Are we headed for another Oklahoma land rush?

The U.S. insurance market is at a key juncture in its development as recent regulatory initiatives pave the way for a significant uptick in restructuring activity. Restructuring and runoff transactions in 2017 followed the upward trend of 2016 deal activity, and early signs indicate that the strong market is poised to continue through 2018. This reflects the increasing recognition by owners of discontinued insurance business of the benefits of proactive management of legacy liabilities and back books.

Many insurers are taking steps to improve their operational efficiency, focus on new business, and discontinue or divest businesses that have underperformed and/or are no longer a strategic fit.

Among the insurance companies that have recently restructured are MetLife Inc., American International Group Inc., Axa SA and Hartford Financial Services Group Inc. In PwC's 2018 Survey of the Global Insurance Runoff Market, more than two-thirds of companies in the United States said they thought it was likely or highly likely they would be involved in restructuring activity in the next two years.

An IBT as a restructuring tool

A key driver of this desire for change is the fact that many insurance groups have multiple portfolios of discontinued business that they developed over many years and in many formats. These portfolios can be resource-draining and possibly problematic to the modern insurance organization. Accordingly, moving discontinued or capital-absorbing product lines to another business' balance sheet can provide an important strategic advantage.

There are many jurisdictions throughout the world that have a restructuring tool to achieve this type of transfer. The most familiar is the Part VII Transfer in the U.K., a court-sanctioned novation of policies from one insurer to another that insurers use to rationalize portfolio and corporate restructurings and assist in the closure of discontinued businesses. Generically, this mechanism is referred to as an insurance business transfer.

An IBT involves the substitution of one counterparty for another within the same contract. The IBT's primary value is the potential to conclusively relieve the transferor of its policy obligations and vest these in the transferee. As a restructuring tool, the IBT can benefit insurers because it allows them to adapt themselves to changing business environments through group reorganization that can streamline the corporate structure, provide operational costs savings and efficiencies, enable exit from problematic lines of business, bring finality to the runoff businesses and encourage more efficient capital management and improved capital and solvency metrics by releasing excess capital tied up in underperforming insurance portfolios.

Since the U.K. Part VII legislation was enacted in 2000, hundreds of successful transfers have been completed, none of which have subsequently encountered financial difficulties. Similar laws also are prevalent and used throughout continental Europe. However, the U.S. has been slow to adopt an IBT type of restructuring tool. For many years, reinsurance in the form of loss portfolio transfers has been the preferred option. While loss portfolio transfers provide economic benefits to the transferring company, they do not provide legal finality. Assumption reinsurance statutes also are available in some states and provide for a traditional novation. However, many insurance companies view these statutes as cumbersome, time-consuming and expensive. In some cases, management may choose to sell companies in runoff, but frequently this is not an effective solution because the runoff may be embedded in a much larger portfolio of active business with no effective means of segregating the blocks of business.

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An evolving regulatory landscape

In August 2015, Rhode Island became the first U.S. jurisdiction to pass legislation to provide for insurance business transfers. This legislation closely resembles the U.K. Part VII Transfer, although its application is limited to property/casualty commercial runoff liabilities. Unfortunately, this legislation has suffered interpretational issues that have limited its use.

Another wave of legislative developments has involved division statutes. These statutes allow a domestic company to divide into two or more insurers. While this is not actually a transfer of a block of business, these statutes can pave the way for future sale or IBT transfers. Connecticut, Pennsylvania and Arizona have division statutes. Iowa, Illinois and Georgia considered similar legislation, but the governors of each ultimately vetoed it. Similar legislation is pending in Michigan.

Oklahoma IBT legislation

On May 7, 2018, Oklahoma Gov. Mary Fallin signed S.B. 1101 into law. S.B. 1101, called "The Oklahoma Insurance Business Transfer Law," allows companies to move blocks of insurance business from one company from any jurisdiction to another company that must be an Oklahoma insurance company. The legislation is closely modeled on the U.K. Part VII Transfer legislation. Like the Part VII Transfer, the Oklahoma legislation applies to all lines of business, live and runoff.

The Oklahoma IBT approval process requires review and approval from the transferring company's domiciliary regulator and the Oklahoma insurance commissioner, as well as review and approval by the court. Like the Part VII, the Oklahoma IBT law also requires the report of an independent expert who focuses on policyholder security. In a recent presentation at the NAIC Summer 2018 Meeting in Boston, Oklahoma Insurance Commissioner John Doak said "we have looked at what worked in the U.K. with the Part VII and we have designed a policy and legislation that is a sound framework for protection of policyholders in these types of business transfers."

The Oklahoma IBT law has multiple safeguards to protect policyholders:

- Notice to all policyholders
- Regulatory and judicial approval
- Report of independent expert to evaluate impact on policyholders
- 60-day comment period
- Opportunity to be heard at court hearing

The broader application of the Oklahoma IBT has appeal to a much larger market that is challenged to find effective options for restructuring their business. The court-sanctioned novation process set forth in the Oklahoma IBT provides companies with an effective means to transfer all or part of a portfolio to another company achieving complete finality for the transferring company while also adequately protecting the rights of policyholders through a robust regulatory and judicial review process. A significant finding from U.S. respondents to the PwC Global Insurance Runoff Survey was reflected by some 41% citing they anticipate using an insurance business transfer as an exit mechanism in the next three years.

In some ways, the Oklahoma IBT is similar to a sale of a business. However, rather than selling a legal entity, it is the sale of a block of business. The Form A review process has worked well for the industry for many years and the more robust review in the IBT review process should give comfort to regulators that this process will work equally as well.

The U.K. experience shows that the insurance business transfer concept is a successful business model for the transfer of all lines of insurance business. Going forward, U.S. insurers can consider an insurance business transfer as a strategic tool to allow insurance groups, captive insurance companies and others to restructure or to exit certain lines, or portfolios of runoff business to unleash capital for better emerging opportunities, as well as to free management attention and oversight to more core activities.

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