



Periodic Payment Reinsurance Q&A

Q. What are the most common applications of the Periodic Payment Reinsurance Product?

A. Since the product does not rely on IRC §130, it can be used to provide structured settlements for various “non-qualified” settlements.

Q. Does the product work for IRC §104(a)(1) and IRC §104(a)(2) settlements?

A. Yes. Any periodic payment that is income tax free with the “assignment + annuity” model would also be income tax free with the reinsurance model. While it has been generally understood that reinsurance can be used for workers compensation claims under IRC §104(a)(1), it can also work for settlements under IRC §104(a)(2). National Indemnity Company has provided this product since 1982, and in 1984 secured a private letter ruling confirming that the product can be used for future periodic payments in compliance with IRC §104(a)(2).

Q. What about IRC §130? Does the product also work for settlements that do not qualify for assignments?

A. Yes. Since a reinsurer does not need IRC §130 to protect against a mismatch in the timing of income, the product also works for pre-1997 workers compensation claims, disability claims governed by IRC §104(a)(3) (which do not fit under IRC §130) and even “non-qualified” settlements.

Q. How are the periodic payments taxed when they do not fit under IRC §104(a)(1) or IRC §104(a)(2)?

A. For non-qualified settlements, periodic payments are taxed as and when received. Taxation for IRC §104(a)(3) settlements depends on how the underlying insurance policy was paid for. Any portion allocable to premium originally funded by the payee is income tax free. Any portion allocable to premium originally funded by the employer is taxed as and when received.

Q. Can the product be used for structured sales, deferred compensation, or contract disputes?

A. No. For the product to fit the definition of “reinsurance”, the contract must be made between National Indemnity Company and a direct insurance company.

Q. Can the product be used with self-insureds?

A. No. For the product to fit the definition of “reinsurance”, the contract must be made between National Indemnity Company and a direct insurance company. If sold to a self-insured, even a “qualified self-insured” who has posted a bond with a state regulatory agency (as may be the case for workers’ compensation self-insureds), we would consider it to be “insurance” rather than “reinsurance”.

Q. What about deductibles and self-insured retentions?

A. Settlement proceeds allocable to a deductible can be reinsured since the original insurer is responsible for the entire loss and receives reimbursement only if the defendant/insured is willing and able to pay the deductible amount. Settlement proceeds allocable to self-insured retentions are not the responsibility of the original insurer and cannot be reinsured. Keep in mind, however, that money from the self-insured retention can be used to fund the cash portion of a settlement and money paid by the original insurer to National Indemnity Company can be used to fund periodic payments.

Q. Can the product be used for Attorney Fees?

A. It depends. As with the “assignment + annuity” product, we can agree to pay an attorney for the benefit and convenience of the plaintiff/claimant. We are currently accepting attorney fee structures on qualified cases. We are not accepting attorney fees on non-qualified cases due to their administrative complexity.

Q. Can the product be used for QSFs?

A. No. The QSF would not be considered to be an “insurer”. Once a QSF is standing in the shoes of the original insurer, we have lost the opportunity to provide “reinsurance” to the original insurer.

Q. Can the defendant/insured and the original insurer secure a full and final release from the plaintiff/claimant?

A. Yes. If the settlement provides for a full and final release (i.e. no contingent liability), the vehicle used for the periodic payments has no bearing on that release. This is reinforced in our three-party reinsurance agreement as follows:

The Claimant and each Payee agree to look solely to the Reinsurer for payment of the Periodic Payments and fully and completely release and discharge the Insured Defendant and the Company from any liability for the Periodic Payments. Neither the Insured Defendant nor the Company shall incur any liability, obligation or responsibility for any default, nonperformance or nonpayment by the Reinsurer of the Periodic Payments.

Q. Can the defendant/insured and the original insurer also secure a full and final release from the plaintiff/claimant using a two-party reinsurance agreement?

A. Yes, but the two-party reinsurance agreement does not provide that release. The parties would need to agree to the reinsurance transaction and accomplish the release within the settlement agreement.

Q. What if local statute requires that the defendant/insured or original insurer remain contingently liable?

A. Our standard two-party reinsurance agreement is silent in respect of the release, allowing the settlement agreement to govern. We can also manuscript the three-party agreement to provide for this circumstance and have a template available which should address the majority of such situations.

Q. What are the advantages of using a three-party reinsurance agreement rather than a two-party reinsurance agreement?

A. The plaintiff/claimant is not a party to the two-party reinsurance agreement and the reinsurer is not a party to the settlement agreement. Since both are parties to the three-party reinsurance agreement, the reinsurer is better equipped to protect the post-settlement interests of itself as well as the original insurer and the defendant/insured.

Q. I heard that with reinsurance, the original insurer can't get a release. How does this reconcile with what was described above?

A. The confusion is in respect of who is releasing whom. For example, if a medical malpractice insurer settles a claim on behalf of an insured doctor, the claimant would be required to release both the doctor and the insurer, but the underlying insurance policy would remain intact and the doctor would still have coverage thereunder in respect of other occurrences.

Q. Is this assumption reinsurance, a novation, or something else?

A. Broadly speaking, a novation is the substitution of one obligor for another with the consent of the obligee. As with a qualified assignment, our reinsurance product provides a novation of the obligation to make the periodic payments whenever the plaintiff has provided consent. The insurance code in some states describes a novation in a different context as being the same as assumption reinsurance. This product is not assumption reinsurance because the reinsurer is not substituted for the original insurer as the obligor to the policyholder in respect of all the obligations under the insurance policy. The only obligation being transferred is the obligation to make the periodic payments agreed to within the settlement agreement.

Q. I understand that traditional reinsurance is "owned" by the original insurer. What assurance does the plaintiff/claimant have that the original insurer is out of the picture?

A. To assure that the original insurer cannot make a claim on the periodic payments, the reinsurance agreement includes the following language:

Neither the Company nor, in the event of its insolvency, its receiver, liquidator, or statutory successor, have the right to any of the Periodic Payments. The Company releases and discharges the Reinsurer from any obligation to make any payments under this Reinsurance Agreement to or at the direction of the Company, or in the event of the Company's insolvency, to or at the direction of its receiver, liquidator or statutory successor.

Q. Does the original insurer need to reflect the reinsurance on its books and records?

A. Whenever the original insurer is not contingently liable, there should be no need to show a ceded reserve in Schedule F of its statutory annual statement or to show a contingent liability in its footnotes.

Q. Is this product available everywhere?

A. National Indemnity Company is authorized to write reinsurance in all 50 states and the District of Columbia. In some circumstances, the two-party product may also be available outside of the United States, but National Indemnity Company does not profess to understand the tax rules affecting payees in foreign jurisdictions.

Q. How safe is this product?

A. As reinsurance, this product is unlikely to qualify for coverage from the state guaranty associations. That being stated, one needs to form an opinion within the context of National Indemnity Company's significant financial strength. In many cases, the amount to be structured is well in excess of guaranty fund limits and the parties must decide for themselves whether to split a case or place it all with just one company. For larger transactions, creditworthiness is paramount and counterparties should find it more economically rational to opt for National Indemnity Company's "immense capitalization".

Q. In the "assignment + annuity" model, Columbia Insurance Company provides a corporate guaranty for the obligations of BHG Structured Settlements, Inc. Is a corporate guaranty available with the reinsurance product?

A. No. National Indemnity Company is by far the strongest credit risk available in the marketplace and as such neither Columbia Insurance Company nor any other company in the Berkshire Hathaway Group will further guarantee its obligations.

Q. What about secured creditor status?

A. A Qualified Assignment, Release, and Pledge Agreement provides for the payee to take ownership of the annuity in the event that the assignment company fails. As the reinsurer is filling the role of both the assignment company and the annuity issuer, this concept is not transferable to the reinsurance model.

Q. What is different about the process with the reinsurance product?

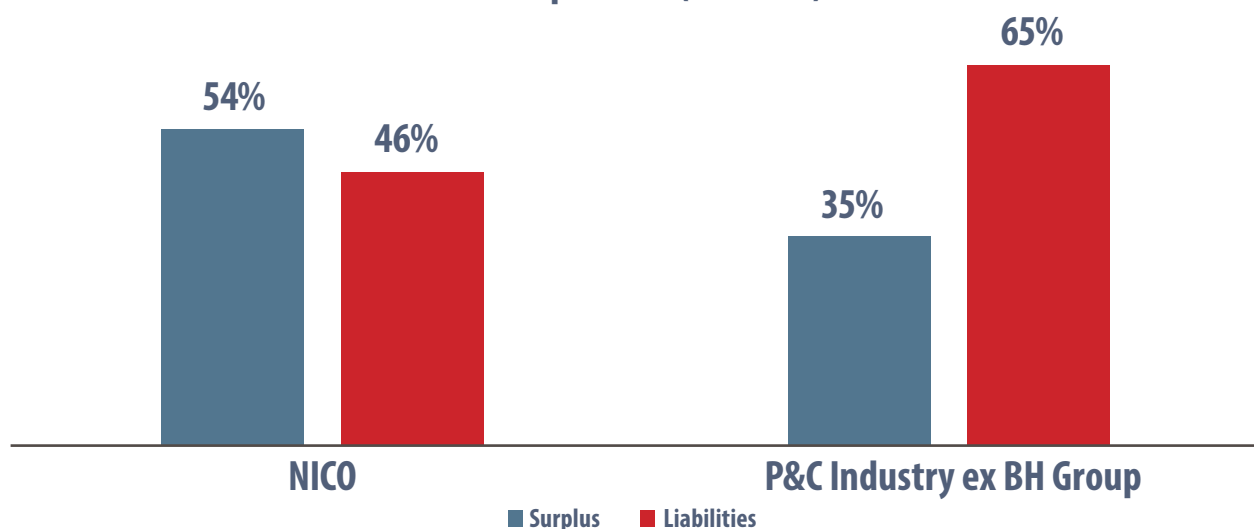
A. The parties to the underlying action still enter into a settlement agreement. Rather than a Qualified Assignment & Release, they enter into a Periodic Payment Reinsurance Agreement which also replaces the role of the annuity. As far as additional information, we need the original insurer's policy number and the line of business under which the claim is covered. Whenever premium exceeds \$2M, we also need to get a copy of the Declarations Page for the underlying policy (provided it has not been lost). Our ancillary forms and our Reinsurance Underwriting Guidelines are available at <https://www.bhstructures.com>.

Q. What does it mean when you say National Indemnity Company is "immensely capitalized"?

A. National Indemnity Company is the flagship insurance carrier in the Berkshire Hathaway Group. When measured by Statutory Surplus, National Indemnity Company is by far the largest insurer in the United States, having 15.7% of the combined statutory surplus of the entire industry. National Indemnity Company has more than two times the combined Statutory Surplus of all the life insurers currently engaged in the structured settlement business.

In terms of asset composition, National Indemnity Company is also very safe. At the highest level, the assets of an insurance company can be described in terms of "the company's money", represented on the balance sheet as "Surplus" and "other people's money", represented on the balance sheet as "Liabilities". "Other people's money" can be thought of as leverage, similar to debt. As illustrated below, National Indemnity Company (NICO) operates with significantly less leverage than the Property & Casualty industry as a whole.

Asset Composition (12/31/18)



The simplified Balance Sheet below provides a deeper dive into National Indemnity’s asset composition:

		US Dollar Billions at 12/31/2018
Admitted Assets		
Cash		20.8
Bonds		4.1
Non-Affiliated Common Stock	Apple	28.8
	Coca-Cola	13.0
	Wells Fargo	10.3
	Bank of America	6.4
	American Express	11.4
	JP Morgan	4.1
	Delta Air Lines	2.9
	US Bancorp	2.4
	Southwest Airlines	2.2
	Other Common Stock	12.8
Affiliated Common Stock	GEICO	29.3
	Berkshire Hathaway Life	5.4
	Berkshire Hathaway Specialty	3.5
	Other (Mostly Insurance) Affiliates	10.4
Other Invested Assets	BNSF, Inc.	42.7
	Loans to Berkshire Hathaway, Inc.	9.3
	Other	2.2
Other Assets		6.2
Total		228.2
Liabilities		105.7
Statutory Surplus		122.5

National Indemnity Company is rated A++ by AM Best's, the highest rating available. There are eighteen large A++ rated property & casualty insurers (with large defined as \$3B or more of Statutory Surplus), seven of which are members of the Berkshire Hathaway Group.

Q. Life insurance carriers' assets are widely diversified. Does that make them "safer"?

A. National Indemnity Company's "immense capitalization" offsets concentration risk. National Indemnity Company also wholly owns substantial operating companies that provide for additional stability against market swings, with the largest being GEICO and BNSF, Inc. Simply put, it would take an extreme event or series of events to exhaust \$122.5 billion of Statutory Surplus and any set of such events would likely have first bankrupted most if not all other U.S. insurers. Note that even if National Indemnity Company's two largest holdings were to immediately be valued at "zero", it would still be the second largest insurance carrier in the United States.

Q. I only get a short window with the court. What should I tell a judge to explain why this product is works?

A. For qualified cases, there is no substantive difference between this product and the "assignment + annuity" product. That said, since the product does not rely on IRC §130, it also works for non-qualified cases. The plaintiff, defendant, and original insurer are all left in the same place as if they had done a traditional structured settlement. National Indemnity Company has written this product since 1982, is rated A++ by AM Best, and with the largest surplus of any insurer in the United States, is "immensely capitalized". It is extremely well positioned to meet this obligation.

Q. Is there anything else I should consider before marketing National Indemnity Company's Periodic Payment Reinsurance Product to a particular payee?

A. As with our "assignment + annuity" product, BHG Structured Settlements is competitive on long-duration cases and cannot quote certain short-duration business. In particular, if the plaintiff's primary goal is to spread payments across just enough years to avoid a higher tax bracket, it is likely that National Indemnity Company will not be a good fit.

Q. How else does National Indemnity Company participate in BHG Structured Settlements business activities?

A. With our "assignment + annuity" product, the assignment company's obligation is guaranteed by its parent, Columbia Insurance Company (\$19.2B of Statutory Surplus, with an Asset Composition of 80% Statutory Surplus, 20% Liabilities). To encourage plaintiffs to place large cases (\$3M or bigger) with BHG Structured Settlements rather than splitting them to achieve diversification, our "immensely capitalized" National Indemnity Company offers a second guarantee. The resulting dual guarantee is superior to the more typical diversification strategy because the payee can go to either guarantor to collect 100% of the payments due.