



INSURANCE AND FINANCIAL SERVICES UPDATE

New York Becomes the Latest State to Adopt a Version of Section 711 of the Insurer Receivership Model Act

On December 12, 2011, New York became the latest state to adopt a version of Section 711 of the National Association of Insurance Commissioners (NAIC) Insurer Receivership Model Act (“IRMA Section 711”). The New York version was codified as Section 7437 of the New York Insurance Laws (“NY Section 7437”) and generally provides counterparties to derivative transactions with New York domiciled insurance companies protections similar to insurer receivership counterparties facing U.S. Bankruptcy Code-eligible debtors.¹

IRMA Section 711 was originally adopted in 1997 as part of the predecessor Model Act to IRMA, because the insurance insolvency laws of most states pre-date many modern financial transactions, including over-the-counter derivative transactions. Even today, many state insurance company insolvency laws do not specifically address derivative transactions, and there is a lack of judicial precedent addressing the treatment of derivative transactions in an insurance company insolvency proceeding. This lack of legal, regulatory and judicial guidance has tended to create uncertainty as to the effect of an insurance company’s insolvency on its over-the-counter derivative transactions.

Based on New York’s prominence as an OTC derivatives trading center, the dealer community and many insurance companies have been advocating New York’s adoption of a version of IRMA Section 711 for years. In fact, versions of NY Section 7437 have been introduced in prior legislative sessions, only to fail at various stages of the legislative process. Even during the preceding session, while NY Section 7437 seemingly had overwhelming legislative support, it took several months for the New York Department of Financial Services, and ultimately the Governor, to sign off on the final version of NY Section 7437.

NY Section 7437 generally provides that the termination, closeout netting and settlement provisions in a “netting agreement” and “qualified financial contract”, as well as any collateral arrangement in connection therewith, will be enforceable against a New York-domiciled insurance company which is subject to an insolvency proceeding.² Additionally, any counterparty exercising such rights will not be subject to the stay order typically imposed by the court overseeing the insolvency proceeding. Further, NY Section 7437 provides that a transfer of money or other property arising under or in connection with a “netting agreement” or a “qualified financial contract” will not be subject to “claw-back” as a voidable preference.³

¹ Unlike most corporations, U.S.-domiciled insurance company-debtors are not subject to the Bankruptcy Code. See Section 109 of the U.S. Bankruptcy Code. Instead, each state has its own set of insolvency laws, regulations and rules governing the financial impairment and insolvency proceedings of domestic insurance companies.

² NY Section 7437 does not apply to financial guaranty insurers.

³ The provisions setting forth the enforceability of a “netting agreement” and “qualified financial contract” are subject to various limitations that are beyond the scope of this Client Update and which should be considered in the context of any particular trading relationship.

The definitions of “netting agreement” and “qualified financial contract” in NY Section 7437 are fairly broad, and the term “netting agreement” generally would include the ISDA Master Agreements. Additionally, the term “qualified financial contract” follows the definitions set forth in the Federal Deposit Insurance Act, which broadly defines “qualified financial contract” to include a broad array of swaps, including total return swaps, credit swaps, as well as repurchase and securities loan arrangements.

The certainty provided by NY Section 7437 should provide counterparties to derivative transactions with New York-domiciled insurers a degree of legal certainty as to the enforceability of their rights in the event the New York domiciled insurer becomes subject to an insolvency proceeding. Such certainty could lead to favorable regulatory treatment for financial institution (dealer) counterparties, as well as more favorable contractual terms for insurance companies domiciled in New York.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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