Washington State
BILL
House of Representatives
ANALYSIS
Office of Program Research

Business & Financial Services Committee

HB 1033

Brief Description: Regulating the settling of certain insurer transactions.

Sponsors: Representatives Stanford and Chandler.

Brief Summary of Bill

- Adds a series of definitions, including "qualified financial contract" and "netting agreement."

- Establishes a framework for resolving netting agreements where one party to the agreement is an insolvent insurer.

Hearing Date: 1/17/13

Staff: Jon Hedegard (786-7127).

Background:

Minimum financial requirements for insurers.
Insurers are required to have minimum amounts of capital and surplus to transact business in Washington. The amounts are based on which type(s) of insurance the insurer is licensed to sell. There are a number of financial standards and to assess the financial condition of insurers. There are a number of reporting requirements to inform the Insurance Commissioner (Commissioner) of the financial condition of insurers. The Commissioner has different regulatory tools to address various levels of the financial precariousness. One tool available to the Commissioner if the insurer does not meet the appropriate financial standards is to appoint a receiver. The first option is usually to try to get the insurer's affairs in order and return control to the insurer. Selling the insurer to another insurer may also be an option. Liquidation may be a possibility if there are no other options.

An insurer's insolvency is subject administration under to the state insurance laws, not to general bankruptcy laws.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

<u>Guaranty Associations</u>.
Guaranty Associations are mechanisms to pay the claims of policyholders of an impaired or insolvent insurer. There is usually a maximum amount of coverage that is provided by the guaranty association (for example, the maximum amount available under a life insurance policy is $500,000). Washington has two guaranty associations. One guaranty association addresses most of the property and casualty coverages. The guaranty associations addresses life and disability insurance. The associations are run by a Board composed of member insurers under a plan of operation that must be approved by the Commissioner. Solvent insurers in that line of business are assessed to pay the claims. The insurers get a credit against future premium tax assessments.

<u>National Association of Insurance Commissioners (NAIC)</u>.
The NAIC was created by state insurance regulators in 1871 to "address the need to coordinate regulation of multistate insurers." The NAIC holds quarterly meetings. The meetings are primarily a series of committee and subcommittee sessions. Model laws and rules and other matters typically advance through the committees before they are discussed by the entire membership.

<u>Insurer Receivership Model Act (IRMA)</u>.
In 2005, the NAIC adopted the IRMA. One section of the IRMA (section 711) addresses how certain transactions may be settled when an insurer is in receivership or liquidation.

Summary of Bill:

<u>Definitions</u>.
A number of definitions are added to the chapter in the Insurance Code that establishes standards for mergers, financial oversight, rehabilitation, and liquidation.

A "qualified financial contract" is defined as any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement, and any similar agreement that the Commissioner determines to be a qualified financial contract.

A "netting agreement" is defined to include:
- a contract or agreement involving one or more transactions between the parties to the agreement related to one or more qualified financial contracts that provides for the netting, liquidation, setoff, termination, acceleration, or close out under or in connection with one or more qualified financial contracts or present or future payment or delivery obligations or payment or delivery entitlements among the parties to the netting agreement;
- any master agreement or bridge agreement for one or more master agreements; or
- any security agreement or arrangement or other credit enhancement or guarantee or reimbursement obligation related to any contract or agreement.

Any contract or agreement relating to agreements or transactions that are not qualified financial contracts is a netting agreement only with respect to those agreements or transactions that are qualified financial contracts.

A person is not prohibited from exercising:

- an enforceable contractual right to resolve obligations related to any netting agreement or qualified financial contract with an insurer because of; (a) the insolvency, financial condition, or default of the insurer at any time or; (b) the commencement of a formal delinquency proceeding;
- any right under a pledge, security, collateral, reimbursement, or guarantee agreement or any other similar security agreement relating to one or more netting agreements or qualified financial contracts; or
- any right to set off or net out any termination value, payment amount, or other transfer obligation related to one or more qualified financial contracts.

If a counterparty (another party to a master netting agreement or a qualified financial contract with an insurer that is the subject to a proceeding) terminates, liquidates, closes out, or accelerates the agreement or contract, damages are measured at the time of the termination, liquidation, close out or acceleration. The amount of damages is the actual direct compensatory damages.

Upon termination of a netting agreement or qualified financial contract, the net or settlement amount, if any, owed by a non-defaulting party to an insurer must be transferred, even if the insurer is the defaulting party.

In making any transfer of a netting agreement or qualified financial contract of an insurer subject to a proceeding, the receiver must:

- transfer to one party all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty; or
- transfer none of the netting agreements, qualified financial contracts, rights, obligations, or property.

If a receiver for an insurer transfers one or more netting agreements or qualified financial contracts, then the receiver must attempt to notify any person who is a party to the netting agreements or qualified financial contracts of the transfer on the business day after the transfer.

Generally, a receiver may not avoid a transfer of money or other property related to a netting agreement or qualified financial contract that is made before the commencement of a formal delinquency proceeding. A transfer may be avoided under if the transfer was made with actual intent to hinder, delay, or defraud the insurer, a receiver appointed for the insurer, or existing or future creditors.

In exercising the rights of disaffirmance or repudiation with respect to any netting agreement or qualified financial contract to which an insurer is a party, the receiver for the insurer must:

- disaffirm or repudiate all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty and the insurer that is the subject of the proceeding; or
- disaffirm or repudiate none of those netting agreements and qualified financial contracts.

Any claim of a counterparty against the estate arising from the disaffirmance or repudiation of a netting agreement or qualified financial contract that has not been previously affirmed in a

proceeding must be allowed or disallowed as if the claim had arisen before the date of the filing of the petition for liquidation, conservation, or rehabilitation. The amount of damages is the actual direct compensatory damages at the time of the disaffirmance or repudiation.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.