INTERNATIONAL ASSOCIATION OF INSURANCE RECEIVERS
PROMOTING PROFESSIONALISM AND ETHICS

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Chair, Receivership Model Law (E) Working Group ("RMLWG")

RE: Request for Comments on Results of the Survey of States' Receivership Laws

On behalf of the International Association of Insurance Receivers ("IAIR"), this letter responds to your request for input and perspective on results of the states' survey on information relevant to the International Monetary Fund's Financial Sector Assessment Program critical elements of the Insurance Receivership Model Act ("IRMA"). You also requested that comments include recommendations for specific areas of existing state receivership laws and practices that should be improved and enhancements for consistency between states' receivership laws. IAIR appreciates the opportunity to provide this response.

As you are aware, IAIR was founded in 1991 as an association of professionals involved with insurance receiverships and financially stressed or troubled insurers. IAIR's mission includes facilitating the exchange of information concerning the administration and restructuring of such insurers. IAIR's members include experienced insurance receivers (including liquidators and rehabilitators), insurance regulators, life and health and property and casualty guaranty associations, and other professionals (attorneys, accountants, actuaries, information technology experts, etc.) that provide consulting services in rehabilitation and liquidation proceedings.

In making its comments, IAIR was mindful of focusing efforts that might promote consensus in the regulatory responses to financially distressed or insolvent insurance companies, especially those responses that are the subject of current international and federal discussions. The comments that follow are provided after restatement of the survey question for reading perspective.

QUESTIONS

3. Does the state law contain a provision substantially similar to the NAIC Guideline for Implementation of State Orderly Liquidation Authority, or any other provision specifying that a determination under Title II of the Dodd Frank Act is a ground for receivership?

While only seven of thirty-seven responding states indicated that their state law currently contains such a provision, we note that the circumstances leading to a determination under Title II of the Dodd Frank Act (and indeed the fact of the determination itself) may well indicate grounds for receivership of an insurer under current state law. Examples may be found in laws and regulations substantially similar to the NAIC Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition

(Model 385), which exist in thirty-five states, risk based capital statutes and similar statutes permitting or requiring receivership proceedings. New York did not respond to the survey, but we note that among the grounds for receivership in that state is that the insurer has been the subject of an application for the appointment of a receiver, trustee, custodian or sequestrator of the insurer or its property, or if a receiver, trustee, custodian, or sequestrator is appointed by a federal court *or if such appointment is imminent*. NY Ins. Law § 7402(k)(emphasis added).

As we said in our September 18, 2013 comments on the Financial Stability Board's Consultative Document of the Application of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* to non-bank financial institutions:

> As a general matter, we recognize that some insurers – on their own because of their activities or as one part of a systemically significant group of companies – might represent a risk to the global financial system. We also recognize that "traditional" insurance activities are unlikely to cause or amplify systemic risk. Consequently, our view is that the integrity of the insurance promise need not be compromised for some greater good. The highest good is the assurance that policyholders, claimants and beneficiaries are paid in accordance with the terms and conditions of the pertinent insurance contracts. It must always be crystal clear that the Key Attributes apply only in the case of an institution that is so interconnected, because of its "non-traditional, non-insurance" ("NTNI") activities that its resolution in accordance with the Key Attributes and the draft Annex is necessary to mitigate risk to the global financial system. Even where the Key Attributes do apply, the assets supporting the contractual obligations of "traditional" insurance activities must remain available to protect policyholders, claimants and beneficiaries.

In short, there can be no higher good than the indemnification of losses in accordance with contracts under which individuals and businesses have paid to transfer the risk of those losses to an insurance company. As the United States Supreme Court has said the business of insurance[1] is regulated because it is affected with a public interest. In our view, orderly resolution by the FDIC or any other federal authority not charged to protect policyholders, claimants and beneficiaries unnecessarily risks compromising that public interest. Because the Dodd Frank Act mandates exactly the kind of receivership that may compromise the interests of policyholders, claimants and beneficiaries in favor of systemic concerns in the event the state does not act swiftly enough, we support the broad adoption by the states of the NAIC Guideline for Implementation of State Orderly Liquidation Authority.

[1] Regulation of the business of insurance, of course, includes receivership. *United States Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993).

4. **Are non-regulated entities that are operationally related to insurers subject to receivership under insurance laws in your state?**

The insurance insolvency laws apply only to insurance companies. While insurance companies are not eligible debtors under the federal bankruptcy code, the "non-regulated entities" mentioned in this survey question are bankruptcy eligible pursuant to the Federal Bankruptcy Code. The jurisdictional issue raised by the question, however, is less important than is the receiver's access to books, records and services operationally related to the insurer in receivership. Many different types of entities might have an operational relationship to an insurer. Among such entities, including but not limited to, are: managing general agents (MGAs), professional employer organizations (PEOs), third party administrators (TPAs), agents, brokers, reinsurance intermediaries, as well as accounting, actuarial, legal and information technology vendors. Some of these entities are subject to their own regulatory regimes. There may be other entities being operated as a common business enterprise with the insurer.

The receivership goal of assured access need not supplant other regulatory or professional regimes, provided that the insurance regulatory regime is vigorously applied. Consequently, we support broad adoption of the NAIC Managing General Agents Act (Model 225), Model Act on Custodial Agreements and the Use of Clearing Corporations (Model 298), Business Transacted with Producer Controlled Property/Casualty Insurer Act (Model 325), Reinsurance Intermediary Model Act (Model 790) and Registration and Regulation of Third-Party Administrators (Guideline 1090). With respect to arrangements between an insurer and its affiliates, we advocate vigorous regulatory review of transactions subject to review under statutes substantially similar to the NAIC Insurance Holding Company System Regulatory Act (Model 440), especially with a view to the insurer's ownership of books and records and a possible future receiver's need for access to books, records and services. The receivership order should be structured so as to foster cooperation among entities to the end that the estate under the control of the receiver includes all financial assets, books and records of which insurer had the benefit before receivership. Additionally, tailored and targeted injunctive relief may be available from the receivership court, and we recommend that arrangements with entities outside the jurisdiction include appropriate consents and waivers to ensure that such relief will be meaningful.

6. **Are stays and order of receiverships in other states given full faith and credit in your state?**
7. **What conditions, if any, are placed on giving effect to stays and orders of other states? (e.g., are "reciprocal" and "nonreciprocal" states treated differently?)**

<u>6/7 Combined response</u>: Although it appears from the survey responses that the issue of stay reciprocity is closer to complete conformity, recent experiences of IAIR members indicate that there may be some slippage in practice that the survey failed to identify. We also note that even where a statute may seemingly provide for full faith and credit, there are instances where receivers in certain jurisdictions have applied for recognition of the stay but courts have practiced discretion in the enforcement of the stay depending on the court and the parties involved in the action. We specifically note construction defects claims as an example of this

lack of stay recognition. The handling of certain types of claims are hampered by the failure of stays to receive full faith and credit recognition among states resulting in the unnecessary depletion of the insurer's assets and time resources at a critical time in the receivership.

8. Under what circumstances are ancillary receiverships allowed or required?
9. How are assets located in the state handled if there is an ancillary receivership?

8/9 Combined response: Unless mandated by a particular state statute, ancillary receiverships should be considered when necessary for creditor protection and to bring benefit or value to the insolvent estate. If there are significant assets being held in an ancillary jurisdiction, or there is litigation and the court does not recognize the stay ordered by the receivership court, then it may be beneficial to the domiciliary receiver to have an ancillary receivership established in that jurisdiction to marshal and protect the assets, to prevent misuse or dissipation of such assets and to enforce injunctions established by the domiciliary receivership court. Once the ancillary receiver has marshaled the assets in the ancillary jurisdiction, such assets should be turned over to the domiciliary receiver.

When ancillary receiverships are regularly established, even when there are no issues regarding asset collection, assets are unnecessarily used to support the ancillary receivership. If an ancillary is established, it is recommended that an agreement between the ancillary and domiciliary receivers be established to ensure cooperation and protect the primacy of the domiciliary receivership. Such agreements should be approved by the domiciliary receivership court.

In some jurisdictions, the receivership statutes require that claims by residents of an ancillary jurisdiction be filed in their resident state, assuming the insurer was licensed in that state. Statutory or special deposits in such states are used to pay such claims. Some state statutes may provide that such assets are to pay claims of policyholders with no restriction as to the location of such claimants.

The release of deposits by an ancillary regulator to the domiciliary receiver varies from state to state. Such deposits may be released to the ancillary state's guaranty fund, released to the ancillary receiver, or released to the domiciliary receiver. If ancillary claims are less than the deposit released, the excess deposit amount should be promptly turned over to the domiciliary receiver and the ancillary receivership should close. Too often, IAIR members have experienced the released deposit being fully depleted by an ancillary receiver's or guaranty fund's expenses, even when the claims are far less than the deposits. As soon as possible, assets should be turned over to the domiciliary receiver and the ancillary receivership should be closed.

In some circumstances, if an ancillary jurisdiction determines that an admitted, non-resident insurer is insolvent, and the domestic regulator refuses or delays in placing the insolvent insurer in receivership, an ancillary regulator may place such insurer in receivership to protect policyholders, third parties and public from further deterioration.

11. Does the Commissioner have statutory immunity as Receiver?

If the state receivership statutes or insurance laws do not grant statutory immunity when a Commissioner is acting as a Receiver, such immunity should be included in the final Order of Receivership. State insurance laws should be amended to provide that such the statutory immunity be expanded to protect the Insurance Commissioner in his/her capacity as a Receiver.

12. Does immunity extend to contractors or employees of the insurer acting at the Receiver's direction?

While immunity for the receiver is often provided by statute or incorporated in the final court order establishing the receivership as noted above, it is unclear, however, whether the statutory or court ordered immunity extends to the employees of the insolvent estate and/or the independent contractors hired by the receiver to assist in the receivership (for ex. lawyers, accountants, actuaries, investment advisors, technology companies, et al). It should be made clear that in-house employees are protected by statutory immunity. As to outside vendors, it should be a practice that the engagement agreement address these issues, including any limitations on amounts and timing of the immunity being provided. It is recommended that there be conformity among the states regarding statutory immunity for the named Receiver and Deputy Receiver and the in-house receivership staff of the insolvent estate.

13. Can the Receiver depart from the priority scheme in a rehabilitation proceeding?

IAIR appreciates the discretionary power that is necessary to fully evaluate all opportunities and options for rehabilitation of a troubled company. The decision can often be significantly dependent on factors, including but not limited to product mix, asset composition and liquidity, and market impact. Such discretion should include variations from the priority scheme but only after providing justification that the rehabilitation does not place any policyholder in a worse situation than the policyholder would be in if the company were liquidated including guaranty association protection when applicable. It may be necessary to negotiate reasonable accommodations for the claims of other creditors in order to protect policyholders.

14. Under what circumstances is a plan of rehabilitation required? (i.e. Some state's laws require a rehabilitation plan only in certain circumstances, for example if the Rehabilitator proposes to reorganize the insurer (e.g., "old" IRLMA Section 18))

A plan of rehabilitation should be considered after an identification of, and full evaluation of, viable options to ensure full protection of policyholders and other creditors, avoidance of unnecessary diminution of assets, minimization of any harm to the public, and protection of the integrity of the insurance promise.

15. What are the requirements of a rehabilitation plan? (i.e. Some laws may have specific requirements for a plan, such as requiring that the plan contain certain information (e.g., "new" IRMA Section 403)).

IAIR agrees with aspects of the IRMA based requirements for a rehabilitation plan including the requirement that a policyholder should not receive treatment/value under the plan that is less than what would be provided under a liquidation and it must be able to be implemented. We recommend expansion of the insurance company's financial condition component of a plan to contain measurable target financial objectives that are regularly evaluated in order to avoid unnecessarily prolonging a necessary liquidation that is ultimately more expensive. It would also be beneficial to shape the prioritization in the treatment of creditors under the plan similar to a liquidation distribution scheme. Conformity may be achieved for all these aspects through consistency in practice of the existing receivership laws. Adding additional statutory guidance in this area could unintentionally marginalize or eliminate the flexibility and discretion a rehabilitator may require based on the specific facts of a troubled company.

16. **Are there statutory requirements specifying that a creditor should be no worse off in rehabilitation than in liquidation?**

IAIR promotes conformity of practice rather than legislative fixes to avoid unintended consequences. The purpose of rehabilitation is to reform and revitalize the insurer for the benefit of all policyholders, creditors and the general public, A rehabilitator should consider various factors, including, but not limited to the *Carpenter* test, dollar amount of recovery, timeliness of payment and benefits, and the impact on the marketplace.

IAIR also feels the evaluation of the policyholder protections in a rehabilitation versus a liquidation must involve confidential, detailed communications with the guaranty associations, when applicable. This perspective on the viability of the rehabilitation of a troubled insurance company is one of the goals of early involvement of guaranty associations described in the NAIC's 2005 white paper, *Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: An Approach to a National State Based System*. [

17. **Does the Receiver have authority to sell or dissolve the corporate entity or charter of an insurer separate from the claims of its creditors?**
18. **Does the transfer of assets and liabilities require the consent of any creditor?**

17/18 Combined response: IAIR agrees with the majority responses that the Receiver has the authority to transfer assets and liabilities subject to advance disclosure through the filing of an application with the receivership court, notice to all parties on the court's distribution list, the opportunity for parties to file objections, a hearing to address objections, if any, were filed, and final approval of the receivership court. Consent of any creditor is not required so long as the process of notification and opportunity to raise objections is utilized.

21. **Is there an automatic stay upon filing of a receivership**?

Where available, a stay may be entered upon the filing of a receivership but should not be considered as automatic, and should be utilized on a case by case basis upon request of the receiver when the facts warrant it. The length and breadth of the stay may be catered to address the specific facts of a particular receivership at the request of the receiver and subject to the receivership's court approval.

22. Is there an automatic stay upon entry of a receivership order?

The stay should be automatic upon the entry of a Final Order of Receivership by the Receivership Court.

23. Does the stay apply to actions against the insurer?
24. Does the stay apply to actions against the insureds?

<u>23/24 Combined response</u>: Once the final order of receivership is entered the stay should be applicable to the receiver, the receivership estate and the insurer in receivership. We are aware that there are proceedings in which only the insured is named and as a result the court refuses to recognize the stay because the company is not named The stay should be applicable to both insurer and insureds to afford maximum protection of assets and creditors.

25. Are stays imposed in both rehabilitation and liquidation proceedings?
26. Are stays imposed only in liquidation proceedings?

<u>25/26 Combined Response</u>:- IAIR believes it is preferable to have a stay applicable in both rehabilitation and liquidations; however, the length and type of stay may need to be different in rehabilitations than in liquidations. The extent, duration and other aspects of the stay in rehabilitation specifically must be carefully tailored to further the goal of rehabilitation while protecting the assets of the estate.

27. Is there a limitation on the duration of the stay?

There should be a limit imposed on stays, but states may afford shorter or more limited time periods for rehabilitations. Ultimately, the Receiver would need to justify the length of the stay to the receivership court in the case of a rehabilitation. It may be necessary, in some receiverships, to seek additional time to be added to the stay – but such extensions need to be reasonable under the specific circumstances.

28. How is the receivership function organized in your state?

The organizations of the receivership function in each state may be different not only based on the variations in statutes but by the frequency, type and duration of receiverships. Limitations on resources, both financial and personnel, and the organization of the insurance department may also impact how the receivership function is organized. For example, some states have Receivership Departments, separate Receivership bureaus, or outsourcing for the handling of particular estates. Some states use a combination to handle particular receiverships in their states. There should be limited conformity requirements regarding the organization of the receivership function in the statutes in order to recognize the need for flexibility due to the resource limitations from state to state and to promote more focus on governance rather than structure.

29. What requirements and qualification exist for those acting on behalf of the Receiver?

IAIR firmly believes it is time, if not overdue, for the receivership statutes to set forth specific qualifications for an individual to be employed to design, implement and/or administer a resolution plan for a distressed insurer, whether it is a judicial or administrative plan. Ideally, the individual would have to possess a certification and professional designation from a recognized professional organization, such as IAIR, that demonstrates the individual possesses a general knowledge and understanding of insurance, reinsurance, legal and operational aspects of a receivership, guaranty associations and related functions. Such knowledge would be demonstrated through evidence of the successful completion of a rigorous course of study, training and testing program encompassing troubled company resolutions, the functions of guaranty funds and related subjects. The passing of the written examination would provide the verification that the individual possesses that knowledge and can successfully apply it in practical situations. An individual not possessing such a designation would otherwise have to demonstrate equivalent competency to a regulator or statutory receiver. Reference to the IAIR designation program and its content could be used to determine equivalency. In this way qualified individuals would be retained but a charge of being a "closed shop" would be avoided.

Many years ago when the NAIC established the requirement for an annual certification of loss reserves for a property and casualty insurer by a qualified loss reserve specialist, something similar was done. A qualified loss reserve specialist was defined as a member in good standing of the casualty actuarial society or a person deemed qualified by the insurance commissioner as possessing requisite skills and knowledge.

Making the requirements specific as outlined above would improve the resolution system in the United States by eliminating "reinventing the wheel" approach seen too often, improve consistency between the states, curtail disputes, shorten the duration of resolution plans, lower the cost of resolution plans and otherwise improve the resolution system.

30. Is there an internal governance process for the Receiver's office?

In so far as internal governance is part of an adequate control environment, receivers and receivership offices should establish and maintain internal governance processes appropriate to their circumstances. Public confidence in the receivership function may be enhanced to the extent such processes foster accountability and transparency.

31. What reports of the Receiver's activities and expenditures are required?

IAIR agrees that regular, meaningful reporting should be required. The interval for reporting should be such that interested parties and creditors are sufficiently informed but not so frequent as to be excessively burdensome on the receivership. Annual reporting on very active receiverships is inadequate but quarterly reporting for receiverships nearing wind-down or with minimal activities would cause non-beneficial expense. There should be minimum requirements of activities to report with guidance on the purpose and materiality of the report. The governing principal should be transparency of receivership activities.

We thank you for the opportunity to opine in this matter. IAIR would be pleased to respond to any questions on the foregoing and welcomes the opportunity to assist and participate in further discussions.

Respectfully submitted,

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International Association of Insurance Receivers, First Vice President