Restructuring alternatives: Will new legislation help to bridge the legacy gap?

Financial Examiners Educational Foundation's Insurance Regulation Symposium

Andrew Rothseid[1]
August 2, 2019

Good afternoon. It's great to be in New York with you today.

I have been asked to present an overview of the insurance restructuring landscape. I will attempt to do that in this talk. Naturally, the opinions expressed here are my own and not attributable to any client of RunOff Re.Solve.

So here we are – in New York – in August – to talk about insurance restructuring mechanisms.

If there can be exciting times in the world of insurance restructuring and regulatory reform – these are those exciting times.

Perhaps not as exciting as a walk off home run in baseball, a record breaking tie breaker in the fifth set of the Wimbledon final, an Irishman winning the Open – in Ireland – or watching archival footage of man landing on the moon on the 50th anniversary of that momentous event – but at least for our purposes – at least for today – exciting nonetheless!

[1] ©2019 RunOff Re.Solve LLC. Andrew Rothseid, Principal, RunOff Re.Solve LLC was the advisor to three of the examples referenced here: GTE Reinsurance Company Ltd, in respect of its Rhode Island commutation plan, and the Pennsylvania Insurance Commissioner, in her role as Liquidator of Westmoreland Casualty Company and Rockwood Insurance Company.

I am delighted – especially – to be with you at this hotel – the Warwick.

I spoke here last in 2004. Specifically – on October 28, 2004.

You may ask – "How does he remember the date?"

I remember the date just as I remember August 18, 1967; October 21, 1975; October 2, 1978; and October 25, 1986.

Are there any baseball fans here today?

Are there any Red Sox fans?

Most Red Sox fans of a certain age – those of us who endured decades of disappointment – whose fathers and mothers were fans and who endured decades of disappointment themselves – will know the dates I referenced.

I am like the character played by Jimmy Fallon in the movie Fever Pitch – I have a confession to make – I am a Red Sox fan. I grew up and lived for close to 50 years with one dream in mind – almost – to borrow a phrase from the magical 1967 season – an Impossible Dream. I wanted to see the Red Sox win the World Series once – just once – in my lifetime.

I did on October 27, 2004.

On October 28, 2004 I was chairing a conference at this hotel. The conference began early that day – so early that I had to come to New York the night before and watch the fourth and final game of the 2004 World Series in my hotel room around the corner – my wife and kids on the telephone as the last out was made. As I walked to this hotel early on the 28th, my cell phone kept ringing with congratulatory calls from friends who knew me well – as though I was personally responsible for the Red Sox win.

So how does the Red Sox winning the 2004 World Series – 15 years ago – after an 86-year drought relate to regulatory reform in the insurance sector?

Let's just leave it at this – if the Boston Red Sox could win the World Series in 2004 – an event that no Red Sox fan born after – say 1925 – ever thought would occur in their lifetime – and then see the Red Sox go on to win the World Series again – in 2007, 2013, and 2018. If that can happen – surely there can be regulatory reform in the insurance sector that allows insurance companies to dispose of problematic exposures in an open, transparent, and honorable manner.

Let's get to it and explain how this can happen.

And – if you question why I am referencing the impact of a World Series that occurred 15 years ago – I will remind you that the Rhode Island Voluntary Restructuring Statute became available for use 15 years ago as well with the passage of the initial implementing regulations. The Rhode Island Statute has been used just once since 2004. So – while 15 years may seem a long time – we work in an industry where regulatory reform and industry acceptance of those reforms – take time.

To date regulatory restrictions have limited restructuring alternatives. In the absence of better options, most insurers have simply passed on their difficult liabilities to someone else through sale or reinsurance. But as I will explain – though they remain the default options – sale or reinsurance aren't ideal. Both often come at a cost and reinsurance does not deliver the finality that insurers may ultimately want.

The latest developments in legacy regulation, which include a series of new transfer and division statutes, are therefore quite remarkable. We can move liabilities from state to state, though not necessarily with the express purpose of moving towards finality. We have opportunities to divide live from closed liabilities – taking the legacy liabilities off the books of an active underwriter and into the hands a company focused on dealing with them.

Whether the legislative reforms offer a clean break, and deliver finality, is what we are all trying to work out.

These processes will rightly be the subject of review and scrutiny by policyholders and ceding companies. Legal challenges – raising due process and other constitutional issues – may follow. While legislatures pass and governors sign these acts into law, regulators and financial examiners are the custodians of this legislation. Today's program provides us with an opportunity to review the alternatives, discuss industry reaction and move to an understanding of what options are available, how they are intended to work, and how they might work in application.

We will also look at these new developments within the context of the legislative framework before insurance division and insurance business transfer. There **has** been an option that would actually deliver finality – the Rhode Island Voluntary Restructuring Statute.

Part of this talk will look at how that process has worked, how it has been updated, where it may be the most useful, and why it has only been used once since it became effective in 2004.

Briefly, let's look at why legacy liabilities are a burning issue.

The legacy burden is wholly unsustainable.

Legacy business ties up a vast amount of

- capital
- expense and
- management attention.

All of those are in shorter and shorter supply.

It can be decades before the run off finally expires. And all this time,

- the expense
- distraction and
- reserve deterioration keeps ratcheting up.

This deadweight of legacy is holding back investment in

- technology and
- innovation

Providing insurers with pragmatic and transparent regulatory structures that allow the underlying obligations to be honored and free up the money set aside for administration and reserve deterioration – will benefit all stakeholders.

Claims – eligible for assessment – can be assessed, agreed, and paid with greater speed and efficiency. For eligibility, consider – at least in the first instance – claims between sophisticated reinsurers and their sophisticated ceding companies.

In other words, fully knowledgeable parties.

Regulators and examiners will see the financial positions of domiciliary carriers improved as the values for these legacy risks are determined.

The public – including policyholders and institutional shareholders – will have renewed confidence in the insurance industry's ability to quantify and honor its policy obligations.

So, if we had the opportunity to design a utopian regulatory regime what might a fair and workable framework for resolving these issues look like?

Let's assume that insurers have legacy liabilities scattered around multiple separate active legal entities domiciled in multiple US states.

The first thing they may want to be able to do is aggregate and consolidate these scattered portfolios. At the very least, they may want to consolidate similar exposures from separate balance sheets onto distinct platforms. That would make it more efficient to manage the risks – or dispose of them if that was their desire.

Concentration and scale are certainly at the heart of the current consolidator model.

To allow insurers to consolidate various portfolios, you would ideally want an effective state to state transfer mechanism. This would include <u>explicit recognition among the states</u> of the regulatory and judicial effect of the various solutions.

Question – which we can address later – can that happen in a state based regulatory environment?

You'd also want a mechanism that would allow insurers to separate discontinued from live business. That would enable active underwriting platforms to focus on active business without the drag of legacy. It would also enable insurers to take legacy liabilities off their active balance sheet. In this way, they could be managed separately and effectively, or they could be positioned for sale or closure.

The solutions proposed would have to fit the right books of business. Moreover, you would want to have policyholder or cedent protection through prior notice and review – and regulatory and judicial review – with established, transparent standards that would clarify the process.

Finally, you'd want a mechanism that allowed the insurer to accelerate closure of an eligible portfolio. Legal and financial finality for all of the interested parties.

The utopian concept could be a model law – derived through deliberation at the NAIC and adopted throughout all jurisdictions.

Legacy is too complex to be tied down to a one-size-fits-all solution. Cutting across all this is the need for flexibility and, most importantly, transparency and due process.

For instance, a commutation plan – similar to the solvent scheme – and as adopted in Rhode Island – might be the desired solution for some. Others, however, might just want aggregation, consolidation, and management toward eventual expiration.

I'm going to bring in the UK model here.

With the Part VII transfer process and Scheme of Arrangement the UK comes closest to this flexible, and well-functioning regime. Two separate mechanisms derived under two distinct regulatory authorities – the Financial Services Act and the Companies Act.

Part VII allows for transfer, aggregation, and consolidation. Full closure through a Scheme is then open to either the subject portfolio or an entire legal entity. Although regulatory and market acceptance of the solvent scheme is currently in remission, closure isn't required for Part VII portfolio transfer to occur.

Through Part VII, business that's no longer part of future business plans – live as well as discontinued – can be separated – ready for sale or closure.

So, if the ability to separate live from discontinued business and effective paths to finality are the ideals, how far are we from this in the US?

To date other than the isolated successes of GTE RE and a few insolvent carriers – concerted efforts to tackle the legacy burden – to achieve true legal and financial finality – haven't got off the ground.

Regulation is by no means the only barrier. A combination of market inertia and lack of management focus is also in play. But if we look at this in the round, the US has a big and damaging legacy gap.

The barriers come from many sources:

- State based regulation;
- The US tort system;
- A lack of clarity regarding acceptance of the solutions from other jurisdictions;
- The multiline nature of property and casualty exposure;
- An active receivership and liquidation community;
- The inherent problems associated with problematic lines of business – consider long term care and disability covers; and
- Lack of broad-based industry support for finality.

Some states do offer options that would enable insurers to separate their liabilities and move towards closure. Yet an awful lot don't. And it has been difficult to transfer business to states where the options are available.

So, what are the most favorable jurisdictions – or perhaps stated more plainly – which states have developed regulatory mechanisms to address these issues?

Those of you who may have heard me speak before – or who receive my email blasts – will know that Rhode Island stands out.

The Rhode Island commutation plan process allows a company to crystallize its commercial insurance obligations as at a date certain, accelerate the termination of its (re)insurance obligations and pay creditors 100% of the net present value for their agreed claims.

All with counter party notice and involvement as well as complete regulatory and judicial review.

A clean break – true legal and financial finality.

The eligibility criteria are rightly restricted to knowledgeable parties. So, no direct personal lines insurance or workers compensation – only commercial liabilities – are eligible. But a huge amount of assumed reinsurance is covered. Unlike the Scheme of Arrangement, the Rhode Island Commutation Plan applies only to whole companies domiciled in Rhode Island with the eligible liabilities – not to individual lines of eligible business that reside within Rhode Island domiciled insurers.

Amendments to the Statute in 2007 – and to the implementing regulations in 2015 – greatly increased the scope of the process. Crucially, these allow insurers to transfer eligible business to Rhode Island to pave the way for commutation.

But there has only been one commutation plan so far – GTE RE in 2011 – and no business transfers since the implementing regulations were amended four years ago in 2015. Why is that? Do insurers balk at what they see – rightly or wrongly – as an off-putting daunting process filled with execution and reputational risk along with frictional cost?

Not sure I would agree but this appears to be the current voice of the market.

Other state-sanctioned options include the Vermont Legacy Insurance Management Act. The Vermont statute – LIMA – allows an insurer – not admitted in Vermont – to transfer closed blocks of business to a special-purpose corporate entity, domiciled in Vermont. This new entity need not be an insurer.

By allowing for the transfer of some policies between solvent insurance companies the Vermont statute has been compared – perhaps overoptimistically – to the UK Part VII Transfer process.

However, the Vermont statute has its limitations. Chief among these is that it only applies to excess and surplus lines carriers.

It's also solely a novation process. There is no regulatory mechanism to extinguish legacy liabilities.

Policyholders can opt out of the plan much as they can under the Assumption Reinsurance Model Act. Therefore, no legal and financial finality.

The assuming company need not be an insurer – simply a corporate entity.

Regulatory compliance is required only to the Vermont regulator. No NAIC statements are required.

The options for insolvent business are similarly limited. Guaranty associations take on the applicable liabilities of the insolvent estate. But the liabilities can sit on the books – of the insolvent entity and the guaranty associations – for decades. Ironically, we are discussing this topic in New York – where Union

Indemnity, Ideal Mutual, and Midland have been in liquidation – respectively – since 1985, 1985, and 1986.

There are few regulatory tools to close insolvent estates. The important exception is the inherent power of the regulator, as liquidator, to affect the swift and orderly termination of the insolvent estate.

The Insurance Receivership Model Act – IRMA – does offer limited openings for accelerating closure. Similar to a solvent scheme or commutation plan, it allows an insolvent estate to crystalize its obligations to its creditors – normally the state guaranty associations.

It's then possible to cede those crystallized and determined amounts to the estate's reinsurers. But IRMA has been adopted – in full – only in Texas and Utah plus a few more states in partial form.

Even where IRMA does apply, progress can be difficult in the face of complications over valuation, notification, and the treatment of reinsurance.

However, closure processes modeled on IRMA – in a non-IRMA state – have met with success.

In 2016 and 2017, Westmoreland Casualty and Rockwood Insurance – two twenty plus year old Pennsylvania domiciled insolvencies – crystallized their obligations to their remaining creditors – the guaranty associations covering the liabilities.

As we know, closure has always been tricky where the claims handled by guaranty associations involve workers' compensation injuries. Medical payments to the individual claimants can carry on for decades. The prolonged costs of running the insolvent insurer reduce the amount of funds that are available for final distribution. The win-win would ensure that medical fees are fully covered while the continued administrative expenses of the liquidation are eliminated.

The regulatory options are limited. However, though the use of provisions similar to those available in IRMA, the case reserve values of unliquidated claims can be – and in these Pennsylvania cases were – established.

This paved the way for agreed settlement between the estates and the guaranty associations. Westmoreland and Rockwood each petitioned the court overseeing their liquidations to rule that these determined amounts represented the liquidator's full and final obligations to the remaining creditors – the guaranty associations.

The court agreed and entered the requested orders.

This is indeed a win-win. Compensation claimants have guaranteed support for life. In turn, the insolvent insurer can avoid continued administrative expense and have more funds available for final distribution.

I should also mention New York Regulation 141**.** This process allows an insolvent or financially troubled New York-domiciled reinsurer to self-rehabilitate by commuting its obligations to all of its counterparties on identical terms.

If these are the legislative openings, what are insurers actually doing? Have they been taking advantage of the range of options on offer?

Until recently, with no Part VII process, and a limited number of viable candidates for commutation plans, sale or reinsurance continue to be the default options for legacy in the US.

And sale or reinsurance are the defaults despite the success of GTE RE or the introduction of the portfolio transfer or – as it is known in Rhode Island and Oklahoma – the insurance business transfer – or IBT process.

Yet, these default mechanisms come at a cost and – with the exception of a sale of a legal entity – do not provide finality for the issuing insurer. As we know – adverse development covers and loss portfolio transfers are reinsurance products and, thus, purely an indemnity obligation. The issuing carrier remains ultimately liable for the policyholder or cedent obligations.

Sale eliminates the balance sheet impact – but the obligation remains – albeit on someone else's balance sheet.

Consolidators' appetite for legacy acquisitions are in some cases leading to sales prices in excess of net asset value. Consequently, the acquisition price may not reflect anything like the value of the assets. That's because it needs to take future adverse loss development into account. There also needs to be a significant allowance for continued administrative expense.

Time will tell if the higher prices paid for legacy result in profit for the consolidators, and their investors.

Similarly, reinsurance – while it provides balance sheet relief – can erode value. This is because the transfer price – for that read "reinsurance premium" – needs to be high enough to reflect adverse claims development. The funds that are left to be extracted can therefore be limited.

So, what are the developments we've seen recently and why are they creating such as buzz? (We should also consider who is generating the buzz? Is it the market, regulators, or service providers looking for business opportunities?)

There appears to be a greater willingness to explore options that would aid companies or consolidators in their efforts to separate problematic exposures from core business.

Moreover – many run off consolidators are funded by asset aggregators or asset managers.

Run off does not correlate to general financial market activity. The opportunity to manage large pools of assets is attractive in most cases – more attractive than accelerating finality through accelerated payment.

In the case of Rhode Island, amendment was also needed to clarify regulatory language and market focus. I'll talk about this later.

Just as significant is the competition between states to attract run off business. Some states see legacy as a valuable job creation opportunity, though that has yet to be proven. State regulators and legislatures have also been the focus of intense lobbying from service companies.

If we look at the individual legislation, the Oklahoma Business Transfer Act (effective November 1, 2018) and the 2018 Rhode Island House Bill 8163 – amending certain provisions of the Rhode Island Statute – Voluntary Restructuring of Solvent Insurers – could have the biggest impact. This is because they each offer what is the closest so far to a Part VII-style transfer.

Oklahoma is a good place to start – its legislation is the most closely modelled on the UK Part VII. It allows companies to shed active and discontinued business from their balance sheets to Oklahoma-domiciled entities.

This includes such problematic coverage as long-term care and disability – coverages where the industry is eager – almost desperate – for a viable solution. Yet it remains to be seen if the eagerness for a solution will result in industry support of the IBT for long term care or long-term disability which effect large numbers of individual policyholders.

With home state and Oklahoma regulatory approval, companies from other states can transfer their business into a host company in Oklahoma. This may be a protected cell company established in line with the Oklahoma state legislation.

Again – reinsurance is likely to play a key role in securing approval. It enables the assuming company to increase protection for its policyholders.

Unlike Vermont, or even Rhode Island, the definition of eligible business for the Oklahoma process is quite broad. This includes property, casualty, life, health, and long-term care, accident, surety, title, and annuity business.

As mentioned – the transfer – which "will effect a novation of the transferred contracts" is subject to regulatory and court approval. This should be supported by an independent expert report.

The statute ensures that policyholders have an opportunity for review and consultation. But they have no power of veto. Nor do they have the opt out they have in Vermont or under the Assumption Reinsurance Model Act.

It's up to the Oklahoma court to deem whether the transfer would have a materially adverse impact on the interests of policyholders or claimants. If not, the Insurance Business Transfer should be authorized.

Key advantages of an Oklahoma transfer include being able to package up the portfolio for sale or management on a separate balance sheet. Active business can go forward without the burden of the transferred portfolio.

On top of savings in management time, the group gains more freedom in allocating capital. Further benefits include making it easier to place the business in a new entity. This would not only take it off the balance sheet, but also increase the scope for consolidation.

On paper, Rhode Island House Bill 8163 – amending certain provisions of the Rhode Island Statute – has the potential to be even more ground-breaking. This is because the entity into which liabilities are transferred no longer has to be set up or reactivated "for the sole purpose of effecting a voluntary restructuring under this chapter".

It thus gives insurers the flexibility to transfer business, without requiring that they move forward with a commutation plan. However, finality through a commutation plan remains an option along with sale, reinsurance or, simply, continued management.

The new legislation allows for the use of protected cell entities in voluntary restructuring activities. This would avoid the intermingling of assets and liabilities from distinct parties – especially where a service provider controls the protected cell structure.

The amendment also expands the definition of 'voluntary restructuring'. This would make it possible to use the Rhode Island process for what the legislation explicitly states are "enhancing organization and maximizing efficiencies".

So why the changes to the Rhode Island Statute?

Let me provide a bit of background.

The Rhode Island Statute was amended in 2007 to address a market reality. That reality was that:

- The Statute applies only to commercial – not personal insurance liabilities;
- The Statute requires that the entire company – not a portfolio of business – must be eligible for a commutation plan;
- Most US insurers write multiline policies – most often mixing personal lines coverage (such as workers compensation liabilities) with commercial general liability;
- There are few entire legal entities in run off that wrote only assumed reinsurance – the class of business most suitable for a commutation plan;
- The majority of legacy liabilities that exist in the US are not in entire legal entities in run off but, rather, on the balance sheets of active underwriting entities;
- As of 2007, there were no entire legal entities in run off – domiciled in Rhode Island – containing only eligible commercial lines covers. (To the best of my knowledge – there are no such Rhode Island domiciled carriers today.)

As a result, the Statute was updated in 2007 to amend the definition of a commercial insurer to attract new business to Rhode Island by addressing these realities. It established a portfolio transfer process. This allowed an active underwriting entity – located within or outside Rhode Island – to novate and transfer the eligible commercial liabilities in run off to a newly created or existing shell entity in Rhode Island. But – as required by the language of the 2007 amendment – the transfer would need to be "for the sole purpose of effecting a voluntary restructuring under this chapter."

As of 2007 – and until the Statutory amendments in House Bill 8163 – the only type of voluntary restructuring that was allowed "under this chapter" was a commutation plan.

A lot of insurers – particularly consolidators that are funded by asset managers – would like to separate legacy from live business by transferring it into a new entity. But, as I've said, they may not want to pursue the finality of a commutation plan.

How does the new, more flexible, process work?

The legislation allows for flexible segmentation of a defined portfolio into separate cells or legal entities. The business – subject to transfer – must have been in run off for at least five years.

If a third-party sale is desired, the buyer can be the Assuming Company.

If approved, the process allows for "[i]Implementation of a statutory novation with respect to all policyholders or reinsureds and their respective policies and reinsurance agreements under the Insurance Business Transfer Plan.

There are important provisos to consider. In particular, transfer and commutation are separate legal processes. This gives potential objectors two opportunities for policyholder and judicial challenge. It also creates increased frictional costs, and execution risk.

The other big development is a series of division statutes. The distinction between division and transfer is critical. They are two very different paths, each with their own pros and cons.

Earlier this year, Iowa and Georgia joined Connecticut, Illinois, and Michigan in passing legislation, which is intended to allow domiciled insurers to divide into two or more legal entities.

In addition to the five states with specific insurance division statutes, Arizona and Pennsylvania have corporate division statutes that can be used by insurers domiciled in those states. CIGNA's formation of Brandywine Holdings in the mid-1990s is an example.

Finality appears to be the intention of these new and the prior division statutes. The language within the insurance division statutes differs slightly.

However, they all have the broad intent of allowing the Resulting Insurer to be the successor to the Dividing Insurer for the policy liabilities allocated in the Plan of Division.

Let me read from the Connecticut Division Statute on the effect of the division process:

"[T]he policies and other liabilities of the dividing insurer are allocated between or among the resulting insurers as provided in section 7 of this act and the resulting insurers to which policies or other liabilities are allocated are liable for those policies and other liabilities as successors to the dividing insurer, and not by transfer, whether directly or indirectly;"

Similar provisions are found in each other state's division statutes though Iowa, Illinois, and Michigan include specific reference to the fact that the transfer is by "operation of law".

Although all of the insurance division statutes require regulatory review and approval, only Georgia, Iowa, and Michigan require specific notice of the plan of division to policyholders and a public hearing.

The division statutes in Connecticut and Illinois allow for notice. There would also be a public hearing if the commissioner determines that notice and a hearing are in the public interest – though Illinois will conduct a public hearing if one is requested by the Dividing Insurer.

Contrary to the provisions of the Oklahoma and Rhode Island Insurance Business Transfer Plan processes, none of the insurance division statutes requires judicial review.

Do the insurance division statutes provide carriers with a new tool to address problematic or unwanted exposures? Division of business is common across many sectors other than insurance. Also common are insurance mergers and changes of control. The insurance division and business transfer processes are intended to allow the same result – to extinguish the Dividing or Transferring Insurer from the divided or transferred liabilities.

The insurance business transfer statutes in Oklahoma and Rhode Island specify that the policy obligations are novated to the Assuming Insurer – or have the effect of novation – subject to regulatory and judicial review. The standards for judicial review are set out in each business transfer statute.

The division statutes do not appear to specify that the policy obligations are novated (or that the Dividing Insurer is released from those obligations). Rather, the Resulting Insurer is the successor to the Dividing Insurer (and, as mentioned, in some statutes, by "operation of law".)

There is an important proviso that is relevant to both division and the insurance business transfer process. Approximately 40 states have specific statutes or established case law prohibiting the novation of contractual obligations without the explicit consent of the effected party.

Consequently, while separation of selected liabilities appears at the heart of the insurance division statutes, it would **not** be surprising if prospective division plans were subject to legal challenge. Indeed, until these processes are tested in court, perhaps the legacy limbo and the legacy gap will remain.

The underlying question here is whether to divide or transfer. The liabilities most readily available for either mechanism are legacy assumed reinsurance exposures. They do not involve guaranty fund participation. They are often mature exposures. The counterparties or ceding companies are most often sophisticated insurers that can readily evaluate their ceded exposures.

It may be that assumed reinsurance liabilities are more suited to insurance business transfer than division. Perhaps this is because the transferring company may consider that finality is a more likely option. Perhaps it is because regulators may be concerned about the quantum of assets left to support the remaining – perhaps guaranty fund covered – liabilities of the Dividing Insurer.

These regulatory developments have the potential to expand the capital management tool kit. Some insurers, reinsurers, and consolidators are already looking at how to use these new openings as parts of plans to aggregate their assets and liabilities. This would, in turn, enable them to realize economies of scale in their management.

However, there are important qualifications to all this. Potential legal challenges are possible – perhaps likely.

The attitudes of policyholders and reinsurance cedents – and the industry – both property and casualty and life and health – have yet to be tested.

For example, the absence of the need for specific policyholder assent under the Oklahoma Statute may be challenged under the Contracts Clause to the US and the relevant State Constitutions. Such challenges could also apply to a portfolio transfer under the revised Rhode Island Statute.

The Vermont statute and the Oklahoma and Rhode Island insurance business transfer plans involve either regulatory or regulatory and court sanctioned contractual **novation** processes.

As I stated, most US states have either a specific statute or established case law that prohibits novation of a contractual obligation without specific affirmation from the counterparty. In fact, many carriers are unwilling to remove these transferred or divided liabilities from their records without evidence of specific counterparty assent to the novation.

Novation was not an issue with GTE RE. Instead, GTE RE – containing only commercial liabilities eligible for commutation plan closure under the Statute – was re-domiciled from Vermont to Rhode Island. Two cedents objected to the commutation plan and raised state and federal Contracts Clause challenges which were quickly and successfully rejected.

In GTE RE, the court ruled that while the rights of the ceding counterparties may have been impaired, they were not **substantially** impaired sufficient to be overturned on a Contracts Clause challenge. (The court concluded that the objecting cedents were receiving sufficient compensation under the GTE RE commutation plan – albeit on an accelerated basis.)

Other grey areas that could require legal precedent to settle include the lack of clarity over the mechanics of division.

For the legacy gap to be bridged, we need to know more about the market reaction and what emerges from the legal scrutiny. It should be noted that while state economic development initiatives may have been at the heart of the Oklahoma and Rhode Island transfer processes – each of the insurance division statutes are believed to have had industry sponsors.

These developments are no silver bullet.

There also has to be greater willingness within management to explore these options. It's going to take regulatory custodians like you to explain what's now possible. All involved in this field also need to highlight the risks of continuing to sweep legacy under the carpet.

Even though the options I've described are subject to strict rules, some boards – and regulators from influential states – still see action on legacy as a reputational risk. Again, it's important for professionals in this area to understand the ins and outs. Far from eroding claimants' rights, these options could offer stronger capital protection and a better deal for people these policies seek to protect.

Ultimately, transfer and aggregation are only part of the answer. However much insurers and reinsurers consolidate their portfolios, the liabilities have not been eliminated.

Accelerated elimination of the liabilities through a commutation plan remains the only option that provides true finality. It should therefore be one of the main capital management considerations – for the right portfolio.

In this respect, the Rhode Island Commutation Plan remains the gold standard for those who seek legal and financial finality. It provides full, final and accelerated closure and capital release without the inherent erosion of value that comes from sale or reinsurance. In turn, this transparent, court-monitored process provides claimants with due process protections along with certainty and finality.

Legacy regulation in the US is opening up. And we should see more significant shifts ahead. And this is especially the case in relation to Oklahoma's legislation as this applies to property and casualty covers as well as life and health – and therefore, by extension – potentially – to long term care and disability.

This underlines the importance of looking at all options, not just the default options of sale or reinsurance. As I have noted, however, reinsurance protection should prove to have a continued vital role in any contemplated portfolio or business transfer.

There is still plenty to do to close the legacy gap. And some industry participants remain – rightfully – cautious and skeptical. Concerns regarding transparency of the plans to be implemented, capital adequacy, and industry reputation abound. All of these issues are under consideration within the NAIC.

But – as I said at the outset – if the Red Sox can win a World Series after an 86-year drought – and then go on to win three more – anything is possible.

Thank you for your attention.

Suite 300, Two Bala Plaza, Bala Cynwyd, Pennsylvania 19004
D: 610 660 7738 | F: 610 500 5071 | E: info@runoffresolve.com | www.runoffresolve.com