HOUSE BILL REPORT
HB 1033

As Reported by House Committee On:
Business & Financial Services

Title: An act relating to the settling of certain insurer transactions.

Brief Description: Regulating the settling of certain insurer transactions.

Sponsors: Representatives Stanford and Chandler.

Brief History:
Committee Activity:
Business & Financial Services: 1/17/13, 1/23/13 [DPS].

Brief Summary of Substitute 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.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 14 members: Representatives Kirby, Chair; Ryu, Vice Chair; Parker, Ranking Minority Member; Vick, Assistant Ranking Minority Member; Blake, Habib, Hawkins, Hudgins, Hurst, Kochmar, MacEwen, O'Ban, Santos and Stanford.

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

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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.

Guaranty Associations.
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 insurance coverages. The other guaranty association 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 assessed insurers get a credit against future premium tax assessments.

National Association of Insurance Commissioners.
The National Association of Insurance Commissioners (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.

Insurer Receivership Model Act.
In 2005 the NAIC adopted the Insurer Receivership Model Act (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 Substitute Bill:

Definitions.
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" (QFC) 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 QFC.

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 QFCs that provides for the netting, liquidation, set off, termination, acceleration, or close out under or in connection

with one or more QFCs 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 QFCs is a netting agreement only with respect to those agreements or transactions that are QFCs.

A person is not prohibited from exercising:
- an enforceable contractual right to resolve obligations related to any netting agreement or QFC 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 QFCs; 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 QFC 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 QFC, 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 QFCs between a counterparty or any affiliate of the counterparty; or
- transfer none of the netting agreements, QFCs, rights, obligations, or property.

If a receiver for an insurer transfers one or more netting agreements or QFCs, then the receiver must attempt to notify any person who is a party to the netting agreements or QFCs 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 QFC that is made before the commencement of a formal delinquency proceeding. A transfer may be avoided 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 QFC to which an insurer is a party, the receiver for the insurer must:

- disaffirm or repudiate all netting agreements and QFCs 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 QFCs.

Any claim of a counterparty against the estate arising from the disaffirmance or repudiation of a netting agreement or QFC 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.

Substitute Bill Compared to Original Bill:

An internal reference is corrected.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) The bill is intended to clarify what happens to certain assets in a liquidation proceeding. The bill does not impact what types of investment are available to insurers. The bill is one section of the IRMA that was adopted by the NAIC. At least 20 states have adopted this provision. Those states are similar to Washington in that they have at least one large domestic insurer. Allowing these netting agreements to take place is very important to life insurers. The bill has no impact on the rights of a policyholder. It only affects the insolvency process of domestic insurers. There are only a few life insurers domiciled in Washington and those life insurers are fiscally strong. It only applies to domestic insurers who have QFCs. The amount of money that a domestic insurer can invest in these contracts is limited. The bill is important because it provides a level playing field with other financial institutions. Insurers based in many other states have an advantage over insurers based in Washington. The IRMA was adopted in 2005. The NAIC studied the issue in-depth in the financial crisis and, after that review, recommended that states adopt the model. The bill allows insurers to use a tool to manage risks. Today, insurers located in many other states can use this tool but it is more difficult for a local insurer. The investment is allowed under state law but the Washington insurer may have trouble finding a partner for a contract. Even if one is found, the Washington insurer may be required to pay an additional sum or higher interest rate to the other party or post collateral in order to secure the contract. The Commissioner is required to conduct rigorous financial examinations. This provides protection against any possible financial troubles for the few life insurers located in Washington. The bill allows close-out netting. Close-out netting usually enables the parties to a contract to take some action in a very short period of time, as short as a day. This

provides quick resolution for the parties to the contract instead of the long process of receivership. The bill provides certainty to the process of clearing these transactions. Federal law is moving toward a national clearinghouse and a quick resolution of these issues. States will come into alignment or the insurers in those states will be at a disadvantage.

(Opposed) None.

Persons Testifying: Representative Stanford, prime sponsor; Mel Sorenson and Jon Mangan, American Council of Life Insurance; and Brent Martonik and Jacquie Veneziani, Symetra Financial.

Persons Signed In To Testify But Not Testifying: None.