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Texas Adopts Key Features of NAIC's Amended Model Insurance Holding Company Act

On June 17, 2011, Texas became the first large state to adopt the principal components of the National Association of Insurance Commissioners' ("NAIC's") newly amended Insurance Holding Company Act (the "Model Act").¹ Originally adopted by the NAIC in 1969 and by the Texas legislature in 1971, the Model Act regulates the acquisition and maintenance of control of insurance companies and transactions between insurance companies and affiliated entities. Generally, in Model Act states, including Texas, (i) the acquisition of control of a domestic insurer is subject to prior regulatory approval, and (ii) a licensed insurer must observe various requirements concerning its relationship with its holding company and other affiliates (unless the insurer is subject to substantially similar requirements in its domiciliary state).² Texas's amended holding company act³ takes effect on September 1, 2011,⁴ although certain provisions are phased in beyond that date, as described below.

By way of background, in December 2010 the NAIC amended the Model Act in significant ways. The amendments are primarily responsive to the 2008 financial crisis and, in general, enhance the authority of insurance regulators in the adopting state to oversee insurance holding companies and to subject such companies to new, more rigorous reporting and approval requirements. The NAIC has indicated that the purpose of these amendments is to "address issues that exist within insurer groups, particularly issues identified during this most recent economic downturn"⁵ and to provide state regulators with "important new tools for evaluating risks within insurance groups."⁶ The amendments represent a shift in emphasis from regulating specific transactions and relationships within affiliate groups to understanding group-wide risks more holistically. The principal changes effected by the NAIC amendments include

- the introduction of the concept of "enterprise risk"⁷ (that is, the risk that a non-insurer poses to its insurance company affiliates);

¹ Insurance Holding Company System Regulatory Act (NAIC Model Laws, Regulations and Guidelines 440 1) (hereinafter cited as "Model Act").

² See Model Act §4(A); Tex. Ins. Code §823.059.

³ Tex. Ins. Code Chap. 823 as amended by 2011 Texas S.B. 1431, signed by Gov. Rick Perry on June 17, 2011.

⁴ 2011 Texas S.B. 1431, §19.

⁵ NAIC memorandum dated Sept. 1, 2010 from Noreen Vergara, Staff Attorney, to Commissioners and Interested Parties.

⁶ News release, Dec. 17, 2010, "NAIC Adopts Key Health Care Provisions, Budget, Other Regulatory Issues — Special Session Finalizes Many Pending 2010 Regulatory Issues."

⁷ "Enterprise risk" is defined as "any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including, but not limited to, anything that would cause the insurer's Risk-Based Capital to fall into company action level . . . or would cause the insurer to be in hazardous financial condition. . ." Model Act §1(F).

- stricter standards for inter-affiliate transactions (for example, all management agreements between an insurer and any affiliate will be required to contain specific provisions on allocating costs, indemnifying the insurer and similar matters);⁸
- provisions designed to promote cooperation between state insurance regulators and non-US regulators on multinational holding companies;⁹ and
- reforms in the handling and administration of multistate Form As (applications to acquire control of holding companies owning insurers domiciled in multiple states).¹⁰

In other changes, the NAIC amendments (i) require that any divestiture of control over an insurer be subject to prior regulatory approval,¹¹ (ii) refine the procedure for accepting or rejecting disclaimers of affiliation¹² and (iii) authorize insurance regulators to exempt smaller insurers from requirements to have independent directors (*i.e.*, directors who are not officers, employees or controlling shareholders of the insurer or an affiliate) included on their boards.¹³

Prior to the recent Texas legislation, Texas's law, although very similar to the NAIC's pre-amendment model, differed from the model in certain respects. For example, Texas lacks Section 3.1 of the Model Act (which regulates acquisitions of licensed insurers based on market concentration criteria) and exempts an acquisition from prior-approval requirements if insurance accounts for less than 20% of the assets, revenues and equity of the target company.¹⁴ These differences remain unaffected by the Texas's Model Act amendments, which largely conform to the main concepts of the NAIC proposal.

Texas's most significant departure from the Model Act amendments relates to the "enterprise risk" concept. Under the NAIC amendments, the ultimate controlling person of every controlled insurer must file an annual report identifying the "material risks" within the group "that could pose enterprise risk" to the insurance company.¹⁵ The report must be filed with the insurance commissioner of the group's "lead" state (generally, the domiciliary state of the principal insurer within the group).¹⁶ In adopting this requirement, the Texas legislation qualifies it as follows:

⁸ Model Act §5(A).

⁹ Model Act §7.

¹⁰ Model Act §3(D).

¹¹ Model Act §3(A)(2).

¹² Model Act §4(K).

¹³ Model Act §5(C)(6).

¹⁴ Tex. Ins. Code §823.153. The Model Act exempts acquisitions where the target is "primarily engaged" in non-insurance businesses; "primarily engaged" is not defined or quantified. Model Act §3(A)(4). In both the NAIC Model Act and Texas's version thereof, the exemption available for such companies does not extend to other aspects of holding company regulation, such as reporting requirements for inter-affiliate transactions; however, other relief may be available in such cases.

¹⁵ Model Act §4(L).

¹⁶ *Id.*

- *The reporting requirement is phased in and based on a graduated scale according to annual premiums.* The ultimate controlling person is required to file the first such enterprise risk report with the first annual registration statement¹⁷ that becomes due after
 - July 1, 2013, if the total direct or assumed annual premiums of the insurer ("Premiums") were \$5 billion or more during the preceding 12-month period;
 - January 1, 2014, if Premiums were more than \$1 billion but less than \$5 billion during the preceding 12-month period;
 - January 1, 2015, if Premiums were more than \$500 million but less than \$1 billion during the preceding 12-month period; or
 - January 1, 2016, if Premiums were \$300 million or more but less than \$500 million during the preceding 12-month period.
 - These requirements expire on January 2, 2015.¹⁸

- *Smaller insurers (other than certain distressed companies) are exempt altogether.* The ultimate controlling person of an insurer with Premiums of less than \$300 million is not required to submit an enterprise risk report,¹⁹ except that the Texas insurance commissioner may compel an ultimate controlling person to file such a report where the controlled insurer, regardless of size, is "not in compliance with applicable risk-based capital standards" or is otherwise in "hazardous condition, as determined by the commissioner."²⁰
- *Insurers of a certain size may request an exemption from filing.* An insurer that in the preceding calendar year had Premiums of more than \$300 million but less than \$500 million may request an exemption from the enterprise risk reporting requirement by filing with the Texas commissioner a written statement describing the "undue financial or organizational hardship the insurer . . . would suffer as a result of complying" with the requirement. The commissioner may grant the exemption if the commissioner finds that compliance would "impose an undue financial or organizational hardship on the insurer."²¹
- *Certain insurers are "grandfathered" and need not file.* Under very limited circumstances (generally involving certain insurers organized before 1910 and owned by charitable foundations or trusts), an insurer's ultimate controlling person is not required to submit an enterprise risk report.²²
- *No enterprise risk filing will be required at all until 2014 at the earliest.* The Texas Department of Insurance is not authorized to implement the enterprise risk reporting requirement until the 180th day after the date the commissioner determines that the NAIC has completed an

¹⁷ *I.e.*, the Form B.

¹⁸ 2011 Texas S.B. 1431 §6. It is not immediately clear how such expiration date can be harmonized with the transition provisions insofar as the various phase-in periods straddle the January 2, 2015 expiration. We understand that the Texas Department of Insurance may be reviewing this anomaly.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

enterprise risk form and has proposed a "master confidentiality agreement"²³ and places notice of that determination in the Texas Register. However, notwithstanding the foregoing requirement, an insurer is not required to file an enterprise risk report until January 1, 2014 at the earliest.²⁴

Two other noteworthy Texas deviations from the new amendments to the NAIC Model Act involve disclaimer filings. Under the NAIC Model Act pre-amendment, a person could file a statement, known as a "disclaimer of affiliation," with the domiciliary state regulator in a situation where the person is statutorily presumed to control an insurer but does not in fact control it. For instance, a disclaimer is a common remedy where an investor has acquired or proposes to acquire 10% or more of an insurance company's stock (thereby giving rise to a presumption of control) but lacks the power to appoint directors or otherwise influence management.

Historically under the NAIC Model Act, a disclaimer was considered effective when filed; it did not require an affirmative approval from the regulator.²⁵ However, as a practical matter, many filers have been loath to rely on this so-called deemed approval — and have insisted on receiving affirmative relief from the regulator prior to acquiring presumptive control — because of the concern that the regulator could disallow the disclaimer at any time. Prior to the NAIC amendments, the regulator could disapprove a disclaimer only upon a notice and hearing.²⁶ Under the amendments, by contrast, a disclaimer is deemed effective 30 days after its submission unless disallowed before that time, and such disallowance does not require notice or hearing (although upon a disallowance, the filer is entitled to a hearing on request).²⁷

- *Texas lengthens the period required for deemer.* A Texas disclaimer is deemed approved only after 60 days, rather than 30.²⁸
- *Texas permits the regulator to disallow after the fact.* The NAIC Model Act does not expressly give the regulator the authority to challenge or to nullify a disclaimer once it has become effective (whether by affirmative act of the regulator or "deemed" approval after 30 days). The Texas amendments expressly state that, if "at any time" the commissioner determines that the disclaimer is incomplete or inaccurate or is no longer accurate, the commissioner may disallow it.²⁹

²³ This may be a reference to the confidentiality agreement that the Model Act contemplates between the NAIC and the respective state regulators governing the use by the NAIC of information obtained from holding company act filings. See Model Act §8(C)(4); 2011 Texas S.B. 1431 §3(G).

²⁴ *Id.* §18.

²⁵ Model Act §4(K) (as in effect prior to December 16, 2010).

²⁶ *Id.*

²⁷ Model Act §4(K) (as in effect currently).

²⁸ 2011 Texas S.B. 1431 §2.

²⁹ *Id.*

For More Information

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