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An Alternative to Assumption Reinsurance

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Summary: The National Association of Insurance Commissioners (NAIC) Model law has significantly changed the use of assumption reinsurance. Insurance companies are responding in different ways. In addition, the Model law contains an exemption from the full impact of the law if an insolvent insurance company is involved in a transaction.

Mr. James W. Dallas: I'm actuarial vice president with Reinsurance Group of America. Our first panelist is Tom Skillman, second vice president and director of capital management products for Lincoln National Reinsurance Companies. He's also vice president of Lincoln National Intermediaries. Tom is responsible for designing and delivering capital-oriented reinsurance products, with a focus on using a blend of conventional reinsurance products and nonreinsurance capital markets. Tom has authored and co-authored several articles and is a frequent speaker at industry meetings.

Mike Trier is an attorney with Lord, Bissell, and Brook in Chicago. He has been with Lord, Bissell, and Brook for ten years in their corporate insurance practice group. Mike has represented several companies in 100% indemnity reinsurance transactions, including Pioneer Life, Protective Life, and Primerica Life. Mike has also represented clients in acquisition of blocks of business from insolvent insurers, including Mutual Benefit, Pacific Standard, and Investors Equity. Mike also

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has handled reinsurance commutation, insurance company sales, extraordinary dividend requests, and other holding company transactions. He received his Juris Doctor with Honors from the University of Chicago where he was elected to the Order of the Coif. Mike also holds a bachelor of arts in philosophy from the University of Wisconsin, Madison.

Our third speaker will be Bill Howard. Bill is a senior vice president and actuary for the National Organization of Life and Health Insurance Guarantee Associations (NOLHGA). Bill develops strategic plans for managing insolvencies. He has served on NOLHGA insolvency task forces, and he also serves as Actuary for Guarantee Reinsurance Corporation, a guarantee association owned life insurance company formed to assume the life and annuity business of the insolvent Guarantee Security Life. Bill has been directly involved in assumption reinsurance transactions, many of which he will be telling us about. He has also been a vice president at Jefferson Pilot and Munich American Reassurance, and a corporate actuary with the Acacia Group. Bill received his bachelor of arts in mathematics from Rhodes College in Memphis. He's a Fellow, and a member of the Academy, and a past president of the Middle Atlantic Actuaries Club.

We thought it might be wise to give an overview of the NAIC’s Assumption Reinsurance Model Act. The Assumption Reinsurance Model Act outlines different parameters for accomplishing an assumption reinsurance of a block of business. Assumption reinsurance is the transfer of in-force risks where a novation is affected. A novation occurs when you have a previous valid agreement, all parties agree to a new contract, and they all agree to extinguish the old contract to create a valid, new contract.

There are many provisions of the Assumption Reinsurance Model Act. I'll give a brief overview of some of them and a little more detail of two of them. The Assumption Reinsurance Model Act applies to all authorized insurers with some exceptions. The notable exceptions are insurers in rehabilitation or liquidation and transactions where a guarantee association is involved. Two other provisions about which I will give a little more detail momentarily are the notice requirements of the Act and the policyholder rights requirements of the Act. Also, there are provisions concerning the effect of consent; that is, if a policyholder approves, there is a novation, and the transferring insurer would be relieved of all obligations. There is also a provision to give a commissioner of a state discretion to approve transactions notwithstanding the Model Act if the insurer is in financial trouble.

The Act has detailed requirements for notice to policyholders, agents, and brokers. When a company is looking to assume a block of business, you have to notify all policyholders of these following provisions. You have to notify them of the date of the transfer or the proposed transfer or novation. You have to provide them with the name, address, licensure, and telephone number of the companies that are involved in the transaction. You have to give the policyholders the right to reject or accept, the timing as to when to accept or reject, where to send their response, and the impact of the decision that they would be making. You also have to provide the policyholders with the address of the insurance department, as well as detailed financial information on both companies. The Act outlines the amount of financial data you have to provide. Finally, with the proposed assumption you have to notify the policyholders and give them a postage paid response card.

Another provision of the Act concerns the policyholder's rights. The policyholder has the right to reject the transfer. The Act does say that if the policyholder makes payment to the new insurer within 24 months, that is deemed an acceptance of the novation. If no response is made or deemed to have been made within 24 months, then you have to send the policyholder another notice about the proposed assumption reinsurance and if no response is received within one month after the second notice, then there is deemed acceptance.

Mr. Thomas E. Skillman: One of the big problems in discussing a subject like this is the alternatives that are appropriate really depend upon your objectives. It takes some time some interaction to learn those objectives in your particular case. I will focus more on some generic situations and some alternatives to assumption reinsurance.

Why worry about alternatives? As Jim pointed out, the new rules and regulations are cumbersome to affect assumption reinsurance, but deals still need to be done. If the assumption reinsurance under the new rules isn't something that will accomplish what you need to do, then what other things can you take a look at?

Alternatives include indemnity reinsurance. This might be with or without an administrative services agreement. You could buy or sell an entire company, depending on which side of the deal you are on.

In some situations, you might consider a cut-through endorsement. There is also a new concept called securitization that has been introduced as an option by Wall Street brokers and investment bankers.

There are various forms of joint venture alliances, and, finally, another alternative in some cases is receivership. I'll let Bill talk about that later, and I'll let Mike talk about the cut-through endorsements, since cut-through endorsements have their own severe limitations, not totally unlike what you have in the case of assumption reinsurance.

Securitization is fairly new. Some of you will be familiar with it, but some of you aren't. As Wall Street has taken pools of residential mortgages and carved them up into collateralized mortgage obligations (CMOs), it has also taken a look at different sorts of risks and carving those up. Right now most of the activity in the securitization area has been on the property and casualty side. We were involved in a property catastrophe securitization about three years ago which I've seen billed as the first of its kind. I'm not aware of any that have been done yet on the life side. I suspect this is because property and casualty risks give rise to concentrated risks that are perhaps too large for the insurance industry alone to shoulder. Using the capital markets to expand the risk-taking capacity has benefits. For life insurance risks you normally don't have that situation, although we have seen some interest in it. I think that perhaps for annuity risks, which is more cumulative, it is a possibility. Guaranteed minimum death benefit for variable annuity writers may be a possibility. Perhaps noncancellable disability income (DI) would lend itself to a securitization solution.

There are many ways to do a securitization, but typically a special purpose reinsurer is formed, usually in a tax haven. The capital to back the risk being assumed is provided by selling securities to the capital markets. To date, most of the investors have been insurance companies, which negates the benefits of going to the capital markets, but as these become more accepted, there will be other players. Hopefully, at some point you'll get mutual funds or pension plans investing in these. There is a standard indemnity reinsurance agreement between the ceding company and the reinsurer. There are various ancillary agreements, trust agreements, calculation agreements, and investment management agreements to make everything work out. The bankers have about seven or eight different ways of making fees on these deals.

Joint venture/strategic alliances have a number of different forms which can be taken. There may be a separate jointly owned company. There might be private labeling involved or fronting involved. I am not sure I can tell you the difference between private labeling and fronting. My impression is that private labeling is when you are using your agents to sell somebody else's product. Fronting is where you're using their agents to sell your product. Allocation of functions is typically the key attraction when you're trying to do an alliance. Each party should do what each party does best or what they can negotiate. Who does the distribution, who does the administration, who does the investment management, product management or the risk taking? In many joint ventures or alliances, there's some form of indemnity reinsurance involved.

Which alternative to choose depends upon the strategic premise behind wanting to do the assumption reinsurance if it were easier. Certain things will make the various alternatives we discussed earlier more appropriate or less appropriate. This is not an exhaustive list, but typical strategic premises for the seller would be to:

1. Eliminate the noncore line of business; focus on what they really do well.
2. Discontinue a business which lacks economies of scale and lacks critical mass.
3. The seller may want to adjust the risk profile of its business, maybe reduce its exposure to investment risk by reducing its exposure to the annuity line or reducing its exposure to noncancellable DI risk, and increase its exposure to life risk.
4. The seller might want to take advantage of market conditions. (Now is a wonderful time if you've got some life insurance business to sell. It's a seller's market; there are many buyers, but not many sellers. There are a number of players out there that at any time are willing to buy or sell. They're indifferent. It depends on price. If prices are high they'll sell what they have. If prices are low they'll buy what you're wanting to sell.)
5. One may also want to simply raise capital to improve the risk-based capital ratio.
6. One may want to do something to increase the value of the business. Typically, this would happen when there is a downgrade or a concern that the business may lapse off. They'd like to place the business with a company with high ratings. It may be that the partner can bring in some talent that they don't have in investment management, administration, product management, claims management, or whatever.

Strategic premise for the buyer has a nonexhaustive list, as well as the flip side of the perspectives of the seller, but there's a few that are different. Many of the buyers whose names appear in the paper often seem to be looking at an expense leverage play where they have excess administrative capacity. They need additional business to move through their administrative plant and they've decided it's cheaper to buy that business through an acquisition or some other similar means than to write new business. Typically, such companies have very low marginal expenses, but fairly high fully allocated expenses.

A buyer may simply want to invest some capital in insurance business. Many companies, especially annuity writers, are interested in increasing the amount of assets under management, to give economies of scale to the investment management operation. As with the seller, the buyer may be trying to adjust the risk profile of the block of business, or take advantage of market conditions. They may be looking to acquire distribution or to acquire capabilities, skills, systems, or aspects that they don't have internally and which they haven't been successful at developing.

Beyond the basic strategic premise behind seeking an alternative to assumption reinsurance, some of the other considerations would be financing. How do you finance what you're trying to do? If you're on the acquiring side, it might be an internal war chest, equity, debt, reinsurance, miscellaneous things like securitization, partnership, or limited liability corporation. Those of you that are active in doing deals and haven't looked at limited liability corporations, I recommend that you look at those things. Those have a great deal of interesting potential because of the special tax characteristics.

Regulatory considerations that might influence which of the alternatives you should take a look at would include The Model Regulation for Life and Health Reinsurance Agreements, the Assumption Reinsurance Act, and the Third Party Administrator (TRA) statute. The reason why these things need to be considered is because these regulations can restrict the ability of the parties to decide who is going to do what on a going forward basis after the deal gets done. Parties don't have complete freedom of action in deciding who does what.

In doing any of these alternatives or assumption reinsurance itself, the credit risk is something that needs to be given some attention. Some companies that did assumption reinsurance in the past found out, much to their chagrin, that they didn't pay enough attention to that. The ceding company is a risk to the reinsurer. The reinsurer is a risk to the ceding company. Obviously, that's the main risk of the company writing the cut-through endorsement.

A securitization vehicle usually is designed to be bankruptcy remote, which basically means, if it's structured properly, it should be immune to insolvency, but you do need to make sure that you check that it is structured properly. I would say a company that's getting close to receivership is not a very good credit risk, but, interestingly enough, my attorneys tell me that after a company has gone through insolvency, they are the best risk that you can get, because of what happens to postbankruptcy debts.

The final issue that should never be forgotten in doing a material deal are the tax issues. If reinsurance is involved, then Section 845 could come into play. If indemnity reinsurance is involved, it gives the Internal Revenue Service (IRS) substantial authority. If there's a tax avoidance effect to reallocate things, the IRS has been applying 845 lately. They fortunately lost a very important case recently. If assets are moving back and forth, then either the deferred acquisition cost (DAC) tax or the Colonial American provisions will apply. DAC tax would be the normal situation unless there's a tax qualified business or cancelable health business such as group health.

If a company is getting close to $500 million in assets, and they want to maintain a small company tax deduction they might want to sell off some annuity business or some life business in order to stay down below the $500 million cut off. Likewise, a company that is below $500 million, but that doesn't have much life business might want to acquire a block of life business so they can qualify as a life company and, thereby, qualify for a small company tax deduction.

Other miscellaneous issues are fairly minor unless you're in a very special situation. These may include the dividends received deduction, depending on the structure of alternative you have or on the effect of proration on your existing business as well as the structure you're looking at. Again, a limited liability company has many interesting uses. We're starting to see that used much more.

If you do an acquisition of a company, there's goodwill that may be associated with that. In the old days you couldn't deduct that. Now you can amortize it over 15 years. If you're buying a company and there's a change of control, then you need to be aware of the limitations on the use of loss carry forwards.

Mr. Willis B. Howard, Jr.: Tom, you mentioned a technical issue which is of interest to me, because we run into it with some insolvent companies where we're trying to place the business. What are the different ways that you would price a transaction? I'm talking about on the liability side, statutory reserves, account values, surrender values, tax reserves, and generally accepted accounting principles (GAAP) reserves, and what are the hazards that lurk in any of these?

Mr. Skillman: Of course, the biggest hazard would be that there's a difference of opinion as to what the value for those things are, especially in GAAP reserves. You would think that there's one answer for that, but there's some areas for discretion. Cash-surrender values are fairly safe: that's usually objective as would be account value. Statutory reserves also lend some flexibility. You make sure there's clarity on both parties as to counting deficiency reserves or not, and as to whether you count excess interest reserves or not. What's the right level of claim reserves or claim liabilities? There's certainly a tendency, if you're paying a ceding commission relative to statutory reserves for the ceding company, to be fairly aggressive because that reduces the amount of net assets they would transfer. The real key thing is just you make sure that there's a meeting of the minds as to how the block of business is being valued. What's the proper basis? Be sure there's no change between the date as of which you're doing the numbers and the date as of which the deal is closing.

Mr. Dallas: Along the same lines, Tom, all those items dealt with the liability side. What about the asset side when there's a movement of assets? Are those normally at book, market, or somewhere in between?

Mr. Skillman: I think that the accounting rules say fairly clearly that for GAAP, tax, and statutory, the assets move at market. In the real world, conceptually at least, forget the accounting for a minute, and focus on the economics. It depends a lot on what the intention of the parties are. If you have a block of annuity business where the intention is to maintain the kind of interest crediting strategy that they've maintained in the past, if the market value of the assets are much different than the book value, because business is put on the books in a time of much higher interest rates, then you'd like to have that additional book yield off the assets to help pay the higher credited rate. On the other hand, if the intent is to basically ignore the history behind it and just start it fresh or if the intent of the buyer is to transfer into different asset categories because they don't like the asset categories that the seller had, then doing it on a market value basis probably makes the most sense. Conceptually, we've done deals pricing on both a book basis or a market basis depending on what the intent is going forward. For accounting purposes, it needs to be on a market-value basis.

Mr. Michael P. Trier: Sometimes I think actuaries and lawyers speak a different language, but I hope that's not going to be the case.

I'm going to be talking about using 100% indemnity reinsurance as a means of buying and selling blocks of insurance business. In the past several years, a number of our clients have structured transactions as indemnity deals as an alternative to assumption reinsurance which would have been subject to the requirements of the NAIC’s Assumption Reinsurance Model Act. However, before entering into such transactions, it's very important that the parties understand that they will be exposed to substantial risks that they would not encounter in assumption deals.

As Jim Dallas mentioned, the essential difference between assumption and indemnity reinsurance is that only assumption reinsurance involves a novation in which the reinsurer is substituted for the ceding company as insurer on the ceded business. Assumption reinsurance requires policyholder consents and results in a release of the ceding company's policyholder obligations. A 100% indemnity reinsurance transaction by contrast does not require policyholder consents, because it transfers financial risk on the ceded business without releasing the ceding company. The ceding company remains liable to its policyholders, if the reinsurer subsequently becomes insolvent, the ceding company will have the entire cost of paying policyholder claims.

One way for the ceding company to protect itself against this risk is to add a recapture clause to the indemnity reinsurance agreement. Pursuant to a recapture clause, the ceding company has a right to recapture the business if the reinsurer's financial condition deteriorates. Upon recapture, the ceding company will recover from the reinsurer assets sufficient to pay the ceded liabilities and, at the same time, the reinsurer will be released from its reinsurance obligations.

However, recapture is often not an ideal solution for a ceding company. It’s presumed that the ceding company sold the ceded business in order to get rid of it, and the last thing that it may want is to take this business back. Moreover, as a practical matter, the ceding company will not be able to recapture the ceded business if it has terminated or transferred to the reinsurer all the employees who are capable of servicing the business. Before taking any comfort in the availability of a recapture remedy, the ceding company must make certain that it will have the ability to exercise its recapture rights if the need arises.

Another way that a ceding company can protect itself is to require that the reinsurer deposit assets in a reinsurance trust account where they will be held available for the ceding company when needed to pay ceded liabilities. When setting up a reinsurance trust account, it is very important to take care of all the details. If the trust documentation is not legally sufficient or if title to the trust assets is not conveyed to the trustee, the reinsurer's receiver may be able to ignore the trust and grab the assets.

If a reinsurance trust account is being used, it should be set up at the same time that the reinsurance agreement closes. However, reinsurers typically resist funding reinsurance trust accounts to the full extent of the ceded liabilities at a time when they are financially strong. Under those circumstances, the ceding company may agree to accept a trust account which will initially be funded with only a nominal deposit, provided that it has the right to require the deposit of additional assets sufficient to cover all the ceded liabilities if the reinsurer should fall on hard times.

When negotiating either recapture rights or the terms of a reinsurance trust account, it is very important that the ceding company be aware of the law regarding preferential transfers. Under the insurance insolvency statutes of nearly every state, the receiver of an insolvent insurer can recover assets transferred by the insurer for the benefit of one of its creditors if the asset transfer occurs during the so-called "preference period." Despite some variations in state law, the preference period is generally the four months immediately preceding the date on which the insurer is placed in insolvency proceedings.

Because of these legal rules, it is very important that the ceding company make certain that asset transfers in connection with recapture or the funding of a reinsurance trust account be made prior to the beginning of the preference period. Probably the most common way of dealing with this problem is to trigger the ceding company's remedies upon a significant downgrade in the reinsurer's financial ratings. Alternatively, the parties may agree to allow the ceding company to exercise its remedies if the reinsurer fails to maintain certain minimum surplus or fails to satisfy risk-based capital or other ratios that may be indicative of its financial condition.

One hundred percent indemnity reinsurance transactions also involve substantial risk for the reinsurer in connection with financial difficulties that the ceding company may fall into. If a ceding company is downgraded, the ceded business may begin to melt away because of increased lapsation or surrenders. If the ceding company is actually placed in insolvency proceedings, the reinsurer may find itself locked in a struggle with the ceding company's receiver for control of the ceded business. In any such struggle, the receiver will have available to it a variety of tactics and legal theories depending upon where the economic advantage of the estate lies.

For example, even if the reinsurer is willing to continue to pay claims directly to policyholders, the receiver is likely to demand that reinsurance proceeds be paid to the estate and, thus, subject policyholder claims on the ceded business to the same sorts of delays and limitations that will affect other policyholder claims against the insolvent insurer. Without a cut-through clause in the reinsurance agreement, the receiver is certainly within his rights to make such a demand, because the reinsurance agreement will almost certainly include the standard insolvency clause. This clause provides upon the ceding company's insolvency, claims will be paid by the reinsurer to the insolvent company's estate and not to the policyholders.

In addition, the receiver may attempt to cut off the flow of additional premiums to the reinsurer on the theory that premiums on the ceded business are really an asset of the ceding company's estate. While such an action would endanger the receiver's right to the continued payment of reinsurance claims, the receiver may be willing to run this sort of risk if the premium flow on the ceded business is sufficiently large.

The reinsurer should also be concerned about the possibility that the receiver might try to make a claim against reinsurers based on some sort of actuarial valuation of the ultimate liabilities of the reinsurers under the reinsurance agreement. To date, I'm aware of only one case in which a receiver of an insolvent life insurer has made such a claim. The Liquidator of Inter-American Insurance Company of Illinois made a claim against that company's surplus relief reinsurers for the immediate payment of the net present value of the ceded liabilities. The reinsurers that elected to litigate their objections to that claim lost at the trial court level, and the case is currently on appeal.

As protection against these sorts of risks, the reinsurer may insist upon having the right to convert the indemnity reinsurance into assumption reinsurance if the ceding company's financial condition deteriorates. In essence, conversion into assumption reinsurance will eliminate the ceding company's interest in the ceded business and, thus, should cut off any claim that its receiver might otherwise make against the reinsurer. Of course, conversion into assumption reinsurance is going to require policyholder consent, but in a case where the policyholders are concerned about the solvency of the ceding company, it may be relatively easy to secure the necessary consents.

Short of conversion into assumption reinsurance, there are other steps that a reinsurer may take to protect its interest in the ceded business. The reinsurer may strengthen its claim to the continued payment of premium on the ceded business by requiring that the reinsurance agreement include an assignment of all the ceding company's rights to future premium payments. Such an assignment goes one step beyond the promise to pay reinsurance premiums that is included in all indemnity reinsurance agreements, since it transfers the ceding company's right to collect premiums on the underlying insurance contracts.

The reinsurer may also consider the addition of a cut-through clause to the reinsurance agreement. A cut-through clause provides that the reinsurer will pay claims directly to policyholders. Cut-through rights may be made contingent upon the ceding company's insolvency, upon its failure to pay claims, or even upon a downgrade in the ceding company's financial ratings. If the ceding company is downgraded and the ceded business begins to melt away because of increased lapsations or surrenders, the reinsurer should have the right to notify or remind the policyholders of the existence of the cut-through in order to reassure them concerning the security of their coverage.

Cut-through alters the terms of the standard insolvency clause by denying the ceding company's receiver the right to collect reinsurance proceeds. A handful of states, such as Illinois, have enacted statutes that expressly permit the use of a cut-through clause. However, most states require the use of the standard insolvency clause, which would provide for the payment of reinsurance proceeds to the receiver, as a condition of the ceding company's right to take financial credit for the reinsurance. As a result, ceding companies may refuse to allow the addition of a cut-through clause to a reinsurance agreement unless they are domiciled in a state that has enacted a cut-through statute.

Another potential problem with the use of cut-throughs is that some receivers have argued that payments to policyholders pursuant to a cut-through effect an illegal preference in favor of those policyholders who have the benefit of the cut-through as against policyholders who have no cut-through rights. This argument exposes a reinsurer that grants a cut-through to the threat of having to pay its reinsurance obligations twice—once to policyholders pursuant to the cut-through and another time to the estate, because the receiver refuses to acknowledge the effectiveness of the cut-through. This risk of double liability is certainly less if the ceding company is domiciled in a state that has enacted a cut-through statute. However, even in such a state, it is conceivable that the receiver will insist that the cut-through would effect an illegal preference and, thus, force the reinsurer to litigate its obligations pursuant to the cut-through clause.

I don't want to leave you with the impression that the only problems in connection with these types of transactions involve the insolvency or potential insolvency of one of the parties to the deal. In fact, some of the more difficult issues to negotiate in these deals often involve the allocation of responsibility for policy administration.

The reinsurer usually demands and obtains the right to administer the policies because it bears 100% of the financial risk on the ceded business. However, because the business remains on the paper of the ceding company, the ceding company is still at risk if the reinsurer mishandles claims or otherwise fails to administer the business properly. Under those circumstances, the ceding company may be sued for extra contractual damages, may be the subject of a regulatory complaint, or may find that its reputation in the marketplace is suffering substantial damage. In addition, if the reinsurer handles policyholder complaints by rescinding coverage and returning premiums, the ceding company must be concerned about the reaction of its producers who will be called upon to refund their commissions on the rescinded contracts.

The reinsurer generally indemnifies the ceding company against any losses, including extra contractual damages occasioned by the reinsurer's administration of the ceded business. However, indemnification will be insufficient to fully compensate the ceding company for any damage to its reputation or to its relationships with producers or regulators. In order to protect these interests, the ceding company may want the right to be consulted by the reinsurer before it takes certain actions, such as rescinding coverage or responding to regulatory complaints or inquiries. It may also want the right to participate in the defense of litigated claims, although such participation would be at its own expense. In general, however, the reinsurer will resist making any concessions to the ceding company on these sorts of issues for fear that those concessions will lead to undue interference in the administration of the policies by the ceding company.

The transfer of administrative responsibilities to the reinsurer may also raise certain regulatory concerns. The NAIC has published a set of questions and answers interpreting the model regulation regarding life and health reinsurance agreements. These interpretative guidelines provide that no financial credit should be taken for any reinsurance agreement that gives the reinsurer complete control over cost of insurance and credited interest rates. Although these guidelines don't have the force of law in any state, they are likely to be given considerable weight by any regulator who is considering credit for reinsurance issues. Moreover, the guidelines reflect the view of a number of regulators that the transfer of control over cost of insurance and credited interest rates to the indemnity reinsurer violates a promise that is implicit in the insurance contract that these matters will always be controlled by the insurer. Although this view is subject to debate, the parties may wish to avoid potential regulatory problems by working out some sort of an arrangement which would be acceptable to regulators, but would recognize the interest of the reinsurer in controlling the ceded business while allowing the ceding company some sort of a role in determining cost of insurance and credited interest rates.

I hope that I've given you some useful information about the risks that are involved in entering into 100% indemnity reinsurance transactions. Despite these risks, I think we'll be seeing many more of these transactions in the next few years, unless there is some sort of dramatic and very unexpected change in the regulation of assumption reinsurance.

Mr. Howard: Mike, speaking of risk, I guess there's some legal risk in these transactions. What kind of disputes may arise between buyers and sellers? What mechanisms for dispute resolution have been used and how effective have they been?

Mr. Trier: It is very difficult to predict what the parties will find to dispute in any transaction. However, I think probably the most common disputes involve the calculation of post-closing adjustments, especially if they involve earn-outs and the determination of reserves on the ceded contracts or if the reinsurer has agreed to secure those reserves. In addition, if the ceding clause is not drafted carefully, there may be disputes over the extent to which certain liabilities have been transferred.

As to how the parties generally handle those disputes, they usually agree to arbitrate. However, if the business is being sold out of an insolvency estate, the receiver is usually going to insist that all disputes are handled by the receivership court. Both of these alternatives for dispute resolution have drawbacks. I think it is well known by now that arbitration can be as costly or nearly as costly and time-consuming as litigation. Also, the reinsurer that is faced with the prospect of litigating before the receivership court is apt to think that it's at a disadvantage in arguing before a judge who is familiar with the receiver and has had a chance to develop some sort of a working relationship with the receiver over the course of the insolvency proceedings. However, it's really not necessary to arbitrate or litigate every dispute that the parties can't resolve amicably. One thing that we have recommended to our clients in the past is to reach an agreement for the settlement of disputes involving calculations by an independent auditor or actuary.

Mr. Dallas: Mike, I've got one more question for you. You mentioned that often the recapture provision is placed into the 100% indemnity agreement and the ceding company requires the reinsurer place the assets in trust. Is it your thought that the assets in the trust are completely protected for the ceding company in the event of the insolvency of the reinsurer?

Mr. Trier: It is my thought that they should be protected, but I'm not sure that's always the case. The insurance insolvency statutes generally provide that a secured party has the right to realize the value of its security interest. If the reinsurance trust account is set up properly and title to all the assets is conveyed to the trustee so that the ceding company has a valid security interest in those assets, the ceding company should be entitled to realize the value of that security interest.

However, I think you are all aware that when an insurer becomes insolvent, the receiver usually has an injunction order entered which would prohibit any ceding company from withdrawing assets from a reinsurance trust account established by the insolvent company. This sort of order should really only require that the ceding company be able to establish either to the receiver or to the receivership court that it has a right to the assets under the terms of the trust agreement and the reinsurance agreement. However, when you litigate these matters, you end up arguing before the receivership court. It is a very politically charged issue, because the court is trying to protect policyholder interest, and there is or may be a tendency of the court to bend over backwards to favor the arguments (even if they are weak) made by the receiver. For that reason, I think that you never can be fully safe.

Mr. Howard: The life and health insurance guaranty association system provides a safety net to policyholders of life insurance companies so that people have peace of mind. The guaranty association system provides a safety net for policyholders. We protect people's dreams. And, plainly, if the industry is not regarded as financially strong, it doesn't sell its products.

Every state, the District of Columbia, and Puerto Rico have enacted laws establishing guaranty associations and limits of coverage. These limits vary from state to state, but are typically $300,000 for life insurance death benefits, $100,000 for life insurance cash values, $100,000 for health insurance benefits, and $100,000 for an annuity. The aggregate limit is $300,000 on any one life. Some states provide coverage of unallocated annuities, typically up to $5 million. There's an amendment to the Model Act working its way through the NAIC now to increase the coverage on health insurance to $500,000 (Table 1).

TABLE 1
NAIC MODEL GUARANTY ASSOCIATION ACT LIMITS (1995)

Life Insurance Death Benefits	300,000
Life Insurance Net Cash Surrender Values	100,000
Health Insurance Benefits*	100,000
Present Value of Annuity Benefits, Including NCSV	100,000
Structured Settlement	100,000
Aggregate Limit, Per Individual	300,000
Unallocated Annuity	5,000,000

*Limit recently increased to $500,000

I will describe the process that the guaranty associations go through. There are no typical insolvencies, but the process goes something like this. A company is licensed to do business in multiple states and has policyholders in those states. The regulator of the state of domicile determines that the company is financially impaired. When he does so the regulator typically has three options to choose from in dealing with a financially troubled insurer after administrative efforts have failed. (1) He can put the company under administrative supervision, where the regulator oversees the company's operation, but does not take control. (2) The regulator can take control under a court ordered rehabilitation and supervision and try to determine whether the company can be restored to the marketplace. (3) Finally, there's liquidation. The regulator obtains a court order calling for liquidation, including the gathering of all assets and liabilities with the goal of paying creditors what he can and dissolving the company. By law the commissioner of insurance becomes the rehabilitator or liquidator and has such powers and authority as are set out in the statutes and the court order. The receiver conducts a due diligence financial examination of the company and determines the value of its assets and the value of all of its liabilities. If the regulator finds that the further transaction of business would be hazardous financially or otherwise to its policyholders, creditors, or the public, he can seek an order of liquidation. When a court enters a final liquidation order with the finding of insolvency the state guaranty associations are triggered. Only then do they have the statutory power to perform their duties to protect policyholders.

When multiple state guaranty associations are affected by an insolvency, each state association has statutory obligations to its residents. Each association has the right to step in and do its own due diligence. This is where NOLHGA comes in. A NOLHGA task force composed of guaranty associations with the largest financial obligations and the state of domicile of the failed insurer is the principal hands on mechanism by which NOLHGA, through its members participation council, performs the coordination among the state guaranty associations affected by an insolvency. The task force uses a single set of consultants or advisers from the disciplines of law, accounting, actuarial science, and investment management to do its due diligence exam. They will put together a bid package for blocks of business that the insolvent company may have available for sale, and evaluate and give advice to the receiver regarding the bids. The task force does only what the individual affected guaranty associations have the right to do independently. Can you imagine organizing 40 actuaries from 40 different guaranty associations?

Task force chairs of pending insolvencies make progress reports to the members participation council and respond to questions from the members. Every task force is supported by a NOLHGA staff person, such as myself, who attends meetings, takes minutes, gathers and disseminates information, and, who may, as in my case on the recent Coastal States insolvency, act as project manager. We would also, of course, participate in our technical specialty as actuary, accountant, or lawyer.

The mission of the guaranty associations is to continue coverage, and it may be fulfilled through assumption or exchange agreements, and usually involves substantial guarantee association contributions. Executive Life, for example, was enhanced by $2.8 billion. That means the member companies will contribute through assessments $2.8 billion.

Let me place this process in context. Life insurance insolvencies are rare and are declining in number. In 1991 there were 23 multi-state life and health insurance company insolvencies out of over 2,000 life insurance companies nationwide. In 1994 there were only six, although that included Confederation Life, the Canadian company with over $7 billion in U.S. policyholder liabilities. In 1995 there was one and so far in 1996 there has been only one. There are fewer insolvencies today because the economy has improved, interest rates are stable and lower than they were in the 1980s, and insurers had been more cautious with investments. Insurance companies and regulators working through the NAIC now are applying tighter controls to the asset side of the business. Some would say they are too tight.

A few years ago the guaranty system and the insurance industry were targets of conspicuously adverse treatment by the news media in the Executive Life and the Mutual Benefit Life cases. The perception was that the system needed to be improved. This was a dangerous development for those who favor state regulation of insurance, encouraging those in Congress and elsewhere who think the federal government should step in and take over. We believe the record is clear that the state guaranty association system is closer to the people and less expensive than any conceivable federal operation.

Is the guaranty association system perfect? It's certainly improving all the time. We recognize that all strong organizations are built from the ground up, and we're working hard to make the system more responsive to policyholders. As NOLHGA has evolved over the past few years, several key developments have combined to close cases more quickly. First, guaranty associations have made a concerted effort to work cooperatively with commissioners and regulators, sharing information and pooling efforts to resolve conflicts as they arise. Second, development of joint work plans and sharing resources by receivers in NOLHGA task forces has shortened the time from rehabilitation to closing on assumption reinsurance or exchange. Joint planning, plus shared resources, equals speed for the policyholders and savings for the member companies.

I'd like to think about these three messages: (1) The safety net works and it works well. (2) Insolvencies are rare and their numbers are declining. The industry is financially strong and stable. (3) The system is more responsive to the policyholders because it operates on a state-by-state basis. The guaranty associations are proud of their operations and of the life insurance industry for doing the right thing for providing the safety net.

Now that I've given this background on the operations of the Guaranty Association, let's look at some examples and talk about some of the hurdles that must be crossed.

Andrew Jackson was a Mississippi domiciled company put into rehabilitation in 1992 (Table 2). It took 17 months for the guaranty associations to close a reinsurance transaction. The issue that we ran into here was a reserve dispute. The company's reserves were questionable. There was a question of what basis to use for the transfer of assets between the guaranty associations and the reinsurer. It was agreed to use account values, but the parties did not agree to what the "usual actuarial adjustments" to account values would be, and this was eventually resolved through arbitration. In that case as well, the company that had the winning bid for the block of business was a relatively small company, and had to retrocede part of the risk not only to domestic reinsurers, but, also, to European reinsurers. In that case the guaranty associations, in order to make sure that the reserves didn't disappear, required that assets backing the reserves be put into a trust.

TABLE 2
ANDREW JACKSON LIFE (1992)

Policyholder Liabilities (millions)	66.1
Guaranty Association Coverage Adjustments	6.4
Dedicated Assets, Including Policy Loans	4.7
Guaranty Association Covered Obligations	55.0
Estate Asset Distributions	5.7
Other Adjustments	(8.0)
Reinsurer Enhancement	11.4
Estimated Guaranty Association Cost	45.9
Issues: Reserve dispute; Reinsurer assets in trust (17 Months)	

Coastal States Life is the one 1996 insolvency to date (Table 3). We expect to close an assumption reinsurance transaction in early November 1996, which will be only ten months after the superseding rehabilitation order was entered in January 1996. This is a good example of how the process has matured and has enabled the guaranty associations to move policyholders more quickly from the rehabilitation to a solid insurer. There are always some unexpected bumps in the road and, in this case, it was discovered upon due diligence that 100% of the company's annuity policies likely failed to satisfy the requirements of Internal Revenue Code (IRC) Section 72(S). The rehabilitator's counsel met with the IRS and was able to negotiate a closing agreement which has been approved and executed by the IRS. Endorsements bringing their policies into compliance with Section 72(S) have been mailed to all policyholders. There was a substantial settlement required with the IRS to achieve this closing agreement, but we got the closing agreement and we're moving forward.

TABLE 3
COASTAL STATES LIFE (1996)

Policyholder Liabilities (millions)	71.6
Guaranty Association Coverage Adjustments	2.5
Dedicated Assets, Including Policy Loans	0.0
Guaranty Association Covered Obligations	69.1
Estate Asset Distribution	43.9
Other Adjustments	0.0
Reinsurer Enhancement	2.1
Estimated Guaranty Association Cost	23.1
Issues: 72(s) (10 Months)	

Guarantee Security Life was put into rehabilitation in 1991 (Table 4). It was one of the big three of 1991. The other two were the huge insolvencies—Executive Life and Mutual Benefit. The initial shortfall on Guarantee Security was estimated at something over $400 million. There was concern that the guaranty association system, facing not only this $400 million shortfall, but also the $2.8 billion estimated shortfall in Executive Life and, at that time, not knowing what the shortfall would be for Mutual Benefit, that there might be insufficient assessment capacity. A creative arrangement was worked out where a guaranty association-owned company, Guaranty Reassurance Corporation, was formed to take over the assets and liabilities of Guarantee Security. There were 25% moratorium surrender charges placed on the policies to discourage withdrawals by policyholders. These graded off by 5% a year. This, of course, reduced the likelihood of cash flow out of the newly formed insurer and enabled the guaranty associations to fund guaranteed return contract (GRC), not with cash, but with guaranty association obligations which are payable over a five-year period. By the way, that company is going to be for sale sometime between November 1996 and 1998, so there's another block that's going to be on the market.

TABLE 4
GUARANTY SECURITY LIFE (1991)

Policyholder Liabilities (millions)	658.3
Guaranty Association Coverage Adjustments	28.5
Dedicated Assets, Including Policy Loans	29.7
Guaranty Association Covered Obligations	600.1
Estate Asset Distributions	269.3
Other Adjustments	102.9
Reinsurer Enhancement	0.0
Estimated Guaranty Association Cost	227.9
Issues: Illiquid assets; Assessment capacity; Work out period (20 Months)	

Investment Life of America, in 1993, had the one thing that was different, there was no formal rehabilitation period (Table 5). NOLHGA received a call from the North Carolina Insurance Department on April 2, 1993 that said, "Come get your policies, we just put a liquidation order through on Investment Life of America." The other issue that arose here was a dispute with the prior reinsurer of Investment Life of America. There were allegations that the company had misrepresented its business plans. There was negotiation among the guaranty associations, the rehabilitator, and the reinsurer to reach a settlement that included the reinsurer working with an assumption reinsurer to develop a plan for taking over the policies. At the last minute, it was discovered that the assuming reinsurer for the business was not licensed in all states where the guaranty associations had obligations. This is one of the fundamental requirements of the guaranty associations. Fortunately, this company had an affiliate which was licensed in the one state where the primary company was not, so that worked out all right.

TABLE 5
INVESTMENT LIFE OF AMERICA (1993)

Policyholder Liabilities (millions)	74.3
Guaranty Association Coverage Adjustments	5.2
Dedicated Assets, Including Policy Loans	1.4
Guaranty Association Covered Obligations	67.7
Estate Asset Distributions	46.0
Other Adjustments	(0.1)
Reinsurer Enhancement	0.3
Estimated Guaranty Association Cost	21.5
Issues: Dispute with prior reinsurer; Licensing of assuming carrier (No Rehab; 17 Months)	

Kentucky Central was the largest insolvency from the standpoint of number of individual policyholders affected (Table 6). That's one of my favorites. I had been at work at NOLHGA about ten days when Kentucky Central was put into rehabilitation and I was given the assignment of working with that one. It took 28 months to get an agreement that the guaranty associations could participate in. Initially the rehabilitator believed that he could work out a plan that would not require guaranty association participation. He developed a complex plan that was put out for bids.

There was a two-step bidding process with the winning bidder in the first step permitted to negotiate a detailed definitive assumption reinsurance plan. That plan was then put out for bids on the second round and probably not surprisingly, the winning bidder in the first round was the winning bidder ultimately. Then they discovered they had a problem. The estate was about a $100 million short of having enough assets to fund this transaction—even though this plan also started out with very significant moratorium surrender charges. When the guaranty associations were brought into the table, they said, well, those haircuts that you're giving the policyholders are so severe that we don't believe that this plan meets the Guaranty Association's obligations.

We had to negotiate a separate participation agreement under which the guaranty associations agreed to provide a safety net. That way, if a policyholder surrendered, he or she got the greater of the restructured account value or the account value he would have received under his original policy guarantees in Kentucky Central. Negotiating the participation agreement took several months. Then we discovered that there was about $100 million of account values on policies that were out of compliance with IRC Section 7702. This led to protracted negotiations with the IRS National Office in Washington, which were finally concluded by a closing agreement that included a substantial payment by the liquidator to the IRS. This closing agreement was executed by the IRS September 30, 1996, 18 months after the original closing of the assumption reinsurance transaction between the rehabilitator, the guarantee associations, and the assuming company. This meant that the policyholders affected by the 7702 were in limbo for that length of time. We hope to have all of the refund of premiums calculated and distributed to the policyholders by November 30, 1996.

TABLE 6
KENTUCKY CENTRAL LIFE (1993)

Policyholder Liabilities (millions)	936.4
Guaranty Association Coverage Adjustments	99.3
Dedicated Assets, Including Policy Loans	0.0
Guaranty Association Covered Obligations	837.1
Estate Asset Distributions	714.3
Other Adjustments	(264.5)
Reinsurer Enhancement	233.6
Estimated Guaranty Association Cost	153.7
Issues: Illiquid Assets; Life and Health Agreement; 7702 (28 Months)	

From the Floor: How large was the 7702 toll charge?

Mr. Howard: I don't think that's public information yet. The closing agreement is subject to the approval of the Liquidation Court, and until it is approved, I can't say.

Old Colony Life went insolvent in 1992, and it took 30 months to move the policyholders to a new carrier (Table 7).

This one had flawed policies and resulted not in an assumption reinsurance insurance transaction or even a restructuring of the policies, but in an actual exchange. Therefore, there had to be an opt out election by the policyholders. They had to choose whether to participate in the exchange. There was a question as to whether the policies being offered by the assuming carrier met the requirements of the guaranty associations. The new policies had slightly higher surrender charges than the policies of Old Colony, and after some negotiation the guaranty associations agreed to pay several million dollars to the assuming carrier, who agreed to put the policyholders at a point in scale that would give them the same surrender charges as under their Old Colony policies.

TABLE 7
OLD COLONY LIFE (1992)

Policyholder Liabilities (millions)	227.4
Guaranty Association Coverage Adjustments	36.5
Dedicated Assets, Including Policy Loans	0.0
Guaranty Association Covered Obligations	190.9
Estate Asset Distributions	176.1
Other Adjustments	1.3
Reinsurer Enhancement	0.0
Estimated Guaranty Association Cost	13.5
Issues: Flawed policies; Substantially similar coverage (30 Months)	

We still have a few insolvencies that we're working on, but we've made some progress in the last few years.

Mr. Trier: Bill, you've touched on this question in discussing Old Colony and Kentucky Central, but I wonder if you could comment generally about the conflict that sometimes arises in these insolvency transactions between the need for the guaranty associations to determine that the restructured policies are substantially similar to the policies that the insolvent company issued, and the need of the company that will come in and purchase the business to have the policies restructured so that their profitability is enhanced to a commercially reasonable level, and to make certain that the policies can be administered on the existing systems of the assuming carrier.

Mr. Howard: This is where the guaranty association work gets interesting. You get the mix of financial, legal, and political considerations. The guaranty associations feel strongly that they need to provide at least the minimum benefits required by the guaranty association statutes. The statute itself says "this statute shall be liberally construed to effect its purposes," but there are state guaranty associations who are strict constructionists and would spend $10 to avoid paying an additional $1 of benefits. You do run into some negotiating problems on that. As I mentioned in Kentucky Central, this was one of the things that took a long time to resolve. The assuming carrier did not want there to be a possibility for the surrendering policyholders to get their full value, because they thought this would tend to increase the shock lapses, and they wanted the business for the long haul. They had done a business plan on the assumption of the additional moratorium surrender charges. The answer is that you can do it, but if it's not a straight assumption deal it's going to take longer and cost much more, because you're going to have a lot more negotiations among lawyers, actuaries, and financial people.

Mr. Skillman: Bill, whose role is it to call NOLHGA into an insolvency and at what point does NOLHGA get called?

Mr. Howard: As I mentioned, typically the guaranty associations are not triggered until there is a liquidation order with a finding of insolvency. However, the best time for the guaranty associations to become involved is as soon as the commissioner decides he has to put the company into rehabilitation. This enables the guaranty associations and the receiver to work together to develop a plan, so that when the liquidation is finally ordered by the court, there is a plan in place to take care of the policyholders. What we have tried to do in recent cases is to have the effective date of an assumption reinsurance transaction, for example, be close to the date of the liquidation order. There are some cases where the rehabilitation has been an informal supervision or maybe has been vigorously contested and the court records were sealed and we could not be involved directly, but in those cases there have been informal conversations on a confidential basis between the affected insurance department and the president of NOLHGA. In one case we heard, "The company has been put into liquidation." Although this was a surprise to me, it was not a surprise to the president of NOLHGA.

There is a provision in the Model Guaranty Association Act, and in many state acts that says that a guaranty association may be triggered if a member company is an impaired insurer. I don't believe this provision has been used. This is a politically sensitive area. Put yourself in the position of a member insurer. You may already have lost business to a company that promised more than it should have in the way of higher crediting rates, and now you're getting hit a second time when that company goes into liquidation for assessments to make the policyholders whole. I can't imagine a situation where the member insurers would stand still for being assessed to let the guaranty associations lend money to an impaired insurer. Three bites at the apple seems a little strong for the political consequences.

Mr. Dallas: We've heard from Tom Skillman on such issues as securitization and joint ventures. Mike Trier described mainly 100% indemnity reinsurance. Bill Howard discussed an alternative that I think most of us would rather avoid, but we thought it would be good to at least talk about it.

One thing I did want to point out was that this session’s purpose was not to discuss ways to get around regulation. It was to give acceptable alternatives to the Assumption Reinsurance Act. Of the alternatives that were presented, I think all of the transactions the panelists have seen usually involve State Insurance Commissioners or regulators. Again, these are alternatives to some of the requirements of the Assumption Reinsurance Act, without some of the more onerous aspects of that Act. However, each of these alternatives do have their own pitfalls which you have to watch out for.

Mr. Lawrence D. Miller: In the discussion of indemnity reinsurance and the ceding company's concern about the credit risk of the reinsurer, I heard trust accounts mentioned, but I don't recall having heard either funds withheld or modified co-insurance mentioned, and I wonder if the panel could comment on whether either of those forms as still a practical remedy for credit risk issues.

Mr. Trier: This certainly is a workable remedy from a protection standpoint. The ceding company, if it were to go that route, would have protection against the insolvency of the reinsurer. I just haven't seen 100% indemnity reinsurance transactions where that has been used. From the reinsurer's standpoint, leaving the funds with the ceding company may not be such an attractive proposition. There's no logical reason why it couldn't be done that way. It also could be done through the use of letters of credit as a security device which I suppose is another alternative. The transactions that I've been involved in have used a reinsurance trust account.

Mr. Dallas: Other issues that might pop up would be the management of those assets, that they remain with the writing company. The reinsurer may be reluctant, if they're taking on all the risk, to let the writing company maintain management of those assets.

Mr. Skillman: We do all of the above. I mean we have some agreements that are co-funds withheld. We have some that are modco. We have some that are cash co-insurance. Basically, what you get into is there is always credit risk if you're a ceding company and if you're worried about credit risk you might not want to do cash co-insurance, at least not without a trust. You may want to do it for funds withheld or modco. If you're a reinsurer as Mike said, then you may be concerned about the ceding company's risk and, generally speaking, for the ceding company, it's not always true, but in many cases the reinsurer has a better credit rating than the ceding company. So it may well be that the reinsurer—especially for co-funds withheld agreements, but in some cases for modco as well—may insist on a trust or an escrow agreement to protect it in the event of deterioration of the ceding company.

No matter which side of the deal you're on, credit risk is something that you need to assess and reach a mutually satisfactory approach.

Mr. Edward H. Baker: I learned of an interesting situation a few months ago in Colorado and this question is directed most specifically to Bill and Mike. A representative of the Colorado Guaranty Association informed a group of agents in Denver that in the event of an insurer's insolvency, separate account assets may be subject to the depredations of the receiver/rehabilitator. This came as such a shock that they referred the question to Jack Ehnes, the Insurance Commissioner in Colorado, who surprisingly didn't know the answer, so he consulted the Colorado Attorney General's Office. I don't know the outcome of that little story, but I was wondering if you gentlemen had encountered any such similar opinion regarding the inviolatability of the separate account assets.

Mr. Trier: I'm afraid that I haven't worked with that issue specifically. I am aware that separate accounts are intended to be inviolate in the case of the insolvency of a company that issues the coverage. Unfortunately, I'm not really familiar with the statutory provisions. However, I'm aware that there have been criticisms in the past concerning the adequacy of the statutes to do that job, and I know that at some point there was some language which was bandied about as a better way of protecting the interests of the policyholders that have the benefit of separate accounts. I don't know what the Colorado statute looks like, but I am aware that there has been, at least among attorneys discussing this issue, some controversy as to whether separate account policyholders are always protected and, whether those accounts are kept outside of the insolvency proceedings.

Mr. Howard: Again, I'm not sure exactly what the speaker was referring to, but generally—and the Colorado Act is close to the Model Act on this—it says that this act shall not provide coverage for any portion of a policy or contract not guaranteed by the insurer or under which the risk is borne by the policy or contractholder. However, there are guaranteed separate accounts. This would be something that was originally issued in a separate account, but then moved into a fixed-income option where the insurer was guaranteeing you the principal, or a minimum interest rate, or both. I can see that would be subject to control by the rehabilitator in a rehabilitation.

Mr. Baker: Bill, didn't Old Colony have some unfunded separate accounts, and didn't the policyholders wind up in your pocket?

Mr. Howard: The contract called for a separate account.

Mr. Baker: They didn't bother with those little details.

Mr. Howard: Little details like that just didn't bother the management of Old Colony. It’s correct that the separate accounts were never established. That was one of the many flaws in those policies and the reason why they could not be assumed by any company and why there had to be an exchange.

Mr. Baker: But NOLHGA did have to include those as coverages I believe.

Mr. Howard: Yes. There was no separate account, although the policies made provision for one if the policyholder paid another $300 a year.

Mr. Dallas: I will say that I have asked that same question of my parent companies' in-house attorneys, and they are of the opinion that the separate accounts would be subject to the general claims of the creditors. They are not completely protected and, in fact, they have worked in the last few years to get a statute passed in Missouri that would not make those assets subject to the general claims of the creditors, so I think it may vary by state.

Mr. Dale S. Hagstrom: In the marketplace, how many transactions have occurred that are assumption reinsurance? Is there much zero activity? What's the situation?

Mr. Howard: As I say, we expect to close one in early November 1996, involving an insolvent company, but, of course, that's the part that's exempt from the Model Act. There was one closed in 1995, and about four closed in 1994.

Mr. Hagstrom: Were they insolvencies or solvent companies?

Mr. Howard: Insolvencies.

Mr. Hagstrom: My question was about solvent companies.

Mr. Trier: Our office really hasn't handled any assumption reinsurance deals that have been subject to the Model Act, but we have closed assumption reinsurance deals since the Model Act has been promulgated. One thing that you need to recognize is, aside from the exception in the Model Act that deals with insolvent estates, there's only perhaps half a dozen states that have passed the Model Act. If you have a book of business that doesn't have any involvement with those states, you're still under the old rules, so we have seen transactions on those rules.

Mr. Dallas: What I have heard about or seen is transactions that they want to do assumption reinsurance, but they want to go ahead and move the block now. So they'll go ahead and execute a 100% indemnity transaction with the intent of converting it to assumption reinsurance within two years.

Mr. Howard: Nothing is ever as simple as it seems, so even though the guarantee associations are exempt from the provisions of the Model Act, I believe there are about six states that have requirements that do require guarantee associations to get permission or approval of the commissioner before moving blocks of business, so we have to go through the same drill.

Mr. Baker: It wasn't my intention to make a long drawn out debate out of this question of the inviolate separate accounts. Three out of four panelists seem to indicate that the industry is guilty of a vast misrepresentation with respect to the issue of variable annuity, variable life, and variable universal life. Do you not get that same sense here, because I'm confident that everyone that purchases variable products thinks that they are safe?

Mr. Howard: I must say I was surprised by Jim's comment that in some states they believe that separate accounts are subject to the claims of general creditors.

Mr. Dallas: I was surprised, too.

Mr. Skillman: I'll just credit that to the fact that there's a great deal of creative lawyers out there and let Mike take another shot.

Mr. Trier: Well, it may be that my comment and perhaps the advice that Jim got from his attorneys are an instance of attorneys taking a very technical view of the statute and trying to determine whether or not it's immune from all attacks. I'm not saying that the statute wouldn't be upheld so that policyholders would be safe from the claims of general creditors if the issue ever were litigated in particular states. I'm just aware that from an attorney's standpoint there may be some problem there, but as to what will happen if that issue ever comes to litigation I really can't make a prediction.