Affiliate Transfers: A Practical Guide for Migrating Insurance Policies Between Legal Entities

By James Talbert*

Introduction

From time to time, insurers find it useful to transfer policies between legal entities within their holding company systems. This process is frequently referred to as an "affiliate transfer."

Although affiliate transfers are not uncommon, they have received scant attention in the insurance literature. This article is an initial step toward filling that gap. It provides a basic overview of the affiliate transfer concept, and it offers several threshold recommendations for performing these inter-company transfers.

Holding Companies and Underwriting Companies

Insurers are typically structured as holding companies with several or even dozens of subsidiaries. The subsidiary entities serve various purposes, such as business support, investment management, and realty management. Also included in the holding company systems are the entities that engage in the core business of insurance: issuing, and servicing insurance policies. These entities are known as "underwriting companies."

Most insurers maintain several underwriting companies. Large insurers may have dozens of them. Typically, each underwriting company specializes in a particular level of risk or a certain class of policyholder. Some underwriting companies, for example, only issue non-standard (high-risk) automobile policies; others might specialize in residential properties that were built using asbestos.

Maintaining a number of underwriting companies can be useful. Among other things, it facilitates pricing flexibility, and can help to silo the negative consequences (e.g. regulatory supervision) of a state- or line-specific trend or catastrophe.

Unnecessary Underwriting Companies & Affiliate Transfers

Occasionally, however, insurers encounter situations where they have created or inherited too many underwriting companies. This situation commonly arises following an inter-insurer merger or acquisition. For example, imagine that two insurers each maintain underwriting companies designated to issue preferred (low-risk) personal auto policies. If these two

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companies merge, the surviving company will be left with two legal entities that serve the same essential purpose – issuing and servicing low-risk automobile policies. Under most circumstances, this constitutes a redundancy.

Maintaining unnecessary underwriting companies can be expensive and also risky. First, it entails various costs, including licensing fees, filing fees, record maintenance costs, reporting costs, and costs associated with keeping each entity appropriately capitalized. Second, the added complexity of the enterprise can make it harder to ensure that each entity remains compliant with various laws, regulations, vendor agreements, and agent contracts.

The obvious solution is to eliminate the unnecessary underwriting companies. Unfortunately, this process can itself be difficult and risky. First, the insurer will have to determine which entities it wants to keep on a go-forward basis. The following considerations commonly influence the decision:

- The number of in-force insurance policies and annual premium attributable to each of the existing underwriting companies;
- The number of in-force agent contracts associated with each underwriting company, and the difficulty of assigning or rescinding and reforming these contracts;
- The relative functionality of the software platforms used by the various underwriting companies, and the difficulty of transferring such platforms to new entities;
- The companies' A.M. Best ratings; and
- The companies' names (an entity's name may not be appropriate to use on a go-forward basis if, for example, the name is associated with a previously-acquired company, and the buyer no longer wishes to write business under that name).

Second, after an insurer decides to eliminate a particular underwriting company, it must reckon with how to dispose of that entity's in-force insurance policies. Generally speaking, it will have two options: it can terminate the policies, or it can transfer those policies to another company within the insurer's holding company system.

Assuming the policies are profitable, insurers will generally prefer the second option – preserving the relationship with the policyholders by transferring the policies to an affiliated underwriting company. But affiliate transfers are subject to a host of regulatory, litigation, and business risks. They are regulated differently in different states. This necessitates state-specific research, which, if it is not performed carefully, can set the stage for non-compliance and regulatory actions. Additionally, affiliate transfers can be confusing processes for policyholders. The insurer and/or the agent may have to do some handholding to make the transition as smooth as possible for the policyholder. Otherwise, the policyholder may get exasperated and decide to shop for insurance elsewhere.

Guidance for Insurers Seeking to Perform Affiliate Transfers

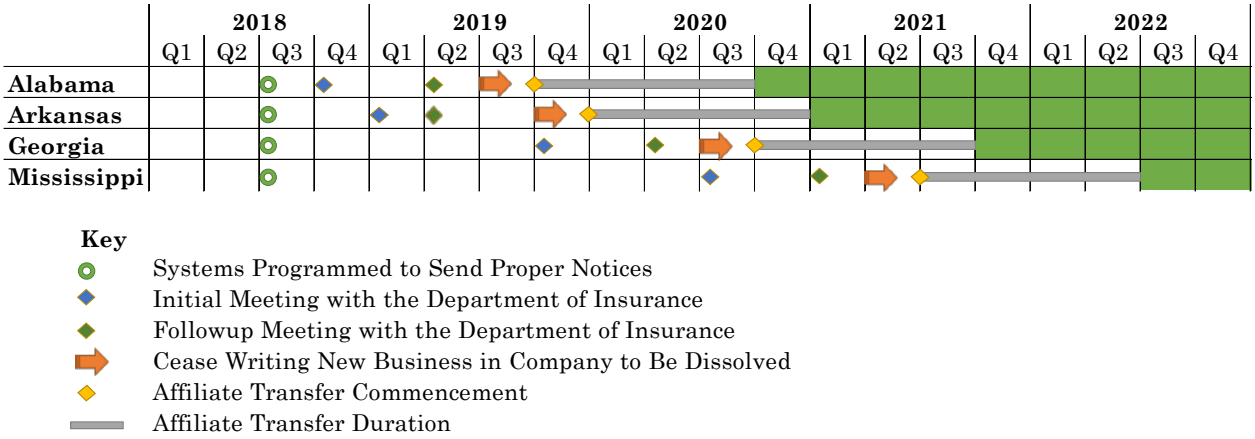
This section offers a number of suggestions to reduce the risk that an affiliate transfer will result in regulatory action or litigation. The suggestions also contain logistical guidance

focused on making affiliate transfers run more smoothly from the standpoint of the insurer as well as the policyholder.

a. Develop Timelines for Performing the Affiliate Transfers in Each State

When preparing for an affiliate transfer, a good first step is to create "transfer timelines" for each state where affected policies (i.e. policies that are slated to transfer between underwriting companies) have been issued. The timelines should include important dates, such as the date that renewal policies will begin rolling over into the new entity, and the date that the transfer will be complete (the date that all of the policies will have migrated to the new entity).

When an affiliate transfer involves policies in multiple states, the insurer should consider performing the transfer in phases – starting with one state and proceeding consecutively with the others. Phasing-in an affiliate transfer helps prevent any serious workload bottlenecks, and enables personnel to learn from any mistakes made during the early phases of the transfer. For example, with respect to an affiliate transfer involving policies in Alabama, Arkansas, Georgia, and Mississippi, the timelines might end up looking something like the following:



Note: Because affiliate transfers normally take place upon renewal/expiration (rather than during the middle of the policy term), an affiliate transfer typically takes at least one policy cycle to complete.

b. Set up Meetings with the Relevant State Departments of Insurance

An insurer should consider discussing its plans to initiate an affiliate transfer with the department of insurance ("DOI") in each state where affected policies have been issued. As the reader knows, insurance regulators like to be kept in the loop. Regulators may also offer valuable insights, including information regarding unwritten "desk drawer" rules that impact a proposed affiliate transfer.

In these DOI meetings, the insurer should generally inform the regulator of its plan to transfer business, review the mechanics of the proposed conversion, welcome any feedback,

and notify the department that it may set up a follow-up meeting to pose additional questions. The insurer might also consider preparing a nutshell explanation of the transfer for each DOI – something that department staff can reference if policyholders call in asking about the changes.

Typically, the DOI will send two or three representatives to meet with the insurer. They may have various questions or comments about the transfer plan. The insurer's representatives should take notes during these meetings. The notes will serve to memorialize the insurer's conversations with the DOI, and should be circulated to the process stakeholders, including any attorneys assigned to do the state-specific research in preparation for the transfers.

c. Determine How Best to Characterize the Affiliate Transfers in Each State

A crucial first step to executing an affiliate transfer is knowing what to call it. Depending on the state and the line of business, an affiliate transfer may constitute a "renewal," or it may constitute a "non-renewal and re-write" of the policy. States generally break down into four categories with respect to how they characterize affiliate transfers:

(1) States that expressly permit one or more lines of business to be renewed within an affiliated underwriting company;

(2) States that expressly permit one or more lines of business to be renewed within an affiliated underwriting company, but only if certain requirements are met (e.g. the underwriting company to which the policy is transferred must have an A. M. Best rating which is at least as favorable as that of the transferring company[1]);

(3) States that expressly declare affiliate transfers to constitute non-renewals and re-writes; and

(4) States that simply do not address affiliate transfers.

Consider the following examples:

- ***Idaho*:** Idaho is a good example of category number one – states that explicitly permit affiliate transfers to be accomplished via "renewal." Section 41-1842, which applies to most commercial property and casualty policies, defines "renewal" as "the issuance, or the offer so to issue, by an insurer of a policy succeeding a policy previously issued and delivered by the same insurer *or an insurer within the same group of insurers*."[2]
- ***Florida*:** With respect to residential property policies, Florida exemplifies the second category of states (states that explicitly permit affiliate transfers to be accomplished via "renewal," but only if certain conditions are satisfied). Florida law states that a residential property policy may be "renewed" within an affiliated underwriting company, but only if the following requirements are met:

[1] Iowa Code § 515.128.3.b.
[2] Idaho Code § 41-1842(2)(e) (emphasis added).

(a) The authorized insurer to which the policy is being transferred must be admitted in Florida and other states, and writing residential property insurance in multiple states.

(b) The transfer must not cause the transferred policy to be converted to a surplus lines policy.

(c) The underwriting company to which the policy is being transferred must have been determined by the Florida Office of Insurance Regulation to have the same or better financial strength than the transferring insurer.

(d) The transfer must result in substantially similar coverage.

(e) The policyholders subject to the transfer must have been selected on a nondiscriminatory basis.

(f) The Florida Office of Insurance Regulation must approve the transfer.[3]

If a residential property policy transfers underwriting companies upon the expiration of its policy term, but the requirements of (a)-(d) are not met, then the transfer would likely be considered a non-renewal and re-write.

- ***Kentucky*:** In connection with private passenger automobile policies, Kentucky exemplifies the third category of states (states which expressly provide that affiliate transfers are considered non-renewals). Section 304.20-040 provides: "The transfer of a [private passenger automobile policy] between companies within the same insurance group shall be considered a non-renewal."[4]
- ***Colorado*:** Colorado serves as a good example of the fourth category of states (states that simply do not address affiliate transfers). As is the case with many states, Colorado law is silent with respect to affiliate transfers. Because these states do not permit an affiliate transfer to be characterized as a renewal, the safest course of action is to assume that the transfer must be performed via non-renewal and re-write.

Insurers should keep in mind that the proper characterization for an affiliate transfer may differ depending on the state and the line of business. For example, just because commercial property policies may be "renewed" with an affiliated underwriting company in a particular state, this does not mean that the same rule applies to, for instance, personal property policies or medical malpractice policies. If there is any ambiguity about how an affiliate transfer should be characterized, the insurer should consult with the applicable state insurance department.

However, as a general matter, it is worth noting that an insurer should avoid placing too much reliance on the DOI's position that a particular action is permissible – especially when statutory language seems to indicate otherwise. Department assurances might mitigate regulatory risk (i.e. the risk that the DOI will investigate or penalize the insurer), but they do not eliminate litigation risk. Courts and arbitrators, after all, are not bound by unpublished interpretations of the law by the DOI.

[3] Fla. Stat. § 627.4133(8).
[4] Ky. Rev. Stat. § 304.20-040(6).

d. Identify the Correct Policyholder/Lienholder Notice Requirements and Prepare to Comply with Them

After the insurer determines how to characterize the affiliate transfer, the next step is to identify the proper notices to send in connection with the transfer. Consider the following examples:

- ***Minnesota*:** With respect to Minnesota workers' compensation policies, affiliate transfers will likely constitute non-renewals and re-writes.[5] Accordingly, at least 60 days prior to performing the affiliate transfer, the insurer must mail or deliver notice of non-renewal to the policyholder.[6] The insurer must also give this notice to the agent of record, if any.[7] Finally, within 10 days after the issuance of the new workers' compensation policy, the insurer must file notice of coverage with the Commissioner of Labor and Industry.[8]

- ***Mississippi*:** With regard to Mississippi property and casualty policies, if the affiliate transfer results in "the same or substantially similar coverage," then the transfer may be characterized as a "renewal," and the following notice requirements will apply:

  (1) The insurer must mail or deliver to the policyholder at least 30 days' prior notice of any terms or conditions that are less favorable to the policyholder.[9]

  (2) The transferring insurer shall notify the policyholders of the affiliate transfer. This notice shall include the financial rating of the affiliated company to which the policies are being transferred, and must be provided to the policyholders along with the notice of renewal premium at least 30 days prior to the effective date of the transfer.[10]

  (3) The insurer shall also give the DOI at least 45 days' advance notice that the policies will be transferred to another licensed insurer within the same group or holding company. This notice shall include the name of the transferring insurer and the name and financial rating of the receiving insurer.[11]

  If, with respect to Mississippi property and casualty policies, the affiliate transfer does <u>not</u> result in the same or substantially similar coverage, the insurer must mail or deliver to the policyholder and any loss payee, at least 30 days' prior notice of non-renewal and re-write.[12]

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[5] Because Minnesota law does not contemplate that affiliate transfers may be characterized as "renewals," the conservative assumption is that these transactions must effected through non-renewal and re-write of the policies.
[6] Minn. Stat. § 176.185, subd. 1.
[7] Minn. Stat. §§ 60A.38, subd. 3; 60A.352.
[8] Minn. Stat. § 176.185, subd. 1a.
[9] Miss. Code § 83-5-28(1); S.B. 2311, 2018 Reg. Sess. (Miss.).
[10] Miss. Code § 83-5-28(5); S.B. 2311, 2018 Reg. Sess. (Miss.).
[11] Miss. Code § 83-5-28(4); S.B. 2311, 2018 Reg. Sess. (Miss.).
[12] Miss. Code § 83-5-28(1).

- ***New Mexico*:** With respect to New Mexico property and casualty policies, affiliate transfers constitute "renewals," and the insurer must provide the policyholder at least 30 days' prior notice of any change of limitation, restriction in coverage, or change in deductible.[13] Additionally, at least 30 days prior to the expiration date of the policy, the insurer must provide written notice of affiliate transfer to the agent of the policyholder."[14]

- ***Iowa*:** In Iowa, when an insurer migrates a commercial property or casualty policy between two affiliated underwriting companies, the transfer may be characterized as a "renewal" if the following requirements are satisfied:

  (a) The transfer does not result in an interruption in coverage.

  (b) The rating of the affiliate from the A. M. Best company or a substitute rating service acceptable to the commissioner, is the same or better than the rating of the transferring insurer.

  (c) The transfer results in the same or broader coverage.

  (d) Notice of the transfer is delivered to the policyholder or sent by first class mail to the policyholder's last known address not less than 45 days prior to the transfer. This notice is not, however, required in the event that the policyholder requests or consents to the transfer.

  (e) The notice of transfer provides the name and telephone number of the policyholder's insurance producer, agent, or agency, if any.[15]

  If an affiliate transfer *does not* meet the aforementioned requirements, it must be treated as a non-renewal and re-write. In this case, the insurer will have to mail or deliver notice of non-renewal to the policyholder and any loss payee at least 45 days prior to the existing policy's expiration date.[16]

  If an Iowa affiliate transfer *does* meet the aforementioned requirements ((a)-(e) above), then the insurer must send notice of the affiliate transfer to the policyholder. This notice must be sent by first class mail at least 45 days prior to the transfer.[17] Additionally, at least 45 days prior to the transfer, the insurer must notify the policyholder of any of the following changes:

  - An increase in the deductible of 25% or more;
  - An increase in the premium rates of 25% or more; or
  - A material reduction in the limits or coverage of the policy.[18]

Some states do not explicitly require insurers to provide any sort of notice in connection with an affiliate transfer. In these states, insurers should nevertheless notify policyholders of the

[13] N.M. Code R. 13.8.4.11.
[14] N.M. Code R. 13.8.4.12.
[15] Iowa Code § 515.128.3.
[16] Iowa Code § 515.128.2; *see also* Iowa Code § 515.129.6.
[17] Iowa Code § 515.128.3.d.
[18] Iowa Code § 515.128A.1.

affiliate transfer and of any material policy changes that occur during the course of the transfer. Courts across the country have held that insurers have the right to expect that a policy will be replaced on the same terms and conditions unless they are given notice of any changes.[19] As stated by *Couch on Insurance*: "If there is a change in the condition or terms of the renewal policy, it is the duty of the insurer to call attention to the change, and if the latter fails to do so, the renewal contract is subject to reformation by the courts of equity to make it conform to the original contract." [20]

e. Legal Teams Should be Prepared for Pushback from Business Units

Affiliate transfers can be burdensome undertakings, sometimes requiring insurers to re-execute policy documents and send multiple forms and notices (some of which must be manually generated) to each policyholder. For the sake of time and money, business units may balk at these requirements. For example, they might take umbrage at the idea that, in some states, affiliate transfers should be characterized as non-renewals and re-writes. Understandably, the business units—and probably also the policyholders—often think of the transferred policies as mere continuations of the expiring policies, and they would prefer to avoid the hassle of generating and mailing non-renewal notices.

In response to this sort of pushback, the company's legal team should generally inform the business of the risks associated with relying on bold or tenuous interpretations of the law. Additionally, while it may be reasonable in certain circumstances to adopt risky interpretations of the law, the legal department should take a harder line where the business advocates anything resembling willful non-compliance with clear legal requirements.

f. Be Aware that Affiliate Transfers May Trigger State Withdrawal/Block Non-Renewal Requirements

Many states set forth certain notice or filing requirements that are triggered when an underwriting company ceases to write a certain line of business, non-renews a block or class of business, withdraws from the state, or surrenders its certificate of authority in that state.[21] Arkansas, for example, provides: "Any insurer desiring to surrender its certificate of authority, withdraw from [Arkansas], or discontinue the writing of certain classes of insurance in [Arkansas] shall give ninety 90 days' notice in writing to the State Insurance Department and shall state in writing its reasons for such action."[22]

Affiliate transfers sometimes implicate these sorts of withdrawal and block non-renewal requirements. If, for example, an affiliate transfer causes a company to cease writing a certain line of business, this would trigger Arkansas's block non-renewal requirement

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[19] *American Casualty Co. v. Hambleton*, 233 Ark. 942, 947-48 (1961); *Fields v. Blue Shield of California*, 163 Cal. App. 3d 570, 579 (Cal. App. 4th 1985); *Industro Motie Corp. v. Morris Agency, Inc.*, 76 Mich. App. 390, 396 (1st Dist. Ct. App. 1977); *Bauman v. Royal Indem. Co.*, 36 N.J. 12, 25-25 (1961); *MCD Acquisition Co. v. N. River Ins. Co.*, 898 F. Supp. 2d 942, 952 (N.D. Ohio 2012); *Medley v. German Alliance Ins. Co.*, 55 . Va. 342, 360-61 (1904).
[20] Lee Russ et al., Couch on Insurance 27:79 (3d ed. 2011).
[21] *See e.g.* N.D. Cent. Code § 26.1-25-04.4; Okla. Admin. Code § 365:15-1-18; Ark. Code § 23-63-211(e); S.D. Codified Law § 58-11-62.
[22] Ark. Code § 23-63-211(e).

(discussed in the paragraph above). In some states, such as New Jersey, block non-renewals and withdrawals can be cumbersome and lengthy processes, and this must be factored into the overall timeline for the affiliate transfer processes.[23] Accordingly, insurers should research these provisions in each state affected by the proposed affiliate transfer.

g. Be Aware that Affiliate Transfers May Trigger Reporting and Filing Requirements Found in State Motor Vehicle and Labor Codes

State insurance codes and regulations are not the only sources of law that govern affiliate transfers. State motor vehicle codes (also referred to as "transportation codes") and state labor codes (also referred to as "workers' compensation codes") also set forth requirements that are applicable to affiliate transfers.

For example, section 72-311 of Idaho's Workers' Compensation code provides:

> No [workers' compensation policy], where the policy . . . is intended to provide coverage of greater than one hundred eighty (180) days, shall be canceled or not renewed until at least sixty (60) days after notice of cancellation has been filed with the [Idaho Industrial Commission], and also served on the other contracting party either personally or by certified mail to the last known address of the other contracting party.[24]

Because Idaho does not permit workers' compensation policies to be "renewed" in affiliated underwriting companies, the insurer would likely have to characterize the transfers as non-renewals and re-writes. Accordingly, affiliate transfers would implicate section 72-311's 60-day filing requirement.

Affiliate transfers can also implicate motor vehicle financial responsibility laws. For example, Pennsylvania regulations provide:

> An insurer who has issued a contract of motor vehicle liability insurance and knows or has reason to believe that the contract is for the purpose of providing financial responsibility, shall immediately notify the Department [of Transportation] if the insurance has been cancelled or terminated by the insured or by the insurer. The insurer shall notify the Department [of Transportation] not later than 10 days following the effective date of the cancellation or termination.[25]

In Pennsylvania, affiliate transfers may be characterized as "renewals" *only if* the new policy provides "types and limits of coverage at least equal to those contained in the policy being

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[23] *See* N.J. Rev. Stat. § 17:33B-3 (When an underwriting company transfers its business to another insurer, this constitutes a "withdrawal" from the state of New Jersey, and, with certain exceptions, this transfer shall not commence prior to one calendar year and ninety days following the submission of an informational filing to the DOI pursuant to N.J. Admin. Code § 11:2-29.3.).

[24] Idaho Code § 72-311(2).

[25] 67 Pa. Code § 221.3(a).

superseded."[26] Thus, if the affiliate transfer is accompanied by a diminution of the "types and limits of coverage," the affiliate transfer will constitute a non-renewal and re-write, and the insurer will be required to provide notice of non-renewal to the Department of Transportation.

h. Consider the Effects of the Affiliate Transfer on Previously Executed Policy Documents and Endorsements

Insurance policies are frequently modified or accompanied by supplementary or amendatory forms, agreements, and disclosures (electronic funds transfer authorizations, e-delivery agreements, uninsured motorist coverage rejection/selection forms, etc.). For simplicity, these documents will hereinafter be referred to as "ancillary documents."

Affiliate transfers may have the unintended consequence of rendering these ancillary documents ineffective. Take the following example: An electronic funds transfer ("EFT") agreement typically grants a particular underwriting company the right to withdraw premium payments from the policyholder's bank account. After the policy undergoes an affiliate transfer, an entirely different underwriting company will collect the premiums for that policy. Because the new underwriting company is not privy to the previously executed authorization form, that company will not have valid consent to perform electronic fund transfers in connection with that policyholder.

In preparation for performing an affiliate transfer, the insurer should review the ancillary documents associated with the policies slated to transfer underwriting companies. The insurer should attempt to determine whether changes stemming from the affiliate transfer (changed underwriting company, changed policy number, etc.) would render those documents ineffective following the transfer. If so, then the insurer should obtain new copies of the ancillary documents, signed by the insured.

Insurers should also be aware that in some cases, state law specifically addresses whether certain ancillary documents will remain effective following an affiliate transfer. Arizona, for example, does so with regard to uninsured motorist coverage rejection forms. That state requires every motor vehicle liability policy to include uninsured and underinsured ("UM/UIM") motorist coverage with limits equal to the policyholder's policy limits for bodily injury or death.[27] Policyholders are, however, free to reject UM/UIM coverage by signing a rejection form which has been approved by the DOI.[28] Arizona law indicates that an insurer may continue to rely on such rejection forms following the "transfer, substitution, modification, or renewal of [the] existing policy."[29] The statute's use of the word "transfer" likely indicates that a UM/UIM rejection form will not be rendered ineffective solely by the fact that the policy transfers to another underwriting company.

[26] 40 Pa. Cons. Stat. §§ 1171.3; 991.2001; 31 Pa. Code § 113.81.
[27] *See* Ariz. Rev. Stat. § 20-259.01.A, B.
[28] *Id.*
[29] *Id.*

i. Comply with the Most Stringent Timing and Mailing Requirements when Sending an Affiliate Transfer "Packet"

States often require insurers to send several different policyholder notices in connection with an affiliate transfer. Florida, for example, sets forth two notice requirements that apply when an insurer transfers private passenger automobile policies between affiliated underwriting companies. Specifically, the insurer must send:

- 45 days' prior notice of affiliate transfer[30]; and
- 30 days' prior notice of the renewal premium.[31]

Typically, it is cheaper and easier for the insurer to combine these notices in a single packet and issues them all at once, rather than sending them separately. This is probably also more convenient for the policyholder.

When an insurer combines multiple notices in a single packet, the packet should be sent in accordance with whichever notifications' advance notice and mailing requirements are the most stringent. For example, a particular state might require an insurer to provide the policyholder at least 45 days' advance notice of the affiliate transfer, and at least 30 days' advance notice of any change in the premium. If the insurer proposes to combine these notices in a single packet, then it would be bound to ensure that the policyholder receives the packet at least 45 days prior to expiration. The same reasoning holds true with mailing requirements. If one notice in the packet may be sent by first class mail, but another requires a certificate of mailing, the insurer will have to obtain a certificate of mailing for the packet.

j. Ensure that the Migration does not Result in a Company Writing Lines of Business Outside the Scope of its Certificate of Authority

Finally, when moving business from one underwriting company to another, the insurer must be certain that new underwriting company is licensed to write the selected lines of business. This recommendation is common sense, but insurers do sometimes overlook this basic requirement.

Conclusion

Affiliate transfers are widely performed, but have received little attention. Over the past decade or so, state legislatures have begun to address the subject, but there is still very little in the way of publicly available guidance for insurers seeking to transfer blocks of business between entities. This is somewhat frightening, considering the scale of such undertakings and the potential for liability for across-the-board errors in conducting affiliate transfers. While this article is far from an exhaustive study of affiliate transfers, it should help lay some groundwork for insurers considering such undertakings.

[30] Fla. Stat. § 627.728(4)(d).
[31] Fla. Stat. § 627.7277(2).