Legacy Transfers under Rhode Island Reg. 68

Insurance Business Transfers under Rhode Island Regulation 68 may offer insurance companies an additional tool when dealing with legacy liabilities, providing true legal finality in addition to economic protection.

Rhode Island Regulation 68

A Rhode Island Reg. 68 transfer would allow a company to transfer a block of legacy liabilities to a properly licensed Rhode Island-domiciled reinsurer with absolute finality. In effect a Reg. 68 transfer is a court approved novation of the cedant's liabilities under its original insurance contracts to the Rhode Island domiciled reinsurer. Following the transfer, the cedant is relieved of all future liabilities under the transferred policies and the insured's only recourse is to the Rhode Island domiciled reinsurer.

For those familiar with it, Rhode Island Reg. 68 is an attempt to replicate the UK's successful and long-standing Part VII Transfer regime in the U.S.

This degree of finality distinguishes it from retroactive reinsurance transactions such as Loss Portfolio Transfers or Adverse Development Covers. A reinsurance transaction does not extinguish the original insurer's liability and they may be called upon if the reinsurer is unable to pay or if the reinsurance limit is exhausted.

Background

The Rhode Island legislation was originally enacted in 2007 but drew little attention until it was amended in mid-2015 to allow for protected cell structures. In June, 2016 Pro Global, a UK based insurance outsourcing and consulting firm that provides legacy solutions, filed the first application under Reg. 68. Late last month it announced that the license for that new company, ProTucket Insurance, had been received. We are aware of one other legacy solutions company that has an application pending with the state.

How it Works

The business to be transferred must be commercial lines insurance or reinsurance (i.e., any business other than life, workers' compensation and personal lines), must be in a closed book or consist of a "reasonably specified group of policies" and must have a natural expiration more than sixty months prior to filing.

As may be expected, the process for a Reg. 68 transfer is more involved than that for a standard retroactive reinsurance transaction. The requirements for approval under Reg. 68 are quite comprehensive and include:

- Approval of the transfer by the domiciliary state of the cedant
- An expert report on the impact of the transfer on policyholders
- Independent actuarial evaluation of the adequacy of the reserves being transferred and the sufficiency of the assuming company's assets
- Approval by the Rhode Island Department of Insurance
- Notification of all affected policyholders, and
- Review and approval by the Providence County Superior Court

The full text of the Regulation may be found on website of the Insurance Division of the Rhode Island Department of Business Regulation at:

http://www.dbr.state.ri.us/documents/rules/insurance/InsuranceRegulation68.pdf

Who Could Benefit

As discussed above, the expansion of Reg. 68 is fairly recent and the first license was just approved so no actual transfers have occurred to date.

A Reg. 68 transfer could be beneficial to a company seeking absolute finality with respect to qualifying legacy business beyond what was previously available in the market. A Loss Portfolio Transfer with sufficient coverage (or, in theory unlimited coverage) can provide a high degree of *economic* finality but still leaves the cedant with credit risk and the ongoing responsibility of handling claims. The latter can be transferred to a reinsurer along with the economic risk (LPTs with claims handling are not uncommon) but still leaves the cedant with trailing legal liability to its insureds. A Reg. 68 transfer could potentially eliminate *all* risks with respect to the covered business.

It should be noted that the cost to the cedant will increase under each transaction form described above: an LPT with higher limits will cost more than one with lower; transferring claims handling adds an additional layer of cost (think ULAE + a profit margin) as will moving to a Reg. 68 transfer.

A secondary consideration may be that the treatment of a Reg. 68 transfer as a novation rather than a reinsurance transaction would allow for a more favorable accounting treatment under both Statutory and GAAP accounting principles.

Finally, intercompany Reg. 68 transfers *within* a group (rather than to a 3rd party reinsurer) could allow the sequestration of legacy liabilities on a dedicated balance sheet, cleaning-up and improving the capitalization of operating entities.

Conclusion

What are the prospects for Reg. 68? Part VII Transfers are widely used in the UK but not for *all* legacy transactions. Some insurers eschew the extra cost while others may want to transfer economic risk without surrendering claims handling responsibilities.

In the U.S., the system of state-based regulation may also militate against wide-spread use of Reg. 68 transfers. Insurance departments in larger states may object to transfer affecting their resident policyholders and the Rhode Island DOI and Courts may be wary of transferring complex liabilities.

We will continue to monitor developments in this area and look with interest to the first transfer. In the interim we will keep everyone apprised of any developments. Of course if you have any questions or would like to discuss in more detail, please do not hesitate to call.

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