



# US Options for Accelerated Closure of Legacy Liabilities

## Casualty Actuarial Society – September 2015

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# Agenda



- Putting run off into perspective
- Closure options available to solvent insurers and reinsurers in run off
- Available UK/BDA/US exit strategy alternatives
- NAIC White Paper: Alternative Mechanisms for Troubled Companies
- New York Regulation 141
- The Vermont Statute: Insurance Business Transfer Act
- Final Report of the Special Task Force on Insurance Company Run-Off and Reorganization, Connecticut
- The Rhode Island Statute
- Background to GTE REinsurance Company
- The Commutation Plan – Outline, Development, Reserve Allocation Methodology and Timeline
- Post Decision Events and Plan Benefits
- Statutory and Regulatory Amendments

# Putting Run Off into Perspective



- Run off is a substantial segment of the US and Global insurance markets
  - Steadily gaining visibility and focus from regulators, rating agencies, shareholders and counterparties
- Ultimate size of the run off market is unknown
  - US reserves in run off have been estimated between \$150 and \$200 billion
  - Approximately 500 US companies are in receivership and over 400 are in solvent run off
  - PwC has estimated the size of European run off to be €242 billion

# Closure options available to solvent insurers and reinsurers in run off



- Options are limited
  - Solvent run off to expiry
  - Accelerated run off through accelerated commutation
  - Sale to a third party
  - Reinsurance protection/Portfolio transfer
  - Plan of administration/scheme of arrangement/commutation plan
  - NY Regulation 141

# Available UK/BDA exit strategy alternatives



- Closure through scheme of arrangement
  - An agreement between the insurer and its creditors
  - Insurer pays 100% of the net present value of the agreed claim amount
  - Orderly and equitable distribution of liabilities
  - Eliminates prospective liabilities
  - Encourages cedent/policyholder participation
  - Treats open and contingent (IBNR) claims separately
- Part VII Transfer of Liabilities
  - Allows for court approval of the transfer of legal obligation for the risk
  - Based upon actuarial assessment of liability
  - Not available in Bermuda

# Available US exit alternatives



- Limited
  - Run off to expiry
  - Accelerated commutation followed by sale or reinsurance
  - Sale
  - Reinsurance/loss portfolio transfer
  - NY Regulation 141
  - Rhode Island Commutation Plan
  - Vermont's quasi – Part VII type of transfer
- Issues
  - Erosion of value through ongoing run off (expense) or sale (discount to net asset value)
  - Limited capital extraction opportunities
  - Potential for regulatory intervention for financially challenged entities

# NAIC White Paper: Alternative Mechanisms for Troubled Companies



- Provides guidance to state insurance regulators and is intended to be an advisory resource
- Discusses approaches and concepts that are available within and outside the United States to assist regulators with assessing possible alternatives for handling troubled insurers
- It includes discussions on various alternative mechanisms for troubled companies; observations and considerations before using alternative mechanisms; advantages and disadvantages of the various types of alternative mechanisms

# NAIC White Paper: Alternative Mechanisms for Troubled Companies



- The types of alternative mechanisms are:
  - Run-Off troubled insurer
  - New York Regulation 141
  - Rhode Island Statute and Regulation for Voluntary Restructuring of Solvent Insurers
  - UK-Like Solvent Schemes of Arrangements.
    - Chapter 15 of the US Bankruptcy Code may be used to assist with a scheme arrangement in the United States.
  - Part VII Portfolio Transfers



# New York Regulation 141: Commutation of Reinsurance Agreements



- A provision of New York Insurance law that enables an impaired domestic insurer or an impaired US branch of an alien insurer to commute its assumed reinsurance arrangements with a view to eliminating its impairment
- Applicable only to insurers identified as impaired in order to rectify the impairment
- Not applicable to unimpaired insurers seeking to exit the market or seeking to bring finality to a book of business
- The Superintendent of Insurance monitors the process

# New York Regulation 141 Procedure



- Impaired insurer submits a plan to the Superintendent of Insurance setting out how its impairment will be removed through commutation of its assumed reinsurance agreements
- Submitted with the plan is a set of financial statements detailing the insurer's impairment and how the plan will rectify that impairment, along with full details of ceded reinsurers' participation in the plan
- Once the Superintendent has agreed the plan, commutation proposals are submitted to all the ceding companies for agreement without further negotiation
- Copies of cedents' agreements and rejections of the proposals are then passed to the Superintendent who determines, based upon the level of uptake of the commutation proposals, whether the company's surplus will be restored to the required minimum
- If the Superintendent is satisfied that the Company's surplus will be adequately restored by the agreed commutations, then those executed commutation agreements become effective
- If not, then it is open to the Superintendent to impose supervisory proceedings over the insurer and the executed commutation agreements will not become effective

# The Vermont Statute: Insurance Business Transfer Act



- The purpose of the act is to facilitate and streamline the process for transfers of commercial insurance policies and reinsurance agreements between solvent insurance companies
- The chapter does not apply to any transfer of a policy or reinsurance agreement if all parties with an interest in the policies and reinsurance agreements being transferred have approved the transfer and the transfer is otherwise permitted under applicable law
- Does not apply to captive insurers
- Has an opt out provision for policyholders that do not want their insurance transferred from the issuing entity

# The Vermont Procedure



- A transferring insurer and assuming company file an insurance business transfer plan (“plan”) to the commissioner and pay the required fee
- The commissioner determines which information in the filed plan qualifies for confidential treatment
- Within 10 days the commissioner informs the transferring insurer and assuming insurer whether notice shall be provided to all relevant parties. If granted, the period of notice is 30 days
- Comment period: comments on the plan from any party shall received and addressed
- Hearing on the plan shall be held no later than 60 days after the comment period
- Commissioner shall then review the insurance transfer plan considering: solvency, compliance of the assuming insurer and fairness of the plan to all parties
- Within 30 days of the date the hearing is held on the plan, the commissioner shall issue an order approving or disapproving the plan

# Connecticut Special Task Force on Insurance Company Run-Off and Reorganization



- Formed to study the need for laws regulating run-off companies and the feasibility of establishing such laws
- Report Recommendations:
  - Laws be implemented to regulate the conduct of all run-offs
  - More regulation oversight should be afforded marginally solvent run-off companies than substantially solvent run-off companies
  - The law should provide protection to commuting creditors against preference avoidance in a subsequent liquidation proceeding
  - The Insurance Department should have the right to insist on at least a threshold minimum treatment for policyholders and creditors with small claims to ensure that they are treated fairly
  - Substantially solvent and marginally solvent companies in run-off should have the opportunity to wind up their affairs through a court proceeding

# Connecticut Special Task Force on Insurance Company Run-Off and Reorganization



- Report Conclusions:
  - Anticipated increase in the number of companies in run-off
  - Regulation involvement should differ depending on:
    - Financial Strength of a company (i.e. whether substantially solvent or marginally solvent)
    - Strategy employed in bringing finality to the run-off
  - Disclosure requirements should be imposed when a company plans to undertake a commutation of a substantial portion of its outstanding liabilities

# The Rhode Island Statute



- “Voluntary Restructuring of Solvent Insurers” – Chapter 27–14.5 applies only to commercial carriers domiciled in Rhode Island
  - Workers compensation and personal risks are excluded
  - Allows for termination of liabilities, elimination of ongoing expense and extraction of capital in limited time
- Applicable only to entire company not a separate portfolio unless that portfolio is transferred to an existing or newly capitalized Rhode Island carrier
- Requires prior regulatory review
- Court monitored process
- Must receive assent of 50% or more of creditors by number, representing 75% or more by value of those voting in person or by proxy

# GTE REinsurance Company



- Formed in Bermuda in 1976
- Wrote owner related and non-related assumed reinsurance
- Non-Related Business was written from 1978 to 1989
- Went into run off in 1990
- Moved to Vermont in 1994
- Moved to Rhode Island in June 2010
- Filed Petition to Implement Commutation Plan in June 2010



# Business of GTE Re Subject to Plan



- Only assumed reinsurance
- No direct insurance exposures
- 440 non-commuted cedents
- Company carried reserves for 125 cedents
  - 227 of the 440 cedents were covered by short tail property or catastrophe covers
  - 88 cedents with no reported reserves are covered by casualty contracts
  - 92% of these 88 have had zero reserve balances and no activity for eleven or more years

# Timeline



|   |                    |
|---|--------------------|
| Ascertainment Date                      | December 31, 2009  |
| Claim and Proxy Forms Due               | October 29, 2010   |
| Meeting of Creditors                    | November 30, 2010  |
| Hearing to Approve Commutation Plan     | March 16, 2011     |
| Commutation Plan Effective Date         | April 27, 2011     |
| Final Claims Submission Time            | August 1, 2011     |
| Final Date for Payment of Agreed Claims | September 30, 2011 |

# Composite Reserve Methodology



- A weighted average of:
  - One times the company's IBNR/OSLR Gross Reserve plus five times the Company's Survival Gross Reserve
  - The resulting weighted average figure is discounted for the time value of money
- Survival figure accounts for billings received for the five year period immediately preceding the Ascertainment Date and dividing by five
- The annualized figure was multiplied by 25.7 to come up with the Survival Gross Reserve
- Present value based upon US T Bill Rates

# The Commutation Plan



- Single class of creditors
- Regulator approval and judicial oversight
- Independent Chairman of Meeting of Creditors
- Independent Plan Adjudicator
  - Judicial review of Plan Adjudicator's decisions if disputed
- Composite Reserve calculation allows cedents to receive full value for their claims
- Cedents representing in excess of 87% by number and 97% by value voted in favor of the Commutation Plan
- Plan confirmed by April 25, 2011 decision

# Post Decision Activities



- Objectors filed a timely appeal to the Rhode Island Supreme Court and, thereafter, sought to stay their compliance with claims submission process
  - Court ruled that Objectors had to submit claims by the bar date.
  - GTE RE and Objectors reached agreement as to the value of the Objectors' claims before the bar date
- In December 2011, Objectors filed petition for partial vacatur of the April 25 Decision so that “settlement” could go forward
  - Following January 4 hearing Court granted the partial vacatur motion on January 12, 2012
- Appeal withdrawn on February 6, 2012

# Post Decision Activities



- On March 23 2012 the Court entered an Order indicating that:
  - GTE RE complied with all aspects of the [Court's February 1, 2012 Amended] Implementation Order;
  - GTE RE paid all claims that were properly and timely submitted;
  - GTE RE completed the Commutation Plan and the Commutation Plan is hereby terminated; and
  - GTE RE was discharged from all obligations to all creditors as set forth more completely in paragraphs 6 and 8 to the Implementation Order
- On April 17, 2012, the Court entered an Order terminating the GTE RE Commutation Plan

# Commutation Plan Benefits



- Preserve industry reputation by honoring all presented and agreed policy claims in full
- Avoid prospective adverse reserve development on posted reserves
- Avoid prospective rehabilitation or insolvency of financially impaired entities
- Realize value from reserve redundancy and ceded reinsurance collections
- Eliminate management distraction and expense from legacy liabilities
- Release trapped capital for productive purposes

# 2013 Amendments



- Various sections of Chapter 27-14 were amended in March 2013 to provide for increased:
  - Notice to creditors
  - Transparency of disputed resolution procedures
  - Choice of law provisions



# Notice – Chapter 27–14.5–3



- The notice provision (27–14.5–3) was amended to ensure that the NCIGF and all guaranty associations in all relevant states receive notice of the proposed plan and all events requiring notice
- Applicable regardless of the solvency of the entity proposing the commutation
- Relevant language:
  - (2) By first class mail to the national conference of insurance guaranty funds and all guaranty associations for the states in which the applicant is doing business;

# Dispute Resolution – Chapter 27 – 14.5–4



- The dispute resolution procedures (27–14.5–4) were amended to increase the transparency and due process provisions of the adjudication process
- Ensures that the process is consistent with the provisions of the Federal Arbitration Act (to avoid ambiguity as to the applicable process)
- Relevant language:
  - (d) Applicable law and procedure with respect to dispute resolution procedures.
    - (1) Any dispute resolution procedure in any commutation plan brought by a ceding insurance creditor to challenge the value of its claim assessed in any commutation plan will be consistent with the provisions of title 9, United States code;

# Dispute Resolution – Chapter 27 – 14.5–4



- The dispute resolution procedures (27–14.5–4) were amended to clarify that the law applicable to the effected contracts continue to apply
- Relevant language:
  - (2) The adjudicator and the court, if applicable, hearing any appeal from an adjudication proceeding where the ceding insurance creditor challenges the value of its claim assessed by the applicant in its commutation plan, shall:
    - (i) Not attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract;
    - (ii) Not apply the laws of Rhode Island to reinsurance agreements of ceding insurers not domiciled in Rhode Island unless the reinsurance contract provides that Rhode Island law shall apply;

# Dispute Resolution – Chapter 27 – 14.5–4



- Amendments to the statute ensure that the law of the underlying reinsurance contracts will apply to claim disputes or, if no choice of law provision exists, that the law of the ceding company's domicile applies
- Relevant language:
  - (2) The adjudicator and the court, if applicable, hearing any appeal from an adjudication proceeding where the ceding insurance creditor challenges the value of its claim assessed by the applicant in its commutation plan, shall:
    - • •
    - (iii) Apply the law applicable to the underlying contract between the ceding insurer and the applicant or, if the underlying reinsurance contract has no choice of law provision, the law of the state of domicile of the ceding insurer shall apply

# Insurance Regulation 68 Commutation Plans



- “The purpose of this Regulation is to outline the procedural requirements for insurance companies applying for the implementation of a Commutation Plan. . . .”
- Regulation 68 is required by Chapter 27-14.5-6
  - “The commissioner shall promulgate rules and regulations that may be necessary to effectuate the purposes of this chapter. . . .”

# Amendments to Regulation 68



- Certain portions of Regulation 68 were amended following a public hearing held on May 14, 2014
- General purpose of the amendments is to:
  - Increase transparency of commutation plan activity;
  - Provide guidance to parties effected by a commutation plan;
  - Provide a timeline for creditor objections to a proposed commutation plan; and
  - Clarify the application of letters of credit to a prospective claim relevant to a commutation plan

# Amendments to Procedure



- Section 4C to the Regulation has been amended to reflect the practicalities of DBR review and retention of consultants
- Relevant language:
  1. The Department may engage independent consultants, at the Applicant's expense, as set forth in Section 11(C) below, to assist the Department in its review of the Commutation Plan.
  2. If the Department is unable to complete its review within the sixty (60) days it may extend the time by informing the Applicant of the reason for the extension and providing an estimate of the time necessary to complete the review.
  3. If the Department determines that it cannot support the Commutation Plan as filed, the Applicant will be so informed and given the opportunity to amend the Commutation Plan to satisfy the concerns of the Department or withdraw the Commutation Plan.

# Amendments to Procedure



- Section 5 to the Regulation has been amended simply to to reflect the form and procedure by which an applicant petitions the Court to implement its commutation plan.
- Relevant language:
  - B. The application shall be in the form of a Petition for Implementation of the Plan in the Providence County Superior Court
  - C. Following the filing of the Petition the Applicant may file a motion on the Business Calendar . . . .



# Amendments to Procedure



- Section 6 “Meeting of Creditors” has been amended to indicate when a creditor should object to a commutation plan.
- Relevant language:
  - D. Any Creditor that objects to the Commutation Plan, or any aspect thereof, including but not limited to, the schedule for the Meeting of Creditors or the designation of classes of creditors should file any such objection with the Court and serve any such objection within sixty (60) days of the date the Applicant transmits notice of the Court’s Order setting the date for the Meeting of Creditors

# Amendments to Procedure



- Section 6 “Meeting of Creditors” has been amended to indicate how letters of credit effect the voting procedure at a meeting of creditors.
- Relevant language:
  - 5. i. Account will be taken of any known set off or cross claim in relation to any particular Creditor. However, a Creditor’s claim will not be reduced by the value of any letter of credit or other form of collateral posted by the Applicant to secure its obligation to the Creditor.

# Amendments to Procedure



- Additional amendments address:
- Process following the Meeting of Creditors to either confirm the plan if approved at the Meeting or alternatives if the plan is disapproved at the Meeting (Section 7 (B))
- Fees to be paid by an applicant to the DBR for proceeding with a plan and compensating the DBR's retained advisors. (Section 11)

# 2007 Amendment to the Statute



- Chapter 27–14.5–1 was amended in 2007 to define a “commercial run-off insurer”, in part, as:
- “A Rhode Island domestic insurance company meeting the requirements of subsection (i) hereof and formed or re-activated for the sole purpose of entering into a voluntary restructuring under this chapter and whose liabilities consist of commercial liabilities transferred to said company with the approval of the commissioners and pursuant to the regulations issued by the department under this chapter. The amount of the commercial liabilities transferred must be less than or equal to the amount of assets transferred to the newly formed or re-activated company.”

# Insurance Regulation 68 Commutation Plans



- “The purpose of this Regulation is to outline the procedural requirements for insurance companies applying for the implementation of a Commutation Plan. . . .”
- Regulation 68 is required by Chapter 27-14.5-6
  - “The commissioner shall promulgate rules and regulations that may be necessary to effectuate the purposes of this chapter. . . .”

# 2015 Proposed Amendments



- The proposed amendments to Regulation 68 follows from the 2007 amendment to the Statute
- The proposed amendments set forth the process by which a solvent insurer, domiciled within or outside of Rhode Island (the “Transferring Company”), can novate commercial run off liabilities to an assuming solvent Rhode Island insurer (the “Assuming Company”)
- The liabilities transfer process (the “Insurance Business Transfer Plan”) is subject to regulatory review and approval by both the current domiciliary regulator and the DBR
- Following review and, if appropriate, approval of the Insurance Business Transfer Plan by the DBR, the Assuming Company will seek an order from the Providence County Superior Court (the “Court”) approving the Insurance Business Transfer Plan

# Transfer Process



- Following the domiciliary regulator's approval of the intent to transfer the business, the Assuming Company must submit the Insurance Business Transfer Plan for review, consideration and approval by the DBR
- DBR will be aided in its review by independent experts
- DBR and the Assuming Company will correspond and make changes to the plan as deemed appropriate by the DBR
- Once DBR is satisfied with the format of the plan, it shall notify all persons who have requested notice of insurance issues that the plan has been filed and is available for review upon request
- Any party wishing to comment on the plan or proposed transfer may submit comments within fifteen (15) days of receipt of notice from DBR

# Transfer Process



- Comments will be received and reviewed by DBR before the regulator determines that the plan should proceed to Court for approval
- Once DBR determines that the plan should proceed to the Court for approval, the Assuming Company will file a Petition for Implementation of the Plan
- Assuming Company must notify all effected policyholders within fifteen (15) days from the date the Court issues a scheduling order on the proposed transfer
- Policyholders will have sixty (60) days from the date of the notice to submit their comments to the proposed plan
- After the Assuming Company petitions the Court to find no material adverse impact to policyholders on the to be transferred policies, the Court will hold a hearing on the Petition and any comments submitted before determining the merits of the Petition



# Transfer Process



- If the Court approves the terms of the Insurance Business Transfer Plan, and concludes that there is no material adverse impact on policyholders, reinsureds or claimants, the following will occur:
  - A statutory novation of the Transferring Company's obligations under the effected policies to the Assuming Company
  - A release of the Transferring Company from, and an assumption by the Assuming Company of, all obligations under the effected policies
- If the Court disapproves the Insurance Business Transfer Plan
  - The Petition is dismissed
  - The Assuming Company may be given leave to file an amended Plan

# Insurance Business Transfer Benefits



- Amendment allows owners of active insurers and reinsurers that have legacy liabilities, eligible for closure under the commutation plan process within the active underwriting entity, to transfer those liabilities and related assets to an existing or newly capitalized Rhode Island insurer
- Under the Insurance Business Transfer Plan process policyholders will be as protected, if not more protected, by the security of the Assuming Company, than they were with the Transferring Company
- Amendment provides transparency and due process protections to the portfolio transfer process and effected policyholders and cedents
- Following an approved transfer, the Assuming Company may, but is not obligated to, petition for implementation of a commutation plan