Spotlight to Shine on US Actuaries as Independent Experts

Moderator: Joshua Merck, Deloitte

Panelists: Andy Schallhorn, Oklahoma Insurance Department

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OKLAHOMA INSURANCE DEPARTMENT

CASUALTY LOSS RESERVE SEMINAR

OKLAHOMA’S INSURANCE BUSINESS TRANSFER ACT

Andy Schallhorn
September 15, 2020

Actuaries as Independent Experts – What do we mean?

- Insurance Business Transfer
  - Transfer (Sell) a block of business from one company to another company
  - Purchasing company assumes liability as if business was written by them originally
  - Selling company is released from liability
  - “Independent Expert” required to give opinion regarding effect on policyholders of companies involved in transaction
  - Want that expert to be an actuary

Insurance Business Transfer Act

- Modeled after UK Part VII
- Independent Expert
- All lines of business
- Not limited to runoff
- Commissioner approval & Court approval

Insurance Business Transfer Act

- Novation without affirmative consent
- Assuming insurer treated as if it wrote the policies
- The key is:

Policyholder Protection

OKLAHOMA INSURANCE DEPARTMENT

Policyholder Protection

- Notice and opportunity to be heard
- Two-stage review and approval
  - Commissioners & Court
- The Independent Expert
  - Material adverse impact on policyholders?

Department Considerations

- Business Rationale for IBT
- Any regulatory issues (past or future)
- Competition considerations
- Changes affecting policy/stakeholders
- Objections
- Unresolved issues
- Communication strategy

Notice Requirements

- Chief Insurance Regulator where licensed or has policyholders
- Guarantee associations/funds
- Reinsurers
- Policyholders
- Agents/brokers of subject business
- Publication in newspaper

States With IBTs and Key Distinctions

- Oklahoma
  - No restrictions on-line of business or active v. run-off
  - Policyholders receive notice and opportunity to object, court approval substitutes for policyholder consent
  - $ 10,000 administrative fee, plus Department costs

- Rhode Island
  - Run-off commercial and reinsurance lines (must be in run-off 5 years) eligible
  - Policyholders receive notice and opportunity to object, court approval substitutes for policyholder consent
  - $5,000 administrative fee (with discretion), plus Department costs

- Vermont
  - Limited to commercial non-admitted policies and reinsurance agreements
  - Court approval not required but policyholders can opt out of transfer
  - $30,000 administrative fee, plus Department costs and transfer tax

Alternatives To An IBT

- Run off until the policy obligations expire.
  - May take a very long time with ongoing expenses
- Reinsurance or Loss Portfolio Transfer
  - Insurer ceases book of business and enters into reinsurance treaty where an insurer cedes policies and the loss reserves to pay them to a reinsurer
  - No legal finality and limited transfer of risk.
  - Costly premiums.
- Sale.
  - Only viable when the business is a stand-alone entity.
- Division – AZ, CT, IL, and MI
  - Only within a single state.
  - Permits corporate transaction through which the corporation is divided into two entities, each part retaining the business it originally wrote.
  - Affirmative individual consent from each policyholder is not required.

Alternatives To An IBT (cont’d)

- Novation/Assumption Reinsurance.
  - Expensive.
  - Time-consuming.
  - Requires notice to and consent from all policyholder, who may accept or reject the transfer.
  - Requires approval from transferor and transferee domiciliary regulators.
  - No judicial review or approval required.
- Ten states have adopted some version of the NAIC Assumption Reinsurance Model Act, Colorado, Georgia, Kansas, Maine, Missouri, Nebraska, North Carolina, Oregon, Rhode Island, and Vermont. The Act allows for the transfer and novation of insurance contracts through assumption reinsurance agreements, defined as a contract that transfers insurance obligations or risks of existing or in-force contracts to an assuming insurer and it intended to effect a novation such that the assuming insurer becomes directly liable to policyholders. Virginia also has its own statute that is not based on the NAIC model act.

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The New Frontier of the Runoff Market - Insurance Business Transfers in the US

Casualty Loss Reserve Seminar
September 15, 2020

Prepared by:
Stephen R. DiCenso, FCAS, MAAA

Agenda

Runoff Market - What is it?

Business that is non-core to the group

Claims that last unexpectedly longer than anticipated.

Business that is being wound down and no longer actively underwritten

Portfolio of claims that a company no longer wishes to adjudicate

Carriers or business units closed to new business

Runoff Market in the U.S.

- U.S. runoff market is estimated to be $350 billion in liabilities for non-life insurance, according to a recent study performed by accounting firm PwC.
  - Could be over $1 trillion if include life insurance and long-term care.
- Includes liabilities from:

Insurers | Reinsurers | Captives | Self-Insurers | RRGs | Etc.

Major Players

Berkshire Hathaway Inc.

Arch

ENSTAR

Munich RE

The Hartford

R&Q Commercial Risk Services

Travelers

ARMOUR

RiverStone A FAIRFAX Company

Catalina Holdings (Bermuda) Ltd

Swiss Re

Predominant Lines of Business in the Runoff Market

Types of claims exposures	Mean
Asbestos	41.6%
Workers' Comp	22.8%
Professional lines	12.6%
Accident / health	6.6%
Environmental	4.0%
Product	2.6%
Other latent	1.9%
Construction defect	1.5%
Other	6.3%

From EY/AIRROC(re)insurance runoff survey: In Search of Finality - annual survey

What Does Runoff Entail?

Loss Portfolio Transfer	Novation	Commutation	More traditional exit strategies
Financial reinsurance transaction in which loss obligations that are already incurred and will ultimately be paid are ceded to a reinsurer.	Agreement to replace one party to an insurance policy or reinsurance agreement with another company from the beginning of the coverage period.	Agreement between a reinsurer and a cedant in which payment is exchanged contractually.	Such as a sale, reinsurance.

Current Trends in the United States Runoff Market

Limited Exit Options

- Sale
- Commutation
- Novation
- Reinsurance
- Loss Portfolio Transfer

Company-Driven Issues

- Larger companies entered into reinsurance arrangements with Berkshire Hathaway that aren't available to the general market
- Large amounts of capital are often needed to support run-off portfolios, which can be an obstacle to investors looking for returns

Market-Driven Issues

- Low interest rates
- Pricing pressures
- Specific difficulty with asbestos and environmental claims

Recent Legislation Approved

- Rhode Island Regulation 68
- New York Regulation 141
- Vermont Legacy Insurance Management Act
- Connecticut Divisions Statute

Insurance Business Transfers in the U.S.

Oklahoma passed the Insurance Business Transfer Act effective 11/1/18.

- Other states (RI, NY, VT, CT, IL, GA) have passed similar laws but no transactions have occurred to date.
- Oklahoma act:
  - Applies to life, health, and property-casualty liabilities
  - Open to both runoff and active books of business
  - Has no seasoning (waiting) period as to required age of portfolio

Policyholder safeguards in Oklahoma law:

- Report of Independent Expert
- Communication plan and notice requirements to all policyholders, reinsurers, brokers, guaranty funds
- Regulatory and Court review and approval
- 60-day comment period
- Court hearing opportunity

IBT is modeled after the UK's Part VII Transfer.

Law is designed foremost to provide for policyholder security.

IBT allows one insurance company to novate and transfer insurance policies to another insurance company without policyholder consent and is a legally binding transaction.

Specific Benefits of IBTs

Transferor achieves full and final relief of its policy obligations

- No more worries about credit / counterparty risk

Specialized run-off carrier can handle the business more efficiently and provide better policyholder service

Improved organizational alignment and efficiencies for seller, with enhanced ability to redeploy capital more strategically

IBTs can allow for better pricing of runoff deals, given legal certainties achieved

Allows smaller acquiring companies to compete with larger companies; reduces collateral needs.

Independent Expert

The role of the Independent Expert ("IE") provides insight and perspective on the fairness of the IBT to the regulators and courts that must ultimately approve the IBT. The IE ultimately works for the court and is relied upon to assess the terms of the IBT with a specific focus on protecting interests of the policyholders involved.

Under the Oklahoma IBT law, the companies involved must submit a list of IEs, from which one is selected by the Insurance Commissioner.

The Report of the IE - Scope

Assignment includes review of:

- Adequacy of the transferring and assuming insurers' reserves
- Financial condition of both transferring and assuming insurers, and effect of IBT on financial condition of each company
- Whether proposed IBT has a <u>material, adverse impact</u> on policyholders and claimants of transferring and assuming insurers, including security and level of service
  - Including also non-transferring policyholders that remain
- Plans of assuming insurer for administration of policies subject to the proposed IBT
- Assuming insurers' corporate governance structure to ensure there is proper oversight and expertise to manage the business.
- Likely effects if the IBT is, or is not, implemented and consideration of any alternative arrangements.

Expert testimony may also be required.

Milliman

Independent Expert Report (cont.)

In sum, the IE must consider the likely effects of the IBT on policyholders and claimants, distinguishing between:

- Transferring policyholders and claimants
- Policyholders and claimants of the transferring insurer whose policies will not be transferred
- Policyholders and claimants of the assuming insurer

Communication Plan

The IE must review the IBT application Communication Plan, which must include:

A proposal for plan implementation and administration, including the form of notice to be provided under the IBT to any policyholder whose policy is part of the subject business.

A full description of how such notices shall be provided.

Who is the Fairest of Them All?

While not specifically stated in the IBT act, the IE role seems uniquely suited to actuaries for the following reasons:

Critical issues regarding the review and analysis of capitalization, reserve adequacy, and reinsurance are all items within an actuary's training and mandate.

Actuaries have relevant and deep knowledge of the types of business typically involved in run-off, which tend to be difficult exposures such as asbestos, construction defect, and workers' compensation.

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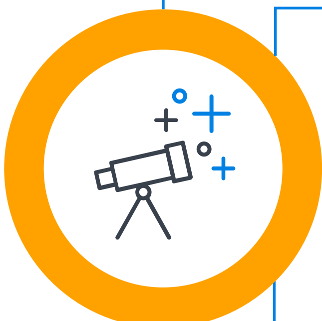
Actuaries have experience in working with insurance regulators in financial matters such as the provision of statutory Statements of Actuarial Opinion, Risk Based Capital (RBC) calculations, and Own Risk and Solvency Assessments (ORSAs), provided annually.

Actuaries are trained to provide expert opinion and testimony, possessing the ability to communicate technical concepts in an understandable form to audiences such as legislators, members of court, and policyholders.

The IE may also rely on information provided by and the judgment of others.

What Does the Future Look Like?



Lots of enthusiasm for IBTs within the runoff community.
- PwC survey of runoff entities indicates that 41% of U.S. respondents plan to use an IBT in the next three years.

Regulators (NAIC) are already very involved and will likely develop guidelines. Some reservations exist within industry.

Once the first deal is approved by the Court, many deals and states with similar laws could follow.

The new laws will all need to be tested, challenged, and approved in court before insurers take full advantage of them.

Actuaries are ideally suited to play the key role of IE, allowing this process to proceed and flourish.

Thank you

Stephen R. DiCenso, FCAS, MAAA
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Realising Value

Enstar Group Limited

CLRS – Benefits of Insurance Business Transfers

September 2020

ENSTARGROUP.COM

Run-off industry

Non-Life Run-off

Market Opportunity: Size of the Market

The non-life legacy market is large and growing.
Global run off liabilities are estimated at $791bn.

NORTH AMERICA

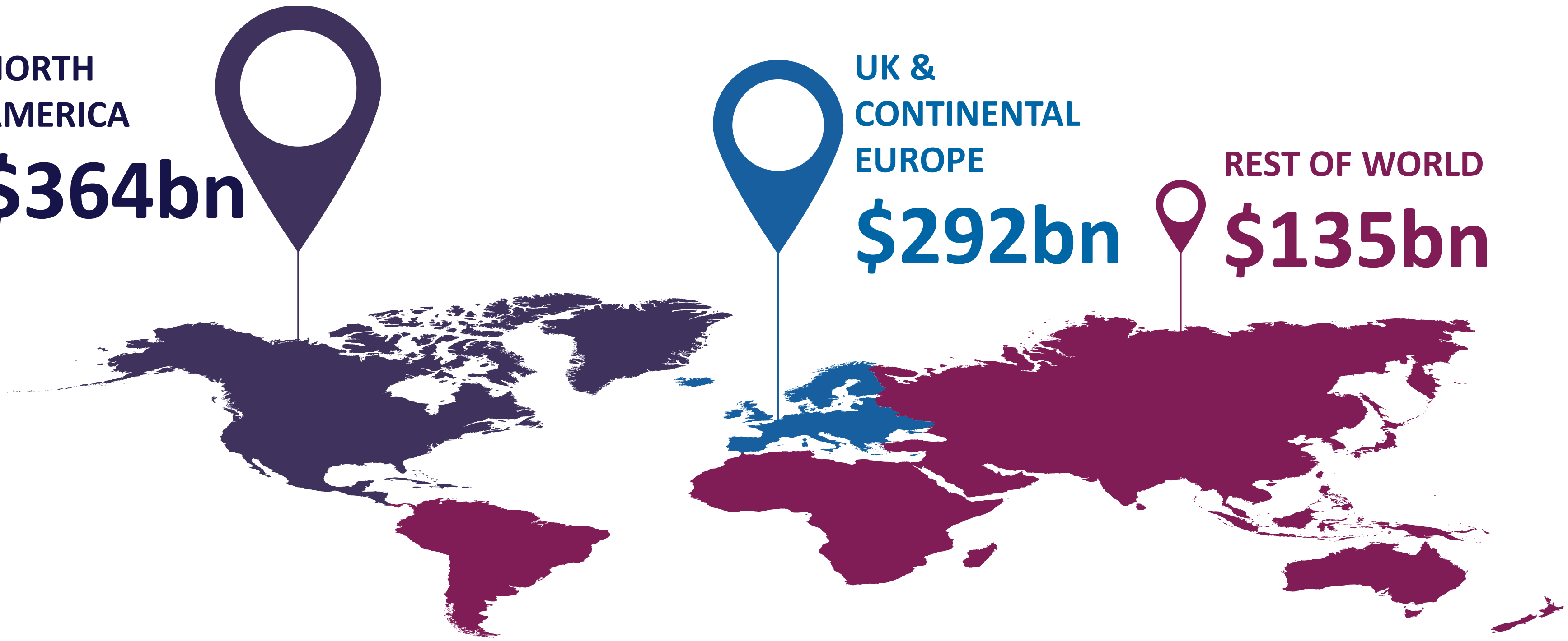
$364bn

UK & CONTINENTAL EUROPE

$292bn

REST OF WORLD

$135bn



Source: Global Insurance Run-Off Survey 2019 performed by PWC, IRLA, AIRROC

An Overview

ENSTAR

Founded in 2001, Enstar is a multi-faceted insurance group that offers innovative capital release solutions and specialty underwriting capabilities.

$21.3bn

Assets
June 30, 2020

$5.2bn

Shareholders' Equity
June 30, 2020

$213.06

Fully Diluted Book Value per Share
June 30, 2020

$15.6bn

Investable Assets [1]
June 30, 2020

$106.5m

Atrium
Gross Premiums Written
Six Months Ended June 30, 2020

22.9%

Debt to Capital Ratio [2]
June 30, 2020

$10.6bn

Total Reserves
June 30, 2020

$281.7m

Net Earnings
Six Months Ended
June 30, 2020

104

Total acquisitive transactions / new business since formation

1 Includes total investments, cash and cash equivalents, restricted cash and cash equivalents and funds held

2 Total capital attributable to Enstar includes Enstar Group Limited shareholders' equity and debt obligations and excludes noncontrolling interest and redeemable noncontrolling interest

Insurance Business Transfer - Oklahoma

Insurance Business Transfer (IBT)

Effective November 1, 2018, the Insurance Business Transfer Act in Oklahoma allows for the transfer of direct liability for insurance policies from one company to another

An insurer can apply to the Oklahoma Insurance Commissioner to transfer policies to an Oklahoma-domiciled insurer with approval of its own domestic regulator

An IBT plan must be filed with the Commissioner that includes a proposal for the transfer of policies, including related reinsurance, and **an opinion report from an independent expert selected by the Commissioner addressing whether policyholders are materially adversely affected by the transfer**

Upon Commissioner approval, **notice is provided to stakeholders identified by statute of a court hearing at which any objections to the transaction will be heard**

Upon court approval of the IBT plan, an order of statutory novation is issued, transferring all rights, obligations, and liabilities with respect to the subject policies to the assuming insurer as if it were the original insurer of such policies

An IBT provides additional safeguards to a policyholder as compared to an acquisition or merger

Regulatory Safeguards
Checks and Balances

Robust procedure of check balances:

- Approval of the Domestic Regulator of the Transferring company
- Regulatory review and approval by the Domestic Regulator of the Assuming company (e.g Oklahoma under its IBT statute)
- Independent Expert Review
- Court Review and approval

Significantly more checks and balances than a standard Form A review

Almost 300 transfer successfully completed in Europe under similar legislation

Regulatory Safeguards
Checks and Balances

Due Process- Extensive Notice Provisions

- Policyholders
- Agents and brokers of record
- State regulators
- State guarantee funds
- Reinsurers

Ability to comment and present evidence to the court at the hearing

Assuming Insurer will be regulated in the same states as the Transferring Insurer under its certificate of authority

Court Hearing
Based on UK Part VII Transfers

At the final hearing, the court will:

check that its directions order has been complied with;

review the report prepared by the independent expert;

consider the views of the Regulators and anyone else that presents themselves;

consider any objections raised by policyholders (such objections may be raised at the hearing directly, by objectors in person or their legal representatives, or to the Transferor or Transferee in advance of the hearing following communications exercise); and

determine whether the proposed transfer is fair as between the different classes of person to be affected by it.

Benefits of IBTs

Professional run-off management has experience, incentive and focus to more efficiently protect the policyholder interests	More efficient use of capital and elimination of unnecessary expenses	Transferring insurer achieves complete finality	Allows for increased competition in the "run-off" market	More protection for policyholders as compared to acquisition or merger

Enstar Experience
PWIC IBT
First IBT in the United States

Enstar
Providence Washington IBT

Transferring Insurer
Providence Washington Insurance Co ("PWIC")

- Rhode Island domicile
- Incorporated 1799, PWIC is oldest insurance company in NE and 3rd oldest in country
- In run-off since 2004
- Wholly owned by Enstar since 2010

Assuming Insurer
Yosemite Insurance Co ("Yosemite")

- Oklahoma domicile
- Wholly owned by Enstar since 2018
- Licensed in all states (and DC) except MA and NY

Both PWC and Yosemite are managed by Enstar (US) Inc. under shared services agreements

Enstar
Providence Washington IBT

Subject Business Being Transferred

- Commercial policies
- Assumed reinsurance
- WC policies

All existing business of PWIC (except as referenced)

Subject Business Not Being Transferred

- Policies where Yosemite is not yet licensed – currently NY and MA business
- Unigard business (100% reinsured by Unigard / QBE)

Enstar
Providence Washington IBT

All PWIC business is currently 100% reinsured by Yosemite

Reserves to be transferred – approx. $160m

- Direct WC
- Other commercial / assumed reinsurance
- Assumed reinsurance of WC blocks

Capitalization

- Yosemite operates at approx. 350 target RBC
- Minimum RBC guaranteed by Enstar Group Ltd

Enstar
Providence Washington IBT

IBT Process

Independent Expert report - complete

Approved by RIDBR and OID – November 26th, 2019

Court process (District Court of Oklahoma County Case No. CJ 2019-6689):

- Scheduling hearing held – December 17th, 2019
- Notice of hearing mailed between January 8th – January 15th to:
  - Policyholders – 60,736
  - Agents and brokers – 122
  - 50 states regulators – 51
  - Guarantee funds – 104
  - Reinsurers – 269
- Publication notice – Wall Street Journal / Providence Journal – January 15th, 2020
- Deadline for filing objections – March 17th, 2020 (extended due to COVID-19 until May 18th, 2020)
- **Final hearing date – May 13th, 2020 (extended due to COVID-19 until October 15th)**

Providence Washington IBT

Further Information and links to key documents

https://www.oid.ok.gov/wp-content/uploads/2020/01/PWIC-YOSEMITE-IBT-Plan.pdf

https://www.oid.ok.gov/wp-content/uploads/2020/01/PWIC-YOSEMITE-IBT-IE-Report.pdf

https://www.oid.ok.gov/wp-content/uploads/2020/01/PWIC-YOSEMITE-IBT-Communications-Plan.pdf

https://www.oid.ok.gov/wp-content/uploads/2020/01/19-0738-IBT-GCA-Order-11-26-19.pdf

https://enstargroup.box.com/v/PwicYosemiteIBT