

___th General Assembly

Regular Session

S. B. No. ____

2010 -2011

As Introduced

Sen. _____ moved to amend as follows:

Section 1. Amend § 3903.01 of Title 39 as follows:

“As used in *sections 3903.01 to 3903.59 of the Revised Code*:

(A) "Admitted assets" means investment in assets which will be admitted by the superintendent of insurance pursuant to the law of this state.

(B) “Affiliate” shall have the same meaning as “affiliate of” or “affiliated with” in Section 3901.32 of the Revised Code.

(C) "Assets" means all property, real and personal, of every nature and kind whatsoever or any interest therein.

(D) "Ancillary state" means any state other than a domiciliary state.

(E) “Commodity Contract” means any of the following:

(1) A contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a board of trade designated as a contract market by the commodity futures trading commission under the federal Commodity Exchange Act, 7 U.S.C. § 1 et seq., or a board of trade outside the United States.

(2) An agreement that is subject to regulation under section 19 of the federal Commodity Exchange Act, 7 U.S.C. § 1 et seq., and that is commonly known to the commodities trade as a margin account, margin contract, leverage account or leverage contract.

(3) An agreement or transaction that is subject to regulation under section 4c(b) of the federal Commodity Exchange Act, 7 U.S.C. § 1 et seq., and that is commonly known to the

commodities trade as a commodity option.

(4) Any combination of the agreements or transactions referred to in this paragraph.

(5) Any option to enter into an agreement or transaction referred to in this paragraph.

(F) "Creditor" means a person having any claim, whether matured or unmatured, liquidated or unliquidated, secured or unsecured, absolute, fixed, or contingent.

(G) "Delinquency proceeding" means any proceeding commenced against an insurer for the purpose of liquidating, rehabilitating, reorganizing, or conserving the insurer, and any summary proceeding under *section 3903.09* or *3903.10 of the Revised Code*. "Formal delinquency proceeding" means any liquidation or rehabilitation proceeding.

(H) "Doing business" includes any of the following acts, whether effected by mail or otherwise:

(1) The issuance or delivery of contracts of insurance to persons resident in this state;

(2) The solicitation of applications for such contracts, or other negotiations preliminary to the execution of such contracts;

(3) The collection of premiums, membership fees, assessments, or other consideration for such contracts;

(4) The transaction of matters subsequent to execution of such contracts and arising out of them;

(5) Operating under a license or certificate of authority, as an insurer, issued by the department of insurance.

(I) "Domiciliary state" means the state in which an insurer is incorporated or organized, or, in the case of an alien insurer, its state of entry.

(J) "Fair consideration" is given for property or obligation when either of the following apply:

(1) When in exchange for such property or obligation, as a fair equivalent therefor, and in good faith, property is conveyed, services are rendered, an obligation is incurred, or an antecedent debt is satisfied;

(2) When such property or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small as compared to the value of the property or obligation obtained.

(K) "Foreign country" means any other jurisdiction not in any state.

(L) "Forward contract" has the same meaning as set forth in the Federal Deposit Insurance Act, 12 U.S.C.S. Section 1821(e)(8)(D), as amended from time to time.

(M) "Guaranty association" means the Ohio insurance guaranty association created by *section 3955.06 of the Revised Code* and any other similar entity hereafter created by the general assembly for the payment of claims of insolvent insurers. "Foreign guaranty association" means any similar entities now in existence in or hereafter created by the legislature of any other state.

(N) "Insolvency" or "insolvent" means:

(1) For an insurer issuing only assessable fire insurance policies either of the following:

(a) The inability to pay any obligation within thirty days after it becomes payable;

(b) If an assessment is made within thirty days after such date, the inability to pay the obligation thirty days following the date specified in the first assessment notice issued after the date of loss.

(2) For any other insurer, that it is unable to pay its obligations when they are due, or when its admitted assets do not exceed its liabilities plus the greater of either of the following:

(a) Any capital and surplus required by law for its organization;

(b) The total par or stated value of its authorized and issued capital stock.

(3) As to any insurer licensed to do business in this state as of the effective date of *sections 3903.01 to 3903.59 of the Revised Code* that does not meet the standard established under division (K)(2) of this section, the term "insolvency" or "insolvent" means, for a period not to exceed three years from the effective date of *sections 3903.01 to 3903.59 of the Revised Code*, that it is unable to pay its obligations when they are due or that its admitted assets do not exceed its liabilities plus any required capital contribution ordered by the superintendent under provisions of Title XXXIX [39] of the Revised Code.

(4) For purposes of divisions (K)(2) to (4) of this section, "liabilities" includes, but is not limited to, reserves required by statute or by rules of the superintendent or specific requirements imposed by the superintendent upon a subject company at the time of admission or subsequent thereto.

(O) "Insurer" means any person who has done, purports to do, is doing, or is licensed to do an insurance business, and is or has been subject to the authority of, or to liquidation, rehabilitation, reorganization, supervision, or conservation by, any insurance commissioner, superintendent, or equivalent official. For purposes of *sections 3903.01 to 3903.59 of the Revised Code*, any other persons included under *section 3903.03 of the Revised Code* are deemed to be insurers.

(P) "Netting agreement" means:

(1) a contract or agreement (including terms and conditions incorporated by reference therein), including a master agreement (which master agreement, together with all schedules, confirmations, definitions and addenda thereto and transactions under any thereof, shall be treated as one netting agreement), 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, liquidation, setoff, termination, acceleration or close out under or in connection with one or more qualified

financial contracts or present or future payment or delivery obligations or payment or delivery entitlements thereunder (including liquidation or close-out values relating to such obligations or entitlements) among the parties to the netting agreement;

(2) any master agreement or bridge agreement for one or more master agreements described in paragraph (1) of this subsection; or

(3) any security agreement or arrangement or credit support document or guarantee or reimbursement obligation related to any contract or agreement described in paragraph (1) or (2) of this subsection; provided that any contract or agreement described in paragraph (1) or (2) of this subsection relating to agreements or transactions that are not qualified financial contracts shall be deemed to be a netting agreement only with respect to those agreements or transactions that are qualified financial contracts.

(Q) "Preferred claim" means any claim with respect to which the terms of sections 3903.01 to 3903.59 of the Revised Code accord priority of payment from the assets of the insurer.

(R) "Qualified financial contract" means any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement and any similar agreement that the commissioner determines by regulation, resolution or order to be a qualified financial contract for the purposes of this chapter.

(S) "Reciprocal state" means any state other than this state in which in substance and effect division (A) of section 3903.18, and sections 3903.52, 3903.53, and 3903.55 to 3903.57 of the Revised Code are in force, in which provisions are in force requiring that the superintendent or equivalent official be the receiver, liquidator, rehabilitator, or conservator of a delinquent insurer, and in which some provision exists for the avoidance of fraudulent conveyances and preferential transfers.

(T) "Repurchase agreement" has the same meaning as set forth in the Federal Deposit Insurance Act, 12 U.S.C.S. Section 1821(e)(8)(D), as amended from time to time.

(U) "Secured claim" means any claim secured by mortgage, trust deed, security agreement, pledge, deposit as security, escrow, or otherwise, but not including special deposit claims or claims against assets. The term also includes claims which have become liens upon specific assets by reason of judicial process.

(V) "Securities contract" has the same meaning as set forth in the Federal Deposit Insurance Act, 12 U.S.C.S. Section 1821(e)(8)(D), as amended from time to time.

(W) "Special deposit claim" means any claim secured by a deposit made pursuant to statute for the security or benefit of a limited class or classes of persons, but not including any claim secured by assets.

(X) "State" has the meaning set forth in division (G) of *section 1.59 of the Revised Code*.

(Y) "Superintendent" or "superintendent of insurance" means the superintendent of insurance of this state, or, when the context requires, the superintendent or commissioner of insurance, or equivalent official, of another state.

(Z) "Swap agreement" has the same meaning as set forth in the Federal Deposit Insurance Act, 12 U.S.C.S. Section 1821(e)(8)(D), as amended from time to time.

(AA) "Transfer" includes the sale and every other and different mode, direct or indirect, or disposing of or of parting with property or with an interest in property, or with the possession of property or of fixing a lien upon property or upon an interest in property, absolutely or conditionally, voluntarily, or by or without judicial proceedings. The retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by the debtor."

Section 2. Amend Chapter 3903 of Title 39 of the Revised Code by inserting a new Section 3903.301 that reads as follows:

“Section 3903.301. Qualified financial contracts.

(A) Notwithstanding any other provision under sections 3903.01 through 3903.59 of the Revised Code, including any other provision of this insurers supervision, rehabilitation, and liquidation act permitting the modification of contracts, or other law of a state, no person shall be stayed or prohibited from exercising:

(1) A contractual right to cause the termination, liquidation, acceleration or close out of obligations under or in connection with any netting agreement or qualified financial contract with an insurer because of:

(a) The insolvency, financial condition or default of the insurer at any time, provided that the right is enforceable under applicable law other than this insurers supervision, rehabilitation, and liquidation act; or

(b) The commencement of a formal delinquency proceeding under sections 3903.01 through 3903.59 of the Revised Code;

(2) Any right under a pledge, security, collateral, reimbursement or guarantee agreement or arrangement or any other similar security arrangement or arrangement or other credit enhancement relating to one or more netting agreements or qualified financial contracts;

(3) Subject to any provision of section 3903.30 of the Revised Code, any right to set off or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more qualified financial contracts where the counterparty or its guarantor is organized under the laws of the United States or a state or a foreign jurisdiction approved by the Securities Valuation Office (SVO) of the NAIC as eligible for netting; or

(4) If a counterparty to a master netting agreement or a qualified financial contract with an insurer subject to a proceeding under sections 3903.01 through 3903.59 of the Revised Code terminates, liquidates, closes out or accelerates the agreement or contract, damages shall be measured as of the date or dates of termination, liquidation, close out or acceleration. The amount of a claim for damages shall be actual direct compensatory damages calculated in accordance with subsection (F) below.

(B) Upon termination of a netting agreement or qualified financial contract, the net or settlement amount, if any, owed by a non-defaulting party to an insurer against which an application or petition has been filed under this insurers supervision, rehabilitation, and liquidation act shall be transferred to or on the order of the receiver for the insurer, even if the insurer is the defaulting party, notwithstanding any walkaway clause in the netting agreement or qualified financial contract. For purposes of this subsection, the term " walkaway clause " means a provision in a netting agreement or a qualified financial contract that, after calculation of a value of a party's position or an amount due to or from one of the parties in accordance with its terms upon termination, liquidation or acceleration of the netting agreement or qualified financial contract, either does not create a payment obligation of a party or extinguishes a payment obligation of a party in whole or in part solely because of the party's status as a non-defaulting party. Any limited two-way payment or first method provision in a netting agreement or qualified financial contract with an insurer that has defaulted shall be deemed to be a full two-way payment or second method provision as against the defaulting insurer. Any such property or amount shall, except to the extent it is subject to one or more secondary liens or encumbrances or rights of netting or setoff, be a general asset of the insurer.

(C) In making any transfer of a netting agreement or qualified financial contract of an insurer subject to a proceeding under sections 3903.01 through 3903.59 of the Revised Code, the receiver shall either:

(1) Transfer to one party (other than an insurer subject to a proceeding under sections 3903.01 through 3903.59 of the Revised Code) all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty and the insurer that is the subject of the proceeding, including:

(a) All rights and obligations of each party under each netting agreement and qualified financial contract; and

(b) All property, including any guarantees or other credit enhancement, securing any claims of each party under each netting agreement and qualified financial contract; or

(2) Transfer none of the netting agreements, qualified financial contracts, rights, obligations or property referred to in Paragraph (1) of this subsection (with respect to the counterparty and any affiliate of the counterparty).

(D) If a receiver for an insurer makes a transfer of one or more netting agreements or qualified financial contracts, then the receiver shall use its best efforts to notify any person who is party to the netting agreements or qualified financial contracts of the transfer by 12:00 noon (the receiver's local time) on the business day following the transfer. For purposes of this subsection, "business day" means 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 is closed.

(E) Notwithstanding any other provision of sections 3903.01 through 3903.59 of the Revised Code, a receiver may 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 is made before the commencement of a formal delinquency proceeding under this insurers supervision, rehabilitation, and liquidation act.

However, a transfer may be avoided under sections 3903.26 through 3903.28 of the Revised Code if the transfer was made with actual intent to hinder, delay or defraud the insurer, a receiver appointed for the insurer, or existing or future creditors.

(F) (1) In exercising the rights of disaffirmance or repudiation of a receiver with respect to any netting agreement or qualified financial contract to which an insurer is a party, the receiver for the insurer shall either:

(a) Disaffirm or repudiate all netting agreements and qualified financial contracts between a counterparty or any affiliate of the counterparty and the insurer that is the subject of the proceeding; or

(b) Disaffirm or repudiate none of the netting agreements and qualified financial contracts referred to in subparagraph (a) (with respect to the person or any affiliate of the person).

(2) Notwithstanding any other provision of sections 3903.01 through 3903.59 of the Revised Code, any claim of a counterparty against the estate arising from the receiver's disaffirmance or repudiation of a netting agreement or qualified financial contract that has not been previously affirmed in the liquidation or immediately preceding conservation or rehabilitation case shall be

determined and shall be allowed or disallowed as if the claim had arisen before the date of the filing of the petition for liquidation or, if a conservation or rehabilitation proceeding is converted to a liquidation proceeding, as if the claim had arisen before the date of the filing of the petition for conservation or rehabilitation. The amount of the claim shall 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 term "actual direct compensatory damages" does not include punitive or exemplary damages, damages for lost profit or lost opportunity or damages for pain and suffering, but does include normal and reasonable costs of cover or other reasonable measures of damages utilized in the derivatives, securities or other market for the contract and agreement claims.

(G) The term "contractual right" as used in this section includes any right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility, including a swap execution facility, registered under the Commodity Exchange Act, a security-based swap execution facility registered under the Securities Exchange Act of 1934, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof and any right, whether or not evidenced in writing, arising under statutory or common law, or under law merchant, or by reason of normal business practice.

(H) The term "receiver" as used in this section includes any conservator, rehabilitator, or liquidator, as the context may require.

(I) The provisions of this section shall not apply to persons who are affiliates of the insurer that is the subject of the proceeding.

(J) All rights of counterparties under sections 3903.01 through 3903.59 of the Revised Code shall 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 are available only to counterparties to netting agreements and qualified financial contracts entered into on behalf of that separate account.”

Section 3. This bill will take effect immediately upon enactment, except that it will only apply to a delinquency proceeding that commences under this insurers supervision, rehabilitation, and liquidation act on or after enactment of this bill.



**Association of Ohio
Life Insurance Companies**
100 South Third Street
Columbus, Ohio 43215-4291
(614)227-4860
www@aolic.com

Legislative Counsel:
Bricker & Eckler LLP
Kurtis A. Tunnell
(614)227-8837
Faith M. Williams
(614)227-2374
Miranda C. Motter
(614)227-4810

Derivatives Netting Amendment

In 2010, AOLIC discussed the derivatives netting issue with several key members of the General Assembly, and with the Ohio Department of Insurance. There was broad support for the amendment; no opposition was expressed.

The ODI's budget submission in the Fall 2010 included the derivatives netting amendment.

Lt. Governor Taylor's budget submission also included the derivatives netting amendment.

It is our understanding that OBM removed this amendment from the Governor's budget submission because this amendment does not have a direct impact on the State budget.

We are not aware of any substantive concerns about the derivatives netting amendment.

March 2011

MEMBER COMPANIES

Anthem Life Insurance Co.
Columbus, Ohio

The Cincinnati Life Insurance Co.
Cincinnati, Ohio

Grange Life Insurance Co.
Columbus, Ohio

Great American Financial Resources, Inc.
Cincinnati, Ohio

MetLife
New York, New York

Motorists Life Insurance Co.
Columbus, Ohio

Nationwide Financial Services
Columbus, Ohio

New York Life Insurance Co.
New York, New York

Ohio National Life Insurance Co.
Cincinnati, Ohio

Patriot Life Insurance, member of Frankenmuth Insurance,
Frankenmuth, Michigan

The Prudential Insurance Co. of America
Newark, New Jersey

Western Reserve Life Assurance Co. of Ohio
St. Petersburg, Florida

Western & Southern Financial Group
Cincinnati, Ohio

Netting: Helping Insurers Manage Risk and Protect Policyholders

Introduction

Life insurers' products—life insurance, annuities, long-term care insurance and disability income insurance—provide individuals, families and businesses with financial protection that may last decades. Because of the long-term nature of these products, life insurers must be able to withstand credit and market risks of substantial duration. Life insurers use derivatives to manage risk and maintain their financial stability in a constantly changing global economy. This helps assure that regardless of economic conditions, insurers will be able to honor their obligations to policyholders. Eliminating unnecessary and costly barriers to the use of derivatives is thus in everyone's interest.

How Netting Works

In order to manage risks through use of derivatives, many insurers enter into qualified financial contracts "QFC" with counterparties, which are usually banks or other financial institutions. While these can take many forms, a basic QFC might involve a series of interest rate swaps. During the course of the transaction, each party may owe payments to the other. When the QFC is settled or terminated, the obligations are "netted" against each other. For example, assume that an insurance company and a bank enter into a QFC of 10 interest rate swaps. The bank owes the insurer \$70 million arising from seven of the 10 swaps, while the insurer owes the bank \$30 million arising from three of the 10 swaps. Upon termination of the QFC, the obligations are netted, resulting in net \$40 million obligation from the bank to the insurance company.

The Problem

Ohio-domiciled insurance companies face a disadvantage in obtaining derivatives to manage risk because Ohio's receivership laws do not permit netting in the rare instance an insurer is placed into rehabilitation or liquidation. By contrast, the receivership statutes of 11 other states specifically allow netting; similarly the federal bankruptcy code specifically allows netting with respect to non-insurance entities.

If an insurer is placed into receivership in Ohio, the counterparty would be obligated to pay the full amount it owes the insurer but may not be able to collect the full amount owed to it by the insurer. This unequal treatment of QFCs may deter counterparties from entering into such contracts with insurance companies or could result in them charging higher fees on insurers. The result is that prudent risk management is becoming more difficult and more expensive for Ohio-domiciled life insurers.

The Solution

Ohio's receivership law should be amended to specifically allow netting. The National Association of Insurance Commissioners (NAIC) has adopted a model law—*The Insurer Receivership Model Act*—which contains a provision that specifically allows for the netting of QFCs when an insurer is placed into receivership. As of March 1, 2011, this provision has been enacted in 11 other states. Enacting netting legislation would give Ohio-domiciled insurers broader parity with non-insurers, which in turn, would benefit both insurance companies and policyholders by enhancing the range of risk-management tools available to insurers.

