CONSIDERATIONS**

In the U.S., state insurance regulators are accustomed to the fundamental principle that the interests of policyholders (used here as including insureds), especially consumers, should take precedence over those of unsecured non-policyholder creditors. This principle is not mandated in non-insurer

bankruptcies in the U.S. and may not have the same importance in non-U.S. jurisdictions. It is helpful to identify the likely principal interests of policyholders (including insureds), as they may be affected in insurer restructuring.

In addition, this subsection will identify key considerations for reinsureds and creditors when a non-U.S. reinsurer restructures. The treatment of reinsureds is the primary consideration; however, a proper restructuring plan will keep tax authorities and other creditors informed as well. While the nature of the reinsured/reinsurer (sometimes referred to as cedent/assuming company) relationship invokes many of the same key considerations—because typically reinsureds are sophisticated business entities rather than individual consumers—slight differences may arise.

#### a. RIGHT OF PAYMENT

Not surprisingly, the principal interest of policyholders is likely to be assurance that claims (perhaps including those for return of unearned premium) will be paid promptly and in full. With the arguable exception of continuation of coverage, it is likely that policyholders' other interests (discussed below) are derivative of and ancillary to payment concerns.

The ability to obtain full payment of claims may turn on many factors, only some of which may be attributable to the nature of the proceeding. For example, the debtor's financial condition will always be a key consideration, regardless of the nature of the proceeding. The nature of the claim will also be an important consideration. For example, policyholders making claims based on IBNR must rely on actuarial estimates, which can vary widely. Such policyholders face a risk that any payment under a restructuring plan would be insufficient to meet future liabilities. This section does not address such considerations, which—however important—are unrelated to the nature of the proceeding or the regulatory or supervisory scheme under which it operates.

#### b. CONTINUATION OF COVERAGE

Under a variety of circumstances, it may be difficult for a policyholder to find acceptable coverage to replace that provided by the restructuring insurer. In the U.S., this interest is typically given more weight in the insurance rather than reinsurance context, and in the case of life accident and health insurance rather than in the context of property and casualty insurance.

#### c. CLAIM PRIORITIES

As noted, we are accustomed in the U.S. to the supremacy of policyholders over other unsecured creditors. This priority is critically important when available assets may not suffice to discharge fully all liabilities of the insurer. Of course, in insurer insolvencies, typically the category of general creditors includes most notably reinsureds. Thus, the interests of reinsureds and policyholders, treated as congruent in much of this section, may be very divergent in particular circumstances. Policyholder priority may not be observed as strictly, or at all, in other jurisdictions.

#### d. GUARANTY ASSOCIATION COVERAGE

Over the last four decades the U.S. insurance sector has implemented nearly universal guaranty fund mechanisms, providing at least basic protection for the insureds of most failed insurers. There are, of course, notable exceptions like HMOs, risk retention groups, surplus lines carriers and certain lines (separate account annuities, fiduciary bonds, etc.) in the main; however, this “safety net” serves to soften

the impact of insurer failure and effectively provides a standard against which are measured the anticipated results of restructuring. Most non-U.S. jurisdictions have not implemented nearly as comprehensive an insolvency protection scheme. The guaranty association mechanism is typically not available to reinsureds in the U.S. or elsewhere.

e. RIGHT TO VOTE

Although largely foreign to U.S. insurer restructuring and insolvency proceedings, in other jurisdictions, policyholders may have a right to vote on the restructuring plan. Most often, however, that right exists when the plan does not require that policyholder contracts be fulfilled in their entirety. In such plans, policyholders whose claims consist of incurred but not reported losses may have different rights from policyholders who have unsettled paid claims or outstanding losses.

f. CRAM DOWN

In certain jurisdictions, it is possible for policyholders and reinsureds to be compelled to accept a restructuring plan that requires that they make economic concessions. The plan may require approval upon the votes of creditors, or it may simply require regulatory or court approval. This should be contrasted with U.S. laws, which typically do not permit restructuring plans in which policyholders' interests are compromised for the benefit of non-policyholder creditors.

g. VOICE IN REPLACEMENT

The restructuring plan may entail coverages being transferred to other insurers or reinsurers with whom policyholders and reinsureds had no relationship. In some cases (including instances in the U.S.), policyholders and reinsureds may have little discretion in the transaction (except potentially non-payment of premium and forfeiture of coverage).

h. TRANSPARENCY

The ability of creditors, including policyholders or reinsureds, to obtain information about the proceeding, and the financial factors upon which key decisions will be based, varies considerably from jurisdiction to jurisdiction. Access to relevant information, however, is often the essential first step in policyholders' ability to protect their interest in a restructuring.

i. ACCOUNTABILITY

The individual or entity responsible for managing the restructuring may be a private practitioner engaged by the restructuring entity's management, a group of creditors, or a regulatory authority. Alternatively, the process may be placed in the hands of a public official. The degree to which the individual or entity in charge of the process is accountable to a superior or independent authority can be critically important in ensuring the fairness and efficacy of the process. In those instances in which oversight consists principally of court supervision, the independence of the tribunal is important, as is the degree to which interested parties have access to that tribunal.

j. REGULATORY PROTECTION

In some jurisdictions (including the U.S.) statutory or common law (judicial decision) standards govern the manner in which an insurer may be restructured. They range from fundamental constitutional

protections against the taking of property without due process to specific thresholds that must be satisfied before a Rehabilitation Plan can be approved. The availability of such protections and of viable enforcement mechanisms (such as an empowered administrative agency) are generally key to the prospect of a meaningful recovery or protection for policyholders and reinsureds.

#### k. ENFORCEMENT IN THE UNITED STATES

Non-U.S. restructuring plans have been enforced by the U.S. courts under Chapter 15 of the United States Bankruptcy Code. Chapter 15 governs cross-border insolvencies and is a framework whereby representatives in corporate restructuring procedures outside the U.S. can obtain access to U.S. courts. Chapter 15 permits a U.S. bankruptcy court to cooperate with a foreign procedure in which assets and affairs of the debtors are “subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.” Recent Bankruptcy Act amendments resulting in the current form of this provision were intended in part to bring U.S. law into greater harmony with the provisions adopted by the United Nations Commission on International Trade Law (UNCITRAL) and observed throughout much of the world. Applicability of these rules can be complex and often commences with a determination of which jurisdiction’s proceeding will control. The emerging trend is to defer to the jurisdiction in which lies the Center of Main Interest (COMI). However, it is important to note that the COMI may not necessarily be the domiciliary jurisdiction of the insolvent, and cases applying this principle sometimes reach puzzling results. While further discussion of these issues is beyond the scope of this section, the subject merits careful attention when applicable.

#### l. STANDING TO APPEAR

The ability to appear before the tribunal or agency conducting or overseeing the proceeding may be an important component of creditor protection. Of course, the fairness and impartiality of such a tribunal or agency are of critical importance. Moreover, the right to appear may be far less important when the individual managing or overseeing the process is charged principally or in material part with protection of policyholders and reinsureds and takes that responsibility seriously.

#### m. SET-OFFS, CLAIMS ACCELERATION AND ESTIMATION, PREFERENCES, AND VOIDABLE TRANSFERS

Insolvency proceedings can trigger a number of unique technical rules that are common in U.S. jurisdictions but may not receive the same treatment in other regimes. Among these are provisions that govern set-offs of claims and credits, acceleration and estimation of claims, when payments before commencement of a proceeding may be deemed to be reversible preferences, when such payments may constitute fraudulent or voidable transfers, and other such rules.

The issue of claims acceleration and estimation is illustrative of this difference in rules. Reinsurers have repeatedly expressed opposition to any system that could result in the accelerated and involuntary payment of their obligations based on any estimation of policyholder claims. Reinsurers oppose compelled payment of reinsurance recoverables based on IBNR on the basis that they are theoretical losses with theoretical values allocated in a theoretical fashion. Because reinsurance is a contract of indemnity, reinsurers assert that they cannot be required to pay losses, such as IBNR losses, which are unidentified or unknown.

While it is beyond the scope of this section to consider the details of each of these “technical” issues, it is important for the affected party to identify those that may be important in the particular case and

determine how they are addressed in the specific proceeding. It should be noted that the application of these rules may not always be immediately evident. For example, if only part of a company's business is subject to the restructuring plan, reinsurers may be concerned that they will lose existing set-off rights. This concern by reinsurers may affect the ability of reinsureds to receive full payment.

#### n. POLITICS

Finally, it should never be forgotten that "all politics are local." In the U.S., the degree to which political considerations control an outcome is somewhat mitigated by cultural and legal constraints. These constraints, however, may not be as applicable in non-U.S. jurisdictions. Familiarity with the local environment is essential in order to avoid unpleasant surprises. And political considerations may not relate just to governmental entities—they may relate to the industry as well. For example, when the reinsured is also a reinsurer, it may be unwilling to help one of its potential competitors with a restructuring. The presence of existing disputes or investigations may also affect how a reinsured views a restructuring plan.



## VI. CONCLUSION

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Overall, although alternative mechanisms for troubled insurers can provide cost savings or greater efficiency over the current system, these mechanism can also pose unique risks for consumers and require specialized surveillance monitoring, practices, and procedures, particularly where the activities may occur outside of court-supervised receivership proceedings. In this context, regulators are encouraged to consider implementing standards and best practices responsive to these risks in order to preserve important consumer protections, increase transparency, and provide appropriate procedural safeguards.

First and foremost, it is the responsibility of regulators to protect insurance consumers. Thus, proponents of alternative mechanisms for troubled insurers should be pressed to prove to the regulator's satisfaction that the claims of greater efficiency or flexibility will not be used to strip policyholders and claimants of their policy rights so that value can be returned to investors. And regulators should ensure that all alternative mechanisms for troubled insurers place the interests of consumers ahead of other competing interests, coupled with a clear statement of goals and objectives and a meaningful oversight mechanism.

## VII. APPENDIX

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### A. CASE STUDIES

This appendix describes troubled insurance company situations to illustrate some of the alternative concepts and techniques discussed earlier in this paper. The names of the insurers have intentionally been omitted. These case studies are not intended to reveal all problems or situations that may arise during the restructuring of a troubled reinsurance company. Additionally, the proposed actions with respect to the subject company may not be appropriate in all jurisdictions in light of changing market conditions and the possible differences in statutes, regulations, and implementing tools and resources.

#### 1. RESTRUCTURED TROUBLED REINSURANCE COMPANY

Company characteristics, circumstances, and concerns:

- A property/casualty reinsurance company (treaty and individual risk basis).
- Primary reinsured lines included allied lines, commercial multiple peril, accident & health, workers' compensation, liability, and non-proportional reinsurance.
- Immediate parent and primary reinsurer of a direct property/casualty insurer.
- Non-U.S. ultimate parent.
- Parent refused to provide further financial support to its subsidiary.

**BACKGROUND.** Restructured Troubled Reinsurance Company (RTRC) was an established property/casualty reinsurer that appeared to be reporting significantly improving financials since two years earlier, accomplished through active re-underwriting and non-renewal of underperforming business. RTRC was a large reinsurer licensed or accredited in 27 states. Growth was moderate over the years, and the company remained adequately capitalized until significant adverse development constrained resources. Almost all property/casualty lines of reinsurance were written by RTRC with primary focus on workers' compensation, accident & health, liability, and proportional reinsurance. The group restructured through a series of transactions and separated its third-party assumed reinsurance business into an independent corporate structure. RTRC received a surplus note contribution from its ultimate parent that provided for semi-annual interest payments.

**CAUSES OF TROUBLE.** The Insurance Department had no information immediately on hand that would have raised a question regarding the solvency of RTRC. The financial statements reported much improved underwriting results, as well as ratios that were also continuing to show improvement. Approximately six months after the financial examination, but a few months prior to the restructuring, management met with the Department to discuss the rising amount of reinsurance recoverable related to its "Unicover" business. RTRC conducted a detailed internal review of its prior years' U.S. casualty business and found that significant reserve strengthening was necessary in its general liability and specialty liability lines, causing a substantial surplus strain and the triggering of the Department's hazardous financial condition regulation.

**PRELIMINARY ACTIONS.** The Department had several telephone conferences with RTRC management whereby the Department was informed that a capital contribution from RTRC's ultimate parent would be forthcoming as a result of the significant adverse development discussed above. Management then contacted the Department for a meeting on the premise that the Chairman was in town and wanted a face-to-face meeting to discuss what was going on at the group. During that meeting, the Department

was informed that RTRC and its direct subsidiary would be placed in run-off and neither would it receive a capital infusion as originally discussed. A firm was hired by RTRC's parent to assist in the development of a strategic plan for a solvent run-off.

**CORRECTIVE ACTIONS.** The Department sought to institute more rigorous financial monitoring. RTRC entered into a confidential letter agreement with the Department that required the Department's approval prior to, among other things, making any material changes to management; moving books and records; making any withdrawals from bank accounts outside the ordinary course of business; incurring any debt; writing or assuming any new business; or making dividend payments or other distributions. It also provided that the Department would receive a monthly report of commutation activity (which, as can be seen below, was the bedrock of the run-off plan); a copy of the final reserve analysis report prepared by an outside firm; and any additional reports the Department reasonably determined were necessary to monitor the financial condition. Finally, the agreement provided that senior management would meet with Department staff weekly, in person or by conference call.

RTRC hired outside actuaries to conduct an external audit. In addition to the reserve strengthening was a non-admission of its deferred tax asset.

A cash flow analysis was commissioned by the Department to conclude whether RTRC could, in fact, have a solvent run-off. RTRC developed a Business Plan/Run-off Plan, which combined commutations with expense cuts (staff and facilities reduction). Quarterly RBC filings were required. Employment levels were reduced commensurate with the Plan, and a retention plan was implemented to help retain talented, necessary staff and management. Surplus note interest payments were disapproved. The Department requested NAIC staff to set up a conference call for regulators to inform states of the situation and provide them time to ask questions or air concerns.

Ultimately, an RBC plan was approved by the Department. Subsequently, a revised Business Plan/Run-off Plan was filed and approved, and the agreement was extended for an additional year.

As commutations continued and improvements began to take hold, the company and its subsidiary were eventually sold. A new plan was developed, as—under new ownership with substantial resources—emphasis was no longer on an aggressive commutation strategy but was now on an aggressive asset management strategy. Monthly calls with management were temporarily put into place to ensure the Department would be aware of any changing circumstance. A less restrictive agreement was implemented as the Department was more comfortable with the possibility of a positive outcome. Ultimately, the subsidiary was again sold—another positive development for RTRC. The frequency of reserve reporting was reduced to an annual basis as long as there was no change in Chief Actuary, and RTRC was released from the agreement.

## **2. NEW YORK REGULATION 141 PLAN**

Company characteristics, circumstances, and concerns:

- Professional property and casualty reinsurers and insurers that write such business and also assume reinsurance of property and casualty business.
- All property and casualty lines, but not life business.
- Member of a holding company group or stand-alone entity.
- Other members of the holding company would not or could not provide further financial help.

**BACKGROUND.** ABC Reinsurance Company (ABC) was a professional reinsurer incorporated in New York in 1977. ABC became capital-impaired and ceased underwriting in 1985. ABC's management sought approval to commute certain assumed contracts, but the New York Superintendent of Insurance maintained that these commutations would prefer certain creditors over others and that the Superintendent lacked statutory authority to approve such commutations under then-existing New York insurance laws.

**CAUSES OF TROUBLE.** The parent company refused to add capital. The Department, lacking the authority to authorize the commutations, moved to place ABC in rehabilitation pursuant to New York Insurance Law Article 74. In 1987, the Superintendent moved in Supreme Court, New York County, for an order of liquidation. ABC remained in liquidation until 1992.

During those five years, ABC's liquidator approved some cedents' claims, but paid none. In 1990, however, the New York Insurance Department introduced, and the legislature adopted, an amendment of NYIL 1321 to permit an impaired or insolvent New York insurer to commute reinsurance agreements and, with the Superintendent's approval, eliminate the risk that those agreements could be avoidable as a preference.

In May 1992, the Superintendent, in his role as ABC's liquidator, petitioned the court to approve a plan of reorganization based on a 100% quota share of ABC's portfolio of outstanding losses on all business that ABC wrote before its liquidation. XYZ Reinsurance Company of New York (XYZ) proposed the reorganization plan and provided the reinsurance cover.

After a July 1992 hearing, the court approved ABC's reorganization plan and entered a final order and judgment that terminated the liquidation proceeding. The XYZ quota share contained a \$305 million limit and an expansion of the quota share's limit that expanded based on a formula that included, among other things, paid losses, reinsurance recoveries, and interest income. ABC resumed operations with new directors and officers, but the plan also provided for a manager to administer ABC's run-off.

When the Superintendent petitioned the court in 1992 to approve the reorganization plan, ABC's projected liabilities were, as of December 31, 1990, \$295.3 million. By 1993, ABC and its quota share reinsurer had paid more than \$302.8 million to its ceding insurers. In 2002, ABC substantially increased its asbestos-related IBNR reserves, as did much of the industry. As reported on its 2002 annual statement, ABC's capital became impaired by more than \$12.7 million.

**PRELIMINARY ACTIONS.** As a result of its 2002 impairment, and pursuant to New York Insurance Law § 1321 and Insurance Regulation 141 (11 NYCRR Part 128) (Regulation 141), ABC submitted to the New York Insurance Department a plan to eliminate capital impairment pursuant to Regulation 141. As required under Regulation 141, ABC's board and the company's sole shareholder stipulated that if ABC's implementation of the Regulation 141 Plan failed to restore ABC's surplus to policyholders to the minimum required as determined in accordance with Regulation 141, ABC would not oppose a petition to again liquidate the company pursuant to New York Insurance Law Article 74.

Under Regulation 141, no commutation of ABC's assumed reinsurance could become effective, and no consideration for any such commutation agreement could be paid, until the Superintendent determined that a sufficient number of fully executed commutation agreements had been returned to restore ABC's surplus to the required minimum (11 NYCRR § 128.5). Regulation 141 also required that ABC provide the Superintendent with copies of all e-mail, correspondence, and other communications between ABC

and its ceding insurers relating to the current Regulation 141 commutation offers, including any such communications rejecting the offer.

The proposed 141 Plan and Regulation 141 also required that ABC offer the same, non-negotiable commutation terms to all of its ceding companies. The 141 Plan further required that an offer to commute reinsurance agreements be made to every ceding insurer for which ABC had paid losses and LAE (Paid Losses) or known case losses and LAE (Case Reserves) on its books as of June 30, 2003.

Under its Regulation 141 Plan, ABC offered to pay 100% of Paid Losses and 60% of Case Reserves to commute obligations under the reinsurance agreements. Cedents were required to respond to this offer within 90 days.

**CORRECTIVE ACTIONS.** In January 2004, the Superintendent approved the 141 Plan and allowed ABC to extend commutation offers to its cedents. Shortly thereafter, ABC mailed commutation offers pursuant to the Plan to about 580 cedents. In October, ABC delivered to the Superintendent more than 300 executed commutation agreements along with copies of all correspondence with cedents relating to the Plan. The Superintendent subsequently determined that these commutation agreements would, upon his approval, eliminate ABC's impairment.

With the Superintendent's approval, ABC paid \$22,558,221 to those ceding insurers that accepted its Regulation 141 commutation offers. The post-Plan ABC balance sheet showed a positive surplus of \$3,675,366 and the elimination of its 2002 impairment.

The completed Regulation 141 Plan left ABC with many cedents. No cedents were compelled to accept the 141 commutation offers, and the Superintendent's approval of the Plan was premised on ABC's sufficient surplus to policyholders to complete its run-off. At the same time, Regulation 141 gave the Superintendent the statutory authority to permit commutation with a troubled company—avoid a protracted receivership—while also respecting every cedent's right to reject the proposed commutation offers and run the risk that ABC would lack sufficient capital to complete its run-off.

### **3. COMMERCIAL INSURANCE COMPANY RUN-OFF**

Company characteristics, circumstances, and concerns:

- A property/casualty insurance company, writing primarily commercial lines on a national basis.
- Primary lines included commercial multiple peril, accident & health, workers' compensation, general liability.
- Member of a large multinational property/casualty insurance and reinsurance group with a non-U.S. ultimate parent.
- Parent sought to provide sufficient capital support to its subsidiary.

**BACKGROUND.** Restructured Troubled Insurance Company (RTIC) was an established property/casualty insurer pursuing a business model outsourcing most of its underwriting and claims functions to managing general agents (MGAs) and third-party administrators (TPAs), respectively. RTIC was licensed and operated in 50 states and wrote directly and through six subsidiary companies. The company had been operating for over 50 years and independent for approximately six years prior to being purchased by its current parent. Following the acquisition, RTIC pursued a modified business strategy for three years before being placed into run-off. RTIC wrote most lines of commercial liability insurance with primary focus on workers' compensation, accident & health, and general liability insurance.

**CAUSES OF TROUBLE.** Although the parent company installed new management and sought to reverse the business decline at RTIC following the acquisition, continued underwriting losses and adverse development from past years resulted in a ratings downgrade at the company. In addition, the California Insurance Department had been monitoring RTIC for some time due to the poor underwriting results and concern over the company's capitalization. The parent determined that the business model for the company was not appropriate for the then-current market and was not likely to result in a return to profitable business for the company. The parent also determined that the profitable lines of business RTIC was writing could be pursued through restructured and separately capitalized subsidiary companies, while the potential for continued adverse development in certain lines written by RTIC—particularly workers' compensation—would require substantial new capital for RTIC to regain its ratings. Accordingly, the parent determined to place RTIC into run-off.

**PRELIMINARY ACTIONS.** The parent developed a run-off plan that called for the capital and operational restructuring of RTIC. Representatives of the parent, RTIC, and the run-off manager met with the Department to present a detailed plan for RTIC in run-off. The plan included a restructured capital base intended to provide sufficient flexibility and liquidity for the run-off. A principal component of this restructuring was the merger of a subsidiary of the parent already in run-off into RTIC. This contributed company had been in solvent run-off for a number of years and held sufficient excess capital to support RTIC in run-off. The resulting merged entity was to be placed under the management team of the contributed company, a dedicated professional team with 10 years of experience in the operation of run-off companies.

Over the course of a three-month period, the Department and the company representatives met frequently to refine the run-off plan. The Department was receptive to a solvent run-off under the control of the parent, provided that the parent could demonstrate sufficient capitalization within RTIC, the establishment of certain financial standards for RTIC, and enhanced financial and operational reporting by the company. Upon approval by the Department of the run-off plan and the merger, RTIC was formally placed in run-off.

**CORRECTIVE ACTIONS.** The Department, the parent, and RTIC entered into an agreement that required RTIC to maintain a minimum RBC standard of 200%, a net-reserves-to-surplus ratio of no greater than 3-to-1, and a specified minimum surplus amount. The parent guaranteed that RTIC would meet these standards. RTIC also agreed to provide frequent and detailed reporting to the Department on the progress of the run-off.

Based upon the company's actuarial analysis and a separate review by the Department, RTIC strengthened reserves in certain lines. The run-off plan also included a restructuring of the capital of RTIC which, in addition to the merger, included the contribution of a three-year term note from the parent to insure liquidity and sufficient capital, and the transfer of the stock of certain affiliated companies from RTIC into a trust in favor of RTIC. Certain subsidiaries of RTIC were purchased by the parent to continue writing certain lines outside of the run-off. RTIC reduced staff, and certain operations were subsequently transferred directly to the run-off manager. A retention plan was created to help retain knowledgeable, talented staff and management for the run-off. RTIC met separately with the domestic regulators of its subsidiary insurance companies to inform them of the plan and obtain their approval where necessary. RTIC and the Department also coordinated with NAIC staff to inform all interested states of the situation at an NAIC regulator meeting and to provide regulators with the opportunity to ask questions or air concerns.

With the Department's agreement, RTIC began to terminate its MGA and most of its TPA agreements and assumed direct control of most of its claims. The company then began to aggressively settle claims, reduce its overall exposures, and commute certain reinsurance contracts where protection was uncertain or disputed. The investment manager restructured RTIC's investment portfolio to better address the anticipated cash flow and capital requirements of the run-off.

**PROGRESS OF THE RUN-OFF.** The Department's cooperation with management and establishment of clear operating guidelines, the capital support at RTIC provided by the parent, and singular focus of management on the satisfaction of RTIC's obligations and responsible management of the company's assets have resulted in a stable and successful run-off. Five years into the run-off, RTIC had reduced open claims by approximately 85%, reduced reserves by approximately 40%, and increased surplus by over 70%. The stabilization of RTIC, its successful execution of the run-off plan, and gains in its investment portfolio have resulted in the Department's agreement to terminate the trust arrangements created for the affiliated company investments, deferral, and subsequent forgiveness of the third installment of the parent note and the return of excess capital from RTIC to the parent. RTIC continues to adhere to the established financial standards, maintaining a comfortable margin over the minimum requirements established by the Department. RTIC management and the Department continue to meet approximately quarterly to review the progress of the run-off.

#### **4. RESTRUCTURED TROUBLED LONG-TERM CARE COMPANY**

Company characteristics, circumstances, and concerns:

- A stock life, accident and health company.
- Part of a large national life and A&H group.
- Primary line of business is a closed block of predominately long-term care in force.
- Ceased writing new business five years prior to restructuring.
- Received large capital contributions from parent for many years.
- Continuous premium rate increase requests.
- Adverse claim development and reserve strengthening.
- Low RBC ratio.

**BACKGROUND.** Restructured Troubled Long-Term Care Company was a writer of predominately long-term care business, operating in most of the 46 states, D.C., and the U.S. Virgin Islands. It had held a firm niche position in the long-term care market with profitable operations and a conservative balance sheet. The long-term care block of business was written by the Company and its predecessor companies prior to being acquired by the Company in the 1990s.

**CAUSES OF TROUBLE.** Shortly after the acquisition of long-term care blocks in the 1990s, the Company reported a reserve deficiency. The Company phased in a new reserve valuation basis for long-term care policies, requested and implemented premium rate increases, and implemented tighter underwriting standards. The cause of trouble was under-pricing and under-reserving that became evident as the company experienced claim costs and utilization that exceeded expectations. The original pricing assumptions on long-term care assumed a 4% to 5% lapse rate, while the actual lapse rate was only 1% to 2%. Additionally, the Company's investment return assumptions were much higher than actual returns.

Over the course of more than a dozen years, the Company received capital contributions to offset losses. The Company reported an increasingly larger reserve deficiency each year from 1998 to 2007, several years in excess of \$100 million deficient. The Company reported net losses in each year from 1997 to 2007.

**PRELIMINARY ACTIONS.** In 2003, Company management decided to stop marketing insurance products and to place the Company in run-off. The insurance department began monitoring the Company monthly and meeting with Company management on a quarterly basis as a result of continued poor operating performance, reserve deficiencies, and multi-year rate increase requests. A study was conducted of the Company's incurred claims experience. As a result, the Company updated the claim cost assumptions underlying the contract reserves and unearned premium reserves for the long-term care policies. The change was made using the "pivot" method, such that the change in claim costs would be accrued into the reserve balance over time. Multiple premium rate increases were sought. Over the course of 15 years, the Company received over \$900 million in capital contributions from the parent. The parent company indicated that no future capital contributions would be forthcoming.

The Company also came under scrutiny for market conduct issues, including claims administration and complaint handling practices. The Company underwent a market conduct examination to get a further understanding of the market conduct problems within the Company and, as a result, a settlement agreement was reached, recommendations for corrective measures were made, and an improvement plan was developed. The settlement included a monetary penalty for violations; a contingent penalty for non-compliance with improvements, including systems upgrades and improved claims administration; and restitution and remediation regarding the reevaluation of denied claims.

**CORRECTIVE ACTIONS.** With the approval of the insurance department, the Company's parent transferred the stock of the Company to a non-profit independent trust. In connection with the transfer, the parent contributed additional capital to the Company to fund future operating expenses. The capital was in the form of senior notes payable, invested assets, cash, and the forgiveness of unpaid dividends. The trust is intended to operate the Company for the exclusive benefit of the long-term care policyholders, without a profit motive. It is governed by a board of trustees under the oversight of the insurance department, as outlined in the Form A Acquisition Order.

## **5. LIABILITY OF INSURERS TRANSFERRED TO THIRD PARTY – EUROPE**

**BACKGROUND.** The European market is a provider of insurance and reinsurance to insureds and cedents worldwide.

Events that took place in Europe during the 1990s provide an example of an extreme case of a market coming to the brink of collapse, only to be saved by a series of transactions that were simple in concept but, of necessity, very complex in their implementation. Those transactions amounted to what has become a famous event in the history of insurance. Most recently the final transaction took place, which had the effect of removing the outstanding liabilities of the re/insurers in question.

**CAUSES OF TROUBLE.** In the early 1990s there was an unexpected, huge increase in long-tail liability claims (typically asbestos, pollution and health hazard) made against certain European market insurers. Many of these insurers faced collapse, as the liabilities swamping the market and the difficulty in estimating the IBNR and calculating an appropriate reinsurance premium were so great. The effect was that several troubled European insurers were without protection and remained exposed to the incoming claims.



**CORRECTIVE ACTIONS.** The situation was so dire that immense efforts were made to bring about a solution. One solution, in particular, allowed certain troubled European insurers to pay a premium (which varied according to exposure) and have all the liabilities for the exposed years 1992 and earlier to be reinsured by a specially formed company, ABC Reinsurer. Claims handling and all other aspects of the run-off were transferred to XYZ insurer (a wholly owned subsidiary of ABC Reinsurer). XYZ also reinsured ABC Reinsurer under a retrocession agreement. Certain rights of the original troubled insurers as reinsureds of ABC Reinsurer were held on trust for policyholders: In this way, the benefit of all reinsurance recoveries were applied in paying the liabilities due to policyholders. The intervening 10 years to 2006 found XYZ working to plan with a controlled program of inwards and outwards commutations as a means of dealing with the run off of these liabilities. In all practicality the original troubled insurers had finality—i.e. they were no longer financially exposed personally so long as XYZ remained solvent. However, as a matter of law, they did remain personally liable to policyholders for any excess liability over and above that paid by XYZ.

By early 2006, the market in the purchase of portfolios in run-off had taken off. XYZ was the world's largest business in run-off, so large that the number of likely purchasers was very limited. However, fortunately by the end of 2006, the two-stage deal with a large conglomerate—XOX—was announced, the stages being:

- 1) XYZ retroceded to XOX's subsidiary, BOB, its liabilities to ABC Reinsurer arising under the agreement. Cover was limited to approximately \$6 billion (U.S.) over and above existing reserves of approximately \$9 billion, as of March 2006. The premium was all of XYZ's assets less approximately \$340 million, plus a \$145 million contribution from some of the original troubled insurers. Staff and operations were transferred to another XOX subsidiary, RRR.
- 2) A "Part VII transfer" of all the liabilities of the original troubled European insurers (and the protection of the ABC Reinsurer–XYZ–BOB reinsurance chain) to a third-party company. Provided the transfer was to take place before December 2009, XYZ would be entitled to purchase further reinsurance from BOB of up to \$1.3 billion if XYZ's net undiscounted reserves had not deteriorated by more than \$2 billion from their March 31, 2006, position.

Part VII of the UK Financial Services & Markets Act 2000 (FSMA) provides a statutory novation of business (i.e., reinsureds' obligations to their policyholders) by a transferor re/insurer to the transferee re/insurer, provided that strict procedures are complied with. The novation is effected by court order. The court order has the effect of vesting the transferor's business in the transferee without the need for consent of the policy holders/reinsureds. The court can and usually does order assets attributable to the underlying business to be transferred—i.e., including the outwards reinsurance contracts. There are strict definitions of business that are subjected to a Part VII transfer. Put broadly, it applies to transfers of business carried on in the UK or elsewhere within the European Economic Area (EEA) with a UK connection as defined and where the transferred business is to be carried on from an establishment of a transferee in an EEA state. There are various conditions and exclusions.

The unusual position of these particular re/insurers, should they wish to avail themselves of Part VII, was recognized at the time Part VII first became law. However, additional changes to the legislation had to be made to facilitate this transaction, and they became law in 2008. In particular, the Part VII provisions in the FSMA were extended to a further cohort of these particular re/insurers.

Under the Part VII transfer procedure, there are two court applications. The first gives directions as to notices to be served and other technical requirements allowing any opposing reinsureds or outwards

reinsurers to object to the transfer. In the case of the XYZ Part VII, certain requirements were dispensed with taking into account the high volume of notices that would have to be given to individual names and other relevant parties. An essential part of the procedure is the report provided by an independent expert whose identity is approved by the Financial Services Authority (FSA). Furthermore, the FSA itself provides a report indicating its views that is made available to those interested in the transfer. Time is allowed for any objectors to produce their own case in the context of the independent expert report and the FSA's report. In the case of the XYZ transfer, the FSA indicated that it would not object to the transfer.

The second and final stage of the process is the application for sanction by the court. The court has discretion whether to sanction the transfer scheme but may not do so unless it considers it appropriate in all the circumstances of the case. Under case law on the statutory provisions, the court is concerned as to whether a policyholder, employee or other interested person will be adversely affected by the transfer scheme. The hearing took place in mid-year 2009, and the judge concluded that the Part VII transfer scheme should go ahead.

During the hearing, the judge was satisfied that other requirements protecting policyholders of the business being transferred had been fulfilled, such as that certificates of solvency for the transferee company were obtained confirming the adequacy of the transferee's solvency for the purpose. Presentations explaining the import of the transfer had been carried out in the UK and in the jurisdiction of XOX to transferring policyholders, the original troubled insurers, and their representatives. Help lines and a Web site had been set up. Numerous telephone calls, e-mails or letters had been sent in response by the Part VII advisers, with less than 10 people raising substantive issues.

**ENFORCEMENT IN OTHER JURISDICTIONS.** Part VII of the FMSA originates from EU Directives. The sanction order is thereby recognized throughout the EEA. A further step would be needed to ensure enforcement in the United States and other countries where policyholders were located. However, the shape of the scheme is such that enforcement in the United States and other jurisdictions is most probably unnecessary. Policyholders would be entitled to drawdown on trust funds located in the United States, Canada, Australia and South Africa, providing them with security for amounts accruing due to them over time should there be any default payment.

**PROGRESS.** With the sanction of this transfer scheme granted during mid-year 2009, the two-stage transaction provided by the XOX group was completed in time. Because the transfer was affected prior to December 2009, it is believed that the further amount of \$1.3 billion (U.S.) reinsurance cover will be available to secure future payment of all policyholder claims.

## B. SAMPLE DOCUMENTS

### 1. SAMPLE SUPERVISION CONSENT ORDER

-----§  
In the Matter of: §  
§  
The Administrative Supervision of §  
RESTRUCTURED TROUBLED §  
REINSURANCE CORPORATION, a § Docket No. EX xx-xx  
Connecticut domiciled property and casualty insurance company. §  
-----§

#### CONSENT ORDER

This Consent Order is entered into by and between Restructured Troubled Reinsurance Corporation (RTRC) and the Insurance Commissioner of the State of Connecticut (the Commissioner) to provide supervision and regulatory oversight of RTRC in the run-off of its insurance and reinsurance obligations in force.

WHEREAS, the Commissioner hereby finds, and RTRC agrees, as follows:

1. The Commissioner has jurisdiction over the subject matter and of RTRC.
2. RTRC is a Connecticut-domiciled property and casualty insurer and reinsurance company having its principal office at XXX Street, Anywhere, XX 00000, and holds a certificate of authority to transact the business of insurance and reinsurance in Connecticut and is licensed or accredited in a number of other states.
3. RTRC is a wholly owned direct subsidiary of Restructured Troubled Corporation (RTC), a Delaware corporation and an indirect subsidiary of Restructured Troubled (Barbados) Ltd., a Barbados corporation which is a wholly owned direct subsidiary of Restructured Troubled Group Ltd. (RTG), a Bermuda corporation.
4. Due to the significant deterioration of RTG's financial condition in 20XX, on December 3, 20XX, RTRC entered into a "letter of understanding" with the Connecticut Insurance Department (Department) as part of the Department's continuing financial monitoring of RTRC pursuant to which RTRC agreed that it would not take certain actions without the prior written approval of the Connecticut Insurance Commissioner or her designee, including, among others, disposing of any assets, settling any intercompany balances or paying any dividends.
5. RTRC has submitted to the Department a risk-based capital report, (the RBC Report) pursuant to CONN. AGENCIES REGS. § 38a-72-2. The RBC Report indicates that RTRC was at the "Regulatory Action Level Event" as of December 31, 20XX. On July 30, 20XX, RTRC filed with the Department an updated RBC Report which estimates that RTRC was at the "Authorized Control Level Event" as of June 30, 20XX.
6. RTRC has ceased underwriting activities and has determined that it is in the best interests of its policyholders and creditors to run-off the existing operations of RTRC in such a manner as would

maximize the availability of funds to satisfy the interests of policyholders, creditors, and other constituents.

7. RTRC has retained the services of a firm with expertise and experience in run-off management to review the operations of RTRC and its subsidiaries in run-off, to supplement its internal resources, and to accelerate the successful completion of the run-off, all pursuant to a comprehensive run-off plan (including therein, among other items, a plan to effectuate commutation of existing reinsurance obligations). The run-off management consultant will develop and submit, along with a more extensive run-off engagement agreement retaining their services to manage the run-off, to the RTRC Board of Directors for approval and, if such plan and agreement are approved, to the Commissioner, creditors of RTC, and other constituencies for approval.

8. On April 15, 20XX, the Department commenced a targeted examination of the financial condition of RTRC pursuant to CONN. GEN. STAT. § 38a-14. The examination was called based on RTRC's submission of a Cash Flow Projection Model to demonstrate that RTRC has sufficient assets and cash flow to pay both claims and operating expenses as those obligations become due.

9. On August 20, 20XX, RTG and RTC filed for protection under Chapter 11 of Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

10. RTRC is in such condition that regulatory control of the insurer is appropriate to help safeguard its financial security and is in the best interests of the policyholders and creditors of the insurer and of the public as RTRC administers the run-off of its existing business.

IT IS THEREFORE ORDERED AND AGREED THAT:

11. RTRC hereby consents to and shall be placed under the administrative supervision of the Commissioner pursuant to CONN. GEN. STAT. § 38a-962b and under the terms herein.

12. RTRC hereby knowingly and voluntarily waives receipt of written notice under CONN. GEN. STAT. § 38a-962b of grounds for the Commissioner to effectuate administrative supervision by the Commissioner.

13. The period of administrative supervision by the Commissioner shall commence upon execution of this Consent Order. The period of supervision pursuant to this Consent Order shall be coterminous with the run-off of RTRC's existing business, unless the Commissioner takes action pursuant to Paragraph 27 hereof.

14. The determination that RTRC shall be subject to administrative supervision by the Commissioner may be abated and thereby released from administrative supervision by the Commissioner if RTRC complies with the orders of supervision provided herein and, during the period of supervision, RTRC shall have attained sufficient liquidity, surplus, and reserves necessary to exceed and maintain Company Action Level RBC, as defined in CONN. AGENCIES REGS. § 38a-72-1, or the Commissioner in her sole discretion determines the supervision of RTRC is no longer necessary for the protection of policyholders, claimants, creditors, or is no longer in the public interest.

15. During the period of supervision, RTRC shall not undertake, engage in, commit to accept, or renew any insurance obligations including without limitation, insurance or reinsurance policies or any similar arrangements or agreements of indemnity or, without the prior written approval of the

Commissioner, make any material change in any insurance or reinsurance agreement which would increase the financial obligations of RTRC in any material respect. Moreover, RTRC shall not engage in activities beyond those that are routine in the day-to-day conduct of its business in run-off and are otherwise consistent with its comprehensive business run-off plan (Run-off Plan) to be filed with, and found acceptable by, the Commissioner, without the prior approval of the Commissioner or her designee. The routine day-to-day conduct of RTRC's business in run-off includes but is not limited to: (a) paying claims and operating expenses as such obligations become due and in accordance with the applicable law and the settlement and commutation of claims and insurance and reinsurance obligations, unless otherwise provided in the following paragraph or otherwise directed or approved by the Commissioner or her designee; (b) defending RTRC and persons insured or claiming to be insured by RTRC against claims arising from or related to insurance policies and reinsurance agreements previously issued, assumed, or ceded by RTRC; (c) settling or otherwise resolving or attempting to adjust and resolve such claims; (d) engaging, directing, discharging, and compensating counsel (including reasonable costs incurred) with respect to such claims or other matters; (e) paying settlements or judgments with respect to such claims; and (f) investing the assets of RTRC and liquidating such assets in an appropriate manner as required to pay claims, operating expenses, settlements, commutations, and other charges in the ordinary course of business and subject to the provisions of this Consent Order.

The routine day-to-day conduct of RTRC's business in run-off also includes but is not limited to: (a) submitting information to reinsurers with respect to RTRC's reinsured losses and loss adjustment expenses; (b) advising reinsurers of all sums due to RTRC under their respective reinsurance contracts and treaties with RTRC (including settlement and commutation thereof, provided, however, that RTRC shall not enter into commutation of liabilities (either inward or outward including obligations of others to RTRC) or settlements of claims other than for amounts not in excess of \$250,000 except as otherwise provided in the Run-off Plan or otherwise approved by the Commissioner or her designee); and (c) taking all actions necessary and appropriate to recover all sums due to RTRC from reinsurers and others.

The following activities, to the extent not necessary for the adjusting and payment of losses and expenses associated with claims adjusting and settlement or commutation of reinsurance agreements are understood to be outside the day-to-day conduct of RTRC's business in run-off, and in no event shall RTRC engage in or undertake the following activities without the prior approval of the Commissioner or her designee:

- (a) Dispose of, convey, or encumber any of its assets or its business in force.
- (b) Withdraw any of its bank accounts.
- (c) Lend any of its funds.
- (d) Invest any of its funds.
- (e) Transfer any of its property.
- (f) Incur any debt, obligation, or liability.
- (g) Merge or consolidate with another company.
- (h) Write new or renewal business.
- (i) Enter into any new reinsurance contract or treaty.
- (j) Terminate, surrender, forfeit, convert, or lapse any insurance policy, certificate, or contract, except for nonpayment of premiums due.
- (k) Release, pay, or refund premium deposits, unearned premiums, or other reserves on any insurance policy, certificate, or contract.

- (l) Make any material change in management.
- (m) Increase salaries and benefits of officers or directors or the preferential payment of bonuses, dividends or other payments deemed preferential.

RTRC shall make a recommendation with the reasons therefore in writing to obtain the prior approval of the Commissioner as to any of the foregoing actions.

16. The Commissioner shall have the final authority to approve or disapprove the initiation, settlement, or withdrawal by RTRC of any action, dispute, arbitration, litigation, or proceeding of any kind involving RTRC that is not in the ordinary course of business or would require payment in excess of \$250,000. RTRC shall prepare a written report to the Commissioner with a recommendation for approval or disapproval with the reasons therefore.

17. Without the prior written approval of the Commissioner, RTRC shall not (i) add any individual who is not currently a senior executive officer of RTRC, or one of its affiliates, to the board of directors of RTRC or (ii) move the principal offices or records of RTRC to a location outside of Connecticut.

18. RTRC shall file with the Department a monthly financial statement consisting of a balance sheet and income statement on the 25th day of each month as of the end of the prior month.

19. At least annually, RTRC shall submit an actuarial analysis prepared by a qualified actuary as defined in CONN. AGENCIES REGS. § 38a-53-1 of the loss and loss adjustment expense reserves.

20. RTRC shall submit a report on a quarterly basis containing detailed information on all commutations of reinsurance treaties and related activities which have occurred year-to-date, including specific impact on RTRC's statutory financial statement.

21. RTRC shall submit to the Department any additional reports that the Department reasonably determines as necessary to ascertain the financial condition of RTRC.

22. RTRC shall submit any and all reports or items required by this Consent Order, and all requests for the Commissioner's action or approval to:

\_\_\_\_\_ (name)  
Connecticut Insurance Department  
P.O. Box 816  
Hartford, Connecticut 06142-0816  
(860) 297-3823  
(860) 566-7410 FAX

23. The Commissioner may retain, at RTRC's expense, such experts (including, but not limited to, attorneys, actuaries, accountants, and investment advisors) not otherwise a part of the Commissioner's staff, as the Commissioner reasonably believes is necessary to assist in the supervision of RTRC.

24. RTRC hereby knowingly and voluntarily waives all rights of any kind to challenge or to contest this Consent Order, in any forum now available to it, including the right to any administrative appeal pursuant to CONN. GEN. STAT. § 4-183.

25. This Consent Order of supervision, and proceedings, hearings, notices, correspondence, reports, records and other information in the possession of the Commissioner or the Department relating to the

administrative supervision by the Commissioner of RTRC are subject to the confidentiality provisions of CONN. GEN. STAT. § 38a-962c and § 38a-8.

26. RTRC shall continue to comply with all obligations under law, including applicable financial, regulatory, and tax reporting requirements.

27. Nothing in this Consent Order shall preclude the Commissioner from taking further action as the Commissioner in her sole discretion deems appropriate and in the best interest of RTRC’s policyholders and the public, including commencement of further legal proceedings if and as necessary under Chapter 704c of the Connecticut General Statutes.

28. This Consent Order shall supersede in all respects the “letter of understanding” between RTRC and the Department referenced to in Paragraph 4 of this Consent Order, which letter shall have no further force and effect.

29. The Board of Directors of RTRC, at a specially called meeting or by unanimous written consent, has simultaneously, with the entry of this Consent Order, approved and provided resolutions complying with the terms of this Consent Order, which is effective upon entry of this Consent Order.

The foregoing Consent Order for Restructured Troubled Reinsurance Corporation is entered and shall be effective at 3:00 p.m. on this \_\_\_\_\_ day of September 20XX.

\_\_\_\_\_  
(name)  
Insurance Commissioner

Agreed and Consented to by RESTRUCTURED TROUBLED REINSURANCE CORPORATION on this \_\_\_\_\_ day of September 20XX.

By:  
\_\_\_\_\_  
(name)  
President

(Corporate Seal)

On this \_\_\_\_\_ day of September 20XX, before me, the subscriber, personally appeared \_\_\_\_\_, the President of Restructured Troubled Reinsurance Corporation, who I am satisfied is the person who has signed the preceding Consent Order, and he did acknowledge that he signed, sealed with the corporate seal, and delivered the same as such officer aforesaid and that the Consent Order is the voluntary act and deed of such company made by virtue of the authority vested in him by its Board of Directors.

\_\_\_\_\_  
(name), (Title)

## 2. SAMPLE REINSURER LETTER AGREEMENT

November , 20XX

President  
Restructured Troubled Reinsurance Company  
XXX Street  
Anywhere, XX 00000

Dear \_\_\_\_\_:

The Any State Insurance Department (Department) continues its financial monitoring of Restructured Troubled Reinsurance Corporation (RTRC or Company).

The Company's parent, Restructured Troubled Group Ltd. (RTG) reported an operating loss of \$245 million for the third quarter of 2002 and an operating loss of \$252.6 million for the first nine months of 2002. The loss resulted principally from approximately \$100.7 million of loss reserve increases recorded by the operating subsidiaries and a \$64.5 million loss related to the establishment of a deferred tax valuation reserve. The operating results for the first nine months of 20XX included approximately \$33 million of loss development related to the September 11<sup>th</sup> terrorist attacks recorded in the first quarter of 20XX. On October 18, 20XX, A.M. Best Company lowered the ratings of the operating subsidiaries of RTG from A- to B+. Subsidiary Insurance Company was lowered from A- to B. The downgrade constituted an event of default under RTG's bank credit facility, under which banks had issued \$336 million in letters of credit to support RTG's underwriting at its Lloyd's operation. On November 1, 20XX, with the approval of the Department, the Company entered into an Underwriting and Reinsurance Arrangement with Facility Re, Inc., whereby new business is underwritten by Facility Insurance Company, a member of the Facility Group. On November 14, 2002, A.M. Best again lowered the ratings of the operating subsidiaries of RTG from B+ to B-. Subsidiary Insurance Company was lowered from B to C++.

In order to protect the existing quality and integrity of RTRC's assets, reserves, and management to protect policyholders/reinsureds and the public, it is requested that the Company agree to the following:

1. RTRC shall not take any of the following actions without the prior written approval of the Insurance Commissioner or her designee:
  - a. Dispose of, convey, or encumber any of its assets or its business in force.
  - b. Withdraw any of its bank accounts except in the ordinary course of business.
  - c. Settle any intercompany balances.
  - d. Lend any of its funds.
  - e. Transfer any of its property.
  - f. Make any investments other than cash equivalents.
  - g. Incur any debt, obligation, or liability, except liabilities in the ordinary course of business.
  - h. Make any material change in management.
  - i. Make any material change in the operations of the Company.



- j. Move any books and records from its office in Stamford, Connecticut.
  - k. Pay any dividends, ordinary or extraordinary.
  - l. Enter into any affiliated reinsurance contracts, affiliated commutation agreements, or settlement agreements.
  - m. Enter into any unaffiliated insurance or reinsurance contracts that would constitute new or renewal business, or any unaffiliated commutation agreements or settlement agreements in excess of \$1 million not in the ordinary course of business.
  - n. Enter into affiliated transactions of any nature.
2. Senior management shall meet with the Department, in person or by conference call, with such frequency as may be deemed necessary by the Insurance Commissioner or her designee, to provide updates on the status of the parent and any changes in the status of the Company.
  3. A monthly financial statement consisting of a balance sheet and income statement shall be filed with the Department on the 25th day of each month as of the prior month end.
  4. The above-described terms shall continue in effect until such time as the Insurance Commissioner shall deem they are no longer necessary or issues an order that supersedes this agreement.
  5. RTRC acknowledges that nothing contained herein shall in any way limit any power or authority given the Insurance Commissioner under the laws of the State of Connecticut, including the right to initiate any further actions as she deems in her discretion to be necessary for the protection of RTRC's policyholders/reinsureds and the public.

I have enclosed two originals of this letter to your attention. Please sign and date both originals, retain one for your file, and return one executed original to me.

Sincerely,

\_\_\_\_\_, Chief Examiner  
Financial Analysis & Compliance

AGREED TO this \_\_\_\_\_ day of November, 20XX, by a duly authorized representative of RTRC.

## **C. SAMPLE OUTLINE FOR RUN-OFF PLANS**

The following is a sample outline for a run-off plan.

- I. Introductory Overview
  - A. Executive Summary: Providing an executive level summary of the history, current business conditions, recent significant transactions, and proposed run-off solution.
    - 1. Status
    - 2. Mission
    - 3. Business (Guiding) Principles
  - B. Plan Objectives: Describing the ability of the plan to fully and timely settle all valid policyholder claims in compliance with the liquidation priorities of state distribution scheme.
  - C. Advantages
  - D. Benefits
  
- II. Corporate History
  - A. Summary
  - B. Recent Happenings: Description of business plans, significant transactions, prior restructuring plans, and financial performance related thereto.
    - 1. Mergers & Acquisitions
    - 2. Employment
    - 3. Internal Growth
    - 4. External Factors
    - 5. Current Position
  - C. Business Description: Including a comprehensive description of organizational and corporate structure, lines of insurance, nature of policyholder and other risks, and claim-handling function associated with the run-off.
    - 1. Lines
    - 2. Programs
    - 3. Markets
  - D. Reserve Development
    - 1. Environmental Issues
    - 2. Underwriting Issues
    - 3. Adverse Development
    - 4. Reserves by Line – Summary

E. Financial Condition: Summary of recent financials

1. Summary
2. Statutory Surplus
3. Consolidated Financial Statement(s)
4. Operating Expenses
  - a. Staffing
  - b. Insurance
  - c. Real Estate
  - d. Fixed Costs
  - e. Information Technology
5. Taxes

F. Operations: Description and historical comparison of staffing, real estate, expenses, insurance and information technology, and other pertinent operations associated with run-off.

1. Claims Handling
2. Reinsurance
  - a. Outstanding Balances
  - b. Disputes
  - c. Solvency Issues
  - d. Uncollectables
  - e. Write-offs
  - f. Collateral
  - g. Lines of Business
  - h. Programs
  - i. Processes & Systems

III. Run-off Plan: Description of initiatives and priorities, including demonstration of Run-Off Plan serving the best interests of policyholders and other claimants.

A. Summary

B. Financial Projections: Including description of surplus-enhancing initiatives and transactions, loss development, liquidity and expense projections.

1. Key Factors
2. Assumptions
3. Revenues
4. Expenses

5. Surplus Projection
  6. Liquidity Projection
- C. Initiatives
1. Surplus Enhancing
    - a. Policy Buybacks
    - b. Expense Reductions
      - i. Operating Expenses
        - a. Staffing
        - b. Real Estate
        - c. Fixed Costs
        - d. Insurance/Benefits
        - e. Information Technology
      - ii. Allocated Loss Adjustment Expenses
    - c. Reinsurance Commutations
  2. Liquidity
    - a. Asset Portfolio Assessment
    - b. Encumbered Assets
    - c. Unencumbered Assets
    - d. Statutory Deposits
- D. Risk Factors: Description and projection of risks associated with Run-Off Plan, including regulatory concerns, preferences, and risks associated with policyholders, and guaranty funds/associations, including identification of critical elements for plan success.
1. Define Uncertainties
    - a. Business
    - b. Economic
    - c. Regulatory
  2. Additional Adverse Loss Reserve Development
  3. Increased Reinsurance Disputes
  4. Unexpected Liabilities
  5. Drastic Asset Value Changes
  6. Financial Market – Investments
- E. Voluntary Run-off vs. Receivership: Analysis and comparison between the alternative mechanisms from best interests of policyholders, claimants, and guaranty funds/associations.

- F. Regulatory Reporting: Description of proposed regulatory supervision and reporting requirements—e.g., monthly statutory basis financial statements (balance sheet, statement of income and statement of cash flow), including comparison of actual results to Plan projections; quarterly reports demonstrating reinsurance recoverables and premium receivables past due, in dispute, litigation or arbitration; report demonstrating material credit exposures, related collateral held, and identity of credit impaired transactions; unpaid losses on state-by-state basis; weekly cash flow report; periodic review of loss reserves and amortization of any permitted loss reserve discounting, including appropriate actuarial certification; copies of all internal and external audit reports within five business days of issue; approval of all transactions exceeding pre-determined thresholds; and identification of prohibited transactions.
- G. Corporate Governance: Description of proposed governance and internal controls.

## **D. RELEVANT NAIC MODEL LAWS & REGULATIONS AND STATE STATUTES**

This appendix section provides current and relevant NAIC Model Laws and Regulations, as well as specific state statutes that pertain to an insurance department's authority and responsibilities in dealing with troubled insurers. The sections are not intended to be all-inclusive, but rather a reference source.

### **1. NAIC MODEL LAWS & REGULATIONS**

- Administrative Supervision Model Act
- Insurers Receivership Model Act
- Model Regulation to Define Standards and Commissioners' Authority for Companies Deemed to be in a Hazardous Financial Condition
- Criminal Sanctions for Failure to Report Impairment Model Bill

### **2. RULES AND REGULATIONS OF THE STATE OF NEW YORK – TITLE 11 INSURANCE DEPARTMENT – CHAPTER IV FINANCIAL CONDITION OF INSURER AND REPORTS TO SUPERINTENDENT – SUBCHAPTER D REINSURANCE – PART 128 COMMUTATION OF REINSURANCE AGREEMENTS (REGULATION 141)**

(Text is current through February 15, 2008.)

Section 128.0. Purpose.

Section 1321 of the Insurance Law authorizes the Superintendent of Insurance to permit an impaired or insolvent domestic insurer or an impaired or insolvent United States branch of an alien insurer entered through this state to commute reinsurance agreements as a means of eliminating such an impairment or insolvency. This Part sets forth applicable standards that the superintendent will use in determining whether such commutations will be approved.

Section 128.1. Applicability.

This Part shall be applicable to any domestic insurer or United States branch of an alien insurer entered through this state, other than a life insurance company as defined in section 107(a)(28) of the Insurance Law.

Section 128.3. General provisions.

- (a) Nothing in this Part shall require the superintendent to give prior consideration to a plan which contains the commutation of reinsurance agreements in lieu of taking any other action against an impaired or insolvent insurer in accordance with the Insurance Law, including proceeding against such insurer pursuant to article 74 of the Insurance Law.
- (b) All the terms and conditions of any plan which contains the commutation of reinsurance agreements are subject to approval by the superintendent and no such plan will be approved by the superintendent unless the effect of the plan shall eliminate the insurer's impairment or insolvency and restore the insurer's surplus to policyholders to the greater of the minimum amount required to be maintained pursuant to the applicable provisions of the Insurance Law or to the amount the superintendent determines is adequate in relation to the insurer's outstanding liabilities or financial needs. The determination regarding the adequacy of the insurer's surplus to policyholders shall be made in accordance with the factors set forth in section 1104(c) of the Insurance Law.

Section 128.4. Requirements.

- (a) Any plan submitted by an impaired or insolvent insurer which contains the commutation of reinsurance agreements shall provide that:
  - (1) the offer to commute reinsurance agreements is made to each and every ceding insurer to which the impaired or insolvent insurer has obligations;
  - (2) the terms of the commutation agreement to be offered to each and every ceding insurer are the same, except that the percentage by which the impaired or insolvent insurer proposes to discount obligations due to each ceding insurer may vary in regard to the type of business being commuted. Any variance by type

of business shall be reasonable, actuarially sound and supported by documentation justifying such a variance; and

- (3) the impaired or insolvent insurer agrees to enter into a stipulation with the superintendent consenting to an order of rehabilitation or liquidation in the event that the implementation of the plan by the insurer does not result in restoring the insurer's surplus to policyholders to the minimum required as determined in accordance with section 128.3(b) of this Part.
- (b) Any plan submitted by an impaired or insolvent insurer which contains the commutation of reinsurance agreements shall include:
- (1) a balance sheet that reflects the insurer's impairment or insolvency as determined by the superintendent, a pro forma balance sheet reflecting the financial condition of such insurer subsequent to the effective date of the plan, and a reconciliation between both balance sheets;
  - (2) an exhibit setting forth the obligations due to each and every ceding insurer as of the proposed effective date of such plan and the consideration to be offered each and every ceding insurer for the commutation of such obligations. The obligations shall be classified in accordance with the categories contained in the definition set forth in section 128.2(c) of this Part; and
  - (3) details regarding any retrocessionaire's participation in the plan.

#### Section 128.5. Procedures.

- (a) Any plan which contains the commutation of reinsurance agreements shall be submitted to the superintendent by the impaired or insolvent insurer within a period designated by the superintendent, which shall not be more than 90 days from the determination of the insurer's impairment or insolvency.
- (b) If the superintendent has no objection to any of the plan's terms and conditions and determines that the impaired or insolvent insurer's surplus to policyholders will be restored to the minimum required as determined in accordance with section 128.3(b) of this Part, the proposed plan shall be approved and the insurer shall offer the commutation proposals to its ceding insurers. No commutation agreement shall become effective and no consideration for any commutation agreement shall be paid by the impaired or insolvent insurer until the superintendent determines that, as a result of the commutation proposals agreed to and executed by the ceding insurers, along with the effect of any other components of the plan, the impaired or insolvent insurer's surplus to policyholders is restored to the minimum required.
- (c) Within 10 days after the superintendent approves the plan, the impaired or insolvent insurer shall deliver the proposed commutation agreements to each ceding insurer. The terms of any commutation agreement shall not be subject to negotiation between the impaired or insolvent insurer and the ceding insurer.
- (d) The impaired or insolvent insurer shall submit to the superintendent, within a designated period as determined by the superintendent, copies of the executed commutation agreements from those ceding insurers agreeing to the proposed terms, copies of rejections of the commutation agreements by those ceding insurers not agreeing to the proposed terms and copies of any other correspondence pertaining to all such offers made to the ceding insurers. This submission shall include a balance sheet that reflects the effect of the executed agreements, together with any other components of the plan, upon the insurer's impairment or insolvency as determined by the superintendent. The insurer shall also submit copies of executed agreements with any retrocessionaires which either modify, commute or assign any retrocession agreement.
- (e) If the superintendent determines that, as a result of the executed commutation agreements submitted by the impaired or insolvent insurer, together with any other components of the plan, the insurer's surplus to policyholders is restored to the minimum required as determined in accordance with section 128.3(b) of this Part, the executed commutation agreements shall become effective.
- (f) If the superintendent determines that, as a result of the executed commutation agreements submitted by the impaired or insolvent insurer, together with any other components of the plan, the insurer's surplus to policyholders is not restored to the minimum required as determined in accordance with section 128.3(b) of this Part, the superintendent may proceed against the insurer in accordance with the stipulation executed pursuant to section 128.4(a)(3) of this Part.

#### Section 128.6. Reporting requirements.

Any impaired or insolvent insurer which eliminates such impairment or insolvency using commutations approved by the superintendent in accordance with the provisions of this Part shall exclude all historical data pertaining to such commutations from the loss development schedules contained in future financial statements filed in

accordance with applicable provisions of the Insurance Law. The historical data pertaining to the business commuted shall be reported on a supplemental loss development schedule in a form consistent with the schedule contained in statutory financial statements as filed with this department. The supplemental schedule shall show the aggregate experience of such business as of the effective date of commutation agreement.

### **3. RHODE ISLAND STATUTE AND REGULATION – VOLUNTARY RESTRUCTURING OF SOLVENT INSURERS TITLE 27 CHAPTER 14.5 AND REGULATION 68**

§ 27-14.5-2 Jurisdiction, venue, and court orders.

- (a) The court considering applications brought under this chapter shall have the same jurisdiction as a court under chapter 14.3 of this title.
- (b) Venue for all court proceedings under this chapter shall lie in the superior court for the county of Providence.
- (c) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this chapter. No provision of this chapter providing for the raising of an issue by a party in interest shall be construed to preclude the court from, on its own motion, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

§ 27-14.5-3 Notice.

- (a) Wherever in this chapter notice is required, the applicant shall, within ten (10) days of the event triggering the requirement, cause transmittal of the notice:
  - (1) By first class mail and facsimile to the insurance regulator in each jurisdiction in which the applicant is doing business;
  - (2) By first class mail to all guarantee associations;
  - (3) Pursuant to the notice provisions of reinsurance agreements or, where an agreement has no provision for notice, by first class mail to all reinsures of the applicant;
  - (4) By first class mail to all insurance agents or insurance producers of the applicant;
  - (5) By first class mail to all persons known or reasonably expected to have claims against the applicant including all policyholders, at their last known address as indicated by the records of the applicant;
  - (6) By first class mail to federal, state, and local government agencies and instrumentalities as their interests may arise; and
  - (7) By publication in a newspaper of general circulation in the state in which the applicant has its principal place of business and in any other locations that the court overseeing the proceeding deems appropriate.
- (b) If notice is given in accordance with this section, any orders under this chapter shall be conclusive with respect to all claimants and policyholders, whether or not they received notice.
- (c) Where this chapter requires that the applicant provide notice but the commissioner has been named receiver of the applicant, the commissioner shall provide the required notice.

§ 27-14.5-4 Commutation plans.

- (a) *Application.* Any commercial run-off insurer may apply to the court for an order implementing a commutation plan.
  - (1) The applicant shall give notice of the application and proposed commutation plan.
  - (2) All creditors shall be given the opportunity to vote on the plan.
  - (3) All creditors, assumption policyholders, reinsurers, and guaranty associations shall be provided with access to the same information relating to the proposed plan and shall be given the opportunity to file comments or objections with the court.
  - (4) Approval of a commutation plan requires consent of:
    - (i) fifty percent (50%) of each class of creditors; and
    - (ii) the holders of seventy-five percent (75%) in value of the liabilities owed to each class of creditors.
- (1) The court shall enter an implementation order if:
  - (i) the plan is approved under subdivision (b)(4) of this section; and
  - (ii) the court determines that implementation of the commutation plan would not materially adversely affect either the interests of objecting creditors or the interests of assumption policyholders.
- (2) The implementation order shall:
  - (i) Order implementation of the commutation plan;



- (ii) Subject to any limitations in the commutation plan, enjoin all litigation in all jurisdictions between the applicant and creditors other than with the leave of the court;
- (iii) Require all creditors to submit information requested by the bar date specified in the plan;
- (iv) Require that upon a noticed application, the applicant obtain court approval before making any payments to creditors other than, to the extent permitted under the commutation plan, payments in the ordinary course of business, this approval to be based upon a showing that the applicant's assets exceed the payments required under the terms of the commutation plan as determined based upon the information submitted by creditors under paragraph (iii) of this subdivision;
- (v) Release the applicant of all obligations to its creditors upon payment of the amounts specified in the commutation plan;
- (vi) Require quarterly reports from the applicant to the court and commissioner regarding progress in implementing the plan; and
- (vii) Be binding upon the applicant and upon all creditors and owners of the applicant, whether or not a particular creditor or owner is affected by the commutation plan or has accepted it or has filed any information on or before the bar date, and whether or not a creditor or owner ultimately receives any payments under the plan.

(3) The applicant shall give notice of entry of the order.

(1) Upon completion of the commutation plan, the applicant shall advise the court.

(2) The court shall then enter an order that:

- (i) Is effective upon filing with the court proof that the applicant has provided notice of entry of the order;
- (ii) Transfers those liabilities subject to an assumption reinsurance agreement to the assumption reinsurer, thereby notating the original policy by substituting the assumption reinsurer for the applicant and releasing the applicant of any liability relating to the transferred liabilities;
- (iii) Assigns each assumption reinsurer the benefit of reinsurance on transferred liabilities, except that the assignment shall only be effective upon the consent of the reinsurer if either:
  - (A) The reinsurance contract requires that consent; or
  - (B) The consent would otherwise be required under applicable law; and
- (iv) Either:
  - (A) The applicant be discharged from the proceeding without any liabilities; or
  - (B) The applicant be dissolved.

(3) The applicant shall provide notice of entry of the order.

*(e) Reinsurance.* Nothing in this chapter shall be construed as authorizing the applicant, or any other entity, to compel payment from a reinsurer on the basis of estimated incurred but not reported losses or loss expenses, or case reserves for unpaid losses and loss expenses.

*(f) Modifications to plan.* After provision of notice and an opportunity to object, and upon a showing that some material factor in approving the plan has changed, the court may modify or change a commutation plan, except that upon entry of an order under subdivision (d)(2) of this section, there shall be no recourse against the applicant's owners absent a showing of fraud.

- (1) The commissioner and guaranty funds shall have the right to intervene in any and all proceedings under this section; provided, that notwithstanding any provision of title 27, any action taken by a commercial run-off insurer to restructure pursuant to chapter 14.5, including the formation or re-activation of an insurance company for the sole purpose of entering into a voluntary restructuring shall not affect the guaranty fund coverage existing on the business of such commercial run-off insurer prior to the taking of such action.
- (2) If, at any time, the conditions for placing an insurer in rehabilitation or liquidation specified in chapter 14.3 of this title exist, the commissioner may request and, upon a proper showing, the court shall order that the commissioner be named statutory receiver of the applicant.
- (3) If no implementation order has been entered, then upon being named receiver, the commissioner may request, and if requested, the court shall order, that the proceeding under this chapter be converted to a rehabilitation or liquidation pursuant to chapter 14.3 of this title. If an implementation order has already been entered, then the court may order a conversion upon a showing that some material factor in approving the original order has changed.

- (4) The commissioner, any creditor, or the court on its own motion may move to have the commissioner named as receiver. The court may enter such an order only upon finding either that one or more grounds for rehabilitation or liquidation specified in chapter 14.3 of this title exist or that the applicant has materially failed to follow the commutation plan or any other court instructions.
- (5) Unless and until the commissioner is named receiver, the board of directors or other controlling body of the applicant shall remain in control of the applicant.

RI Regulation 68 – [www.dbr.state.ri.us/documents/rules/insurance/InsuranceRegulation68.pdf](http://www.dbr.state.ri.us/documents/rules/insurance/InsuranceRegulation68.pdf)

#### Section 2 *Purpose*

The purpose of this Regulation is to outline the procedural requirements for insurance companies applying for the implementation of a Commutation Plan pursuant to R.I. Gen. Laws § 27-14.5-1, *et seq.* and related matters.

#### **4. PART VII OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FSMA)**

[www.opsi.gov.uk/acts/acts2000/ukpga\\_20000008\\_en\\_1](http://www.opsi.gov.uk/acts/acts2000/ukpga_20000008_en_1)

<http://fsahandbook.info/FSA/html/handbook/SUP/18>

<http://fsahandbook.info/FSA/html/handbook/PRIN>

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National Association of Insurance Commissioners

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