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Insurance Business Transfer Finality Getting Closer to Reality

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WHAT IS AN INSURANCE BUSINESS TRANSFER IN THE U.S. MARKET?

The "Insurance Business Transfer" or "IBT" is the transfer of insurance liabilities and assets where the original insurer is replaced by the acquiring insurer who assumes the rights and responsibilities of the original insurer, effecting the release of the original insurer of the liabilities.[1] The legal term for a contractual transfer and release is called a "novation". This then means insurers and reinsurers can achieve closure or "finality" in a given legacy insurance book, providing complete financial and operational freedom from any obligations to support a given set of policies or claims, either outstanding or emerging, as those obligations move to the run-off provider.

WHAT IS THE CURRENT STATE OF INSURANCE FINALITY THROUGH IBT IN THE U.S. MARKET?

Today, the states of Oklahoma, Rhode Island and Vermont have made the most headway addressing insurance finality, having passed IBT laws to varying degrees. Other states, primarily Connecticut and Pennsylvania, have corporate division law that provides for the insurer to divide into two separate companies, transferring the legacy insurance business to the new company. These IBT legislative developments show promise as a useful mechanism for dealing with run-off of legacy insurance books. However, there has yet to be an IBT approved and executed in the U.S market. We think that will change.

For some time, U.S. insurers have been anticipating such an option to achieve closure of insurance liabilities once assumed. Emerging IBT legislation in the U.S. is similar to what already exists in the UK in the form of a "Part VII Transfer," which is a court-sanctioned novation that has been available there since 2001, bringing finality to legacy insurance obligations of the transferring insurer/reinsurer. The number of Part VII Transfers since 2001 totals 250, with more to come.

1 *"Insurance Business Transfer" is the defined term in the IBT laws of Oklahoma and Rhode Island: the Insurance Business Transfer Act (Article 16C of the Oklahoma Insurance Code) and the Voluntary Restructuring of Solvent Insurers Act (as implemented by Rhode Island Regulation 68).*

While there are differences between each state's IBT laws, each state's IBT law requires insurance regulatory and judicial review that more specifically calls for:

a. approval of insurance department of the state of domicile of the transferring insurer/reinsurer;
b. a business plan as to the IBT;
c. an expert report on the IBT, including financial review of the acquiring insurer;
d. policyholder notification, and
e. a hearing with the insurance department of the state of domicile of the acquiring insurer/reinsurer.

In Rhode Island, an IBT is only available for property and casualty insurance runoff business at present, as compared to Oklahoma where an IBT has no limitation on the insurance business class. The message for insurers is clear: Current regulations within the U.S. still pose significant legal and business risk given the limiting conditions or simply the novelty of the IBT regulation. In all cases, emerging IBT law attempts to provide safeguards for policyholders associated with any Insurance Business Transfer.

Current regulations within States still pose significant legal and business risk, given the limiting conditions.

WHAT ARE THE ISSUES CHALLENGING THE IBT FROM SERVING AS THE PART VII MECHANISM IN THE U.S.?

Given that an IBT results in a novation of a given insurance business and the finality in that, multiple issues arise as insurers and reinsurers look to IBT as a tool across the U.S. market. The first set of issues are those inherent in the transaction itself – e.g., capital and claims handling. The second set of issues relate to challenges and complications that arise when an IBT triggers transactions across borders, not just state borders but international boundaries too. By far the biggest issue with IBT for now occurs when the Insurance Business Transfer impacts policies across state lines, where one state's commissioner or courts have to align with others. For example, there could be issues with the constitutionality of an IBT if any of the portfolio being transferred was held in a state whose courts or regulatory commission had not sanctioned IBT. Thus many important questions on IBT transactions are still on the table. Some of the open IBT issues involved include:

a. licensing of the transferee insurer/reinsurer;
b. the credit rating of the transferee reinsurer;
c. security of capital for the transferred business.

The nature of insurance regulation and laws in the U.S. market present continued challenges, given the limited adoption of formal IBT law in states like Oklahoma and Rhode Island versus the fact that most portfolio and risk transfers may well cross multiple jurisdictions and state lines where there are no laws or precedent around IBT. Or, what happens if the assuming company then reinsures the transferred business with an offshore entity – what does that require (or not) in the way of collateral from the foreign entity, which may not operate in the jurisdiction in which IBT was initially invoked? As always in insurance runoff, there are many complex issues to be addressed – in the law (and across legal jurisdictions), in the policies as written, and in the claims themselves.

WHY IS IT ALL WORTH IT? (WE THINK IT WILL BE)

It's correct to say that the U.S. market does not really know how regulatory authorities will deal with all of this, even in places like Oklahoma where the stance on IBT is seemingly very open. However, the ultimate benefits to the industry in the U.S. market are significant and long-standing if and when there has been enough interest, dialog, and experimentation with regulators. We believe insurers and re-insurers will eventually get to a point where the core benefits of run-off and the momentum being created to achieve them will push the industry to a tipping point. Insurers and re-insurers will then use run-off more strategically, reliably and safely to release capital, reduce costs associated with managing discontinued operations, and achieve greater focus on live insurance lines and a corporate structure that supports policies and claims that are still being actively underwritten by the insurer.

RiverStone supports mechanisms like IBT to bring certainty and finality to the legacy insurance business. In other non-U.S. jurisdictions, RiverStone has acquired multiple legacy books under Part VII Transfers in the UK delivering legal finality, including the 2018 transfer of the commercial employers' liability and public liability business of AXA Insurance UK plc. If experience is any guide, RiverStone believes it can also offer similar economic transfer and legal finality under the U.S. system. This is a worthy goal for the U.S. market as well, because it gives insurers, shareholders and end claimants a reliable "supply chain" of services and capital to ensure that policies once written are ultimately honored and claims handled, or litigated, as appropriate.

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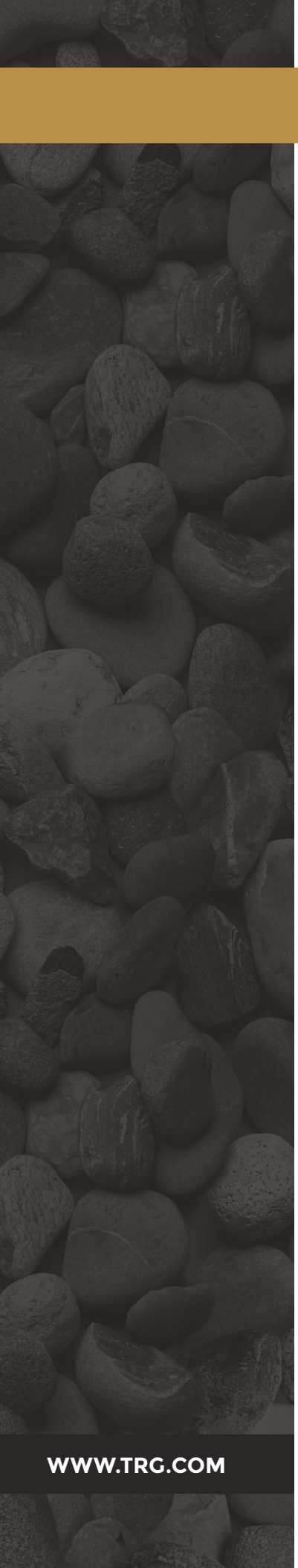

ABOUT RIVERSTONE

RiverStone is a group of insurance, reinsurance, and service companies specializing in the management of legacy and run-off insurance businesses and portfolios. With nearly 500 professionals with deep industry expertise in claims, customer service, litigation, and financial restructuring, we offer creative and varied deal structures to deliver sustainable outcomes you can count on. We lean forward to develop and deliver innovative exit solutions to help shore up capital and meet board-level mandates to help focus an insurer's business. We know that reliability, security, and finality all come from an ability to not only assess the risk up front but to execute the deal at the scale and speed required by the business.

Learn more *here* about our views on due diligence and claims management or visit our website at *www.trg.com*.

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