HB 666

Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

House Bill 666 (Delegates Hammen and Donoghue)
Economic Matters Finance

Insurance - Delinquency Proceedings Against Insolvent Insurers - Financial Contracts

This bill establishes procedures and sets out the rights of parties under a netting agreement or qualified financial contract in a delinquency proceeding against an insolvent insurer.

Fiscal Summary

State Effect: Adoption of any regulations required to carry out the bill's provisions could be handled with the existing resources of the Maryland Insurance Administration. Revenues would not be affected.

Local Effect: None.

Small Business Effect: None.

Analysis

Background: "Netting" is the practice of combining the asset and liability balances of aggregate derivative positions of contracts with any one counterparty to arrive at a *net* position balance at which to settle mutual obligations if all contracts are terminated at a specific point in time. A net asset balance is due to the owner of the derivatives, while a net liability balance is owed to the counterparty. A "derivative" is a financial instrument typically used by large business entities as a tool for hedging or controlling their exposure to various financial risks.

The bill reflects Section 46 of the Insurer Rehabilitation and Liquidation Model Act drafted by the National Association of Insurance Commissioners.

Bill Summary: A person may not be stayed or otherwise prohibited from exercising a contractual right to terminate, liquidate, or close out any netting agreement or qualified financial contract with an insurer because of: (1) the insolvency, financial condition, or default of the insurer, provided that the right is enforceable; or (2) the commencement of a delinquency proceeding. Similarly, a person may not be stayed or otherwise prohibited from exercising: (1) a right under a security arrangement or credit support document relating to a netting agreement or qualified financial contract; or (2) a right to offset or net out a termination value, payment amount, or other transfer obligation arising under or in connection with a netting agreement or qualified financial contract under specified circumstances.

On termination of a netting agreement, the net or settlement amount owed by a nondefaulting party to an insurer against which a petition for a delinquency proceeding has been filed must be transferred to or, on the order of the receiver, for the insurer, even if the insurer is the defaulting party. A limited two-way payment provision in a netting agreement with an insurer that has defaulted is deemed to be a full two-way payment provision against the insurer. Any such net or settlement amount is a general asset of the insurer, except to the extent the amount is subject to a secondary lien or encumbrance.

The bill specifies the transfers that a receiver of an insurer subject to a delinquency proceeding must make as part of a transfer of a netting agreement or qualified financial contract. The bill also specifies the receiver's duties in notifying a party to the netting agreement or qualified financial contracts.

A receiver may not avoid a transfer of money or other property that is made before a delinquency proceeding commences.

When exercising its power to repudiate or disaffirm a netting agreement or qualified financial contract, a receiver must take action against each one and all transactions entered into in connection with each one in its entirety. During a liquidation proceeding, specified claims of a counterparty must be determined and allowed or disallowed as of the filing date of: (1) the liquidation petition; or (2) if applicable, the rehabilitation petition. The amount of such a claim is the actual direct compensatory damages determined as of the date of disaffirmance or repudiation.

All rights of counterparties 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.

The bill does not apply to a person that is an affiliate of the insurer that is the subject of a delinquency proceeding.

Current Law: A life insurer's reserve investments may include derivative transactions and may use derivative instruments to engage in hedging transactions. Generally, in all cases of mutual debts and credits between an insurer and another person in connection with a delinquency proceedings, the debts and credits must be offset and the balance only be must be allowed or paid. In the case of an insurer's insolvency, the offset does not occur automatically. Instead, the receiver has discretion over whether to allow the offset.

Additional Information

Prior Introductions: None.

Cross File: SB 580 (Senator Gladden) – Finance.

Information Source(s): Maryland Insurance Administration, Department of Legislative Services

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