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CLIENT ALERT

U.S. Insurance Business Transfer and Corporate Division Transactions – Origins and State of Play

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I. Background

In the last decade, U.S. states have enacted laws that provide novel mechanisms for an insurer to transfer policy liabilities to another entity without the need for individual policyholder consents. Two distinct statutory regimes have emerged to facilitate such transactions: insurance business transfer ("IBT") and corporate division laws. State adoptions of such laws have accelerated in recent years.

IBT laws are meant to approximate the effect of UK and European insurance portfolio transfer legislation that is now widely used in those jurisdictions. The Part VII[1] process in the UK involves significant engagement with the relevant insurance regulatory authorities and a court approval process together with various protections for policyholders. This is a rigorous process that can often take months and in some cases over a year before it is complete, but in many cases a reinsurance or loss portfolio agreement is put in place to accelerate the economics of the transaction in the meantime. U.S. IBT laws, beginning in Vermont in 2014 and subsequently broadened in other states, allow an insurer to transfer legal liability of some or all business underwritten to another insurer. Some of these IBT laws seem to have been drawn heavily from such UK/European legislation, but in our view in certain instances the IBT legislation has not always been "translated" correctly,

1 Part VII of the UK Financial Services and Markets Act 2020.

and in any event there are important differences between UK/European insurance regulation and U.S. state regulation that mean you cannot simply "cut and paste" the European/UK laws and have them be effective in the United States.

Division laws provide for a corporate-level reorganization by allowing an insurer to divide into separate companies. A division transaction can be viewed as the reverse of a merger. An insurance company divides itself into two or more resulting companies through a plan of division that allocates assets and liabilities between the resulting companies and the division, like a merger, is effected by operation of law. Division laws have a historical model in Pennsylvania and Arizona, where provisions in the general corporations laws allowed business entities—including insurers—to divide. In 2017, Connecticut was the first state to enact a division law specific to insurance companies, and several other states have followed Connecticut's lead in subsequent years.

We summarize in this alert the current and pending IBT and division laws in U.S. states, insurance regulators' responses to these laws and commercial activity under the laws.

II. Insurance Business Transfers—Current State of Play

IBT laws have been adopted in Vermont (2014), Rhode Island (2016), Oklahoma (2018), Arkansas (2021) and most recently Illinois on June 9, 2023.[2] An IBT law is also pending in Texas.[3] The IBT laws first adopted in Vermont and Rhode Island allow an insurer domiciled in those states to assume from a transferring insurer closed blocks of commercial policies, subject to regulatory and/or court approvals. The Oklahoma IBT law applies more broadly to any insurance blocks, in runoff or open for new business, and property and casualty or life and health policies. The Arkansas law and the pending bill in Texas follow the Oklahoma model, while the law in Illinois is limited to property and casualty business and expressly excludes life, accident and health insurance from an IBT.

The IBT laws require the transferring insurer to file a transfer plan with the insurance commissioner of the state containing specified information and exhibits (such as, depending on the state: a description of the business to be transferred, financial statements of the transferring insurer, evidence of non-objection of the transferring insurer's domiciliary regulator, and an opinion from an independent expert). Following approval by the insurance commissioner, in most states, a state court will hold a hearing on the transfer plan. Upon final approval, a novation of the transferred contracts is effected and the assuming insurer becomes directly liable to the policyholders of the transferring insurer, and the transferring insurer's insurance obligations and risks under the contracts are extinguished.

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2 Vt. Stat. Ann. tit. 8 § 7111 *et seq*.; 230 R.I. Code Regs. § 20-45-6.1 *et seq*.; Okla. Stat. tit. 36, § 1681 *et seq*.; Ark. Code Ann. § 23-69-501 *et seq*.; Ill. Public Act 103-0075 (2023).

3 TX HB4498.

The Oklahoma Insurance Department ("OK ID") has been particularly active in facilitating IBTs under its state law. OK ID maintains a webpage with guidance for companies interested in pursuing an IBT and held a public conference in 2022 regarding IBTs. The Arkansas Insurance Department has also promulgated a regulation setting out application and review procedures for IBTs under the Arkansas law.[4]

To date, we are aware of two successfully completed transactions under IBT laws, both of which took place in Oklahoma. In October 2020, OK ID and the District Court of Oklahoma County (the "District Court") approved an IBT plan submitted by Providence Washington Insurance Company ("Providence"), a Rhode Island insurer and subsidiary of the Enstar Group Limited ("Enstar"), allowing Providence to transfer most of its insurance and reinsurance business to Yosemite Insurance Company, an Oklahoma domestic insurer and Enstar subsidiary. This transaction was the first to take place under a state IBT law. In August 2021, OK ID and the District Court approved the state's second IBT, allowing Sentry Insurance Company to transfer a runoff block of reinsurance business to National Legacy Insurance Company, an Oklahoma domestic insurer, along with $2.9 million in cash consideration. In addition, certain companies have announced steps taken in anticipation of effectuating IBTs. For example, in 2017, a new company named ProTucket was incorporated in Rhode Island pursuant to Rhode Island's IBT law for the purpose of assuming and managing runoff business transferred to it pursuant to IBTs or reinsurance arrangements. In 2022, Applied Underwriters announced the acquisition of a Delaware insurer and redomestication of the company to Oklahoma in anticipation of pursuing IBTs.

III. Corporate Divisions—Current State of Play

Division laws have been adopted in Connecticut (2017), Illinois (2018), Michigan (2018), Iowa (2019), Georgia (2019) and Colorado (2021).[5] Each state's law allows a domestic insurer to divide into two or more insurance companies and allocate assets and liabilities among the resulting insurers, subject to approval of a plan of division by the state insurance regulator. The regulator must be satisfied that interests of policyholders and other stakeholders are adequately protected and the resulting companies will be solvent and have adequate assets to support the liabilities allocated by the division. Following the division, by operation of law, each resulting insurer shall hold the assets allocated to it by the plan of division and is liable only for the policy liabilities allocated to it by the plan of division.

In April 2021, the Illinois Department of Insurance approved the first transaction under an insurance-specific division law,[6] permitting The Allstate Corporation to segregate its Michigan automobile business into eight new companies resulting from the division of eight existing Allstate insurers, which subsequently merged into three separate Allstate insurers that were

4 Ark. Ins. Dep't. Rule 126.

5 Conn. Gen. Stat. § 38a-156r *et seq*.; 215 Ill. Comp. Stat. § 5/35B-1 *et seq*.; Mich. Comp. Laws § 500.5500 *et seq*.; Iowa Code § 521I.1; Ga. Code Ann. § 33-14-120 *et seq*.; Colo. Rev. Stat. § 10-3-1701 *et seq*.

6 In 1996, CIGNA effected a division of an insurance subsidiary to isolate asbestos liabilities. Such division was pursuant to Pennsylvania's general business corporations division law and not an insurance-specific law.

formed and licensed in Illinois and Michigan as part of the transaction. Prior to the transaction, three of the dividing insurers redomiciled to Illinois in anticipation of effectuating a division.

IV. Regulatory Reaction

As states continue to enact and consider IBT and corporate division legislation, the National Association of Insurance Commissioners (the "NAIC") is actively engaging with issues relating to these types of transactions through the development of best practices guidance, as well as a separate but related workstream dedicated to ensuring the continuation of applicable guaranty association coverage for policies that are the subject of a division or IBT. This work is described below, and follows the prior adoption by the National Conference of Insurance Legislators ("NCOIL") of an Insurance Business Transfer Model Act in March 2020 based on Oklahoma's IBT law and the NCOIL Insurer Division Model Act in April 2021 based on Colorado's division law, and the American Council of Life Insurer's 2019 development of Principles and Guidelines on Insurance Business Transfer and Corporate Division Legislation.

A. Development of Best Practices

The NAIC's Restructuring Mechanisms (E) Working Group, formed in 2019,[7] is currently developing best practices for state insurance regulators to use in reviewing divisions and IBTs. The draft best practices state that they are intended as recommended minimum review standards not rising to the level of a model law or regulation, and address topics including: recommended filing requirements; the level of regulatory and/or judicial notice or review required for approving a division or IBT; specific requirements and procedures for independent expert review, particularly with respect to the effects of a division or IBT on reserves and capital; considerations for analyzing the effects of such transactions on policyholders, claimants and other stakeholders; means for ensuring due process and adequate communications to a variety of stakeholders; considerations to allow a reviewing regulator to make a factual determination regarding the continuation of guaranty association coverage or other secondary market benefits; and procedures for any entities in runoff that may result from an IBT or division. The Working Group last met in early May 2023 to discuss regulator and interested party comments on the best practices, which remain in draft form, and intends to further revise the best practices for a subsequent upcoming exposure and public meeting.

The Restructuring Mechanisms (E) Working Group is also tasked with preparing a white paper that will, among other things, summarize existing state restructuring statutes and address the issues restructuring statutes are designed to remedy, legal issues posed by a court order or insurance department approval in one state affecting the policyholders of other states, and the impact that a restructuring might have on guaranty associations and protections.

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7 The membership and charges of the Restructuring Mechanisms (E) Subgroup were merged into the Restructuring Mechanisms (E) Working Group at the 2023 NAIC Spring National Meeting.

During the Working Group's most recent meeting in May 2023, Co-Chair Elizabeth Kelleher Dwyer (RI) explained that the Working Group will prioritize finalizing the best practices, and then turn back to the white paper, which will incorporate the best practices by reference. The Restructuring Mechanisms (E) Working Group is targeting to complete these projects by the end of 2023.

B. Guaranty Association Considerations

A common theme during discussions of the NAIC's projects has been the overall goal of ensuring that guaranty association coverage is not reduced, eliminated or otherwise changed due to a change in insurer resulting from a division or IBT. The National Conference of Insurance Guaranty Funds suggested that technical gaps may exist in states that have adopted the NAIC's *Property and Casualty Insurance Guaranty Association Model Act* ("Model 540"), since a "covered claim" under Model 540 could be read to exclude claims under policies transferred to an insurer that was not a member of the guaranty association at the time the policy was issued or an insured event occurred. As a result, in summer 2022 the NAIC's Receivership Law (E) Working Group undertook a project to amend Model 540. Proposed revisions to Model 540 are currently exposed here for a public comment period ending Friday, June 23, 2023.

While the NAIC considers revisions to Model 540, individual states have passed legislation affecting the continuity of guaranty association coverage. For instance, sections of the California Insurance Code that require all insurers admitted to transact property and casualty insurance in California to be members of the California Insurance Guaranty Association were amended effective January 1, 2021 apparently to ensure that IBT or division transactions do not deprive policyholders and claimants of guaranty association protection to which they would otherwise have been entitled.[8]

Although efforts are underway to remediate issues related to guaranty association coverage arising under corporate division or IBT laws, companies considering pursuing such a transaction should continue to carefully assess applicable guaranty association laws in any state where impacted policies or policyholders are located to determine how coverage could be impacted by the proposed transaction and anticipate potential concerns from regulators or guaranty associations in this regard.

V. Commercial Implications

Prior to the advent of IBT and corporate division laws, insurers' options for selling or segregating a block of business were largely limited to reinsurance (e.g., through loss portfolio transfers or assumption reinsurance). One disadvantage of reinsurance without novation is that it lacks total finality for the block with respect to the ceding insurer, since legal liability to policyholders is retained by the original insurer. Alternatively, the insurer could pursue assumption reinsurance but it

[8] Cal. Ins. Code § 1063.1(c)(15).

requires consent of policyholders and not all policyholders may consent. An acquisition of a stock insurer could be another alternative, but this does not provide a mechanism for selecting and separating only certain blocks of business.

Although their respective structures differ, IBT and corporate division laws both provide finality for the subject business without requiring a sale of the full entity. An IBT allows the insurer to directly novate the subject business to another company, which could be an affiliate or a third party. A division allows the insurer to create a new legal entity containing the subject business, which could be retained as part of the insurance holding company system or could then subsequently be sold to a third party.

The rationale for transferring blocks of business using an IBT or division vary depending on a given insurer's circumstances, and may be driven by internal shifts in business plan or operational structures, or by economic goals such as optimizing use of trapped capital. The appropriate choice of restructuring mechanism for an insurer will be guided by which laws have been adopted by the states of domicile of the relevant insurers and what blocks of business will be covered, although redomestication may allow insurers to seek a suitable regime prior to an IBT or division. Redomestication was used in this manner by Enstar in its first-of-its-kind 2020 IBT under Oklahoma's law, as well as by Allstate in its 2021 division transaction.

Although each corporate division and IBT law offers finality and attractive commercial possibilities for insurers that are not available under traditional mechanisms, it will remain important for any company considering a division or IBT to assess and structure a transaction to withstand potential challenges (such as, in addition to the guaranty fund considerations noted above, constitutional considerations). This is particularly true where a transaction involves business written in multiple states that may not recognize IBTs or divisions under their own laws. Once completed and if embraced by the states, the work of the NAIC described above may offer greater certainty.

There has been a significant amount of discussion and at times "hype" about these evolving legal restructuring and transfer mechanisms, but we are finally seeing some meaningful progress, both with evolution of the legislation and with insurance clients utilizing the legislation or seriously exploring its use. There are still some limitations with the various IBT and corporate division laws, but with the right situation, parties and advisors, they can be effective restructuring and transactional tools for our insurance clients, especially if such legislation and its acceptance in the insurance industry and with regulators continue to evolve.

Should you have any questions regarding this client alert or corporate division and IBT laws generally, please contact the following attorneys or the attorney with whom you regularly work.

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