VIEWPOINT

Acceleration of IBT approvals will transform US legacy market

The scope for US carriers to transfer legacy liabilities has been limited in the past
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It remains to be seen whether the majority of the big states will follow the example set by smaller states and adopt new run-off and legacy solutions


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When it comes to insurance market developments on either side of the Atlantic, there is a common pattern: where one market leads, others tend to follow. Legacy business and run-off solutions are no exception.

Unlike in the UK, where the well-established, much-used Part VII mechanism provided via the Financial Services and Markets Act 2000 has long permitted successful portfolio transfers – more than 275 to date and still counting – the scope for carriers in the US to be able to shed themselves of legacy liabilities that weigh heavy on their balance sheets has been much more restricted. That seems set to change.

Developments over the past few months, which, in turn, build on legislative changes quietly achieved over the past few years, are now introducing more innovative insurance restructuring mechanisms, akin to those in the UK.

These aim to address the historic and significant limitations in methods available to US insurers seeking legal and financial finality on blocks of costly, time-consuming business.

Now more than ever, carriers want to move on from old books of business, shed discontinued lines, get shareholder finality on legacy liabilities, and reactivate and redeploy their capital, especially in a prolonged environment of low interest rates putting added pressure on profitability.

In the wake of Covid-19, carriers have also increased their pursuit of balance sheet solutions for historic and more recent legacy liabilities.

The global pandemic and the commercial challenges it has created, have focused carrier minds more acutely on such liabilities and the need to free up access to cash on their balance sheets.

All this means there is significant pent-up demand – a demand that should now increasingly be met by new state-specific run-off solutions, which are emerging at an accelerating pace.

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Expanding toolkit

It is easy to see why such an expanding legacy toolkit is needed. After all, no company maintains the same strategy for 40 or 50 years, and yet the inability for US carriers to free themselves of discontinued or non-core and non-strategic books of business effectively weds a management team – at least in part – to the decades-old direction and decisions of their predecessors.

So, what's new?

In late August, the District Court of Oklahoma County green-lit the first insurance business transfer (IBT) in the US between two separate, unrelated parties when it approved the transfer of a portfolio of reinsurance business (*see box-out on p5*). This marked another key step forward in the evolution of the US legacy solutions market.

Led by Oklahoma, and echoed in Arkansas, there is now a new breed of broad-scope run-off solutions in town. Following in the footsteps of Oklahoma's 2018 action on IBT, the passage of Arkansas Senate Bill 203 earlier this year meant Arkansas became the

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second US state to allow the blanket transfer, or novation, of insurance business from one company to another, without requiring specific policyholder consent.

The Arkansas Insurance Department has lauded the state's new IBT law, based as it is on Oklahoma's model and the Part VII transfer process in the UK. It highlighted how the provision gave insurance companies with an "organized and efficient process" to transfer blocks of insurance business from any jurisdiction to another insurance company in Arkansas, benefiting insurers that are "seeking to restructure and improve operational efficiency, and ultimately creating a unique business opportunity for Arkansas to attract new business to the state".

Similarly, Oklahoma's insurance commissioner pointed to the latest IBT there as something that could bring new commercial opportunities.

These individual state adoptions of IBT law are also indicative of a wider tide of support.

In May, the National Council of Insurance Legislators – whose strapline is "Sound public policy in 50 states for 50-plus years" – voted to adopt the council's Insurer Division Model Act, another form of restructuring mechanism. In turn this built on the organisation's adoption of the IBT model at its previous spring conference, in March 2020, which was based on Oklahoma's IBT law.

All in all, the most recent examples of legislation represent further evidence of support among US insurance regulators for regulatory and judicial review procedures that allow carriers to shed active as well as discontinued risks from their balance sheets, including such problematic coverage as long-term care and disability.

Growing momentum

The opportunity for carriers is clear. They can explore and take advantage of innovation and new US regulatory mechanisms that can provide finality of balance sheet separation for liabilities that continue to develop adversely over time – not to mention carry high costs in the form of management time as well as balance sheet expense.

These new US run-off and legacy solutions are not only emerging at an accelerating pace. They are also broader in application. Momentum is building on permitting blanket transfers in any class, for live or discontinued business and without needing specific policyholder consent – but instead regulatory and judicial approval, meaning policyholder protection is still assured.

So the potential benefits extend well beyond the insurance businesses themselves.

Greater freedom with capital, and the more efficient allocation of it, could bring benefits to policyholders too, in the form of better product pricing – not to mention the fact that, as National Council of Insurance Legislators puts it, "policyholders also benefit… when insurance businesses are aligned with an insurer's current business strategy and are the current focus of management, shareholders and regulators".

Like a neat, contractual divorce for two parties that no longer want to cohabit and find themselves incompatible, the affected children in an IBT – the policyholders – remain protected and provided for. Not requiring explicit policyholder consent does not mean their rights and needs are discounted.

In fact, to achieve this form of separation, the proposing company must demonstrate, to both the insurance regulator, and the court, that the IBT "would not result in an adverse material impact on the interests of policyholders, contract holders, or reinsurers."

With the April 2021 passage of the Arkansas IBT statute, and its universal application echoing that already seen in Oklahoma – that is to say, covering live as well as discontinued business, life and health as well as property and casualty liabilities – we are witnessing a definite uptick in regulatory acceptance of restructuring mechanisms.

Time will tell whether that regulatory acceptance will extend more broadly throughout the US to really open the legacy deal floodgates in a positive way for carriers. After all, Oklahoma, Arkansas, and Rhode Island are not states with big numbers of domiciled insurance companies – although, as the Arkansas Insurance Department argued, this could well help attract new business into the state.

Nevertheless, with National Council of Insurance Legislators this year building on its 2020 model for IBT with a model for insurer division earlier this year, any other states looking to develop laws in the area of insurance restructuring mechanisms can tap into ready-made, extensive guidance and solid foundations on how to develop and enact their own in upcoming legislative sessions.

As yet, the majority of the big states for insurance companies – with the exception of Illinois – have not pursued the creation of these types of mechanisms. So the big question is whether we will now see the likes of California, New York, Delaware, Florida, Texas, and Pennsylvania climb aboard the IBT train and add their own capital-freeing, balance-sheet lightening, time-saving run-off solutions for their domiciled carriers.■

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The growing range of US run-off solutions

Division Statutes

Six states have now enacted division statutes for their domiciled stock insurers, namely Connecticut, Illinois, Iowa, Georgia, Michigan, and Colorado. Two other states – Arizona and Pennsylvania – have corporate division statutes. As the name suggests, these allow for the division of insurance companies to help ringfence liabilities while remaining part of the same entity. Regulatory approval is needed but not court approval.

Rhode Island

Rhode Island began with an equivalent of the UK's solvent scheme of arrangement in 2002 but statute was expanded in 2007 to allow broadly portfolio transfer. The 2018 amendments to the statute's regulations allow for Part VII type transfers, albeit limited to commercial – not personal – liabilities, that have been in run off for at least five years.

Vermont

In Vermont, Legacy Insurance Management Act enables portfolio transfer but allows affected policyholders to "opt out".

Oklahoma

The first blanket transfer statute was in 2018 enabling the novation of insurance business from one company to another, subject to regulatory and judicial approval but without requiring specific policyholder consent. The enactment of this insurance business transfer (IBT) law in Oklahoma was the first time a US restructuring mechanism was able to offer the full scope of the UK's Part VII transfer, covering as it does life and health insurance as well as casualty, and also available to both active and run-off business.

Enstar 2020

This was the first use of Oklahoma's IBT law to facilitate an internal transfer of mostly workers' comp liabilities between two of its own subsidiaries, Providence Washington Insurance Company and Yosemite Insurance Company.

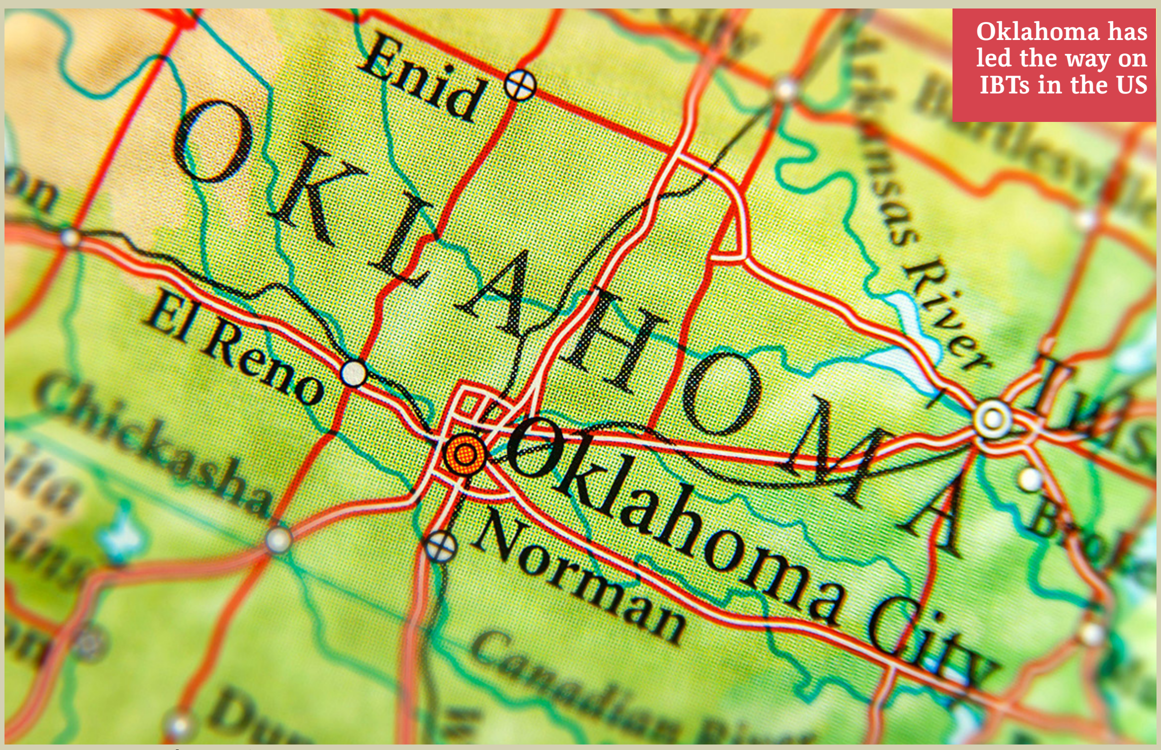
R&Q 2021

The first IBT between two separate, unrelated parties completed in August when the District Court of Oklahoma approved the transfer to a block of reinsurance business underwritten by Sentry Insurance Company to the Oklahoma-domiciled subsidiary of legacy specialist Randall & Quilter Investment Holdings (R&Q), known as National Legacy Insurance Company.

Arkansas

In April 2021, Arkansas became the second US state and latest US regulatory innovation seeking to usher in provisions modelled on the UK's Part VII transfer process. It creates the ability to transfer "property, casualty, life, health and any other line of insurance the commissioner finds is suitable for an insurance business transfer" to another jurisdiction. It is based on the Oklahoma statute and the National Council of Insurance Legislators IBT Model Act approved in March 2020.

As with Oklahoma and Rhode Island, Arkansas' law is predicated upon review and approval from the Arkansas regulator, approval or non-objection by the domiciliary regulator, independent expert review, and court approval. Specific policyholder consent is again not required but parties must demonstrate that the transaction "would not result in an adverse material impact on the interests of policyholders, contract holders, or reinsurers."



Oklahoma has led the way on IBTs in the US

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