

PROJECT HISTORY - 2019

GUIDELINE FOR STAY ON TERMINATION OF NETTING AGREEMENTS AND QUALIFIED FINANCIAL CONTRACTS (#1556)

1. Description of the Project, Issues Addressed, etc.

In 2017 the Board of Governors of the Federal Reserve System (the Federal Reserve), the Federal Deposit Insurance Corporation (the FDIC) and the Office of the Comptroller of the Currency (the OCC) each adopted final rules and accompanying interpretive guidance (Final Rules) setting forth limitations to be placed on parties to certain financial contracts exercising insolvency-related default rights against their counterparties that have been designated as a global systemically important banking organization (GSIB).¹ The Final Rules include the definition of master netting agreement that allows netting even though termination of the transaction in the event of an insolvency may be subject to a “stay” under several defined resolution regimes including Title II of Dodd Frank, the FDIA, as well as comparable foreign resolution regimes.

Notwithstanding NAIC’s request for inclusion through a formal comment letter and subsequent discussions, stays under the state insurance receivership regime (State Receivership Stays) were not included as an exemption within the definition. Therefore, unless the Final Rules are amended to recognize State Receivership Stays, if a state implements a stay as contemplated by the *Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts* (Guideline #1556), insurers would find themselves disadvantaged, potentially resulting in additional costs and/or collateral requirements given the regulatory treatment for contracts that do not meet requirements for qualified financial contracts (QFCs).

On Dec. 2, 2017, the Receivership and Insolvency (E) Task Force received a referral from the Financial Stability (EX) Task Force that included three tasks, one of which was to “evaluate whether there are any current misalignments between federal and state laws that could be an obstacle to achieving effective and orderly recovery and resolutions for U.S. insurance groups (e.g., federal rule recognizing importance of temporary stays on the termination of master netting agreements for QFCs that does not recognize the utility and import of state-based stays in state receivership proceedings).

The RITF assigned the task of evaluating these issues to a drafting group, who evaluated the impact of the federal rule recognizing temporary stays on terminating master netting agreements for QFCs. The regulators held discussions with federal banking authorities regarding the handling of QFCs in banking resolutions to assess the utility of a stay on terminations in insurance receiverships.

To address the conflict with the federal rule, the drafting group proposed amendments to the drafting note of Guideline #1556 explaining the above issue. Therefore, if a state is considering implementation of Guideline #1556, consideration should be given to whether the rules of the Federal Reserve, FDIC and OCC have been amended to recognize State Receivership Stays. For example, a state could adopt a stay that would be effective if and when the Final Rules recognize State Receivership Stays.

2. Name of Group Responsible for Drafting the Guideline and States Participating

The Receivership and Insolvency (E) Task Force is responsible for Guideline #1556. The 2019 members of the Task Force are: Texas (Chair); District of Columbia (Co-Vice Chair), Alaska, American Samoa, Arkansas, California, Colorado, Connecticut, Florida, Illinois, Iowa, Kansas, Kentucky, Louisiana, Massachusetts, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Carolina, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Virginia, and Washington.

The amendments to Guideline #1556 were drafted by the Task Force’s drafting group. The drafting group was comprised of Texas (Lead), Colorado, Connecticut, District of Columbia, Illinois, Massachusetts, Michigan, New Jersey, New Mexico, Pennsylvania, Washington, and Wisconsin.

¹ *Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 FR 42882 (13 November 2017), available at <https://www.federalregister.gov/d/2017-19053>; *Restrictions on Qualified Financial Contracts of Certain FDIC Supervised Institutions*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 FR 50228 (30 October 2017), available at <https://www.federalregister.gov/d/2017-21951>; *Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions*; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definition, 82 FR 61443 (28 December 2017), available at <https://www.federalregister.gov/d/2017-27971>; *Mandatory Contractual Stay Requirements for Qualified Financial Contracts*, 82 FR 56630 (29 November 2017), available at <https://www.federalregister.gov/d/2017-25529>.

3. Project Authorized by What Charge and Date First Given to the Group

The Receivership and Insolvency (E) Task Force is charged with addressing any issues that affect receivership laws, including amendments to models and guidelines. The request to address misalignments with federal rules was first considered by the Task Force on March 25, 2018, at the NAIC 2018 Spring National Meeting, when a work plan to address the Financial Stability (EX) Task Force’s referral and formation of drafting groups were discussed.

4. A General Description of the Drafting Process and Due Process

The drafting group of the Receivership and Insolvency (E) Task Force discussed the proposed amendments on a conference call on March 14, 2019, which included twenty interested parties.

The Receivership and Insolvency (E) Task Force discussed the proposed amendments in open session on April 7, 2019, at the NAIC Spring National Meeting. The Task Force exposed the proposed amendments for a 30-day public comment period ending May 7, 2019. One comment was received supporting the need for Federal rule changes. No changes were made to the Guideline #1556.

The Receivership and Insolvency (E) Task Force adopted the amendments on Aug. 4, 2019, at the NAIC Summer National Meeting.

The Financial Condition (E) Committee adopted the amendments on October 31, 2019.

The NAIC Executive (EX) Committee and Plenary adopted the amendments on [DATE TBD].

5. A Discussion of the Significant Issues

None.

6. Any Other Important Information

None.

PROJECT HISTORY - 2013

GUIDELINE FOR STAY ON TERMINATION OF NETTING AGREEMENTS AND QUALIFIED FINANCIAL CONTRACTS (#1556)

1. Description of the Project, Issues Addressed, etc.

In 2011, the Receivership and Insolvency (E) Task Force (Task Force) recognized that the current economic environment had changed since the *Insurer Receivership Model Act* (#555) (commonly referred to as IRMA) Section 711 was revised in 2005. The Task Force began a research project to assess IRMA Section 711 with respect to the impact on receiverships of any netting agreement or qualified financial contract (QFC). The urgency of such research increased with the requirement under the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to shift standardized derivatives contracts to centralized clearinghouses. The implications of IRMA Section 711 are to: (1) allow immediate netting of offsetting positions between counterparties; and (2) immediate access to collateral pledged against the netted position. The IRMA Section 711 (E) Subgroup was formed in 2011 by the Task Force and charged to:

- Provide Task Force members with a better understanding of the purpose, operational mechanics and implications of *Insurer Receivership Model Act* (#555) (commonly referred to as IRMA) Section 711.
- Assist Task Force members in understanding any policy issues associated with IRMA Section 711 *or* with the absence of IRMA Section 711.
- Provide receivership-focused input on regulatory issues associated with qualified financial contracts.

In 2012, the Subgroup conducted its research of IRMA Section 711, which included surveys to regulators and interested parties on research topics and presentations from industry experts on: (1) the use, regulation and reporting of QFCs, such as derivatives; (2) technical interpretation of the language in IRMA Section 711; and (3) non-insurance insolvencies (i.e., banking) under Section 711-like provisions.

During the Subgroup's research, it determined that state receivership and insolvency laws may permit a contractual right to cause the termination, liquidation, acceleration or closeout of obligations with respect to any netting agreement or QFC with an insurer because of the insolvency, financial condition or default of the insurer, or the commencement of a formal delinquency proceeding. These laws are based upon similar provisions contained in the federal bankruptcy code and the Federal Deposit Insurance Act (FDIA). The Subgroup noted that the FDIA also provides for a 24-hour stay to allow for the transfer of QFCs by the receiver to another entity, rather than permitting the immediate termination and netting of the QFC [12 U.S.C. § 1821(e)(9)–(12)]. Currently, state laws do not include a similar 24-hour stay provision.

Included in the recommendations from the Subgroup's research was that the states that permit the termination and netting of QFCs might want to consider adopting a stay provision similar to the FDIA with respect to the termination of a netting agreement or QFC of an insurer in insolvency. The stay provision would give the receiver 24 hours to transfer a contract before termination.

2. Name of Group Responsible for Drafting the Model and States Participating

The Receivership and Insolvency (E) Task Force was charged by the Financial Condition (E) Committee with drafting a new model guideline. The Task Force delegated the drafting of the guideline to the IRMA Section 711 (E) Subgroup. The 2012 members of the IRMA Section 711 (E) Subgroup that drafted the model guideline were: Illinois (Chair), California, Delaware, Florida, Ohio and Texas. The Subgroup was renamed in November 2012 to the Federal Home Loan Bank Legislation (E) Subgroup. Indiana and Missouri joined the Subgroup in 2013. The eight-member Subgroup adopted the model guideline Feb. 8, 2013.

3. Project Authorized by What Charge and Date First Given to the Group

On a May 7, 2012, conference call vote, the Financial Condition (E) Committee unanimously agreed to request that the Receivership and Insolvency (E) Task Force develop a model guideline for the purpose of recommending to NAIC-member jurisdictions that the 24-hour stay provision be included when the state implements IRMA Section 711. On a May 14, 2012, e-vote, the Receivership and Insolvency (E) Task Force delegated the drafting of the model guideline to the IRMA Section 711 (E) Subgroup.

4. A General Description of the Drafting Process and Due Process

- The stay provision was discussed on open conference calls of the Subgroup held Jan. 26, 2012, and Feb. 27, 2012.
- The Subgroup made recommendations as a result of its research, including a recommendation to draft the model guideline. The recommendations were exposed for public comment from Feb. 14, 2012, until Feb. 23, 2012. One comment letter was received from the industry indicating support for the Subgroup's recommendations.
- The stay provision was discussed on an open conference call of Financial Condition (E) Committee held May 7, 2012, during which the Committee approved the recommendation to draft a model guideline.
- An open conference call of the Subgroup was held Dec. 10, 2012, to discuss the draft.
- The draft model guideline was released for public comment from Dec. 10, 2012, until Jan. 24, 2013. No comments were received.
- An open conference call of the Subgroup was held Feb. 8, 2013, where the Subgroup adopted the model guideline.
- The Receivership and Insolvency (E) Task Force and the Financial Condition (E) Committee adopted the model guideline at the Spring National Meeting during meetings held April 7, 2013, and April 8, 2013, respectively.

5. A Discussion of the Significant Issues

The following topics of the model guideline were discussed with regulators and interested parties:

Uniformity with Federal Law

The Subgroup noted that the FDIA provides for a 24-hour stay to allow for the transfer of QFCs by the receiver to another entity rather than permitting the immediate termination and netting of the QFC [12 U.S.C. § 1821(e)(9)–(12)].

6. Any Other Important Information

None.