Insurance Holding Company Systems

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Following the 1969 adoption by the National Association of Insurance Commissioners (NAIC) of the Model Insurance Holding Company System Regulatory Act (Model Act) to regulate "insurance holding company systems", P.D. No. 612 (Insurance Code of the Philippines), dated December 18, 1974, adopted the same regulation in the Philippines. Today, that regulation remains unamended under Title 20 (Holding Companies), Sections 290 to 306 of the Amended Insurance Code.

Essentially, the regulation seeks to ensure that controlling persons do not enter into transactions with affiliates that are beneficial to the controlling group while detrimental to the insurance company. It seeks to regulate transactions by and among affiliates, known as 'related party transactions', transactions that are potentially not 'arm's length' and therefore ripe for self –dealing, requiring a higher degree of scrutiny given their related party nature. The regulation governs the relationships and activities within insurance holding company systems and regulates certain activities of 'persons' or entities that are affiliated with insurance companies and not otherwise subject to such regulation. To carry out these objectives, a series of safeguards have been imposed which includes: the registration of the controlled insurer, approval of acquisitions, prior approval or prior notice to the Commission of certain transactions, examinations, and reportorial requirements.

The primary features of the regulation of insurance holding company systems under the Amended Insurance Code are hereunder discussed.

At the onset, acquisition of control of an insurer is subject to: a) prior written notice of intent to acquire control; and b) prior written approval of the Commissioner (Sec. 302). The Commissioner may disapprove such acquisition to protect the interests of the people (Sec. 302 [b]). He may take actions (Sec. 306) against the retention of control if found violative of the Code (Sec. 302 [c]).

Control has been vaguely defined in Sec. 290 (b) as "the possession directly or indirectly of the power to direct or cause the direction of the management and policies of a person". A presumption of control exists "if any person directly or indirectly owns, controls or holds with the power to vote forty percent (40%) or more of the voting securities of any other person" (Sec. 290 [b]). The presumption may be modified by facts to the contrary (Sec. 292). The 40% presumption of control exists only as a mere

trigger to put into effect the safeguards of the insurance holding company system. It does not establish or create control as it is understood under the relevant provisions of the Corporation Code.

All controlled insurers are required to be registered with the Commission within thirty days after becoming a controlled insurer. Such registration should be amended within thirty days after a change in the identity of the holding company (Sec. 294 [a]). Moreover, the controlled insurer must submit certain information on the holding company (Sec. 294 [b]).

Among its reportorial requirements, controlled insurers should file reports on information which could affect its operations (Sec. 295). Although not expressly stated, it is in effect an enterprise risk report.

The holding company and the controlled insurer is also subject to examination by the Commissioner "if he has cause to believe that the operations of such persons may materially affect the operations, management or financial condition of any controlled insurer with the system and that he is unable to obtain relevant information from such controlled insurer" (Sec. 296).

There are affiliate transactions that are subject to prior approval by the Commission. These are: sales, purchases, exchanges, loans or extensions or credit, or investments, involving five percent or more of the insurer's admitted assets as of the last December 31 (Sec. 299).

There are also affiliate transactions subject to thirty days' prior notice to the Commission. These are: a) sales, purchases, exchanges, loans or extensions of credit, or investments, involving more than one-half of one percent but less than five percent of the insurer's admitted assets as of the last December 31; b) reinsurance treaties; c) rendering of services on a regular or systematic basis; or d) any material transaction which the Commissioner determines may adversely affect policyholders or stockholders (Sec. 300).

Finally, every insurer must disclose the identity of controlling persons or persons who has taken any action to acquire control of the insurer (Sec. 302 [e]).

Rationale

As the first model text on "insurance holding company" was adopted by the NAIC in 1969, the New York legislature also adopted the first holding company law in the world through Article 15 of the New York Insurance Law also in 1969. Its provisions were substantially similar to that of NAIC's. In December 2010, NAIC amended the Model Act in response to the 2008 financial crisis.

The principal features of the NAIC Model Act are: a) no person may acquire control of an insurer unless prior to the acquisition such person files a disclosure and receives the regulator's approval; b) requirement for a controlled insurer to register as a "holding company system" and the submission of certain information on a regular basis; c) requirements of the standards of fairness and reasonableness in transactions between insurers and their affiliate entities or in related-party transactions; and d) regulation of

large dividends (e.g. extraordinary dividends) made by stock controlled insurers. Secondarily, a controlled insurer may be required to produce books and records to determine compliance. And, under the Amended Model Act, the regulator has the power to examine the affiliates (not the controlled insurer) to obtain information.

A “holding company system” is defined as “two or more affiliated persons, one or more of which is an insurer”. “Affiliates” include “persons that directly or indirectly control, or are controlled by, or are under common control with, the person specified. “Control” refer “to possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or management services, or otherwise, unless the power is the result of an official position with or corporate office held by the person.”

Generally, insurance regulators are only authorized to supervise insurers at the individual entity level “but lack the legal authority to supervise a non-insurance affiliate or any affiliate domiciled and operating outside of the state.” Accordingly, “inherent limitations of state law constrain any particular state regulator from conducting oversight over or obtaining information regarding the operations of a multi-jurisdictional insurance group such as a large, complex global insurance firm.” Consequently, it was deemed that there is a need for insurance regulators to have the indirect authority to seek information concerning a non-insurer parent or affiliate.

In a way, the Model Act indirectly regulates groups by requiring advance approval of transactions between insurance companies and their affiliates. This is in the absence of a group-wide supervision which involves direct regulation over holding companies and other non-regulated entities. There are three forms of group supervision: direct, indirect and hybrid. Direct supervision would entail licensing and regulation of holding companies, non-insurance operating companies and insurers. Indirect supervisions focuses on regulating the relationships among regulated insurers with other members of the group.

After the 2008-2009 financial crisis, the need to regulate insurance holding company systems became driven by “the need for regulators to assess the enterprise risk within a holding company system and its impact or contagion upon the insurers within that group.” This crisis saw how the insurance giant AIG was shook to its core because of the “activities of a relatively obscure London-based non-insurance subsidiary trading derivative securities.” On December 2010, NAIC approved changes to the Model Act to include reports on material risks within the entire holding company system that could pose an “enterprise risk” to the insurer.

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