

## PROJECT HISTORY-2023

### PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION MODEL ACT (#540)

#### 1. Description of the Project, Issues Addressed, etc.

##### Restructuring

In 2019, the Financial Condition (E) Committee formed the Restructuring Mechanisms (E) Working Group, which was charged with documenting the various issues related to insurance business transfers (IBT) and corporate division (CD) transactions in the form of a white paper. Included in the charge was to “[consider] the impact that a restructuring might have on guaranty associations and policyholders that had guaranty fund protection prior to the restructuring.”

The proposed amendments to the *Property and Casualty Insurance Guaranty Association Model Act* (#540) were precipitated by discussions within the Restructuring Mechanisms (E) Working Group’s charge. The number of states adopting laws that permit either of these transactions is still relatively low. However, one of the most significant issues that had been discussed during the Working Group’s meetings was the need for policyholders subject to such transactions to retain guaranty fund coverage. The National Conference of Insurance Guaranty Funds (NCIGF) representatives suggested that an amendment to a state’s guaranty fund act, or other related law, is necessary to address this issue. They specifically suggested that the NAIC update Model #540, and they developed specific language to address this issue. An amendment to Model #540 will better enable states that have incorporated Model #540 into their laws to update their laws for this important issue, ensuring policyholders in all states retain their coverage. Because guaranty association coverage follows the state of licensure rather than the state of domicile, adequately addressing these concerns is necessary regardless of the type of transfer and how few states adopt changes to their laws to allow IBT and CD transactions.

It should be noted that with respect to guaranty fund coverage for life and health insurance, the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) is suggesting a different approach to address the same issue in the life and health context. NOLHGA’s proposal centers around the need for such transactions to require the assuming or resulting insurer to be licensed in all states where the issuing insurer was licensed or ever was licensed to retain the needed coverage for policyholders.

On March 28, 2022, the Restructuring Mechanisms (E) Working Group sent a referral to the Receivership and Insolvency (E) Task Force to request amendments to Model #540.

The Executive (EX) Committee approved a Request for NAIC Model Law Development for amendments to Model #540 during the 2022 Summer National Meeting. The amendments are intended to preserve guaranty fund coverage for policyholders subject to insurance business transfers (IBT) and corporate divisions (CD) where the policyholder had guaranty fund coverage before the transaction.

##### Cybersecurity Insurance

In December 2022, NCIGF requested the Task Force amend Model #540 to ensure cybersecurity insurance policyholders in all states are provided with guaranty fund coverage for this trending line of business. According to NCIGF, cybersecurity insurance coverage is trending into the admitted market. Consequently, NCIGF anticipates the insurance insolvency resolution system will be presented with claims and other issues related to this coverage. These policy obligations may flow both from standalone cyber policies, endorsements, or from coverages that may be found to exist in commercial general liability and other lines of business typically written for business entities. For this reason, policymakers need to determine how such coverages will be handled should an insurer writing this business become insolvent.

The Executive (EX) Committee approved a separate Request for NAIC Model Law Development for additional amendments to Model #540 during the 2023 Spring National Meeting. The amendments will address clarifying guaranty association coverage of cybersecurity insurance.

## **2. Name of Group Responsible for Drafting the Model and States Participating**

The Receivership Law (E) Working Group of the Receivership and Insolvency (E) Task Force was given the task of drafting the initial revisions to Model #540. The 2022 and 2023 members of the Working Group were Illinois (Co-Chair), Pennsylvania (Co-Chair), Arkansas, California, Colorado, Connecticut, Florida, Iowa, Louisiana, Maine, Massachusetts, Michigan, Missouri, Nebraska, Puerto Rico, Texas, and Washington.

A drafting group was formed in November 2022 to review comments received on the first exposure draft of the restructuring amendments and to draft additional revisions. Members included Illinois, Maine, Pennsylvania, Oregon, Barbara F. Cox (Barbara F. Cox LLC), Roger Schmelzer (NCIGF), Rowe Snider (Locke Lord LLP), Stephen W. Schwab (DLA Piper LLP), and Patrick H. Cantilo (Cantilo and Bennett LLP).

## **3. Project Authorized by What Charge and Date First Given to the Group**

As described, the initial charge prompting a review of Model #540 was given to the Receivership Law (E) Working Group at the 2022 Summer National Meeting. The two separate Requests for NAIC Model Law Development to open Model #540 for revision were adopted by the Executive (EX) Committee at the 2022 Summer National Meeting (restructuring) and the 2023 Summer National Meeting (cybersecurity insurance).

## **4. A General Description of the Drafting Process (e.g., Drafted by a Subgroup, Interested Parties, the Full Group, etc.)—Include Any Parties Outside the Members That Participated**

For both the restructuring and the cybersecurity insurance amendments, NCIGF proposed an initial draft of amendments to Model #540. As noted above, a drafting group was formed in November 2022 to review comments received on the first exposure draft of restructuring amendments and consider further edits to Model #540. Upon completion of the drafting group's efforts, the Receivership Law (E) Working Group exposed and addressed comments on both sets of amendments—restructuring and cybersecurity insurance.

After the adoption of the amendments by the Receivership Law (E) Working Group on July 24, 2023, on Aug. 14, 2023, the Receivership and Insolvency (E) Task Force exposed and considered subsequent edits to the amendments before adopting the amendments on Oct. 2, 2023.

## **5. A General Description of the Due Process (e.g., Exposure Periods, Public Hearings, or Any Other Means by Which Widespread Input From Industry, Consumers and Legislators Was Solicited)**

On Sept. 14, 2022, the Receivership Law (E) Working Group met in open session to expose proposed amendments to the definition of covered claims in Section 5 of Model #540 a 30-day public comment period ending Oct. 14, 2022. The initial draft of amendments was proposed by NCIGF. Comments were received from Robert Wake (ME).

On Nov. 7, 2022, the Receivership Law (E) Working Group met in open session to discuss comments received. A drafting group was formed to review the comments on the restructuring amendments and to consider further edits to the Model #540 amendments.

Between January and May 2023, the drafting group met four times and had many email exchanges as they worked through different drafts. The drafting group determined it had reached a point where they needed the broader Receivership Law (E) Working Group's input before moving forward with a single version of the

amendments. The drafting group delivered two versions of the amendments for restructuring, albeit each with multiple alternatives, as proposed by different members of the drafting group, to the Receivership Law (E) Working Group for consideration.

On May 23, 2023, the Receivership Law (E) Working Group met in open session to consider the two versions of the amendments. After hearing presentations from the drafting group members and receiving summary explanations of each version, the Working group agreed to move forward with one version of the amendments. The amendments to Model #540 for restructuring were exposed for a 30-day comment period that ended June 23, 2023.

On May 23, 2023, the Receivership Law (E) Working Group exposed the draft amendments regarding guaranty fund coverage of cybersecurity insurance for a 30-day comment period that ended June 23, 2023.

Three comment letters were received on the exposure of restructuring amendments from Barbara F. Cox (Barbara F. Cox LLC) representing NCIGF, Patrick H. Cantilo (Cantilo and Bennett LLP), and Joseph Torti (Fairfax (US) Inc.). No comments were received on the cybersecurity insurance amendments.

On July 24, 2023, the Receivership Law (E) Working Group met in open session to consider comments received on the restructuring amendments. NAIC staff proposed non-substantive grammatical and formatting edits. The amendments were adopted by the Receivership Law (E) Working Group on July 24, 2023, by unanimous vote.

On Aug. 14, 2023, the Receivership and Insolvency (E) Task force met in option session at the Summer National Meeting. The Task Force heard comments from Barbara F. Cox (Barbara F. Cox LLC) representing NCIGF, Patrick H. Cantilo (Cantilo and Bennett LLP), and Joseph Torti (Fairfax (US) Inc.). The Task Force exposed the Model #540 amendments, including certain subsequent editorial clean-up revisions, for a 30-day public comment period ending Sept. 14.

On Oct. 2, 2023, the Receivership and Insolvency (E) Task force met in option session on a virtual meeting to discuss comments on the exposure that were received from Dan Bumpus (VA), Robert Wake (ME), Roger Schmelzer (NCIGF), and Patrick H. Cantilo (Cantilo and Bennett LLP). No further changes were made. The amendments were adopted by the Receivership and Insolvency (E) Task Force on Oct. 2, 2023, by unanimous vote.

All exposures were distributed by email to members, interested state insurance regulators, and interested parties of both the Receivership Law (E) Working Group and the Receivership and Insolvency (E) Task Force and were posted to the NAIC website.

All issues raised by members, interested state insurance regulators, and interested parties were discussed, explained, or addressed through revisions to the original proposed amendments. The amendments were adopted by the Financial Condition (E) Committee on Oct. 25, 2023.

## **6. A Discussion of the Significant Issues (Items of Some Controversy Raised During the Due Process and the Group's Response)**

### **Amendments to the Assumed Claims Transaction Provisions in Model #540:**

The Restructuring Mechanisms (E) Working Group referral on IBT and CD transactions that kicked off this project included initial draft language suggested by NCIGF specific to the definition of covered claims. During the initial exposure of that draft definition, concerns were raised that the proposed definition for expanding the definition of guaranty association covered claims did not fully address the issue of continuing coverage when a policy is transferred by assumption, rather IBT or CD; and that any amendments to preserve guaranty fund coverage for

policyholders subject to IBT and CDs, should not be at the exclusion of preserving coverage for policyholders subject to other transfers, such as assumption transactions where business is transferred by non-guaranty association members, like a reciprocal, fraternal or trust, to GA member insurers. The amendment adopted by the Working Group and the Task Force is intended to preserve both through the new Section 5G(2) and the new optional Section 5G(3). Therefore, the Working Group and the Task Force believe it met the charge.

Two commenters disagreed with amending the provisions in Model #540 related to deleting the 2009 assumed claims transactions provision and one interested party proposed alternative language. Specifically, provisions in Section 5D, Section 5Q, and the alternatives in Section 8A(3) related to assumed claims transactions were deleted. A new Section 5G(2) was added to ensure that coverage is preserved if coverage existed before an IBT or CD transaction. Because this amendment is broad, it automatically includes common law novation and assumption reinsurance without stating those specifically. In drafting the new Sections 5G(2) and 5G(3), the Working Group understood that there may be some states that feel there is a need for coverage in certain situations where a non-member transfers claims to a member insurer when it is not clear whether the member insurer issued a replacement policy. A new Section 5G(3) was added as optional for those states that want to include assumed claims transaction language.

With regard to the optional Section 5G(3), while the 2009 amendments were proposed to be deleted, the optional language was added, in essence, to preserve the assumed claims transaction language for those states that still may want to consider proposing that coverage to their legislatures. It was noted that only three states have adopted the 2009 assumed claims transaction language. It was the belief of members of the Working Group that the new language in Section 5G(2) and the optional language in Sections 5G(3), 5K and 8A4 are more streamlined and consequently result in greater clarity between the two options, rather than simply adding 5G(2) while retaining the former definition of assumed claim transaction. They also felt that the new proposed language would fit better into the existing statutes of the 47 states that have not adopted the 2009 assumed claims transaction language. By making the replacement language in Section 5G(3) optional, it gives states two avenues to pursue. States can try to pass both Sections 5G(2) and 5G(3) through their legislatures or if they have significant legislative objection to 5G(3), they can propose 5G(2) to address specifically the IBT and CD coverage issue. Members did not agree that the interested party's proposal would sufficiently address the transfer of policyholders being discussed. The issue was discussed by the drafting group, the Receivership Law (E) Working Group, and the Receivership and Insolvency (E) Task Force.

## **7. Any Other Important Information (e.g., Amending an Accreditation Standard).**

The Receivership and Insolvency (E) Task Force has not had formal discussions with respect to whether the current Guaranty Association accreditation standard under the NAIC Financial Regulation Standards and Accreditation Program should be amended to include the current revision to Model #540. However, it should be noted that the accreditation standard for Model #540 is not a substantially similar standard. The Task Force will consider this and make appropriate referrals prior to the 2024 Spring National Meeting.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/RITF/2023 Fall NM/540\_2023PH.docx

## **PROJECT HISTORY – 2009**

### **PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION MODEL ACT (#540)**

#### **1. Description of the Project, Issues Addressed, etc.**

Following the adoption of the revised Insurer Receivership Model Act in 2005, the Receivership and Insolvency Task Force realized revisions were necessary to update the guaranty association model acts for changes in the industry since 1996. The purpose of the Model is to provide a mechanism for the payment of covered claims under certain insurance policies, to avoid excessive delay in payment, and to the extent provided in the Model, minimize financial loss to claimants or policyholders because of the insolvency of an insurer, and to provide an association to assess the cost of such protection among insurers.

#### **2. Name of Group Responsible for Drafting the Model and States Participating**

The Receivership and Insolvency (E) Task Force was charged with updating the Post-Assessment Property and Liability Insurance Guaranty Association Model Act. The 2008 members of the Task Force that adopted the revisions to the Model in March 2008 were: Delaware (Chair at the time of adoption), Texas (Vice-Chair), Arkansas, California, Connecticut, Delaware, District of Columbia, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Missouri, Nevada, New Hampshire, New York, North Carolina, Pennsylvania, Rhode Island, Tennessee, Utah, and Washington.

The Task Force delegated the charge to its Receivership Model Act Revision (E) Working Group. The 2006 members of the Working Group that adopted the proposed revisions to the Model during a October 27, 2006 conference call were: Pennsylvania (Chair), Arkansas, Arizona, California, Connecticut, Delaware, Florida, Illinois, Iowa, Kentucky, Massachusetts, Missouri, Nebraska, New York, Ohio, Oklahoma, Tennessee, Texas, and Utah.

#### **3. Project Authorized by What Charge and Date First Given to the Group**

Following the adoption of the revised Insurer Receivership Model Act in 2005, the Receivership and Insolvency Task Force drafted a charge to develop revisions to the NAIC's two guaranty association model acts, which was approved by the Financial Condition (E) Committee. The Task Force then delegated the charge to its Receivership Model Act Revision (E) Working Group, who first took up the Post Assessment Property and Liability Insurance Guaranty Association Model Act in late 2005.

During 2007, the NAIC created a new framework for considering and approving model law developments. The two factors necessary to receive authorization to continue drafting are: (1) whether the issue that is the subject of the model law necessitates a national standard and requires uniformity amongst all states; and (2) whether NAIC members are committed to devoting significant regulator and association resources to educate, communicate and support a model that has been adopted by the membership. Further drafting was suspended until the complete review and approval process was completed at the Task Force and parent committee levels.

On September 30, 2007, it was determined by the Executive (EX) Committee that the Property and Casualty Insurance Guaranty Association Model Act met the criteria for development as a Model Act by NAIC.

#### **4. A General Description of the Drafting Process and Due Process**

The Receivership Model Act Revision Working Group began working on the Post Assessment Property and Liability Insurance Guaranty Association Model Act in late 2005 and continued reviewing it through October 2006, with the active participation of interested parties, including guaranty funds, their associations, insurers, other industry groups and a number of experienced receivership contractors. The draft Model had also been widely distributed via e-mail to various interested parties for an opportunity to submit written comments in late 2005 and throughout 2006, as well as posted for comment on the NAIC's Working Group Web page. Interested parties that provided written comment include: Allstate, Cantilo & Bennett LLP, Frost Brown Todd LLC, NCIGF, NOLHGA, Puerto Rico Property and Casualty Insurance Guaranty Association. Before the Working Group forwarded the proposed revisions to the Task Force, the Working Group decided during a September 11, 2006, meeting to provide additional guidance to the Task Force in the form of the Highlighted Issues memorandum. The memo was developed to make all participants aware of the Working Group's actions on the more controversial issues contained in the Model. During an October 27, 2006, call, the Working Group adopted the proposed revisions to go before the Task Force.

The Task Force provided an additional opportunity to address the issues in the Highlighted Issues memorandum, as well as other issues not discussed in the memo at the March 12, 2007, meeting. Interested parties that provided written comments include: AIA, Cantilo & Bennett LLP, Frost Brown Todd LLC, NCIGF, NOLHGA, and PCI. However, during a May 30, 2007, conference call, the Chair advised the Task Force that it would not be able to take a vote on the proposed revisions to the Model as in the interim the NAIC adopted a new model law process. The Task Force completed the appropriate review and paperwork according to the new process, which was subsequently exposed and adopted by E Committee. On September 30, 2007, the Executive (EX) Committee determined that the Model met the criteria for development as a Model Act.

During a November 28, 2007, conference call, the Task Force re-exposed the revised Model for comment to interested parties and regulators on issues that had not been previously submitted to the Task Force or Working Group. However, no new comments were received. During a March 30, 2008, meeting, the Task Force made amendments to some revisions initially proposed by the Working Group and then adopted a newly revised Model to be submitted to the Financial Condition (E) Committee.

On March 31, 2008, the Financial Condition (E) Committee received the Task Force's report and adopted a motion to expose the Model for comment. On May 23, 2008, an interim conference call took place to discuss interested party and regulator comments. A few proposed amendments to the proposed model regulation were submitted by regulators and adopted by the Financial Condition (E) Committee. In addition, the newly revised Model was adopted by the Committee.

#### **5. A Discussion of the Significant Issues**

The following significant issues were discussed by the Receivership Model Act Revision Working Group and Receivership and Insolvency Task Force:

##### Purpose and Construction

Section 2 and 4 of the current model was deleted from the proposed model by the Working Group based on concerns that the clauses have, in some cases, expanded the coverages provided by the guaranty associations. Two roll call votes were taken on this section by the Working Group. On December 3, 2005, the vote was 5-7 in favor of retaining the section. On May 25, 2006, the vote was 6-4 in favor of deleting it. On March 30, 2008, the Task Force voted 13-7 in favor of retaining Section 2 and 4 with comments from regulators suggesting that the aforementioned problems arose from specific issues with judges.

#### Assumption of business from unlicensed carriers

Under the current model, policies assumed from an unlicensed carrier are not included within the definition of covered claims for the guaranty association. On May 9, 2006, by a vote of 7-4, these policies were included as covered claims by the Working Group. On March 30, 2008, the Task Force voted 11-9 in favor of excluding assumption of business from unlicensed carriers from the definition of covered claims.

#### Policy protection claims by insureds

On August 31, 2006, a motion to remove the exclusion of claims based on IBNR from the definition of "Covered Claims" (§ 3H(2)(j)), was defeated by a vote of 8-6. Due to lack of a motion, the Task Force did not consider this issue.

#### Coverage limits

On January 17, 2006, a straw vote was taken to determine if there was a consensus on changing the process for determining the coverage limit. Three members favored a fixed \$500,000 cap, three favored an adjustable cap starting at \$500,000, two favored an adjustable cap, and other members were opposed to any change. Because there was no consensus for a change, a fixed cap of \$500,000 was presented and adopted by voice vote in § 6A(1)(a)(iii). Due to lack of a motion, the Task Force did not consider this issue.

#### Claims bar date

On February 7, 2006, a 25-month claims bar date was established in § 6A(1)(b) by a vote of 7-2 with one abstention by the Working Group. On August 31, 2006, the issue was reconsidered, and the 25-month bar date was deleted by a vote of 8-5 with one abstention by the Working Group. The language in the proposed Model requires the guaranty fund bar date to be the same as the estate bar date. The Working Group reached this conclusion in order to avoid confusion. Due to lack of a motion, the Task Force did not consider this issue.

#### Receiver bound by GA claims determination.

On March 4, 2006, a motion to delete § 10C entirely was defeated 9-7 by the Working Group. A subsequent motion to delete only the last sentence of the subsection passed by a vote of 10-5 by the Working Group, so the Act is silent with regard to whether the receiver would be bound by the guaranty association claim determination. On March 30, 2008, a motion to restore the language failed with a Task Force vote of 8 to 12.

#### Net worth exclusion.

During several meetings in June 2006, the Working Group discussed and approved each subsection of § 11. On July 11, 2006, this section was accepted by the Working Group as an optional section by a vote of 5-4 with one abstention. On July 18, 2006, a motion to reconsider the earlier vote was defeated by a vote of 8-4 by the Working Group; therefore, this section as drafted is included as optional. Though already enacted in some form in 35 states according to NCIGF, the existence and operation of the high net worth exclusion is still highly controversial. Due to lack of a motion, the Task Force did not consider this issue.

#### Immunity

On May 25, 2006, by a vote of 6-4, the Working Group adopted a revised version of § 16 on immunity of the guaranty association, its staff, members, directors, and the receiver and its staff. The immunity section in the prior model was substantially unlimited other than as it was interpreted by the courts. The new version of the provision removes immunity for the association for tort claims and for contract claims arising out of its statutory obligations. On March 30, 2008, the Task Force voted in favor of deleting the Working Group's revision given representations from NCIGF that the language is not necessary given the long-standing case law and adding the language could create some ambiguity and litigation.

## **6. Any Other Important Information**

As the Part A. Laws and Regulations of the NAIC Financial Regulation Standards and Accreditation Program only requires a regulatory framework such as contained in the NAIC's model acts on guaranty funds, the newly revised Property and Casualty Insurance Guaranty Association Model Act should not require a request to the Financial Regulation Standards and Accreditation (F) Committee to amend an accreditation standard.