



Telephone: (517) 373-5383 Fax: (517) 373-1986 TDD: (517) 373-0543

H.B. 5930: COMMITTEE SUMMARY

House Bill 5930 (as passed by the House) Sponsor: Representative David Robertson

House Committee: Insurance

Senate Committee: Banking and Financial Institutions

Date Completed: 6-17-04

## **CONTENT**

The bill would amend Chapter 81 (Supervision, Rehabilitation, and Liquidation) of the Insurance Code to do all of the following:

- -- Specify that a person could not be prohibited from exercising a contractual right to end a "netting agreement" or "qualified financial contract" with an insurer subject to Chapter 81 proceedings.
- -- Require that, upon termination of a netting agreement, the net or settlement amount owed to an insurer be transferred to or on the order of the insurer's receiver.
- -- Require that a receiver use its best efforts to notify parties to netting agreements or qualified financial contracts if the receiver made a transfer of any netting agreements or qualified financial contracts.
- -- Prohibit a receiver from avoiding a transfer of money or property in connection with a netting agreement or qualified financial contract if the transfer were made before a delinquency proceeding had begun, unless the transfer were made with intent to defraud the insurer, a receiver, or creditors.
- -- Require a receiver to take action on each netting agreement or qualified financial contract, in its entirety, in exercising powers to disaffirm or repudiate an agreement or contract.
- -- Specify that rights of counterparties under the Code would apply to netting agreements and qualified financial contracts.

The bill would not apply to affiliates of an insurer that was subject to Chapter 81 proceedings.

"Netting agreement" would mean a contract or agreement, including terms and conditions incorporated by reference, that documents one or more transactions between the parties to the agreement for or involving one or more qualified financial contracts and that provides for the netting or liquidation of qualified financial contracts or present or future payment obligations or payment entitlements under those contracts, including liquidation or close-out values relating to those obligations or entitlements, among the parties to the netting agreement. The term would include a master agreement that otherwise met the bill's definition of "netting agreement". A master agreement would include all schedules, confirmations, definitions, and addenda to it and transactions under it, which would have to be treated as one netting agreement.

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"Qualified financial contract" would mean a commodity contract, forward contract, repurchase agreement, securities contract, swap agreement, and any similar agreement that the Commissioner of the Office of Financial and Insurance Services (OFIS) determined by regulation, resolution, or order to be a qualified financial contract for purposes of Chapter 81.

The bill specifies that, notwithstanding any other provision of the law, including any other provision of the Code permitting the modification of contracts, a person could not be stayed or prohibited from exercising any of the following:

- -- A contractual right to terminate, liquidate, or close out any netting agreement or qualified financial contract with an insurer because of the commencement of formal delinquency proceedings under Chapter 81 or the insurer's insolvency, financial condition, or default, provided that the right was enforceable under applicable law other than the Insurance Code.
- -- Any right under a pledge, security, collateral, or guarantee agreement or any other similar security arrangement or credit support document relating to a netting agreement or qualified contract.
- -- Subject to Section 8130(2) of the Code, any right to set off or net out any termination value, payment amount, or other transfer obligation arising under or in connection with a netting agreement or qualified financial contract in which the counterparty or its guarantor was organized under Federal law or the laws of a state or foreign jurisdiction approved by the securities valuation office of the National Association of Insurance Commissioners and approved by the OFIS Commissioner as eligible for netting. (Section 8130(2) specifies conditions under which a setoff or counterclaim is not allowed.)

Upon termination of a netting agreement, the net or settlement amount, if any, owed by a nondefaulting party to an insurer against which an application or petition had been filed under Chapter 81, would have to be transferred to or on the order of the insurer's receiver, even if the insurer were the defaulting party. This would apply regardless of whether the netting agreement provided that the nondefaulting party was not required to pay any net or settlement amount due to the defaulting party upon termination. Any limited two-way payment provision in a netting agreement with an insurer that had defaulted would be considered a full two-way payment provision as against the defaulting insurer. Any such property or amount, except to the extent it was subject to one or more secondary liens or encumbrances, would be a general asset of the insurer.

In making any transfer of a netting agreement or qualified financial contract of an insurer subject to a proceeding under Chapter 81, the receiver would have to do either of the following:

- -- Transfer to one party, other than an insurer subject to a Chapter 81 proceeding, all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty and the insurer subject to the Chapter 81 proceeding, including all rights and obligations of each party under each netting agreement and qualified financial contract and all property, including any guarantees or credit support documents, securing any claims of each party under each netting agreement and qualified financial contract.
- -- Transfer none of the netting agreements, qualified financial contracts, rights, obligations, or property with respect to the counterparty and any of its affiliates.

If an insurer's receiver made a transfer of one or more netting agreements or qualified financial contracts, the receiver would have to use its best efforts to give notice of the transfer to any person who was party to the netting agreements or qualified financial contract by noon of the receiver's local time on the business day following the transfer. (For

this purpose, "business day" would mean a day other than a Saturday, Sunday, or any day on which either the New York Stock Exchange or the Federal Reserve Bank of New York was closed.)

A receiver could not avoid a transfer of money or other property arising under or in connection with a netting agreement or qualified financial contract or any pledge, security, collateral, or guarantee agreement or any other similar security arrangement or credit support document relating to a netting agreement or qualified financial contract that was made before the beginning of a formal delinquency proceeding under Chapter 81. A transfer could be avoided, however, if it were made with actual intent to hinder, delay, or defraud the insurer, a receiver appointed for the insurer, or existing or future creditors.

In exercising any of its powers under Chapter 81 to disaffirm or repudiate a netting agreement or qualified financial contract, a receiver would have to take action with respect to each agreement or contract and all transactions entered into in connection with the agreement or contract in its entirety. Any claim of a counterparty against an estate arising from the receiver's disaffirmance or repudiation of a netting agreement or qualified financial contract that had not been previously affirmed in the liquidation or immediately preceding rehabilitation case, would have to be determined and allowed or disallowed as if the claim had arisen before the date the liquidation petition was filed or, if a rehabilitation proceeding were converted to a liquidation proceeding, as if the claim had arisen before the date the petition for rehabilitation was filed. The amount of the claim would have to be the actual direct compensatory damages determined as of the date of the disaffirmance or repudiation of the netting agreement or qualified financial contract.

The bill specifies that all rights of counterparties under the Code would apply to netting agreements and qualified financial contracts entered into on behalf of the general account or separate accounts, if the assets of each separate account were available only to counterparties to netting agreements and qualified financial contracts entered into on behalf of that separate account.

Proposed MCL 500.8115a Legislative Analyst: Patrick Affholter

## **FISCAL IMPACT**

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Maria Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.